



Dimensions – 99th Edition

Ruling under GST era

M/s Amneal Pharmaceuticals Pvt. Ltd. – Authority for Advance Ruling, Gujarat¹

Issue for Consideration

Whether GST is payable on the notice pay recovered from the employees in terms of the contract between the employer and employee?

Discussion

- The Applicant enters into a contract with its employees by issuing 'Appointment letters' whereby an employee is mandatorily required to serve a three month notice to terminate the contract. If the employee does not serve the mandatory notice period after tendering resignation, then the Applicant (i.e. employer) is entitled to recover the notice pay from the agreed portion of the salary.
- The Applicant had approached the Authority for Advance Ruling ("the Authority") to contend that no GST was payable on such notice pay amount recovered by the Applicant on the basis of the following grounds:
 - The recovery of notice pay is an arrangement to compensate the loss to the employer, for

- breach in serving the stipulated notice period, as per the contractual arrangement.
- It is a sum mutually agreed by the parties for breach of contract and it can be regarded as a consideration flowing from the employment contract itself read with section 74 of the Indian Contract Act, 1872 and not under any other separate contract wherein the employer has agreed to refrain from doing any act against the concerned employee.
- An employer cannot enforce the mandatory serving of the notice period and therefore, such employer cannot be said to have refrained from an act of suing the employee for mandatory serving against the notice pay recovery.
- Notice pay recovery is nothing but a deduction from the salary payable to the resigning employee. It is not a separate consideration flowing from any independent contact and the employee is relieved from the services and issued a relieving letter only once the terms of employment agreement (Appointment letter) are fulfilled. Accordingly, it is covered within clause 1 of the Schedule III to the CGST Act, 2017 which excludes the services by an employee to an employer, in the course of

¹ 2020-VIL-606-ALH



employment, from the purview of being a supply.

- Reliance was placed upon the judgment of *Nandinho Rebello v. Deputy Commissioner of Income Tax*² wherein it was held that the net salary received by the employee after deduction of notice pay was only taxable as income under the head of salary. Accordingly, notice pay recovery was nothing but an adjustment of salary and not chargeable to GST.
- Reliance was also placed upon the judgments of *HCL Learning Systems v. Commissioner of Central Goods & Service Tax, Noida*³ and *GE T&D India Ltd. v. Deputy Commissioner of Central Excise, Chennai*⁴.
- The Authority after taking into account the terms of the employment as per the Appointment letter, observed as follows:
 - Notice pay is a sum mutually agreed between the employer and the employee for breach of contract. It can be regarded as a consideration to the employer for ‘tolerating the act’ of the employee for not serving the notice period, which was the employee’s agreed contractual obligation.
 - Clause 5(e) of Schedule II to the CGST Act, 2017 states that ‘agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act’ shall be treated as supply of service.
 - The recovery of notice pay implies that the employee while accepting the offer of employment, has not only understood the intent on the part of the employer in prescribing this exit condition, but has also accepted it. Therefore, this transaction of the employer agreeing to the obligation of tolerating an act (quitting without any advance notice) on the part of the employee, for payment of a sum (notice pay), will be covered under clause 5(e)

of Schedule II to the CGST Act 2017, as a declared service.

- The rulings relied upon by the Applicant pertain to the Service tax regime and hence are not applicable to the present case.

Ruling

The recovery of notice pay is taxable under GST at the rate of 18%.

Dhruva Comments:

The concept of recovery of notice pay has always been a matter of dispute during the Service tax regime and continues to be the same under GST. Even though the entries under the Service tax (section 66E(e) of the Finance Act, 1994) and GST (clause 5(e) of Schedule II to the CGST Act, 2017) continue to be the same and there being positive judgments dismissing the levy of Service tax, the dispute still continues.

Furthermore, it should be noted that the Authority has not considered the amendment made under section 7 of the CGST Act, 2017, whereby an activity / transaction first needs to be a supply under section 7(1) and only then it can be treated as a supply of goods / services under Schedule II to the CGST Act, 2017.

Equally, another facet would be to evaluate whether breach of any conditions to the contract resulting into a pay-out can translate into a consideration against alleged supply for the purpose of levy of GST.

Judgment under GST era

M/s S.S. Industries v. Union of India⁵

Issue for Consideration

Can the GST authorities block the input tax credit (“ITC”) during an inquiry or investigation in the absence of any

² (2017) 80 taxmann.com 297 (Ahmedabad-Tri.)

³ Order no. 71950/2018 dated November 25, 2019

⁴ 2020-VIL-39-MAD-ST

⁵ 2020 (12) TMI 1120



confirmed liability without issuing any show cause notice (“SCN”) or assessment / adjudication order?

Discussion

- The Petitioner is a partnership firm engaged in the manufacture of TMT bars. The Petitioner is paying GST on goods manufactured and are availing ITC on receipt of tax paid inputs along with tax invoices while filing Form GSTR-3B.
- The Directorate General of Goods & Services Tax Intelligence (“DGGI”) initiated an inquiry against the Petitioner based on information that ITC had been availed on procurements from certain vendors who were providing tax invoices without any supply of goods. The inquiry revealed that the subject transaction was only recorded on paper without involving any supply of goods and therefore the ITC availed on the transaction is inadmissible.
- The Petitioner was made to deposit part of the amount in cash and the balance amount of inadmissible ITC was blocked under rule 86A of the CGST Rules, 2017.
- Upon refusal of the Respondents to refund the amount paid in cash and to unblock the ITC, the Petitioner filed the present Writ Petition before the Hon’ble High Court on the grounds that ITC is an indefeasible right and it cannot be blocked while an inquiry into the allegations of fraudulent transactions involving fake / bogus invoices is pending.
- After perusing the facts of the present case, the Hon’ble High Court observed as follows:
 - Rule 86A of CGST Rules, 2017 confers drastic powers upon the tax authorities if they have reasons to believe that activities or invoices are suspicious. The phrase “reasons to believe” must have a rational connection with the formation of belief; however it is a subjective term and could be interpreted differently to how it is intended. Rule 86A of CGST Rules, 2017 does not mandate the issuance of SCN or an intimation and, therefore, a person may be taken by surprise in not being able to use ITC while paying taxes on the portal.
 - Placing reliance on the judgment pronounced by the Hon’ble Supreme Court in the case of *Osram Surya (P.) Ltd. v. CCE, Indore*⁶, the High Court observed that the availment and utilisation of credit are two separate stages and that the utilisation of accrued credit is a vested right. Furthermore, no vested right accrues before the credit has been availed.
 - After considering various judgments pronounced by the Hon’ble Supreme Court on the issue - whether ITC is a vested right or not - the High Court observed that the theory of “vested right” has been diluted by the judiciary and can be restricted or controlled by notifications. It is a settled law that in case of subordinate legislation, the authorities are empowered to fill the gaps when they notice any loopholes because it is not possible for the Parliament to frequently make laws whilst also maintaining precision.
 - “Reasons to believe” is a necessary condition for blocking ITC in cases of inquiry into fraudulent transactions. Although, an objective test is not required for forming an opinion of the authority, but there must be some material based on which the authority could form its opinion to block ITC. The existence of relevant material is a pre-condition to the formation of opinion.
 - The use of the word “may” in rule 86A of the CGST Rules, 2017 indicates not only the obligation to maintain discretion but an obligation to consider that a necessity has arisen to pass an order of provisional attachment with a view to protect the interest of the government. The opinion to be formed cannot be on imaginary grounds or be based on wishful thinking. The statutory requirement of reasonable belief is to safeguard a citizen from vexatious proceedings. Belief is a mental

⁶ 2002 (102) ECR 515 (SC)



operation of accepting a fact as true, and hence no belief can be formed without fact.

- It is not necessary for the authorities to state reasons for its belief, but relevant materials must be disclosed in case the notion of belief is challenged.
- The Court stated that the formation of an opinion should reflect the intense application of mind along with relevant materials, in order to prove that it had become necessary to block ITC during the pendency of an inquiry. If subjective satisfaction for the blocking of ITC has been arrived at without any credible material, such an action would amount to malice in law. In the present case, it cannot be said that the inquiry initiated into the fake / bogus invoices is *mala fide*.
- The Court analysed the provisions contained under section 83 of the CGST Act, 2017 while examining whether rule 86A of the CGST Rules, 2017 requires a specific order to initiate blocking the ITC. The Court stated that an order is required to be passed in writing on the basis of reasonable belief to provisionally attach property and a bank account. Also, section 11DDA of the Central Excise Act, 1944 and section 73C of the Finance Act, 1994 provides that a provisional attachment can be made only after the issuance of SCN.
- Rule 86A of CGST Rules, 2017 casts an obligation upon the authority to form an opinion but is silent on the communication of any specific order assigning prima facie reasons for invoking the rule. In the present case, an inquiry has revealed prima facie reason for the Respondents to exercise the powers under the rule, without any specific order being passed or communicated to the Petitioner. The Court observed that, in the present case, it cannot be said that the blocking of ITC is *mala fide* or without application of mind.
- In another matter that was raised along with the present Writ Petition, the ITC was blocked under rule 86A of the CGST Rules, 2017 and the related investigation was pending for almost

a year. In the said case, the Court observed that an investigation could not be continued for an indefinite period of time as rule 86A of the CGST Rules, 2017 prescribes a one-year limit for the blocking of ITC.

- The Respondents were directed to complete the investigation within four to six weeks and to come to an appropriate decision to issue SCN under Section 74 of the CGST Act, 2017. However, the Court did not order for the ITC to be unblocked.
- The Court went ahead to state three exceptional circumstances where an interference with proceedings initiated by Statutory Authorities could be justified
 - o challenge to constitutional vires;
 - o proceedings initiated or concluded in total violation of the principles of natural justice; and
 - o where orders are without jurisdiction, or in matters of private and public wrongs or where prevention of public injury and vindication of public justice demands recourse in accordance with Article 226 of the Constitution of India.

Judgment

The Hon'ble High Court rejected the Writ Petitions and held / provided directions as follows:

- The invocation of rule 86A of the CGST Rules, 2017 in order to block ITC is justified if the authority is of the prima facie opinion that ITC is sought to be availed based on fraudulent transactions like fake / bogus invoices etc. However, subjective satisfaction should be based on some credible material or information and should be supported by supervening factors and not on vague, indefinite, distant, remote or far-fetching material.
- The power conferred under rule 86A of the CGST Rules, 2017 is drastic and should be used sparingly and only in the presence of substantive grounds and reasons.



- Rule 86A of the CGST Rules, 2017 should neither be used as a tool to harass the assessee nor to make any irreversible detrimental effect on the business of the assessee.
- Availing ITC and utilising ITC are two separate stages. Although the utilisation of available ITC is a vested right, no vested right accrues before the credit has been availed.
- The Government should lay down some guidelines or procedures for invoking rule 86A of the CGST Rules, 2017 to ensure that the rule is not misused.

Dhruva Comments:

The Court has laid extensive emphasis on the phrase “reasons to believe” and the basis for forming an opinion which leads to the exercising of powers under rule 86A of the CGST Rules, 2017. While the rule does not require passing a specific order, the directions issued by the Court to the Government for creating a framework is a welcome step. This would bring more clarity to the discretionary aspect and would be a useful guide in the process.





ADDRESSES

Mumbai

11th Floor, One World Centre,
Tower 2B, 841, Senapati Bapat Marg,
Elphinstone Road (West),
Mumbai 400 013
Tel: +91 22 6108 1000 / 1900

Ahmedabad

B3, 3rd Floor, Safal Profitaire,
Near Auda Garden,
Prahladnagar, Corporate Road,
Ahmedabad 380 015
Tel: +91-79-6134 3434

Bengaluru

Prestige Terraces, 2nd Floor
Union Street, Infantry Road,
Bengaluru 560 001
Tel: +91-80-4660 2500

Delhi / NCR

101 & 102, 1st Floor, Tower 4B
DLF Corporate Park
M G Road, Gurgaon
Haryana 122 002
Tel: +91-124-668 7000

Pune

305, Pride Gateway, Near D-Mart, Baner,
Pune 411 045
Tel: +91-20-6730 1000

Kolkata

4th Floor, Unit No 403, Camac Square,
24 Camac Street, Kolkata
West Bengal 700016
Tel: +91-33-66371000

Singapore

Dhruva Advisors (Singapore) Pte. Ltd.
20 Collyer Quay, #11-05
Singapore 049319
Tel: +65 9105 3645

Dubai

WTS Dhruva Consultants
U-Bora Tower 2, 11th Floor, Office 1101
Business Bay P.O. Box 127165
Dubai, UAE
Tel: + 971 56 900 5849

KEY CONTACTS

Dinesh Kanabar

Chief Executive Officer
dinesh.kanabar@dhruvaadvisors.com

Ritesh Kanodia

ritesh.kanodia@dhruvaadvisors.com

Niraj Bagri

niraj.bagri@dhruvaadvisors.com

Ranjeet Mahtani

ranjeet.mahtani@dhruvaadvisors.com

Dhruva Advisors has been consistently recognised as the **“India Tax Firm of the Year”** at the ITR Asia Tax Awards in 2017, 2018, 2019 and 2020.

Dhruva Advisors has also been recognised as the **“India Disputes and Litigation Firm of the Year”** at the ITR Asia Tax Awards 2018 and 2020.

WTS Dhruva Consultants has been recognised as the **“Best Newcomer Firm of the Year”** at the ITR European Tax Awards 2020.

Dhruva Advisors has been recognised as the **“Best Newcomer Firm of the Year”** at the ITR Asia Tax Awards 2016.

Dhruva Advisors has been consistently recognised as a Tier 1 firm in **India’s ‘General Corporate Tax’** and **‘Indirect Tax’** ranking tables as a part of ITR’s World Tax guide. The firm is also listed as a **Tier 1 firm** for India’s **‘Transfer Pricing’** ranking table in ITR’s World Transfer Pricing guide.

Disclaimer:

The information contained herein is in summary form and is therefore intended for general guidance only. This publication is not intended to address the circumstances of any particular individual or entity. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. This publication is not a substitute for detailed research and professional opinions. Before acting on any matters contained herein, reference should be made to subject matter experts, and professional judgment needs to be exercised. Dhruva Advisors LLP cannot accept any responsibility for loss occasioned to any person acting or refraining from acting as a result of any material contained in this publication

