

GST updates

Date: 16 April 2020

Issues: Applicability of GST on consideration paid to Directors

Point of debate and recent Advance Ruling

Schedule III of the CGST Act, 2017, provides that 'Services by an employee to the employer in the course of or in relation to his employment' do not qualify as supply of services or goods.

Accordingly, such services are not subject to GST.

In a recent order in the case of *Clay Craft India Private Limited*¹, the Rajasthan Advance Ruling bench has held that the consideration paid to Directors of a company (who are also separately employees of the company), whether in the form of salary and commission, should attract GST. Accordingly, as per entry 6. of Notification no. 13/2017 – Central Tax (Rate), dated 28 June 2017, the company is liable to discharge GST liability, under the reverse charge mechanism.

The Rajasthan Advance Ruling bench may have summarily determined the applicability of GST on said consideration. However, the issue has been a matter of litigation since the Service tax regime. In our view we should delve further into the subject to determine the applicability of GST.

Past judgments

In the case of *Allied Blenders and Distillers Pvt. Ltd. vs. Commissioner of Central Excise & Service tax, Aurangabad*², the assessee company was paying remuneration to its Directors in the form of salary. The company was even deducting Income tax TDS in Form 16. The Directors' names were included in the salary return filed for Income tax by the company. The Directors were not even paid Sitting fee for board meetings. The Mumbai Tribunal bench held as follows:

'16. Also, from the documents produced by the appellant it is crystal clear that the Directors who are concerned with the management of the company, were declared to all statutory authorities as employees of the company and complied with the provisions of the respective Acts, Rules and Regulations indicating the Director as an employee of the company. No contrary evidence has been brought on record by the Revenue to show that the Directors, who were employee of the appellant received amount which cannot be said as 'salary' but fees paid for being Director of the company. The Income Tax authorities also assessed the remuneration paid to the said directors as salary, a fact cannot be ignored. The judgments cited by the revenue cannot be applied to the present case as the facts are different and the finding of Income tax authorities accordingly also different in the said case.'

¹ 2020 (4) TMI 228

² 2019 (24) G.S.T.L. 207 (Tri. - Mumbai)

Separately, in the case of *Brahm Alloy Limited vs. Commissioner of CGST & Central Excise, Durgapur*³, a Show cause notice was issued to the appellant company for payment of Service tax on the consideration paid to Directors. An order confirming demand was issued subsequently. However, the Commissioner (Appeals) later reduced the demand of Service tax only on the remuneration paid to Directors. An appeal against this order was filed with the Tribunal. However, the Kolkata Tribunal confirmed the reduced demand, stating:

'It is my considered view that to establish the employer-employee relationship for the purposes of the remuneration/salary, the Resolution of the company should cover both, "the terms of appointment/hiring of the services of the individual and similarly it should also cover that in case of nonperformance of the specified duties, the individual shall be fired and/or his appointment would be terminated". In short, to establish the employer-employee relationship, the clause of hiring and firing are an essential ingredient without which it cannot be construed whether the individual is the Promoter/Director or an employee Director. The remuneration cheque has to be paid on a month to month basis along with the admissible perquisites. There is a deviation in the facts of the present case. I also observe that the Directors have shown the remuneration under the head 'Salary' in the respective Income Tax Return and Tax was deducted at source by the appellant company on such payments.

8. In view of the above discussions, I do not find any reason to interfere with the impugned order. Accordingly, the same is sustained. The appeal filed by the appellant is dismissed.'

The above judgments bring to light that salary and / or remuneration paid to Directors should be treated differently, depending on the circumstances and manner of appointment.

Our view

In our view, we should explore the possibility that an individual may perform the duties of an employee and as a member of the Board of Directors independent of each other. This is an oft seen phenomenon in Indian companies. Officials of higher management are often awarded positions on the Board.

It is essential to note that the duties and responsibilities of a Director are clearly laid out in the Companies Act, 2013 (Section 166). These may be the same, in part, as those of any other employee. But in essence the role of Directors is that of stewardship and leading the company. Directors are the face of a company and as such could be agents of the company. This is not the case with employees. Also, one could state that the roles of a Director are akin to providing management consulting services to the company whereas employees are the ones who execute such ideas / advices. In such a case the services of one role are not ancillary to the other. For example, the role of the Board of Directors is to determine the future course of the company and it is the employees who execute such vision. It is also pertinent to note that the compensation of

³ 2019 (24) G.S.T.L. 616 (Tri. - Kolkata)

individuals as an employee and as a Director are laid out separately. One may rely on the following judicial precedents for this supposition.

In the case of *Comed Chemicals vs. CN Ramchand*⁴, the Supreme Court held that an individual may hold the position of an employee in a company and also be a Director. The two positions are independent of each other and the individual performs such services in separate capacity.

The Supreme Court relied on *Catherine Lee vs. Lee's Air Farming Limited*⁵ and *Anderson vs. James Sutherland (Peterhead) Limited*⁶.

In the case of *Catherine Lee vs. Lee's Air Farming Limited*, the appellant claimed compensation under the Workers' Compensation Act, 1922, for the death of her husband who was engaged in the capacity of an aircraft pilot. The claim of the appellant rested on the allegation that at the time of his death her husband was a 'worker', in that he was employed by the respondent company. The respondent company denied the claim that the deceased was a 'worker' under the said Act as he was, at the time of the accident, the controlling shareholder and governing director of the respondent company. It was held as follows:

'Their Lordships conclude therefore that the real issue in the case is whether the position of the deceased as sole governing director made it impossible for him to be the servant of the company in the capacity of the chief pilot of the company. In their Lordships' view for the reasons which have been indicated there was no such impossibility. There appears to be no greater difficulty in holding that a man acting in one capacity can give orders to himself in another capacity than there is in holding that a man acting in one capacity can make a contract with himself in another capacity.'

Also, in the case of *Anderson vs. James Sutherland (Peterhead) Limited* one of the Lords on the bench held as under:

'The managing director's powers and functions are defined by the terms of his appointment, his tenure of office is governed by these terms, his salary is specially fixed by them, and he is subject to the direction of the board. The difference between his position and that of a manager who is not a director is that he is also a director. But the functions of a director and manager are not identical... In my opinion therefore, the managing director has two functions and two capacities. Qua managing director he is a party to a contract with the company and this contract is a contract of employment; more specifically I am of the opinion that it is a contract of service and not a contract for services. There is nothing anomalous in this; indeed it is a commonplace of law that the same individual may have two or more capacities, each including special rights and duties in relation to the same thing or matter or in relation to the same persons.'

⁴ Arbitration petition no. 17 of 2007 in the Supreme Court of India, dated 6 November 2008

⁵ 1961 AC 12 PC (The Court of Appeal of New Zealand, dated 11 October 1960)

⁶ 1941 SC 203 (Case decided in the Court of Session, Scotland)

Lastly, one should also read the conditions laid under entry 6. of the abovementioned Notification, which lays the responsibility of the payment of GST on the company, under the reverse charge mechanism. The notification states the category of service as '*Services supplied by a director of a company or a body corporate to the said company or the body corporate*' and the supplier of service as '*A director of the company or a body corporate*'. One may interpret that the intent of the notification should only be to tax the services of directorship provided by the Director. Services provided by the individual / employee (who is also a Director in the company) are not required to be taxed under said Notification. The '*services supplied by a director of a company*' are among others those of stewardship and promoting the objects of the company for the benefit of its members. It is also pertinent to note that the powers of the Board of Directors (Section 179 of the Companies Act, 2013) are vested only with the Directors and as an employee one may only execute such powers on the instructions of the Board. Thus, the said Notification does not provide the power to tax services which a Director may provide separately, as an employee of the company.

Conclusion

While the judgment in the case of *Clay Craft India Private Limited* has stated that all consideration received by a Director is towards his role of Directorship (and therefore, exigible to GST) we beg to differ.

It has been industry wide practice that key managerial persons are often inducted to the board of Directors of a company. The ramifications of the Advance Ruling would lead to companies paying GST on the salaries of such key managerial persons, which would become additional cost of the companies affecting cash flows.

Its just a matter of time that companies will start to receive enquires from tax officers based on the above Advance Ruling.

Companies should take ample care while:

- Determining the contracts of employment of employees and determining roles of Directors.
- Determining compensation for the two roles separately and basis for the same, which should be laid out clearly.
- Redrafting employments contracts where required.
- Making relevant amendments to the Articles of Associations, if required, to support such facts.
- Verify past treatment if Directors fee were in fact fee for Directors' services and erroneously were treated as salary.