

Tax alert: Recovery of salary from employee not leviable to service tax – Allahabad CESTAT

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Summary

The Allahabad bench of the Customs, Excise & Service Tax Appellate Tribunal (CESTAT) has held that recovery of salary on breach of employment contract is not a revenue and hence not leviable to service tax.

Facts of the case

- The Appellant¹ (employer) has been served with a show cause notice demanding service tax from that part of the salary which it recovers from its employees. The recovery happens if the employee breaches the contract of total term of employment.
- This part of the recovery is treated by Revenue as 'consideration' for the purpose of charging service tax.

CESTAT's observations and order²

- **Terms of the contract:** The CESTAT observed that as per the terms of the contract between the Appellant and its employees, the employee shall be paid salary and the term of employment is a fixed term. If the employee leaves the job before the term is over, then certain amount already paid as salary is recovered by the Appellant.
- **Recovery is out of salary:** The CESTAT noted that the said recovery is out of the salary already paid to the employees as per the employment contract between the employer and employee.

- **'Salary' out of service tax purview:** The CESTAT further noted that salary is not covered by the provisions of service tax.
- **Not exigible to service tax:** In light of the above, the CESTAT held that the said recovery would not be chargeable to service tax. Accordingly, the CESTAT allowed the appeal.

Our comments

This is an important and welcome judgement by the Allahabad CESTAT which will provide clarity on the matters pertaining to taxability of recoveries made by employers from their employees on breach of the employment contracts. It will help resolve long-drawn litigations in relation thereto. An analogy can be drawn even under the GST regime as most of the definitions/provisions under the GST law have been borrowed from the erstwhile laws. The required clarity from the government at this juncture will help minimise litigations under the GST regime.

¹ M/s HCL Learning Limited

² Final Order No. 71950/2019 dated 25 November 2019

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