

GST on Director's remuneration

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Introduction:



AS we approach the third anniversary of GST implementation in India, we witness a lot of confusion stemming from conflicting interpretation of legal provisions between the assessee and the authorities. In the past few months, various retrospective amendments have been brought into effect in relation to the GST Acts and rules made there under. While the law should be dynamic, at the same time one should also be mindful of the fact that too many changes in the evolving law carries the burden of unknow fear and uncertainties.

Recently, due to contrary decisions there has been confusion which arose on the issue of applicability of GST on the remuneration being drawn by the director of a company. The following are some of the services offered by a Director to the Company against which remuneration is paid to them :

- Sitting fees
- Commission
- Independent Professional/ Advisory fee

Conflicting AARs

On this issue of Director Remuneration, there have been conflicting decisions by Authority for Advance Ruling (AAR). In this context there are the following two cases, wherein the authorities have held that GST is payable on all directors' remuneration (including salary) since directors are not employees of the company.

a) Karnataka AAR in the case of **M/s. Alcon Consulting Engineers (India) Pvt. Ltd . - [2019-TIOL-378-AAR-GST](#)** (Alcon) :-

In this case, the applicant had approached the authorities with the question as to whether GST should be applicable on the remuneration paid to directors. The Authority had opined that directors are not employees of the Company. Thus, the services provided by directors to the company do not fall under Entry 1 of Schedule III of CGST Act which provides that services by an employee to the employer in the course of or in relation to employment are not considered as supplies under GST. Therefore, remuneration paid to director is liable to tax under Reverse Charge Mechanism (RCM) as per Entry No. 6 of Notification No. [13/2017-Central Tax \(Rate\)](#) dated 28.06.2017

b) Rajasthan AAR in the case of **M/s Clay Craft India Pvt. Ltd. - [2020-TIOL-64-AAR-GST](#)** (Clay Craft) :-

In this case, the directors of the Company received remuneration (salary) and commission. The company was discharging GST under RCM only on the commission paid to directors under RCM. The AAR held that remuneration paid to directors for supply of services is covered under the definition of consideration. Further, directors cannot be treated as employees of the company. Thus, remuneration paid to directors is covered under the notification *supra* and, therefore, is liable to GST under RCM.

The decisions of *Alcon & Clay Craft* had led to a lot of speculation in the industry as these rulings exposed the companies to significant GST liability in respect to the salaries paid to their executive directors. There were expectations of demand notices being issued for payment of such GST liability from 2017-18 onwards.

c) Thereafter the Karnataka AAR gave a conflicting decision in the case of **Mr. Anil Kumar Agarwal - [2020-TIOL-95-AAR-GST](#)**:-

In this case Mr. Anil Kumar Agrawal (unregistered) submitted an application to Karnataka AAR to determine whether his various income, including salary received as a director from a private limited company, would be

included in the aggregate turnover, for the purposes of GST. The AAR *inter alia* answered the question with respect to taxability of the remuneration received by Mr. Agrawal in his capacity as director of a company. The authority made a clear distinction with respect to GST applicability on remuneration paid to executive and non-executive directors of the company. It was held that the remuneration paid to executive directors will be treated as consideration for services supplied by the applicant as an employee. Accordingly, GST shall not be leviable.

Circular dated June 10, 2020

In light of the above contradictory rulings, the CBIC has issued Circular No: [140/10/2020](#) dated June 10, 2020 to clarify the GST applicability in respect of directors' remuneration. The circular has distinguished between independent (non-employee) directors and whole-time directors (employee).

Remuneration paid to independent directors or non-employee directors

As per Section 2(34) of the Companies Act, 2013, "*a director means a director appointed to the Board of a company*". Further, as per Section 2(94) of the above Act, a whole-time director includes a director in the whole-time employment of the company.

Basis the above, the Circular mentions that the definition of whole-time director is inclusive and may include a non-employee as well. However, as per Section 149(6) of the Companies Act, 2013, read with Rule 12 of Companies (Share Capital and Debentures) Rules, 2014, an independent director should not be an employee, proprietor or partner of the Company.

Remuneration paid to Independent Directors or Non-employee Directors

Accordingly, the Circular clarifies that independent directors or non-employee directors are not employees (i.e. excluded from the scope of Schedule III). Therefore, any remuneration paid to such directors shall be liable to GST under RCM in the hands of the company.

Remuneration paid to whole-time Directors or employee Directors

The Circular aims to differentiate between 'contract **of** service' (i.e. employer-employee relation) and 'contract **for** service'. Various courts have deliberated on the same issue and it has been held that a director may act in dual capacities, i.e. as a director as well as an employee;

The Circular relies on Income Tax Act, 1961 and draws attention to tax deduction at source provisions ('TDS'). Under the said Act, 'TDS under salaries' is deducted under Section 192 and 'TDS under professional fees' is deducted under Section 194J.

Accordingly, the Circular clarifies that the portion of directors' remuneration declared as 'salaries' in the books of the company, and subjected to TDS under Section 192 of the Income Tax Act, would be treated as consideration for services by an employee to the employer in relation to his employment as per Schedule III of the CGST Act, 2017. Thus, such services are not taxable under GST.

If any portion of the employee directors' remuneration is declared separately other than 'salaries' in the books and is subjected to TDS under Section 194J of the IT Act as 'Fees for professional or technical services', then such remuneration would be treated as consideration for providing services which are outside the scope of Schedule III of the CGST Act. Therefore, such remuneration becomes taxable under GST. The service recipient i.e. the company, is liable to discharge the applicable GST on it under RCM in terms of Notification No. [13/2017 - Central Tax \(Rate\)](#) dated 28.06.2017.

Comments

In the erstwhile regime, the CBIC (then CBEC) had issued Circular No. [115/09/2009-ST](#) dated 31.07.2009 which clarified that remunerations paid to Managing Directors of company, whether whole-time or independent, when being compensated for their performance as Managing Director would **not** be liable to service tax. Also in the case of Allied Blenders & Distillers Pvt. Ltd. vs Commissioner of CST - [2019-TIOL-25-CESTAT-MUM](#) the Central Excise and Service Tax Appellate Tribunal (CESTAT) concluded that all remuneration received by the whole time directors were done in the capacity of an employee and accordingly, no service tax was applicable. It emphasised that it is the agreement between the employer i.e. the company and the director which will determine the exact relationship between them.

However, the present [Circular](#) seems to have streamlined the view regarding taxability of remuneration received by directors on the basis of the tax treatment of such sums under the Income Tax Act, 1961. Further, since the circular is clarificatory in nature, the applicability of the same might be interpreted to be effective retrospectively, unless there is a change in law. Thus, the Department might take a view and consider this clarification to be effective from July 01, 2017.

This circular has failed to independently analyse the role of a 'whole time director' as an employee and have ignored the fact that it is the agreement entered into between the company and the director that should reveal the nature of the relationship. Given that the Companies Act also mandates maintenance of contract of service or written memorandum

setting out terms of employment of a whole time director, perhaps the CBIC should have relied on such 'contract of service' instead of applicability of TDS provisions under the Income Tax Act, 1961 to determine the nature of relationship between the company and the whole time director and the capacity in which remuneration is being paid.

Now, it becomes important for a company to revisit the current structure of the directors and draft the employment agreement with a director clearly distinguishing the salary and sitting fees. Further, documentation of TDS deduction in relation to remuneration paid to directors should be well-maintained to avoid any future litigation.

[The views expressed are strictly personal.]

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