
ANALYSIS OF THE IMPLICATIONS OF GOODS AND SERVICES TAX ON DIRECTOR'S REMUNERATION

Since the inception of Goods and Services Tax ('GST') in 2017, leviability of GST on director's remuneration has been an ambiguous subject. The question lies in whether services provided by the director to a company is required to be treated as 'services by an employee to the employer in the course of or in relation to his employment' under Schedule III (i.e. neither supply of services and/or goods) of the Central Goods and Services Tax Act, 2017 . (the 'CGST Act')¹ or the same is to be treated as 'supply of services' and made taxable in the hands of the Company through reverse charge under the Act.

The issue was first considered by Authority on Advance Rulings in the State of Karnataka in the case of M/s Alcon Consulting Engineers (India) Pvt. Ltd.², wherein the authority ruled that remuneration paid to the directors is to be treated as supply of service and thereby subjected to GST under Reverse Charge as the same is specifically covered under item 6 of the Notification No 13/2017 – CT. Likewise, the Authority on Advance Ruling in the State of Rajasthan was of a similar view in the case of Clay Craft India Private Limited³.

However, the Authority on Advance Rulings in the State of Karnataka in the case of Anil Kumar Agrawal⁴, took a contrasting view and held that in case the Applicant is drawing income as 'salary' as a working partner or through 'profit share' from a partnership, the income is outside the purview of the CGST Act. The ruling also dealt with taxability of 'salary' received as a director of a private limited company. The Authority distinguished between salary received as an executive director and as a non-executive director. The former was held to be received for services provided by the Applicant as an employee to the employer and hence not taxable under the provisions of the CGST Act, however, the latter remuneration paid by the Company to the nominated/ non-executive director was held to be exigible to GST in the hands of the Company under reverse charge.

Broadly, directors can be classified as whole time/executive directors or independent / non-executive directors. Section 2(94) of the Companies Act, 2013⁵ defines a 'whole time director' as one which 'may or not be an employee of the Company' whereas Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014⁶ excludes an 'independent director' from the definition of an 'employee'. Furthermore, the executive directors are involved in day to day activities of the company and are paid salary/ remuneration as an employee whereas, the non-executive directors are involved in managerial activities of the company and are paid sitting fees/commission. In terms of the Income Tax Act, 1961⁷ (the 'IT Act'), the remuneration received by the executive director are subjected to Tax Deducted at Source ('TDS') under Section 192 of the IT Act and assessed under 'income from salary', whereas the amounts received by the non-executive director are subjected to TDS under Section 194J of the IT Act and assessed as 'income from professional fees'.

¹ Central Board of Indirect Taxes and Customs <<https://www.cbic.gov.in/resources//htdocs-cbec/gst/cgst-act.pdf>> accessed 11 June 2020

² 2019-TIOL-378-AAR-GST

³ 2020-TIOL-64-AAR-GST

⁴ 2020-TIOL-95-AAR-GST

⁵ Ministry of Corporate Affairs <<https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf>> assessed 11 June 2020

⁶ Ministry of Corporate Affairs < https://www.mca.gov.in/Ministry/pdf/NCARules_Chapter4.pdf> assessed 11 June 2020

⁷ Income Tax Department< <https://www.incometaxindia.gov.in/pages/acts/income-tax-act.aspx>> assessed 11 June 2020

Pursuant to the rulings, taxpayers were left to face nuisance on account of divergent views by the State Advance Ruling Authorities and anguish over demand notices issued by tax authorities as result of the rulings. In retrospect, Companies filed representations before the Government to seeking clarification on the issue however, in the meanwhile as a precautionary measure Companies took a conservative approach and started discharging GST on director's remuneration which resulted in a direct hit on the cash flow of the Company.

Three years in to the GST regime, the Board finally took cognizance of the matter and issued Circular No. 140/10/2020-GST dt. 10.06.2020⁸ (the '**Circular**'), whereby it sought to clarify the levy of GST on director's remuneration.

In terms of the Circular, the issue was dealt in detail by drawing reference from the provisions of the Companies Act, 2013 and the IT Act. The Circular clarifies that 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 have been an employee or proprietor or a partner of the said company, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed in the said company. Thereby, as the 'independent director' are ousted from the definition of an 'employee', the services provides by such director would not fall within Schedule III of the CGST Act and instead qualify as 'supply of service' taxable under reverse charge in the hands of the Company.

For the levy of GST on 'whole time directors', the Circular elucidates that in terms of Section 2(94) of the Companies Act, such directors may or may not be employees of the company. Therefore, in such cases it is apposite to look into the activities provided by such director to the Company as also the accounting of their salaries in the books of account of the Company.

The remuneration received by such directors can be either be treated as '*salaries*' in the Company's account and subjected to TDS under Section 192 of the IT Act or as '*fees for professional or technical Services*' in the Company's account and subject to TDS under Section 194J of the IT Act. In consequence of the treatment of income and deduction of TDS, the Circular clarifies that the former income i.e. salary subjected to TDS under Section 192 of the IT Act shall be considered as consideration received towards 'services by an employee to the employer in the course of or in relation to his employment' in terms of Schedule III of the CGST Act and thereby shall not be taxable under the CGST Act. Whereas, income subjected to TDS under Section 194J shall be treated as consideration for providing services which are outside the scope of Schedule III of the CGST Act, and is therefore, taxable. Further, as per notification No. 13/2017 –Central Tax (Rate) dated 28.06.2017⁹, the said income would be taxable under reverse charge in the hands of the recipient of the said services i.e. the Company.

The Circular has sought to clear the implications of GST on director's remuneration however; it has failed to shed light on refund of tax deposited by the Companies pursuant to demand notices issued on non-payment of GST on account of salaries paid to whole time directors where TDS was deducted under Section 192 of the IT Act. Further, it is pertinent to note that as per Article 265 of the Constitution of India "no tax shall be levied or collected except by the authority of law" and pursuant to the circular, as it is clarified that income subjected to TDS under Section

⁸ Central Board of Indirect Taxes and Customs <https://www.cbic.gov.in/resources//htdocs-cbec/gst/Circular_Refund_140_10_2020.pdf> accessed 11 June 2020

⁹ Central Board of Indirect Taxes and Customs < <https://www.cbic.gov.in/resources//htdocs-cbec/gst/Notification13-CGST.pdf>> accessed 11 June 2020

192 of the IT shall not be taxable under the CGST Act, the demand notices would be void per se and Companies shall be refunded the amount of tax paid along with interest.

Another ramification of the Circular would be that companies would now be required to be extra diligent while executing appointment contracts of directors and carefully draft board resolutions appointing independent directors. Additionally, all Companies would be required to run a due diligence of existing contracts for interpret the same in light of the circular for any implication.

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