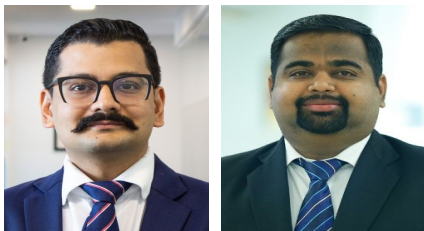


## Eye Share: Taxability of Director Payments under GST in light of the recent Rajasthan AAR

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The Japanese proverb “Aite no nai kenka wa denkinu” translates as “One cannot quarrel without an opponent”. As long as tax departments are there, most taxpayers in India will not rue the lack of an opponent to quarrel with. This is becoming all the more apparent if one goes by some of the decisions given by the AAR under GST. Recently Rajasthan AAR in case of **Clay Craft India Pvt. Ltd.** [[TS-218-AAR-2020-NT](#)] has given ruling that, GST is payable under RCM, on Salary paid to director.



In this outset, **Mr. Jigar Doshi & Mr. Pratik Shah (both founding Partners at TMSL)** along with **Ms. Rebecca Pinto (Director)** in their incisive article explain that the term ‘Employee’ or ‘director’ has not been defined in the GST Law and thus one can draw inference from the closest law that is the Companies Act. The authors point out that this issue was existent in the erstwhile

Service Tax regime as well as in the Income tax. Observing different approaches being adopted for the same income, the authors emphasize, “It becomes crucial for the Authorities to clarify and re-interpret this issue at the earliest, keeping in mind the above factors to avoid confusion and unnecessary burden of compliance. At the same time, this order leaves a risk of exposure to all other companies”.

### Article

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Amidst dealing with the Covid-19 pandemic that has shaken the whole world with its scale, speed and economic damage; companies found themselves dealing with an additional issue that might cause them increased compliance and costs. Recently, the question raised before Rajasthan Authority for Advance Ruling was ‘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.’ The Hon’ble AAR, held in the case of **M/s Clay Craft India Pvt Ltd** [[TS-218-AAR-2020-NT](#)] (‘Company’) that remuneration paid to directors is taxable and hence liable to GST under Reverse Charge Mechanism.

This has sparked up discussions on whether the same is tenable at law. There is a difference in opinion on various grounds and the same will be discussed below.

### Advance Rulings under GST

- **Clay Crafts India Pvt. Ltd.** (Advance Ruling No RAJ/AAR/2019-20/33 dated 20/02/2020): In the recent Advance Ruling issued by the Rajasthan AAR authorities, the Authorities have said that the Directors of the company are not employees of the company and hence, the benefit of Schedule III shall not be available to them. Directors would be considered as supplier of service and Company as the recipient of service, both being located in the taxable territory and thus, the

consideration paid would be applicable to GST under Reverse Charge.

- **Alcon Consulting Engineers Private Limited** (AR No. KAR ADRG83/2-19): The Karnataka Advance Ruling Authorities stated said that services provided by directors of the company are not covered under Schedule III of the CGST Act, 2017. Thus, the services provided by the directors are subject to reverse charge mechanism under Notification 13/2017 – Central Rate dated 28.06.2017.

### **Facts of the Case**

- Directors have additional roles as employees and hold charge of functions like procurement of raw material, production, quality checks, dispatch, accounting etc.
- Directors have an employment contract with the Company wherein the compensation as salary and other allowances have been defined, similar to the arrangement with other regular employees
- The company is deducting TDS on their salary and PF laws as applicable to their service and similarly, is being booked under “Income from Salary” by the Directors in their personal Income Tax returns
- The company is already paying GST under reverse charge mechanism on any commission paid to Directors as such amount pertain to the service provided by them in the capacity of a Director

### **Legislative Overview**

**Supply under GST:** Section 7 of the CGST Act, 2017 pertains to the meaning of supply under GST. Section 7(2)(a) provides that the activities or transactions specified in Schedule III are not treated as supply of goods or services and accordingly, not liable to GST. Relevant to note that Section 7(2) is a non-obstante clause beginning with “Notwithstanding anything contained in sub-section (1)”.

This means that even when an activity or transaction is covered under the scope of Supply, if the same is covered under Schedule III, it would neither be a supply of goods nor supply of services. Para 1 of Schedule III covers “Services by an employee to the employer in the course of or in relation to his employment.”

**Reverse charge under GST:** Entry 6 of Notification No. 13/2017-Central Tax (Rate) dated 28.06.2017 states that ‘Services supplied by a Director of a company or a body corporate to the said company or the body corporate’ shall be paid on reverse charge basis by the recipient of the such services, wherein Supplier of Services is ‘A director of a company or a body corporate’ and Recipient Services of Services is ‘The company or a body corporate located in the taxable territory’

With regards to this, Rajasthan AAR has upheld that directors are not employees of the company and accordingly, Schedule III would not apply to them. In this context it would be

important to analyse, whether the service of director to the company would be considered a service by an employee to the employer for the purpose of GST.

The term 'Employee' or 'director' has not been defined in the GST Law. Hence, the same must be understood in common parlance and with aid of other laws. There are multiple corporate laws and labour laws that define the term, however, the closest law connected to this current issue is Companies Act, 2013 which has been discussed below to provide some clarity on directors and their status in the company.

**Company Law:** Explanation to Section 62(1)(b) of the Companies Act, 2013 defines employee to include 'a director of the company, whether a whole-time director or not but excluding an independent director'

As per section 2(94) of the Companies Act, 2013, "whole-time director includes a director in the whole-time employment of the company".

The definition of 'whole-time director' is an inclusive one. A director refers to a director who has been in employment of the company on a fulltime basis and is also entitled to receive remuneration. Evidently, this definition brings in the position of a director as that of an employee of Company – the remuneration of which is in the nature of salary.

**Service Tax:** This same issue persisted under the Service Tax Regime. Circular No. 115/09/2009 – ST dated 31 Jul 2009 clarified that remuneration paid to Managing Director/Directors of companies whether whole-time or independent being compensated for their performance as Managing Director/Directors would not be liable to service tax. 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.

It was concluded under Service Tax that service provided by a director in the capacity of an employee of the Company or Body Corporate was not chargeable to service tax as the service provided by the director was in his personal capacity and thus, the director remuneration paid by the company should not be liable to tax under reverse charge. It would be treated as part of an employment contract. The companies were not paying service tax under reverse charge on such remuneration. Service Tax payable under Reverse Charge was limited to 'Sitting fees' payable to Directors for attending Board or Committee meetings.

Under **Income Tax Law**, the director remuneration is also taxed as income under the head 'Salaries' by treating the relationship between director and company as that of employee and employer. The company deducts the applicable TDS of the Income Tax Act under the head salaries and tax is being charged

### **Analysis of the Situation**

Looking at the different tax laws, three different approaches are being observed for the same income. Considering the existing Income Tax Laws and GST, contradicting approach has been adopted by two branches of Ministry of Finance on the same subject matter. Would like to highlight the case of **Rent Works India Pvt. Ltd. v. Commissioner of Central Excise**, it was

held that: “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 a different stand on the amount paid to the very same person and treat it differently.”

Another reference to the judgment in *Ramaben A. Thanawala vs Jyoti Ltd. and ors.* under the **Company Law**, clearly brings out the element of employment in whole-time directorship. Moreover, in order for a supplier-recipient relationship to exist, the contract should be a ‘contract for service’. The contract for appointment of the whole-time or executive director is a ‘contract of employment’ amounting to employer-employee relationship.

One may also refer Article 276 Clause (2) of the Constitution of India which states, “The total amount payable in respect of any one person to the State or to any one municipality, district board, local board or other local authority in the State by way of taxes on professions, trades, callings and employments shall not exceed two thousand and five hundred rupees per annum.”

Where the advance ruling has created a reverse charge liability on director’s remuneration, the nature of supply would be intra-state supply and GST chargeable shall be CGST + SGST. This Constitutional Entry might be a limiting factor for the dual-GST system where GST is charged both, by the Centre as well as the State in the form of CGST & SGST respectively. Hence, if GST is applicable, the validity and manner in which Government can collect SGST should also be clarified. It should be ensured that the GST Law and this Advance Ruling does not breach the Constitutional Entry.

### **Impact of the Ruling**

The view upheld by Rajasthan AAR seems to have overlooked the practices prevailing by other branches of the Ministry. The fact that directors can also work in the capacity of employees of the company and their remuneration is termed as ‘Salary’ and not ‘consideration’. There is an employment contract and hence, there is no supplier-recipient relationship. The liability so created may amount of a constitutional breach of interest.

Owing to the current ruling, companies below threshold would have to undergo compulsory registration due to the applicability of RCM which leads to additional compliance in the corporate sector, especially for MSMEs. For registered companies, the payment of GST under RCM (which would otherwise be outside the scope), is an added cost to the Company.

Though an advance ruling pronounced by an AAR shall be binding only on the applicant and on the concerned officer or the jurisdictional officer in respect of the applicant and is not applicable to similarly placed taxable persons in the State. It becomes crucial for the Authorities to clarify and re-interpret this issue at the earliest, keeping in mind the above factors to avoid confusion and unnecessary burden of compliance. At the same time, this order leaves a risk of exposure to all other companies.