

**Customs, Excise & Service Tax Appellate Tribunal
West Zonal Bench at Ahmedabad**

REGIONAL BENCH-COURT NO. 2

Service Tax Appeal No. 11609 of 2019- DB

(Arising out of OIA-VAD-EXCUS-001-APP-491-2018-19 dated 30/11/2018 passed by the Commissioner (Appeals), Central Excise, Customs and Service Tax-Vadodara-I)

Cosmo First Limited

Vemardi Road,
Village-Navi Jithardi,
Taluka-Karjan,
Vadodara, Gujarat

.....Appellant

VERSUS

Commissioner of C.E. & S.T.-Vadodara-I

1st Floor...Central Excise Building,
Race Course Circle,
Vadodara, Gujarat-390007

.....Respondent

APPEARANCE:

Shri Jigar Shah & Shri Amber Kumrawat, Advocate for the Appellant

Shri Shri Neilprakash G Makwana, Superintendent (AR) for the Respondent

CORAM:

HON'BLE DR. AJAYA KRISHNA VISHVESHA, MEMBER (JUDICIAL)

HON'BLE MR. SATENDRA VIKRAM SINGH, MEMBER (TECHNICAL)

Final Order No. 10826/2025

DATE OF HEARING: 10.09.2025

DATE OF DECISION: 29.09.2025

SATENDRA VIKRAM SINGH

M/s Cosmo First Ltd (Appellant) are engaged in the manufacture of BOPP Films & PP Granules falling under Chapter 39 of the Central Excise Tariff Act, 1985. During audit of their records, it came to notice of the department that they had recovered Notice pay from their employees on leaving the organisation which according to the department is liable to service tax w.e.f. 01.07.2012. After necessary investigation, they were issued a show cause notice dated 17.08.2017 demanding service tax of Rs.77,791/- for the period from July, 2012 to March, 2017 under Section 73 (1) along with interest under Section 75 and penalty under Section 77(2) and 78 of the Finance Act, 1994.

1.1 The matter was decided by the Assistant Commissioner who vide order dated 28.05.2018 rejected the plea taken by the appellant and confirmed the service tax demand of Rs.77,791/- along with interest as proposed in the show

cause notice. He also imposed a penalty of Rs. 10,000/- under Section 77(2) and a penalty equal to 50% of the service tax involved for the period from July, 2012 to 14.05.2015 (it should be 13.05.2015) and penalty equal to 100% of the Service tax payable for the period 14.05.2015 to March, 2017. Aggrieved with this order, Appellant filed appeal before Commissioner (Appeals) who vide impugned order dated 30th November, 2018 upheld the order of the lower authority and rejected their appeal. Hence, the present appeal.

2. In their appeal, the appellant took the following grounds:

- a) The Department has maintained that any Notice pay recovered by an employer from the employee in lieu of notice to be provided by the employee to the employer before discontinuing employment which may be in accordance with agreement of employment, written or verbal, is to be taken as taxable amount.
- b) Notice pay is collected from the employees as per the terms and conditions of the employment under agreements entered into between them and their employees. It does not attract the provisions of declared service namely "agreeing to the obligation to refrain from an act, or to tolerate an act or situation, or to do an act".
- c) As per Section 65B(44) of the Finance Act, 1994, any service provided by an employee to the employer in the course of employment does not attract service tax, as it is not a service.
- d) Under Section 66E(e), this service has 4 components:-
 - (A Service Provider) Agreeing to the obligation to refrain from an act (as desired by the Service Recipient); OR
 - (A Service Provider) Agreeing to the obligation to tolerate an act (in favour of the Service Recipient); OR

- (A Service Provider) Agreeing to the obligation to tolerate a situation (for convenience of the Service Recipient); OR
- (A Service Provider) Agreeing to the obligation to do an act (as desired by the Service Recipient)

e) All service providers, when intend to provide a service, to service recipient, they are, to begin with “agreeing to the obligation to do an act” as desired by the recipient. If that be the case, then all exempted services and all negative list services would become taxable and there will no requirement to specify description of different services.

f) Education guide dated 28th June, 2012 issued by CBIC at sub para 2.9.3 mentions that when an employee receives an amount from the employer, for premature termination of contract of employment, the amount received by the employee from the employer shall not be chargeable to service tax as it falls within the contract of employment. This guide though, does not expressly discuss the reverse situation when an employee leaves the company without completing notice period and pays to the employer but applying the same analogy, the amount so received by the employer from an employee should not be liable to service tax.

g) All the transactions relating to recovery of notice pay are fully recorded in their books of accounts at appropriate places. Therefore, demand beyond the normal period of limitation is time barred. The allegation of suppression of facts or wilful misstatement or fraud or collusion on their part cannot be invoked for demanding service tax for a period beyond the normal limitation.

h) The issue has been settled by Hon’ble Commissioner (Appeals), Vadodara in the case of Amoli Organics Pvt Ltd, Vadodara vide OIA No. VAD-EXUCS-001-APP-221-222/2017-18 dated 21.07.2017. Similar view was expressed by the Commissioner (Appeals), Ahmedabad in his OIA

No. AHM-EXCUS-003-APP-086-17-18 dated 30.08.2017 in the case Johnson Controls- Hitachi Air Conditioning India Ltd, Mehsana. Therefore, their appeal may be allowed by setting aside the impugned OIA.

3. During hearing, learned Advocate drew attention of the Bench towards provisions of Finance Act, 1994, CBEC Education guide dated 28.06.2012, Circular No. 178/10/2022-GST dated 03.08.2022 and Circular No. 214/1/2023-ST dated 28.02.2023. He also highlighted the decision of Hon'ble Madras High Court in the case of GE T & D India Ltd Vs. CCE- 2019 (12) TMI 1566, wherein it was held that though normally, a contract of employment qua an employer and employee has to be read as a whole, there are situations within a contract that constitute rendition of service such as breach of a stipulation of noncompete. Notice pay, in lieu of sudden termination, however does not give rise to the rendition of service either by the employer or the employee.

3.1 Learned Advocate also cited the decision of this Tribunal in the case of Linde Engineering Pvt Ltd Vs. CCE, Vadodara reported at 2024 (10) TMI 1544-Cestat wherein it was held that compensation for failure under a contract is not consideration for service under the contract and accordingly, demand of service tax on notice pay received/recovered from the employees was set aside. Learned Advocate also highlighted the decision in the case CST Vs Intas Pharmaceuticals- 2021(6) TMI 906-CESTAT and Ami Lifesceinces Pvt Ltd Vs. CCE- 2024 (8) TMI 790-CESTAT. He argued that recovery of notice period pay is not on account of any service and therefore, demand of service tax on this amount is not sustainable.

4. Countering the arguments, learned AR reiterated the findings of the lower authority. He mentioned that the Adjudicating as well as Appellate authority have recorded their reasoned findings on the issue and held that service tax is leviable on recovery of notice period pay under Section 66E(e) of the Finance Act, 1994.

5. We have seen the records and heard the rival submissions. We find that the issue is no longer res-intera as similar issue was decided by this Tribunal in the case of Linde Engineering India Pvt Ltd. Vs. CCE (cited supra). Para 4 of the said decision is reproduced as below:-

"4. We have heard both the sides. We find that the issue in hand is no longer res integra as the matter has already been decided by this Tribunal in case of Rajasthan Rajya Vidhyut Prasaran Nigam Limited Vs. Commissioner of Central Excise and Service Tax Jodhpur I reported under 2022 (1) TMI 909 CESTAT New Delhi. The relevant extract of the above decision is reproduced here:-

"5. The question which falls for consideration is "whether the amounts received or recovered by the employer from its employees for resigning from the service without giving the requisite notice is exigible to Service Tax as a declared Service under Section 66E(e) of the Finance Act, 1994 or not."

6. During the relevant period, service tax was leviable under section 66B on all services, other than those included in the negative list. Service was defined to mean any service carried out for a consideration and included 'declared services' Declared services were defined to mean any activity carried out by a person for another person for consideration and declaration as such under section 66E. Section 66E included 'agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act'. The legal provisions as applicable during the relevant period were as follows:

SECTION 65B. Interpretations. In this Chapter, unless the context otherwise requires.-

(22) "Declared service" means any activity carried out by a person for another person for consideration and declared as such under section 66E;

(44) "service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include-

(a) an activity which constitutes merely:-

(i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner, or

(ii) such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of clause (29A) of article 366 of the Constitution, or

(iii) a transaction in money or actionable claim

(b) a provision of service by an employee to the employer in the course of or in relation to his employment,

(c) fees taken in any Court or tribunal established under any law for the time being

SECTION 66B. Charge of service tax on and after Finance Act, 2012.

There shall be levied a tax (hereinafter referred to as the service tax) at the rate of fourteen percent. on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed.

SECTION 66E. Declared services. The following shall constitute declared services, namely –

(a)

(e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;"

7. The case of the Revenue is that the appellant had tolerated its employees resigning without the requisite notice period in return for a consideration and therefore, the amounts received or recovered from such of its employees is exigible to Service Tax under Section 66E(e). The case of the appellant is that it did not render any service nor has it entered into any agreement to tolerate its employees leaving without notice It has only collected compensation for such an act of its employees. Therefore, the amounts received or recovered by it cannot be charged to service tax.

8. We find that both 'Service' as defined in Section 65B(44) and 'Declared Service' as defined in Section 65E require the activity to be for a "Consideration". As per Section 66E (e), the following are declared services.

(a) agreeing to the obligation to refrain from an act, or

(b) agreeing to tolerate an act or a situation, or

(c) agreeing to do an act.

9. Each of the above is a declared service and therefore, becomes exigible to service tax if it is done for a consideration. The dispute in this case appears to have arisen because the officers confused compensation for consideration. While a consideration is something received for performance under the contract, compensation is received if the other party reneges or fails to perform as per the contract. Consideration is the object of the contract and compensation is not. The party which suffers because of the reneging or non-performance by the other can get compensated either in the form of unliquidated damages (where the court decides the quantum of damages) or liquidated damages (where the contract itself provides that damages of such and such amount will be paid in case of non-performance of the contract). While a contract for any service specifies both the service to be rendered and

the consideration to be paid for such service, it also has other clauses which define the conditions of the contract which include details of how the parties must fulfil their parts of the contract. These conditions, often include a clause on 'liquidated damages if a party fails to fulfil its obligations under the contract as laid down in the conditions. Consideration is the result of successful performance of the contract while compensation is paid by the party frustrating the contract to the other. Compensation is also paid, if the contract so provides, when one party performs under the contract but not within the conditions laid down, such as delays in performance. A few illustrations will make this point clearer. A doctor performs a surgery and gets paid a fee. Here the surgery is the service of the doctor and the fee is the consideration and the purpose of the contract (written or otherwise), is the surgery. If due to medical negligence of the doctor, the patient loses his eye and the patient gets paid compensation, it is a payment for frustration of the implicit contract for the surgery which presumes that it will be performed carefully. The patient gets paid but it is not consideration. It cannot be said that the doctor and patient agreed that the patient would lose his sight and as a consideration for taking away the sight of the patient, doctor paid an amount. Similarly, a lawyer is expected to defend his client and pursue his best interests. If the lawyer is grossly negligent and the client suffers and gets paid compensation, it is for frustration of the contract which the client had with the lawyer. It cannot be said that there is either a written or implicit agreement that the advocate will be negligent and in allowing the lawyer to be negligent and cause loss, a consideration has been paid to the client. If a bank enters into a loan agreement, the essence of the contract is that the borrower would borrow the amount on interest for an agreed period. If the borrower wants to pre-pay the loan, it frustrates the contract from the point of view of the bank and loan pre-payment charges (in the form of liquidated damages) are charged by the bank as per the loan agreement. These charges are not paid for rendering the service but as a penalty for the borrower reneging on his contract and not borrowing money for the entire period as originally agreed. When a telephone or electricity company renders service and issues a bill, the implicit agreement is that the customer will pay the bill within time. If the customer delays paying the bill, he will be required to compensate the company for the delay in the form of late fee. The late fee is not the purpose of the agreement but is a penalty for failure on the part of the customer to meet his end of the deal in paying the bill within time.

10. The argument of the Revenue is that liquidated damages (in this case, the penalty for resigning without notice period) is built into the contract itself. Therefore, it is agreed beforehand that if one of the parties reneges or fails to perform, the other will tolerate the situation in return for the amount to be paid as decided in the contract. This, according to the Revenue is an

agreement to tolerate a situation and hence constitutes a 'Declared Service' under Section 66E(e) and is exigible to service tax.

11. This, in our view, is not the correct reading of the contract. Contract, is an agreement enforceable by law. Section 2 of The Indian Contract Act, 1872 is reproduced below:

"2. Interpretation-clause. -In this Act, the following words and expressions are used in the following senses, unless a contrary intention appears from the context-

(a) When one person signifies to another his willingness to do or to abstain from doing anything. With a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal;

(b) When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise;

(c) The person making the proposal is called the "promisor", and the person accepting the proposal is called the "promisee";

(d) When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise;

(e) Every promise and every set of promises, forming the consideration for each other, is an agreement;

(f) Promises which form the consideration or part of the consideration for each other are called reciprocal promises.

(g) An agreement not enforceable by law is said to be void,

(h) An agreement enforceable by law is a contract;

(i) An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract,

(j) A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable."

12. The agreement is a set of promises which form consideration for each other. Evidently, the promises have to be for performance under the contract and not for frustrating it. Consideration, correspondingly, is at the desire of the promisee. It must be something which the promisee desires and not something which he does not want. Each party to a contract desires the other to perform his part of the deal and not that the other party does not perform so that it can get a compensation. For instance, the patient desires the doctor

to perform surgery with due care and does not desire that the doctor should be negligent and cause harm so that he can get compensation. The fact that the quantum of penalty or compensation is not decided by a court of law but is preagreed and built into the contract for the service itself in the form of liquidated damages does not make it a consideration, it remains compensation. It is a fall-back option if one of the parties frustrates the contract either by reneging on its commitments or by failing to perform.

13. What falls within the ambit of Section 66E(e) are cases where the essence of the agreement, i.e. the purpose for which the agreement is entered into itself is tolerating a situation or refraining from an Act in return for a consideration. Such an agreement could be

- (a) an agreement agreeing to the obligation to refrain from an act, or*
- (b) agreeing to tolerate an act or a situation, or*
- (c) agreeing to do an act.*

14. Evidently, if none of these are the purpose or the essence of the agreement or if there is no consideration for such an agreement, it does not fall within the ambit of Section 66E(e). If the agreement is for something else and if one of the parties fails to perform as per the agreement and pays to the other a compensation as pre-decided in the agreement, it does not fall under Section 66E(e). This view was taken by this Tribunal in several cases. In M/s. Repco Home Finance Ltd. (Service Tax Appeal No. 511 of 2011), decided by MISCELLANEOUS ORDER NO. 40053/2020 dated 8.6.2020, the larger bench of this Tribunal held that no service tax can be charged on loan pre-payment charges. In South Eastern Coalfields Ltd. [2020-TIOL-1711-CESTATDEL], the amounts received by the appellant as penalty from other parties for non-observance or breach of terms of contract in the commercial contracts it entered into were held to be not chargeable to service tax under section 66E(e). In MNH Shakti Ltd. [2021-TIOL-732-CESTAT-KOL], Revenue's demand of service tax under section 66E(e) on the compensation which the appellant received from the Government for cancellation of the coal blocks was set aside. In the case of Ruchi Soya Ltd. [2021-TIOL-402-CESTAT-DEL], the appellant entered into an agreement for maintenance of wind farms and paid the contractor. However, where the machine availability was not as per the norms, the contractor issued credit notes to the appellant as compensation. Revenue's demand of service tax on this compensation amount under Section 66E(e) was set aside by this Tribunal.

15. The present case deals with contracts of employment. Employment contracts are entered into with the expectation that the employer will continue to keep him employed for the period as agreed and that the employee will perform his duties diligently. They are not entered into so that the employer can remove the employee from service or so that the employee

can resign and leave the service. However, often, for various reasons the employer may decide to terminate the services of the employee which puts the employee to inconvenience and he has to find another job. Conversely, the employee may decide to resign and leave the service which inconveniences the employer who will have to make alternative arrangements such as finding a substitute. A notice period on both sides is provided for so that the other party can make arrangements. If the employer decides to terminate the services without giving the required notice, the employment contract itself provides for a compensation to be paid. Similarly, if the employee resigns without notice, compensation is paid by the employee or recovered from his dues. Both the notice period pay and the compensation are incorporated in the employment contract itself but these are not the purpose of the contract. Consequently, any compensation paid is not a consideration for the contract.

16. Since the provision of section 66E(e) appears to have given rise to some confusion, the Central Board of Excise and Customs issued CBEC's guidance notes dated 20.06.2012 para 2.9.3 clarifies as follows:

"2.9. Provision of service by an employee to the employer is outside the ambit of service.

2.9.3 Would amounts received by an employee from the employer on premature termination of contract of employment be chargeable to service tax?

No Such amounts paid by the employer to the employee for premature termination of a contract of employment are treatable as amounts paid in relation to services provided by the employee to the employer in the course of employment. Hence, amounts so paid would not be chargeable to service tax. However any amount paid for not joining a competing business would be liable to be taxed being paid for providing the service of forbearance to act."

17 Referring to the above clarification by the CBEC, High Court of Madras has, in GE T&D India Ltd. [2019 (12) TMI-1566- Madras High Court] held that notice pay, in lieu of sudden termination, does not give rise to the rendition of service either by the employer or the employee and allowed the writ petitions. Thus, the specific issue in this case is no longer res integra GE T&D India Ltd. was followed in Intas Pharmaceuticals [2021-TIOL-367-CESTAT-AHM], State Street Syntel Services Pvt. Ltd. [2021-TIOL- 152-CESTAT-MUM] Shri Ram Pistons and Rings Ltd. [2020 (42) GSTL 79 (Tri-All)] and HCL Learning Ltd. [2019- TIOL-3545-CESTAT-AII].

18. Learned Departmental Representative submitted that the clarification by the CBEC was clear and it was held that the termination pay received by the employee is not exigible to tax because in such a case, it is the employee

who is the service provider and the service provided by him in the course of employment is excluded from the definition of service. However, where the employer recovers any amount, the service provider will be the employer and his services are not excluded from the definition of service. Therefore, a distinction needs to be made on this count. However, on a specific query from the bench, he fairly submits that there are no case laws to support this argument nor is there any case law contrary to the judgment of the Madras High Court in the GE T&D.

19. In view of our finding that compensation for failure under a cannot is NOT consideration for service under the contract and also following the law laid down by Hon'ble Madras High Court in GE T&D that Notice pay in lieu of termination, however, does not give rise to the rendition of service either by the employer or the employee, the impugned order upholding confirmation of a demand of service tax on the notice pay received/recovered by the appellant from its employees for premature resignation cannot be sustained and needs to be set aside.

20. In view of the above, the appeal is allowed and the impugned order is set aside."

Since the facts of the matter in hand are similar to the one which has been decided in the above mentioned decision by this Tribunal, we follow the same and hold that impugned order-in-appeal is without any merit. We set aside the same."

5.1 This Tribunal also dealt with this issue in the case of Commissioner of Service Tax Vs. Intas Pharmaceuticals reported at 2021 (6) TMI 906-CESTAT wherein it was held that the employer cannot be said to have rendered any service for say much less a taxable service and has merely facilitated the exist of the employee upon imposition of a cost upon him for the sudden exist and therefore, such amounts are not leviable to the service tax.

5.2 We also find that in GST era where provisions are *pari materia* to earlier service tax provisions, CBIC has clarified this issue in para 7.5 of the Circular No. 178/10/2022-GST dated 03.08.2022. The said Para is reproduced as below:-

"Forfeiture of salary or payment of bond amount in the event of the employee leaving the employment before the minimum agreed period

7.5 An employer carries out an elaborate selection process and incurs expenditure in recruiting an employee, invests in his training and makes him

a part of the organization, privy to its processes and business secrets in the expectation that the recruited employee would work for the organization for a certain minimum period. Premature leaving of the employment results in disruption of work and an undesirable situation. The provisions for forfeiture of salary or recovery of bond amount in the event of the employee leaving the employment before the minimum agreed period are incorporated in the employment contract to discourage non-serious candidates from taking up employment. The said amounts are recovered by the employer not as a consideration for tolerating the act of such premature quitting of employment but as penalties for dissuading the non-serious employees from taking up employment and to discourage and deter such a situation. Further, the employee does not get anything in return from the employer against payment of such amounts. Therefore, such amounts recovered by the employer are not taxable as consideration for the service of agreeing to tolerate an act or a situation.”

5.3 Since, the facts in the present case are similar to what has been decided by this Tribunal in the case of Linde Engineering India Pvt Ltd and Intas Pharmaceuticals (cited supra), we find no reason to defer from the above decision. Accordingly, we agree with the contentions of the appellant and allow their appeal.

6. Appeal allowed.

(Pronounced in the open court on 29.09.2025)

(Dr. AJAYA KRISHNA VISHVESHA)
MEMBER (JUDICIAL)

(SATENDRA VIKRAM SINGH)
MEMBER (TECHNICAL)