

# GST on Director's Remuneration

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Recently, in an order passed by AAR, Rajasthan on 05-02-2020, in case of M/s Clay Craft India Pvt. Ltd. it has been held that GST under RCM is applicable on consideration paid to Director of the company. A cursory reading of given ruling adds to the anxiety of a sane GST literate person and tarnishes mental peace. The fuel to the fire is added, when it is reported in leading business newspapers. The given write-up has been prepared with an objective to assist reader to logically understand as to why GST on director's remuneration who are employees be levied and thus tax under RCM need not be paid on the same.

## Brief Facts presented before AAR

- The company was a manufacturer of goods and was registered under GST. The company had 6 directors and were performing all the duties and responsibilities such as holding charge of procurement of raw material, production, quality checks, dispatch, accounting etc. All the directors of the company were treated as Whole Time Directors.
- The directors were paid regular salary and PF was also deducted on such salary. The directors were treated as being working as employees of the company. The Income Tax Return of the Directors was filed under the Head "Income from Salaries".
- The company was paying commission to the Directors which was treated as commission paid to them in lieu of services provided by them as Directors (but not employees) of the company and hence were paying GST under RCM on the same.
- The company on the basis of order passed by AAR, Karnataka in case of M/s Alcon Consulting Engineers (India) Pvt. Ltd. dated 25.09.2019 interpreted a possibility that GST is applicable on services provided by director as an employee reading in light of Section 2(93) *i.e.* definition of recipient.

## Comments from the Jurisdictional Officer

- The salary paid to the Directors by the Company, the services provided by the Directors to the Company are not covered under Para(1) of the Schedule III to the Central Goods and Services Tax Act, 2017 as the Director is not the employee of the Company.

## Findings of the AAR

- We further observe that Consideration in form of salary and commission paid to the Directors by the company is against the services provided by them to the company and the company is recipient of such service and Directors are the supplier.
- We further observe that consideration paid to the Directors

is against the supply of services provided by them to the applicant company and are not covered under Para (1) of the Schedule III to the CGST Act, 2017 as the Directors are not the employee of the Company. In the instant case Director is the supplier of services and the applicant company is the recipient of the services.

- We observe that the consideration paid to the Director for the supply of services to the Company is specifically covered under Notification No.13/2017- Central Tax (Rate) dated 28.06.2017.

### **Loopholes in the AAR**

- The given **AAR is non-speaking** i.e. its conclusion is not backed by any reasoning at all. It has been ruled that the directors of the company in the given case are not employees of the company without specifying the reasons for the same. The submissions made by the company have been just reproduced but no reason for rebuttal has been given.
- The authority has progressed on the basis of wordings mentioned under notification no. 13/2017-CT dated 28.06.2017 i.e. notification for reverse charge mechanism which only decides the person liable to pay tax. However, whether the tax should at all be payable or not, should be decided first which needs to be answered through fulfilling the conditions of Section 9(1) of the CGST Act 2017 i.e. Levy of Tax. Thus, the **application of sections while passing the AAR order is not in accordance with the scheme of the law.**
- The company had asked question to the authority under clause 97(2)(e) of the Act i.e. determination of the liability to pay tax on any goods or services or both. However the AAR has assumed that GST is applicable on Director's Remuneration who are being paid salary and hence they have only answered if it is liable to pay tax under Reverse Charge Mechanism. However it is clear the question was if at all there was any liability to pay tax and if yes, it was applicable then who was liable to pay tax. In fact, **the question should have been asked under clause (g) of Section 97(2) of the Act** i.e. whether any particular thing done by the applicant with respect to any goods or services or both amounts to or results in a supply of goods or services or both, within the meaning of that term. Hence answer given in the AAR is on interpretation of question and thus it lacks substance.

### **AAR Order in case of Alcon Consulting Engineers (I) Pvt. Ltd. dated 25-09-2019 by Karnataka Authority**

In this ruling, it was held that

*Services supplied by director - Remuneration to directors - Services provided by directors to company not covered under Para(1) of Schedule III to Central Goods and Services Tax Act, 2017 as Director is not the employee of company -Liable to tax under reverse charge basis in terms of Serial No. 6 of Notification No. 13/2017-C.T. (Rate) - Sections 2(31), 2(93) and 9(3) of Central Goods and Services Tax Act, 2017. [paras 5, 5.2, 7]*

However, in the said ruling the question which was asked was as under:

**5.1 The question before us is not whether this service is taxable or not, but whether this supply of services is liable to tax under reverse charge mechanism.**

- Thus, in given AAR also it was not discussed at all if service at all is leviable to GST or not. It was only decided if tax under RCM needs to be paid or not. Hence the given ruling also has no substance and the answer given is in the context of question raised which is not correct.

**Merits for non-applicability of GST on Salary paid to the Directors**

1. Under Section 9(1) of the CGST Act 2017, GST is applicable on supply of goods or services. Whereas the scope of the term supply has been brought out in Section 7 of the Act wherein certain activities which are specified in Schedule III have been treated neither as supply of goods nor as supply of service.
2. Under Schedule-III, Entry 1 is read as "*Services by an employee to the employer in the course of or in relation to his employment.*" Hence if any activity falls within the ambit of entry 1 of Schedule-III, it is not a supply and cannot be levied to GST.
3. The important point to note further is that the list of services under RCM notified *vide* Notification No. 13/2017-CT has been issued in exercise of powers conferred under Section 9(3) of the Act which provides '*The Government may, on the recommendations of the Council, by notification, specify categories of supply of goods or services or both, the tax on which shall be paid on reverse charge basis by the recipient of such goods or services..*'
4. Hence the entry in Notification No. 13/2017-CT *i.e.* "*Services supplied by a director of a company or a body corporate to the said company or the body corporate*" is only to be read and referred when a specific activity does not fall under entry 1 to Schedule-III as mentioned above.
5. To clearly ascertain the employer and employee relationship, the nature and characteristics of appointment of the Director and its terms and conditions or other provisions contained in the Memorandum and Articles of Association are to be examined in each case separately so that leviability of GST can be determined. Where the directors are involved in day to day operations of the company and the company has a control over the role of directors and the directors have to obey such rules or role, they are undoubtedly employees of the company.
6. The employee-employer relationship can be also established from one of the facts that under which Section of the Income Tax Act, 1961, the TDS is being deducted by the Company on payments made to a Director. The TDS on income under the head of "Salaries" is deducted under Section 192 of the Income Tax Act, 1961. If the TDS on payments made to a Director by a company has been deducted u/s 192 of Income Tax Act, then the said payments to a Director by the company are not chargeable to GST as the same establishes

employee-employer relationship between a director and the company & thus does not fall under the purview of "Supply" as defined under Section 7 of the CGST Act, 1994.

## Compendium of Relevant Judgments

Judgment	Extract of Decision	Interpretation
<b>Supreme Court</b> <i>Indian Medical Association v. V.P. Shantha</i> [1956 AIR 550, 1995 SCC (6) 65]	<p>"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 discretion. [See: Oxford Companion to Law, P. 1134].</p> <p>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."</p>	<p>The employer-employee relationship is established where the employee works under the superintendence of the employer. A contract for employment is a Contract of service whereas a contract for work is Contract for service.</p>
<b>Supreme Court -</b> <i>Ram Pershad v. CIT</i> - [1972] 2 SCC 696	<p>"6. There is no doubt that for ascertaining whether a person is a servant or an agent, a rough and ready test is, whether, under the terms of his employment, the employer exercises a supervisory control in respect of the work entrusted to him. A servant acts under the direct control and supervision of his master.</p> <p>"14. A perusal of the articles and terms and conditions of the agreement definitely indicate that the assessee was appointed to manage the business of the company in terms of the articles of association and within the powers prescribed therein.</p> <p>The very fact that apart from his being a Managing Director he is given the liberty to work for the company as an agent is indicative of his employment as a</p>	<p>The control of the company over the Director's action decides if they are employees of the company. The same can be understood from AOA and appointment letter (Contract) of Director by Company.</p>

*Managing Director not 'being that of an agent.*

**CESTAT, Mumbai** - *"7. ... If an amount paid by the appellant to Shri Alan Van Niekerk is considered as salary by the Income Tax Department, a branch of Ministry of Finance, Department of Revenue, it cannot be held by the Service Tax Department, another branch of the Ministry of Finance, Department of Revenue, as amount paid for consultancy charges and taxable under the Finance Act. The same department of Government of India cannot take different stand on the amount paid to the very same person and treat it differently. In our view, the amount which is paid to Mr. Alan Van Niekerk, in the circumstances of this case as brought out herein above, has to be treated as salary to the director and the salary is not to be considered as to fall under the category of 'Management Consultancy Services' and liable for Service Tax.*

**Mumbai Tribunal** - *Directors' salary - Whether liable to Service Tax - Four directors appointed in the company in accordance with the provisions of Companies Act, 1956 and Regulation of Article of & ST, Association of Company for Aurangabad managing day-to-day affairs of company - All the necessary deductions on account of Provident Fund, Professional Tax and TDS under Section 192 of Income Tax Act, 1961 made as applicable - Form-16 issued to directors like all other employees and directors' names included in the salary return filed by the appellant-company before the Income Tax Authorities - Director's sitting fee not paid by*

*company to any of the directors -*  
**No contrary evidence was produced by the Revenue to establish that directors not involved in the day-to-day function of the Company, but participate only in Board Meetings and consequently paid remuneration** - Directors shown to be employees by appellant, therefore, directors' salaries not chargeable to Service Tax - Section 65B(44)(b) of Finance Act, 1994. [paras 15, 16]

<p>Supreme Court  <i>Employees State Insurance Corporation v. Apex Engineering Pvt. Ltd.</i>          [1998] 1 SCC 86</p>	<p>Held that Directors of a company, who are receiving remuneration, would fall within the definition of an "employee" as provided under Section 2(9) of the Employees' State Insurance Act, 1948 ('Act') and that the company is bound to deposit contributions in relation to the remuneration paid to such Directors.</p>	<p>The directors can be employees of the company and the understanding of jurisdictional authorities or AAR that directors are not employees of the company is baseless as strengthened by this SC Judgment.</p>
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The Supreme Court referred to the relevant portions of the judgment in *Apex Engineering (supra)* wherein **it was held that there was nothing in the Act to indicate that a 'Managing Director' cannot also be an 'employee' for the purposes of the Act.** The Supreme Court concluded that the ratio of *Apex Engineering (supra)* applies with greater force in relation to a Director of the Company, if the Director is paid remuneration for discharging the duties entrusted to him.

<p><i>M/S Brahm Alloy Limited v. Commissioner of CGST &amp; C. Ex., Durgapur</i>          2019 (24)</p>	<p><i>Brahm Salary/Remuneration paid to Directors for rendition of services to company - Liability of recipient company under Reverse Charge Mechanism to pay Service Tax on such salary/remuneration - Copy of Ledger Account showing that remuneration paid to Directors</i></p>	<p>This is an adverse judgement in this regard.</p> <p>Though this judgement has not rebutted the earlier decision of the Tribunal</p>
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G.S.T.L. 616 accounted on quarterly basis which is quite (Tri. - instead of monthly basis - detailed and Kolkata) Though appellant-company reasoned, however produced Chartered Accountant it lays down some certificate showing appointment additional factors of wholtime Directors and which can be payment of remuneration/salary considered to them on monthly basis as well establish the as copy of Minutes of Meeting of employer-Board of Directors regarding employee their appointment as wholtime relationship. Director and also copy of appointment letter, to establish They are pointed employer-employee relationship as under: for purpose of remuneration/salary, resolution of company must cover the terms of appointment/hiring of services and also the action to be taken for non-performance of specified duties, without which it cannot be construed as to whether an individual appointed as Promoter Director or an employee Director - Further remuneration cheque has to be paid on monthly basis - Since there is deviation from aforesaid principle in the facts of present case, demand of Service Tax from company sustainable particularly when such remuneration shown by Directors in their Income Tax Return under head 'Salary' and tax deducted at source thereon by company - Sections 68(2) and 73 of Finance Act, 1994 read with Rule 2(1)(d)(EE) of Service Tax Rules, 1994 and Notification No. 30/2012-S.T. as amended by Notification No. 45/2012-S.T. [paras 1, 7]

- a. The resolution or appointment letter should have a clause of hiring and also the clause of firing the director in case of non-performance of specific duties.
- b. The remuneration cheque should be paid monthly

### Clarifications under Service Tax regime

1. In relation to service tax liability, which was based on same premise, on remuneration paid to managing directors, a circular was issued by CBEC bearing number 115/9/2009-ST dated 31.7.2009. In the said circular in its para 2(ii) it was elaborated that:

*The Managing Director/Directors (Whole-time or*

*Independent) being part of Board of Directors perform management function and they do not perform consultancy or advisory function. The definition of management consultant service makes it clear that what is envisaged from a consultant is advisory service and not the actual performance of the management function. The payments made by Companies, to Directors cannot be termed as payments for providing management consultancy service. Therefore, it is clarified that the amount paid to Directors (Whole-time or Independent) is not chargeable to service tax under the category 'Management Consultancy service'. However, in case such directors provide any advice or consultancy to the company, for which they are being compensated separately, such service would become chargeable to service tax.*

*3. In view of the above, it is clarified that remunerations paid to Managing Directors/Directors of companies whether whole-time or independent when being compensated for their performance as Managing Directors/Directors would not be liable to service tax.*

2. In fact in the Service Tax Regime, in Regional Advisory Committee meeting under the leadership the Commissioner of Central Excise & Customs, Jaipur vide minutes of the meeting dated 07.2015 (Document No. CCO(JZ)RAC/5/2013/Pt/3003-26) a question in this regard was asked and following answer was given by the department

**Point No.-1- Is Service Tax applicable on services provided by all Directors to a company? Either Director is managing Director/whole-time Director or executive Director [Both Director and company contributes towards ESI, Provident fund and gratuity etc.]**

*REPLY:*

*Section 65B(44) of Finance Act, 1994 as introduced w.e.f. 1-7-2012 reads as follows - "Service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include- (a) - - (b) a provision of service by an employee to the employer in the course of or in relation to his employment (c) - - .*

*Services provided by employee to employer have been excluded from the definition of 'service' itself and therefore applicability of Service Tax on services provided by the directors to a company depends on the fact whether there is employee-employer relationship between the director and the company or otherwise.*

*Employee-employer relationship is established from the fact that under which Section of the Income Tax Act, 1961, the TDS is being deducted by the Company on payments made to a Director. The TDS on income under the head of "Salaries" is deducted under Section 192 of the Income Tax Act, 1961. **If the TDS on payments made to a Director by a company has been deducted U/s 192 of Income Tax Act, then the said payments to a Director by the company are not chargeable to Service Tax as the same establishes employee-employer relationship between a director and the company & thus does not fall under the purview of***



## **"Service" as defined under Section 65B (44) of the Finance Act, 1994.**

*Further to ascertain the employer and employee relationship, the nature and characteristic of appointment of the Director and its terms and conditions or other provisions contained in the Memorandum and Articles of Association are to be examined in each case separately so that leviability of Service Tax can be determined. However, in case of services provided by a director other than an employee (nominated/inducted director), the same are liable to Service Tax*

### **Points of caution to ensure no tax on Director's Remuneration**

Thus, on the basis of above, if following points are taken care of, then one can save themselves from frivolous demand of GST under RCM by department on payment of salary to the MD or WTD or Executive Director:

- i. It should be recorded in no unclear terms in the Board resolution that the directors are being appointed as executive directors and that they are entitled to 'salary'.
- ii. That the forms for appointment of Director on Board should also specify that class of Director to which it belong is "Executive" but not "Independent".
- iii. It is advisable to document a simple offer letter from the Board to the director(s) being appointed, setting forth the terms of appointment, their duties/responsibilities and the salaries.
- iv. The appointment letter should consist of the period for which the director is appointed.
- v. TDS under IT Act should be deducted under Section 192 of the Act. Also, covering such payments under Form No. 16 (viz., certificate for tax deducted at source from salaries) issued under the Income Tax Act, 1961 would save a lot of trouble for the company and director.
- vi. Complying with ESI and PF provisions which are statutory compliances which are to be done for employee should be also done in case of Director. In case the entity is liable for ESI and PF then same should be deducted for director.
- vii. Remuneration should be paid monthly.
- viii. Perquisites payable to director should be part of the appointment letter.

### **Conclusion**

If a company is following the points of caution mentioned above, in our considerate view, no GST is applicable on salary paid to the directors since that salary is paid to them being director of the company and hence the question of payment of GST under RCM does not arise at all. Thus, a sigh of relief should be taken in these chaotic times and peace of mind should not be lost on the unreasoned, illogical and wrongly propagated AAR.

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