

GST on Director's Remuneration: an agglomeration among allied laws

[Examined in light of circular 140/10/2020-GST- & Includes conceptual FAQ's]

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The Reverse Charge Mechanism (RCM) derives its base from the era of Service Tax where it was introduced firstly in case of GTA's and Clearing and forwarding agents in 1997. Since the provisions for levy of service tax were inconsistent for recovery of tax under RCM, its levy was questioned by The Apex Court in case of "*Laghu Udyog Bharti V/s UOI (112) E.L.T. 365(SC)*". To overrule the said judgment Section 68(2) was incorporated in The Finance Act, 1994. The government with the motive of collecting tax for the organized sector, for the supplies made by unorganized sector, had issued various notifications to broaden the base of RCM levy. The *Recipient Curbing Mechanism* has been carried forward under GST regime also, and amongst various supplies of notified goods and services it covers, services supplied by a director of a company to his company. However, we are also aware that the employer and employee relation has been kept out of GST net, then what could be the relevance and scope of this RCM entry?

The authors in this article had attempted to resolve the above conundrum in subsequent para's, also due regard has been given to CBIC circular 140/10/2020-GST.

Provisions relating to levy under GST and exclusion for employer-employee related services

As per Section 9(1) of the CGST Act - GST shall be levied on the Intra state **supplies** of goods or services or both. It means GST could only be levied on those activities which constitute a "supply" under Section 7 of the said Act.

Further, **Schedule III** appended to the CGST Act, lists certain activities or transactions which shall be treated **neither as a supply of goods nor a supply of services**. i.e. GST would not be levied on activities or transactions specified in this schedule".

The relevant entry for our discussion is Entry no 1. to the said schedule which provides "**Services by an employee to the employer in the course of or in relation to his employment.**" Accordingly, all the services rendered by the employee to its employer in the course of his employment would be covered within the scope of this entry.

Provisions related to applicability of RCM on Director's remuneration

Section 9(3) of the CGST Act, empowers Government to notify certain category of supplies on which GST would be payable on reverse charge basis by the recipient.

The Government by issuing notification 13/2017 CT(R), dated 28th June 2017- had *inter-alia* notified the below services pertaining to director's

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

Understanding the issue evolved

Bare reading of above RCM entry would give a view that RCM would be applicable on all the services provided by a director to the company (i.e. services provided under employment/ other services). Meaning thereby – Director's salary would also be taxable under RCM.

Certain AAR's¹ listed below, had also issued their orders on the basis of such understanding.

- AAR Karnataka- Alcon Consulting Engineers (I) Pvt. Ltd. [2019 (030) GSTL 0678].
- AAR Rajasthan- Clay Crafts India Pvt. Ltd. [RAJ/AAR/2019-20/33]

The advance rulings have created a lot of confusion in the industry where the authorities have seemed to have forgotten applying the law in true perspective in their zeal to confirm levy of tax on any matter brought before that.

This requires examination "whether remuneration paid to different director's- taxable under RCM or outside the scope of GST under Schedule III (i.e. Employer Employee Relation)?

Clarification issued by the Circular

There had been widespread confusions among the industry on account of the divergent advance rulings. This necessitated the Government to come out with circular no. 140 to clarify the scope of services liable under RCM. The clarification on RCM applicability has been linked

¹ Note: as per Section 103 of the Act, the AAR's are applicable/ binding only on the applicant. Also, in the matter of *Laxmi Electricals & Decorators V. Comm of CEX. [2016(041) STR 0132, Tri-Delhi]*, it was held that - *rulings of AAR's are not at a binding precedent. Therefore, not binding on taxpayers other than applicant.*

to the manner of deduction of TDS under Income Tax Act on emoluments paid to directors as clarified below:

GST on remuneration payable to Independent Dir's/ Non-Employee Dir's

- Definition of Whole Time Director (WTD) as per Section 2(94) of the Companies Act is inclusive: therefore may include non-employees. Also, Independent Directors (ID) are not employees of company.
- Services by them are outside Schedule III- therefore GST applicable- and needs to be discharged on RCM basis (ref NT 13/2017).

GST on remuneration payable to Employee Dir's

- Test would be- whether it is a "contract for service" or "contract of service"
- As per courts- Director may function in dual capacity- i.e. in capacity of director and in capacity of employee.
- Under Income Tax Act, 1961- for the deduction of TDS- if salary is paid to them- S 192 is applicable and if professional fees is paid- S 194J applicable.
- Therefore- if recorded as a "salary" and TDS deducted under 192- gets covered in employer employee relationship- No GST as per Schedule III. However-if not reported as salary and TDS deducted under 194J then GST under RCM is applicable.

The above circular gives ample clarity as to the GST treatment on payments made to directors, however for deeper understanding, let us examine few aspects on Q & A basis:

1. Whether all the directors are employee of company?

As provided in the circular, the relationship of employer/ employee depends upon the fact that, it is a Contract **for** service V. Contract **of** service. The primary attributes of both such nature of contracts based on decided cases² could be as below:

S.No	Basis	Contract for service	Contract of service
1.	Employer- employee relation	No such relation	Such relation exists
2.	Control	Less	High (but day to day control may not be important)

² *Brahm Alloy Limited vs Commissioner of CGST & C. Ex., Durgapur 2019 (024) GSTL 0616 Tri.-Cal Allied Blenders & Distillers P. Ltd. V. CCE & ST, Aurangabad 2019(024) GSTL 207 Tri.-Mum*

3.	Method of work	Decided by the service provider. Recipient may provide inputs on invitation.	Decided/ authorized by the employer.
4.	Hiring and Firing Clause	No such clause	Such clause exists
5.	Monthly remuneration	Based on agreement, monthly payment may be possible. But not a mandate.	It's a mandate.
6.	Assessment under Income Tax	Income- taxable under the head "PGBP". TDS under Section 194J – In case of professional services.	Income- Taxable under the head salary. TDS deductible under Section 192.

Hon'ble Allahabad High Court in-Sardar Harpreet Singh v. Commissioner of Income Tax – 1990 SCC Online All 929, held that merely on deduction of Income Tax at source cannot be considered that the Director and the Company has employer and employee relationship. It is the agreement between the employer i.e. company and the Director would reveal the exact relationship between them.

From the above, we may construe that, only those directors whose contract satisfies the above tests of employer-employee would be considered as employee's and services provided by them under such employment contract would be out form GST.

2. Whether Circular was correct in considering that WTD, may include non-employee directors?

As per Sec 2(94) *ibid*. "whole-time director" includes a director in the **whole-time employment of the company** - Circular considered it to wider to include non-employee directors also (questionable).

Further, as per explanation to Section 62(1)(b) –read with rules- of the Companies Act, 2013 defines employee as under: "**Employee**" means-

(b) a director of the company, whether a whole-time director or not but excluding an independent director.

Considering above, the authors are of the view that, WTD is an employee of the company. However, he may also provide his services under “contract for service” under his directorial capacity as highlighted by the circular.

3. Whether RCM will always be applicable on “Sitting fees” payable to directors?

It depends upon contractual terms, regularity, and responsibilities. If a director is regularly employed and payment of sitting fees is coming out of employment terms (TDS U/s 192)- then no GST needs to be paid on RCM. However, where the director is not employed (Ex. Independent Director) and sitting fees is paid- then GST needs to be discharged under RCM.

Also, Section 194J(*ba*) of the Income Tax Act i.e. TDS on any remuneration or fees or commission by whatever name called, other than those on which tax is deductible under section 192, to a director of a company- **does not applies when 192 is applicable based on contractual terms.**

Therefore, RCM will not be applicable when sitting fees is paid to employee directors as a part of their salary and in any other case – RCM shall apply.

4. The circular *ibid.* specifies GST treatment on the basis of deduction of TDS under the Income Tax Act, what if deducted under wrong head? Can GST applicability be examined in light of such wrong treatment?

There is an inbuilt assumption being taken in the circular that the assessee company must be correctly complying the Income Tax provisions, therefore the facts in our case must be aligned with given assumption- so as to squarely apply the said circular.

Ex. Co XYZ Ltd, is deducting TDS u/s 194J (say 10%), however, the director while filing his return has correctly declared the income under the head salaries (say, taxable @ 30%). Here, what is important is the fact that “salary” income is being drawn.

For short, it must be TDS **deductible** u/s 194J, rather than deducted- for applicability of RCM. The language if the circular could have been used more cautiously to avoid this ambiguity.

5. Whether Director functioning in “personal capacity” i.e. in capacity other than director- will also be considered as director for RCM applicability?

The circular highlights only two capacities of a director, one as an employee and other as a director. However, there may be a third capacity i.e. personal capacity over which director could render certain services to his company, which may be totally different from the directorial capacity.

Few examples could be:

- Song by the director in “Annual Function” on chargeable basis.
- Renting of premises by the director.

- Guarantee given by the director in lieu of guarantee commission.
- Other professional services.

In the matter of Suessen textile bearings ltd. V. UOI it was held that, guarantee commission is a commission for risk bearing and nothing to do with directorship.

Also, the Companies Act, 2013 under Section 197(4) says- if the director is having requisite qualification/ experience as per Nomination and Remuneration Committee/ Board of Directors and the services are rendered in professional capacity- then such payments are not considered a part of remuneration for calculation of max permissible remuneration under that Act. Even under Income Tax- TDS would be deductible under 194J.

In view of the authors, Forward charge will apply as these services are being rendered in personal capacity rather than in directorial/employee capacity.

6. Sitting fees not paid to director though payable as per industry practice. Whether liability could arise under schedule I as transaction between related person without consideration? If yes, what value to be taken?

Considering the Explanation to Section 15 - the directors who are the employee of company, are considered related parties under GST.

In this case, since there is no separate contract for attending the meetings (also, AOA- not normally excludes such services out of employment contract)- therefore any remuneration payable for such services would be coming out of employment agreement itself and therefore out of GST.

In case of Non-Employee directors – Such question may only arise when they are related as per explanation to Section 15 *ibid.* (Ex. for Independent directors-such question may not arise as they are normally not related person). On this understanding, no GST liability may arise on deemed sitting fees under Schedule I.

7. Foreign company has deputed director in the Indian subsidiary Company. Whether any liability arises on Indian subsidiary for emoluments payable to such director whether directly or through group company?

Director acting as joint employees for more than one company in Group:

There is no bar in a person acting in the joint employment of more than one employer. If the appointment of director is made in the capacity of employee jointly with two group companies, any remuneration paid to them would be covered under Schedule III and not liable to GST. In case the payment is made by one company and recovered from other company, relying on the precedence of Volkswagen India³ case, a view may be taken that such recovery is merely

³ Volkswagen India (Pvt.) Ltd. Versus Commissioner of C. Ex., Pune-I [2014 (34) S.T.R. 135 (Tri. – Mumbai)]

contribution toward salary payment and does not involve any element of supply. No GST liability under FCM or RCM. Utmost care to be given to the defining the contractual relationship in the agreement.

Director acting as employee in one company but deputed in another company

The director in such case may be drawing sitting fees or other emoluments directly from the company where deputed. In the absence of employer employee relationship, such payment could be in the nature of contract for service deductible to TDS u/s 194J and thus liable to RCM.

8. Generally, no invoice is issued by director for sitting fees payable to them. When would liability to pay tax under RCM arises?

As per section 13(3) of the CGST Act, the Time of Supply (TOS) would be earlier of the following dates

- Date of payment (book entry of payment or debit entry in bank, whichever is earlier),
or
- 61st day from the date of issue of invoice by the supplier.

Also, as per the proviso to the said subsection, if it is not possible to determine the TOS, as per above- then “date of entry in the book of recipient” would be considered.

In the present case, since no invoice is raised by the supplier, the TOS would be the “date of payment” and if no payment is made – the date of entry in books of accounts would be the relevant date.

9. Commission is paid to director as percentage of sale made by the company. Does it attract GST liability?

Normally such commission is paid to employee directors as a part of their variable salary and TDS under section 192 is deducted for the same – Therefore, there may not be any GST liability on the same.

If commission is paid to the non-employee directors, it would be liable to GST under RCM. Nomenclature of payment is not relevant.

10. Emoluments received by director as salary or otherwise is required to be included in the computation of aggregate turnover (ATO) for GST registrations where director is engaged in other commercial activities liable to GST?

Threshold for registration has to be seen in the context of definition of aggregate turnover. Salary drawn from company falling within Schedule III may not be said to be falling within definition of aggregate turnover and thus should remain out of the threshold computation. Other supplies made by directors in the course or furtherance of business, whether liable for company under RCM or not, should be included in the value of aggregate turnover for threshold limit computation.

11. Where director is engaged in other commercial activities, but he is not liable for taking registration under the GST law (i.e. T/O less than 20L), therefore no GST is charged by him. Whether RCM would apply for his directorial services rendered to the company as his services are not liable for GST under FCM?

Section 9(3) read with NT 13/2017 *ibid.* specifies the list of services where tax needs to be discharged by the recipient. The fact that the supplier is registered or not registered is irrelevant in this regard.

Also, the primary motive of RCM is to collect tax from organized sector, which was otherwise payable by the unorganized sector – therefore, in myriad instances the suppliers would be unregistered. (Further, as per NT 05/2017 – Exclusive RCM supplies- need not take registration under GST).

12. What are the precautions, to be taken by the Taxable Person – while deciding the non-applicability of RCM on above services?

The below factors need consideration:

- AOA, BODR
- Contract of service (not contract for service)
- Monthly payment
- TDS under section 192
- Deduction for leave
- ITR of director (form 16)
- Provisions, compliance and reporting under companies act
- Provisions, compliance and reporting in annual financial statements
- Reporting in ITR of companies

Conclusion

To conclude, the companies must look at the terms of employment of the directors, and conclude whether it is a “contract of service or not” and in such case, there shall not be GST liability. In case of “contract for service” in directorial capacity - reverse charge mechanism would apply.

Though the circular provides ample clarity, yet the issues highlighted above w.r.t. personal capacity of director are left ajar, which needs to be addressed by the board.

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