

Recently Hon'ble Rajasthan Authority of Advance Ruling (AAR) has given a ruling in the matter of "**Clay Craft India Private Limited**" holding that the remuneration paid to Director whether whole time or not will attract GST under Reverse Charge Mechanism (RCM). Though under GST law, AAR rulings are binding only to the applicant and does not constitute any binding precedent at all. However, it needs to be noted that earlier Hon'ble Karnataka AAR has also passed a similar ruling in the matter of "Alcon Consulting Engineers (I) Pvt. Ltd." Through this update, we have analysed the captioned AAR ruling along with capturing the current legal position on the matter.

A. Understanding the AAR Ruling

The applicant company has raised the following questions before the Rajasthan AAR:

- Whether GST is payable on a reverse charge basis on the salary paid to the director of the company as per the contract?
- Whether GST applicability will differ if the said director is also a part-time director in any other company?

The applicant submitted that GST will not apply on the remuneration paid to directors as they are the employees and they are given salaries along with benefits as per the policy decided by the company for its employees, thus, covered under Schedule III. The company is deducting TDS on their salary u/s 192 of The Income Tax Act,1961, applicable for employees. The salary being paid to Director is being booked under "Income from Salary" by the Directors in their personal Income Tax returns. In support of their contention, the applicant submitted abstract of memorandum and article of association which mentioned that appointment of directors and so on.

On the contrary, the department has simply provided that the director is not the employee of the company and therefore, the amount paid to them will not be covered under Schedule-III.

The AAR held that directors are not the employees of the company and hence, liable to GST. It emphasized that the director is a supplier of services and the applicant (company) is the recipient of such services. The service rendered by the director to the company for which the consideration is paid to them, under any head, is chargeable to GST on reverse charge basis.

B. GST & OTHER APPLICABLE LAWS ON THE SUBJECT

a) **Whether services by director to company is covered under Reverse Charge Mechanism (RCM)?**

Section 9(3) of the CGST Act extends the levy on the recipient of the goods or service for specific category of goods and service as notified. According to Serial no. 6 of Notification No. 13/2017 -

	<p style="text-align: center;">Nominee Director</p>	<p>director or a whole-time director or a nominee director.</p> <p>Nominee director means a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests [Explanation to Section 149]</p>
--	--	---

From the above reading, we can safely say that a Whole-time director or Managing Director, being entrusted with substantial powers of management would be a whole-time employee of the company who take part in the day to day activities of the company. On the other hand, the non-executive director, does not take part in the day to day activities of the company and attend only meetings of board or committee thereof held at periodical intervals. They assist the executive directors in making strategic decisions. They are not employees of the company.

This position is further strengthened by the decision of Hon'ble Supreme Court in "**Employees State Insurance Corpn. v. Apex Engineering P. Ltd., (1998) 1 Comp LJ 10**" wherein the Court held that managing director occupies dual capacity – one as a "**principle employer**" and another as an "**employee**", in the context of Employee State Insurance Act, 1946.

Under the Income Tax law also, master-servant relationship is an essential condition for the purpose of:

- treating an income under the head "salary".
- deducting tax at source (TDS) under section 192 of the Income tax Act, 1961.

The issue as to whether a director is an employee or not has been considered by the courts at many occasions.

- In **Ram Pershad v. Commissioner of Income Tax 1973 AIR 637**, the Hon'ble Supreme Court held that the assessee, a managing director of a company, had to exercise his powers under the agreement within the terms and limitations prescribed under the articles of association and subject to the control and supervision of the directors, This is indicative of his being employed as a servant of the company, and therefore, the remuneration payable to him was salary within the meaning of section 7 of the Income Tax Act.
- In **CIT v. L. Armstrong Smith, 1946 14 ITR 606 Bom**, it was held that remuneration of the assessee, as a chairman and managing director, is to be taxed under the head 'income from salary' and not under 'business income'.
- In **CIT v. M.S.P. Rajes, (1993) 77 Com Cases 402**, Hon'ble Karnataka high Court also, relying on decision in **Dharangadhara Chemical Works Ltd v. State of Saurashtra 1957 AIR 264** wherein test of master-servant relationship was used by the Apex Court, held that remuneration received by managing director is taxable under the head income from salary.

In the light of the above judgments, it is safe to conclude that even under Income Tax Act, the remuneration paid to whole time director/Managing Director, being an employee of the company, is in the nature of “salary”.

d) **What was the position under service tax law as Remuneration to Directors was liable to reverse charge in Service Tax regime as well?**

Under Service Tax Regime as well, taxability and reverse charge conditions were same on Remuneration to Directors.

In ***Allied Blenders and Distillers (P.) Ltd. v. CCE & ST [2019]*** Hon’ble CESTAT of Mumbai Bench vide its Order No. A/88105 of 2018 dated June 25, 2018 stated that 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. Therefore, No Service Tax would be leviable on remuneration paid to Directors if they were employees of the company.

C. Our View

The Decision of AAR is incorrect since it failed to consider fact that Directors were working in the capacity of employees as well as evidences relied upon by the applicant in support of its contention. Salary paid by applicant for employer- employee relationship with Directors was clearly outside the purview of GST law vide Entry 1 to Schedule III of the CGST Act, 2017. Further AAR has failed to pass a speaking order and has just given the decision without discussing the basis for such decision.

In our considered view, a Director can have multiple service contracts with a company like employment contract, rental contract, royalty for IPR services, consultancy contract etc. Reverse charge provisions as enumerated under section 9(3) of CGST Act would take in its ambit only the payments made to Directors for services rendered as Director on the Board of company and no other service. However, if other services provided by director (***not in the capacity of director***) are taxable, then they will fall under forward charge mechanism and not under reverse charge mechanism.

In case a company enters into an employment service agreement with a Director and he works as Managing Director or Whole Time Director, then the remuneration paid to him shall not be a supply and would not be covered under reverse charge mechanism.

Contact Us:

Delhi
A-15, Second Floor, Hauz Khas, New Delhi - 110016
(India)
Ph: +91,011 41655801, 41655802
Fax: +91 11 26567540

Bangalore
No 605, Second Floor, 62nd Cross, 5th Block, Rajajinagar,
Bangalore Karnataka - 560010 (India)
Ph: +91 80 42064178

Pune
Flat No- 2A, Gangotri Complex,
Near Geeta Society, Camp, Pune 411001 (India)
Ph: +91 020 30492191

E-mail:- snr@snr.company
[Click here to unsubscribe for SNR Flash](#)

For private circulation only among clients and associates <http://www.snr.company/>