

Rajasthan AAR rules that consideration paid to directors of a company will attract GST under RCM in the hands of the company

April 10, 2020

In brief

Recently, the Authority for Advance Ruling (AAR) in the State of Rajasthan has ruled¹ that consideration paid to the directors (in the form of salary and commission) by the applicant company will attract goods and services tax (GST) under reverse charge mechanism (RCM).

In detail

Facts

- The Board of Directors of the applicant company (applicant or the company) consists of six directors, who are also working at different levels of management. This means that they also work as employees of the company, for which they are compensated by way of regular salary and other allowances as per company policy and their employment contract.
- Further, the company is also complying with tax deduction requirements under Income-tax law and other compliance requirements under the provident fund laws, with respect to the salary paid to such directors and services provided by them, respectively.

- For activities performed by such directors in the capacity of a “director”, the company paid them a consideration in the form of commission, on which GST under RCM is duly discharged.
- As per Clause 1 of Schedule III of the Central GST Act, 2017 (the CGST Act), the company is of the view that such directors are *de facto* employees of the company, and thus, the payments made to them as salary and related benefits should not be liable to GST.

Key issue before the AAR

Whether remuneration paid to the directors for services provided by them to the company should be liable to GST under RCM?

Applicant’s contentions

- The term “employee” has not been defined under

GST law. As per the dictionary meaning, it implies “someone who is paid to work for someone else.” Since a director is an individual (someone) who works for the company (someone else), he/ she should be considered as an employee.

- Further, the term “director” has been defined under the Companies Act to include a director in the employment of the company.
- Furthermore, an employee of a company also appointed as a director of the company is in the position of director. Conversely, any director working as whole time director would be legally at par with an employee.
- The applicant also placed reliance on the judgements of the Kerala High Court in the case of Sarathi Lines (P)

¹ Advance Ruling No. RAJ/AAR/2019-20/33 dated 20 February 2020

Limited² and the Supreme Court in the case of Ram Pershad³ to establish that a director is an employee.

- As per the Article of Association and Memorandum of Association of the company, the Board of Directors appoints the director and other whole-time directors. This appointment indicates that there exists an employer-employee relationship between the Board of Director and Managing Director/ whole-time director.
- Therefore, the salary paid to directors is outside the ambit of GST, as the same would fall under Schedule III as “services by an employee to employer in the course of or in relation to employment.”

Revenue's contentions

- Consideration paid to the director for the supply of services to the company is specifically covered under Notification No. 13/ 2017-Central Tax (Rate) dated 28 June 2017. As per this notification, in case of “services supplied by a director of a company or a body corporate to the said company or the body corporate,” GST is required to be paid on reverse charge basis by the recipient, i.e. the company or body corporate.
- Consideration paid to the directors is against the supply of services provided by them to the applicant company and are not covered under Clause 1 of the Schedule III to the CGST Act, as the directors are not the employees of the company.

In the instant case, the director is the supplier of services, and the applicant company is the recipient of the services.

AAR's ruling

The consideration paid to the directors by the applicant company will attract GST under RCM in the hands of the applicant, as it is covered under entry No. 6 of Notification No. 13/ 2017 Central Tax (Rate) dated 28 June 2017 issued under section 9(3) of the CGST Act.

The takeaways

- This ruling is important since many taxpayers have taken a position that services are rendered by a director in the capacity of an employee and should not be subject to GST as the same are treated as services rendered by an employee to its employer and covered under Schedule III of the CGST Act. Accordingly, no GST is being discharged by them on it. It is also important to note that a similar view was taken in another Advance Ruling of M/s Alcon Consulting Engineers (India) Private Limited by the AAR in the State of Karnataka.
- It is important to note that the AAR does not provide any specific reason for the transaction to be excluded from Schedule III, i.e. as services provided in the course of employment.
- It is also important to note that the issue of the interpretation of the relevant provisions in this regard has been prevalent since the erstwhile regime, wherein

the service tax law also had a similar provision. However, the Central Board of Indirect Taxes and Customs (CBIC) vide Circular No. 115/ 09/ 2009-ST dated 31 July 2009 clarified that no service tax is leviable on commission paid to managing directors/ whole-time directors, inasmuch as the said managing directors/ whole-time directors do not perform consultancy or advisory function.

- Recently, Customs Excise and Service Tax Appellate Tribunal Kolkata in the case of Maithan Alloys Limited⁴ has held that whole-time directors who are entitled to variable pay in the form of commission are “employees,” and payments actually made to them are in the nature of salaries.
- Based on the judicial precedents and the circular issued by the CBIC, the industry in the erstwhile regime adopted the position to not discharge service tax under RCM on salary paid to its directors.
- Given that the verbiage used under the GST law is exactly similar to service tax law, it can be implied that payments in the nature of fixed salary should not be taxable.
- While the present Advance Ruling is binding only on the applicant and his jurisdictional officers, it is likely that this ruling may be referred to by the revenue authorities while dealing with the taxability of similar situations. The impact of this ruling should therefore be analysed on a case-to-case basis.

² Regional Director, E.S.I. v. Sarathi Lines (P) Limited [1998] ILLJ 28 (Kerala)

³ Ram Pershad v. Commissioner of Income tax [1973] AIR 637 (SC)

⁴ Maithan Alloys Limited v. CCE & ST [Order-in-Original No. 29/ COMM/R/ST/BOL/15 dated 30 November 2015]

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

Our Offices

Ahmedabad

1701, 17th Floor, Shapath V,
Opp. Karnavati Club,
S G Highway,
Ahmedabad – 380051
Gujarat
+91-79 3091 7000

Bengaluru

6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bengaluru – 560 008
Karnataka
+91-80 4079 7000

Chennai

8th Floor
Prestige Palladium Bayan
129-140 Greams Road
Chennai – 600 006
Tamil Nadu
+91 44 4228 5000

Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th
Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034
Telangana
+91-40 44246000

Kolkata

56 & 57, Block DN.
Ground Floor, A- Wing
Sector- V, Salt Lake
Kolkata – 700 091
West Bengal
+91-033 2357 9101/
4400 1111

Mumbai

PwCHouse
Plot No. 18A,
Guru Nanak Road (Station Road),
Bandra (West), Mumbai – 400 050
Maharashtra
+91-22 6689 1000

Gurgaon

Building No. 10, Tower - C
17th & 18th Floor,
DLF Cyber City,
Gurgaon – 122002
Haryana
+91-124 330 6000

Pune

7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006
Maharashtra
+91-20 4100 4444

For more information

Contact us at
pwctr.knowledgemanagement@in.pwc.com

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with over 276,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

In India, PwC has offices in these cities: Ahmedabad, Bengaluru, Bhopal, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai, Pune and Raipur. For more information about PwC India's service offerings, visit www.pwc.in

PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

© 2020 PwC. All rights reserved

Follow us on:



For private circulation only

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwCPL, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. Without prior permission of PwCPL, this publication may not be quoted in whole or in part or otherwise referred to in any documents.

© 2020 PricewaterhouseCoopers Private Limited. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers Private Limited (a limited liability company in India having Corporate Identity Number or CIN : U74140WB1983PTC036093), which is a member firm of PricewaterhouseCoopers International Limited (PwCIL), each member firm of which is a separate legal entity.