GST Alert 02/2020-21
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Director Remuneration - Taxability under GST and allied Controversy

Rajasthan Authority for Advance Rulings (AAR) issued a ruling vide order no. RAJ/AAR/2019-20/33 dated 20.02.2020 wherein they deliberated on 2 questions raised by the petitioner:

a) Whether GST is payable under Reverse Charge Mechanism (RCM) on the salary paid to Director of the company who is paid salary as per contract.

b) Whether the situation would change from (a) above if the Director also is a part time Director in other company

The petitioner represented the matter saying that as the Director are employees of the company, GST cannot be levied on Salary received by them from the company as per the provisions of clause 1 of Schedule III read with section 7 of the CGST Act.

Strangely, the AAR didn't find it prudent to discuss and analyze the issue whether a Director is an employee of the company or not. They have concluded in para 5.8 of the order that Director is not an employee but haven't given any reasoning as to how they have arrived at this conclusion. Based on this, they have adjudged that Director remuneration is leviable to GST and company will be liable to pay it under RCM provisions.

This ruling was discussed in professional circles with much astonishment, as this directly impacted directors, this was also discussed in their circles with a mixed feeling of fear and surprise. Looking at the impending controversy and imminent litigation that could arise out of this, Government chose to come out with a clarification vide circular No: 140/10/2020 – GST dated 10.06.2020. Following is a gist of this circular:

1. Leviability of GST on 2 kinds of transactions is clarified in the circular:

A. Leviability of GST on remuneration paid by companies to the **Independent directors** defined in terms of section 149(6) of the Companies Act, 2013 or those directors who are not the employees of the said company; and

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B. Leviability of GST on remuneration paid by companies to the **Whole-time directors** including managing director who are employees of the said company.

2. Is this circular binding on the department:

All Circulars issued by the Government are binding on its officers, but as GST is being administered jointly by Centre and State, GST circulars are issued under the legal cover of section 168 so that it is binding on State officers as well because they are not directly under the administrative jurisdiction of the CBIC.

3. Taxability for Independent directors and directors who are not employees of the company:

A. To answer this conundrum, the primary issue to be decided is whether or not a 'Director' is an employee of the company. For this the circular refers to certain provisions of the Companies Act, 2013:

a. It refers the definition of a whole time-director given u/s 2(94) of the Companies Act and says that it is an inclusive definition, and thus he may be a person who is not an employee of the company. Certain section from the Companies Act relevant to this discussion are reproduced hereinunder:

2 (94) —whole-time director‖ includes a director in the whole-time employment of the company;

2 (34) —director means a director appointed to the Board of a company;

2 (54) —managing director means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.
Explanation.—For the purposes of this clause, the power to do administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, shall not be deemed to be included within the substantial powers of management;

b. Definition of 'Independent directors' u/s 149(6) of the Companies Act, 2013, read with Rule 12 of Companies (Share Capital and Debentures) Rules, 2014 makes it amply clear that such director should not have been an employee or proprietor or a partner of the

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said company, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed in the said company.

B. Therefore, in respect of such directors who are not the employees of the said company, the services provided by them to the Company, in lieu of remuneration as the consideration for the said services, are clearly outside the scope of Schedule III of the CGST Act and are therefore taxable. In terms of entry at Sl. No. 6 of the Table annexed to notification No. 13/2017 – Central Tax (Rate) dated 28.06.2017, the recipient of the said services i.e. the Company, is liable to discharge the applicable GST on it on reverse charge basis.

C. **Accordingly, the circular clarified that the remuneration paid to such independent directors, or those directors, by whatever name called, who are not employees of the said company, is taxable in hands of the company, on reverse charge basis.**

4. Taxability for Directors who are employees.

Circular has waded through many aspects to explain which directors can be called as an employee of the company and what will be its yardsticks

A. **Contract OF service vs. Contract FOR service**

First concept that the circular relies on is the "Contract OF service" vs "Contract FOR Service". Where there is a Contract of Service it can be safely derived that the person is an employee of the company and in the latter the person is merely a Supplier of service and not an employee. Distinction between these terms has been upheld by a full bench of the Supreme Court in **Indian Medical Association vs. VP Shantha [1956 AIR 550, 1995 SCC (6) 65]**:

> *"A 'contract for services' implies a contract whereby one party undertakes to render services e.g. professional or technical services, to or for another in the performance of which he is not subject to detailed direction and control but exercises professional or technical skill and uses his own knowledge and A `contract of service' implies relationship of master and servant and involves an obligation to obey orders in the work to be performed and as to its mode and manner of performance."*
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> *In the case of a company and its working directors, the company maintains its ultimate control through the Board which has the authority to direct the mode and manner of performance of the working directors. This is also substantiated vide Section 2(54) of the Companies Act, 2013 which reads that:*
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> *"Managing Director" means a director who, by virtue of **the articles of a company** or an agreement with the company or a resolution passed in its general meeting, **or by its Board of Directors, is entrusted with substantial** powers of management*

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of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

Further, in terms of Provisions of MOA/AOA read with Companies Act, 2013, the Whole-time Director/Executive Director/Managing director are responsible for overall compliances and other matters. In view of the above, the contract for appointment of the whole-time / executive director/ Managing Director is a 'contract of service' amounting to employment.

B. Treatment under Income Tax Act

Under the Income Tax Act, 1961 salaries paid to directors are subject to Tax Deducted at Source ('TDS') under Section 192 of the Income Tax Act, 1961 ('IT Act') which is for TDS on Salaries. However, in cases where the remuneration is in the nature of professional fees and not salary, the same is liable for deduction under Section 194J of the IT Act.

In the case of **M/S Allied Blenders And Distillers Pvt. Ltd. Versus Commissioner Of Central Excise & Service Tax, Aurangabad [2019 (1) TMI 433]** – CESTAT Mumbai, where the appeal is allowed observing that:

> *"All the necessary deductions on account of Provident Fund, Professional Tax and TDS under Section 192 of the Income Tax Act are made as applicable; also they were issuing Form-16 like it is issued to all other employees. Even in the salary return filed by the appellant company before the Income Tax authorities, the director's names have been included. The company does not pay the director's sitting fee to any of the directors. To discredit the said statement, no contrary evidence was produced by the Revenue to establish that the directors are not involved in the day to day function of the Company, but participate only in Board Meetings and consequently paid remuneration. Also, from the documents produced by the Appellant it is crystal clear that the Directors who are concerned with the management of the company, were declared to all statutory authorities as employees of the company and complied with the provisions of the respective Acts, Rules and Regulations indicating the Director as an employee of the company - No contrary evidence has been brought on record by the Revenue to show that the Directors, who were employee of the appellant received amount which cannot be said as 'salary' but fees paid for being Director of the company - The Income Tax authorities also assessed the remuneration paid to the said directors as salary, a fact cannot be ignored."*

In view of these 2 concepts, circular clarifies that if the Director remuneration is taxed as Salary under the Income Tax Act and TDS is deducted u/s 192 of the IT Act then the same cannot be taxed under GST law as it will be covered under clause 1 of Schedule III of the CGST Act.

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5. Controversy emanating from the circular:

Benevolent clarifications from the government are always welcome as it adds to the wisdom of the officers and decreases the litigation cost of the taxpayers especially when we have such horrendous Advance Rulings. However, many times an authority in overzealousness of issuing a benevolent circular creates an unwanted controversy which will need another set of clarification. *One* such problem has crept up in terms of para 5.4 of this circular, said para reads as under:

> *5.4 It is further clarified that the part of employee Director's remuneration* ***which is declared separately other than "salaries" in the Company's accounts and subjected to TDS under Section 194J of the IT Act as Fees for professional or Technical Services shall be treated as consideration for providing services which are outside the scope of Schedule III of the CGST Act, and is therefore, taxable****. Further, in terms of notification No. 13/2017 – Central Tax (Rate) dated 28.06.2017, the recipient of the said services i.e. the Company, is liable to discharge the applicable GST on it on reverse charge basis.*

On the first glance, nothing untoward comes out of these innocuous set of sentences, but on close reading it means that any amount paid to a director on which TDS is not deducted u/s 192 will become an independent supply of service taxable under GST and Company will be liable to pay tax thereon under RCM provisions.

Take example of where a director has given one of his personal premises on rent to the company, he receives rental payments from the company after deduction of TDS u/s 194I. The director in his capacity as a Landlord raises invoice for rents and charges GST on the same in his individual capacity and discharges his liability by filing due GST returns.

As per this circular, as the payment is not liable to TDS u/s 192 company will be liable to pay tax on these rents under RCM provisions, director will not be liable to pay tax under forward charge. In some cases where total rent income of a director is below 20 lacs threshold exemption will also not be available to the director as the rents are taxable in the hands of the company.

Our consistent view on this issue has been that while rendering Services of Renting of Immovable Property person is in the role of a Landlord and not a Director hence such payouts will not be covered under RCM provisions, Services rendered purely in the capacity of a

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Director (not being salary) will only be liable to GST in the hands of the company and not otherwise.

The drafters should have taken due care in drafting such far reaching circulars, hope another clarification is issued quick enough to avoid another controversy.

6. Conclusion:

Advance Ruling on many issues is becoming too onerous for the taxpayers and the tax officials, it is giving rise to more questions then it is answering. Governments are called into clarifying some burning ones while similar AARs on other issues go unclarified.

There is a long list of issues on which AARs have given judgements completely contrary to the legal provisions, Government and GST Council should institutionalise a system whereby all such AARs get clarified on regular basis so that we can avoid a tsunami of litigation that awaits us in near future.

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