



The Authority for Advance ruling recently held that GST shall be payable on Reverse charges basis on remuneration paid to directors. In this respect, our firm has summarized the said unresolved dispute as under :-

Authority of Advance Rulings (Raj), in Re : M/s Clay Craft India Private Limited [2020 (4) TMI 228]

### **1. Dispute on Taxability of Remuneration**

The government has power u/s 9(3) of CGST Act & u/s 5(3) of IGST Act, to notify the levy of GST on Reverse Charge Mechanism (RCM) basis on goods or service. Entry no. 6 of the Notification No. 13/2017- Central Tax (Rate) dated 28<sup>th</sup> June 2017 covers the services supplied by director to company.

The relevant portion of the notifications covering directors remuneration is as below:

<b>Sl. No.</b>	<b>Category of Supply of Services</b>	<b>Supplier of service</b>	<b>Recipient of Service</b>
6	Services <b>supplied</b> by a director of a company or a body corporate to the said company or the body corporate.	A director of a company or a body corporate	The company or a body corporate located in the taxable territory.

Further, Schedule III of the CGST Act has enlisted certain exclusions to the definition of 'supply'. In the given case, the Services provided by an employee to the employer in the course of or in relation to his employment are not treated as 'supply' as per Schedule III to CGST Act, 2017.

Therefore, considering the above Schedule III read with the RCM notification, all taxpayers have safely presumed that GST - RCM basis shall not be applicable on remuneration paid to directors.

Further, the GST Department issued a clarification on 10th July 2017 through Press Information Bureau which is reproduced as below:

"It is pertinent to point out here that the service by an employee to the employer in the course of or in relation to his employment is outside the scope of GST (either supply of goods or supply of services). It follows there from that supply by the employer to the employee in terms of contractual agreement entered into between the employer and the employee, will not be subjected to GST."

The recent AAR Ruling has challenged this primary belief of applicability of RCM on such transactions.



### 2. Understanding certain Basic terms

Before we discuss the tax implication of the same, let us understand few important terms.

The terms Employee, Directors, Remuneration & Salary are not defined under the GST Act and hence the same must be understood in common parlance and General Clauses Act alongwith the aid of other laws.

#### ➤ **Roles and Responsibilities of different types of Directors:**

There are different kinds of directors that a company can appoint. Broadly they can be divided into two categories – executive directors and non- executive directors. Executive directors are the ones who are involved in the day to day execution of the affairs of the Company and include whole time directors, managing directors, etc. Non-executive directors include independent director, nominee director, who donot have decision making power in operational matters of the company. The executive directors of a company receive remuneration and are in full time employment of the company. These non-executive directors attend the board meetings and receive sitting fees or commission for providing services to the company or body corporate. Companies Act, 2013 The Companies Act, 2013 has defined the term “whole time director” under section 2(94) of the Companies Act, 2013 as follows:

*(94) “whole-time director” includes a director in the whole-time employment of the company’*

It is evident from the explanation and the definition that the words used are “whole-time employment of the company” and the said words used clarifies the intention of law that the whole-time directors are the persons who devotes their whole time in management of the company.

#### ➤ **The term “Employee”:**

Explanation to Section 62(1)(b) of the Companies Act, 2013 defines employee as under:

“Employee” means

- a. A permanent employee of the company who has been working in India or outside India; or
- b. A director of the company, whether a whole-time director or not **but excluding an independent director; or.....”**

From the above definition of the Companies Act, it is very clear that all directors either whole time or otherwise shall be considered as employee of the company.

#### ➤ **The term – Remuneration & Salary:**

Remuneration is a general term that describes all different forms of compensation for employees in an organization. It can be the salary of an individual, or it can be much more than just the salary. Remuneration often includes non-monetary incentives as well as allowances and other perks. Stock



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options, bonuses etc. offered to employees to motivate them for better performances typically are included in remuneration.

Salary is a fixed amount of money that is given to employees on a monthly basis in exchange for services rendered by them.

Salary is a type of remuneration. *Remuneration being a wider term includes salary.*

Remuneration is a broader term than salary as it consists of bonuses, incentives, stock options, perks etc., in addition to the basic salary of the employee.

### **3. Legal Position under Service tax regime:**

Under the Service Tax regime, Section 65B(44) of the Finance Act, 1994 defined the term “Service” which explicitly excluded “provision of service by an employee to the employer in the course of or in relation to his employment”

In this context it is also relevant to understand the decision of **Rent Works India Pvt Ltd vs. CCE, Mumbai 2016(43) STR 634 (Tri- Mum)** wherein it was held that *“there is a difference between salary and consultancy fee in as much as when the income tax department considers payment in the nomenclature consultancy fee as salaries, on which TDS is also made, the said payments cannot be said towards rendition of taxable service for levy of service tax. He also relied on the decision of the tribunal in the case of PCM Cement Ex. Appeal No. 75277 of 2016 **Concrete Pvt Ltd vs. CCE, Siliguri 2018(9) GSTL 391 (Tri- Kol)** wherein the tribunal observed that consideration paid to whole time directors would be treated as payment of salaries in as much as there would be employer employee relationships and in such cases, there cannot be any levy of service tax.”*

Similar view has been upheld by Customs, Excise and Service Tax Tribunal in case of **M/s. Allied Blenders and Distillers (P.) Ltd. 2019 (24) G.S.T.L. 207 (Tri. - Mumbai)**.

It is also worth noting that under the Companies Act, a General Circular No. 24/2012 dated 09.08.2012 issued by Ministry of Corporate Affairs (MCA) clarifies that:

*“The Non-Whole Time Directors of the company are presently not covered under the exempted list and as such, the sitting fees/commission payable to them is liable to Service Tax. Service tax is payable on the commission/sitting fees payable to Non-Whole Time Directors of the company.”*

It is evident from the above circular that under the service tax regime, service tax was not applicable on director remuneration and was restricted merely to commission or sitting fees paid to Non-Whole Time Directors. The exclusion of Whole-time Directors and Managing Directors in the above circular clarifies the intention of legislature that the said directors are employees of the company and activities carried out by them cannot be termed as service and made liable to service tax.



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### 4. Legal Standi of Advance Ruling:

Section 103 of the CGST Act provides that the order pronounced by the AAR shall be binding only on the applicant and shall not be binding on any other taxpayer or company who has not applicant in that advance ruling.

Therefore, the said AAR Ruling cannot be used as precedence in the court of law. However, it does carry persuasive value in the eyes of judicial authorities.

### OUR LEGAL OPINION

The view taken by AAR is not correct as the said decision ignored the fact that the directors can work in the capacity of the employees of the company and draw remuneration in respect of such services as per clause 1 of Schedule III to Sec 7 of CGST Act.

- 1) The said ruling has distinguished the legal roles between the directors and employees, however failed to accept that one person can work as director during board meetings and work as an employee of the company for earning salary income. The term 'employee' and 'director' are not mutually exclusive. It is possible for a person to work as an employee (CEO / CFO / Etc) and be a director for big decision making in board meeting of the company. Therefore the remuneration paid by the company to Mr. X should be treated as remuneration received in capacity of employee and not in capacity of the director.
- 2) The provisions of the notification cannot over-ride the provisions of the Act. The notification issued by the Central Government derives its powers from Section 9(3) of the CGST Act. The said powers cannot be used by Central Government to violate other provisions of the Act (i.e Schedule III of CGST Act).
- 3) Further, as per Article 286 of the Constitution, the Government shall collect GST on 'services' supplied. The remuneration paid by the company to its directors cannot be treated as 'service' from service provider to service receiver. Therefore, the Central Government has no jurisdiction to collect GST on remuneration paid from directors to company.
- 4) Persuasive value can be taken from other laws in this respect. The said issue is already settled under the Income Tax law that Director Remuneration of Working directors should be taxable under the head 'Income from Salary' and not 'Income from Other Sources'. The same principle should be extended to GST Law and RCM should not be applicable.

**Therefore, we hereby opine that GST - RCM is not applicable on Director Remuneration paid to working directors.** The said AAR Judicial ruling is vague and not exhaustive. The said ruling should not have Legal Standi in the court of law.

It is very vital to note that some tax payers choose to be Risk Averse from Tax Litigation, therefore such taxpayers are advised to pay RCM on Director remuneration and claim ITC on the said RCM transaction accordingly.