



Taxability of service by Directors

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Taxability of services provided by a director

In GST, provisions relating to Authority of Advance Rulings (“AAR”) were enabled to provide certain aid to the taxpayers with respect to unerring interpretation of the legal provisions. However, with flooding of pro-revenue and certain implausible rulings, it appears that AARs are failing time and again to serve the purpose of their establishment. One such occasion, which further raises the doubts of their credibility is the ruling of Rajasthan AAR in the application made by *Clay Craft Private Limited*.

Question before AAR

The issue for consideration before AAR was to analyse the RCM applicability on the salary paid to the whole-time directors, who were serving as employees of the company. The Company was deducting the EPF from their salaries and all other policies and benefits to them were given as per the policy decided by the company for their employees. The company was already discharging GST under RCM on other services received from such directors.

Ruling and observations

The Rajasthan AAR observed that 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 such a case, director is the supplier of services and company is the recipient of the services. Therefore, it is very clear that the services rendered by the directors to the company for which consideration is paid to them in any head is liable to pay GST under RCM. Notification No. 13/2017- Central Tax (Rate) has given the distinct identity to the services provided by the director and specifically included in the category of service on which GST will be payable under RCM.

Issues arising from AAR

The above discussed AAR has raised a panic amongst taxpayers with respect to taxability of these services and casts a doubt with respect to following questions-

- Whether employer-employee transactions can be taxed under GST if such an employee is a director?
- Whether activities performed by a director against salary constitutes as a supply at all?
- Whether salary is in the nature of consideration for a supply ?
- Whether there is a difference between taxability of different types of directors e.g.- managing, independent, executive, non-executive, nominee directors?
- Whether RCM notification can go beyond Section 7 of the CGST Act to apply on the transactions which are otherwise not taxable?

Before trying to attempt these questions, it is pertinent to go through the relevant provisions of the GST law.

Provisions under GST

Services provided by employee in course of his employment

Section 7(1) of the CGST Act, 2017 provides for inclusive definition of the supply such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business. Section 7(2) of the CGST Act provides for activities or transactions which would be treated neither as a supply of goods nor a supply of services. Schedule III specifies such activities and includes “services by an employee to the employer in the course of or in relation to his employment” in its ambit. Therefore, such activities cannot be considered as supply so as to be liable to GST.

RCM on services provided by director

Under Section 9(3) of the CGST Act, Notification No. 13/2017- Central Tax (Rate) has been issued to prescribe supply of services on which GST is payable on RCM basis. S.No. 6 of the said Notification reads as under-

S.No.	Category of supply of services	Supplier of service	Recipient of Service
6	Services supplied by a director of a company or a body corporate to the said company or the body corporate.	A director of a company or a body corporate	The company or a body corporate located in the taxable territory.

It can be seen that while services provided by employee to employer in course of his employment is non-taxable, services supplied by director to his employer company has been kept under RCM. The question arises regarding taxability of services where director is serving as an employee. Further, whether all services provided by a director shall be payable to GST under reverse charge is also not clear.

Director serving as employee

There can be cases where director is serving a company in his capacity of being an employee of the company. The question arises if reverse charge notification overrides Schedule III of the CGST Act, which blanketly applies to services provided by all kind of employees, without any exclusion to the directors serving as employees. It may be noted that under erstwhile service tax regime as well where such activities were excluded from the definition of the service itself. Therefore, in order to answer the abovementioned question, we may refer to the Education Guide issued under the Service Tax which clarified the following

position-

“2.9.1 Are all services provided by an employer to the employee outside the ambit of services?”

No. Only services that are provided by the employee to the employer in the course of employment are outside the ambit of services. Services provided outside the ambit of employment for a consideration would be a service. For example, if an employee provides his services on contract basis to an associate company of the employer, then this would be treated as provision of service.

2.9.2 Would services provided on contract basis by a person to another be treated as services in the course of employment?

No. Services provided on contract basis i.e. principal-to-principal basis are not services provided in the course of employment.”

In view of the above clarification, it can be said that only when services are provided outside the ambit of employment including services provided on contract basis can be leviable to GST. Further, to ascertain if there is an employer-employee relation at all, we can refer to following judicial pronouncements-

<i>Chintaman Rao Vs. State of M.P.</i> , AIR 1958 SC 388	The concept of employment involves three ingredients: (1) employer (2) employee and (3) the contract of employment. The employer is one who employs, i.e. one who engages the services of other persons. The employee is one who works for another for hire. The employment is the contract of service between the employer and the employee whereunder the employee agrees to serve the employer subject to his control and supervision.
<i>D.C Works Limited Vs. State of Saurashtra</i> , AIR 1957 SC 264	The determination of the relationship between master and servant is the existence of the right in the master to supervise and control the work done by the servant not only in the matter of directing what work the servant is to do but also the manner in which he shall do his work. The nature or extent of control which is requisite to establish the relationship of employer and employee must necessarily vary from business to business and is by its very nature incapable of precise definition. The correct method of approach, therefore, would be to consider whether having regard to the nature of the work there was due control and supervision by the employer.
<i>Nilgiri Cooperative Market Society Ltd. Vs. State of Tami Nadu</i> , 2004 (3) SCC 514	Supreme Court laid down following tests for determination of employer-employee relationship- (a) who is the appointing authority; (b) who is the paymaster; (c) who can dismiss; (d) how long alternative service lasts;

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| | (e) the extent of control and supervision;
(f) the nature of the job e.g. whether it is professional or skilled work;
(g) nature of establishment;
(h) the right to reject. |
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In our view, as long as the employer-employee relationship can be satisfied in case of a director, it can be said that same shall not be leviable to GST. Further, since these activities are not covered by the purview of supply, the question of RCM shall not arise in such a case.

Director not serving as an employee

Where a director is not serving as an employee of the company, services provided by him shall not be covered by the scope of the Schedule III of the CGST Act and shall be leviable to GST. However, the question arises whether all the services provided by the director shall be covered by the RCM provisions or RCM is only restricted to the services provided by a director in the capacity of a director.

It may be noted that in addition to the director services, a director may also provide following services to the company-

- Renting of the property to the Company;
- Selling/purchasing of goods to/from the Company;
- Guarantee given to the Company
- Rendering of Professional / Consultancy Services to the company

In this regard, reference can be made to decision of Chennai tribunal in case of *Integra Software Services Pvt. Ltd. Vs. CCE & ST, Pondicherry* [MANU/CC/0193/2017] wherein refund was allowed to the appellant. In the case, Appellant had paid service tax under reverse charge on the provision of “renting of immovable property” by its directors. For the reason of non-utilisation of Cenvat credit, appellant had filed refund which was subsequently disallowed by the revenue contending that appellant was not liable to pay service tax under reverse charge for the provision of services provided by its directors in his individual capacity. However, court decided in the favour of appellant and refund was allowed while making following observations

“4 . I find that there is no dispute about the fact that service tax stands paid by the appellant in respect of services availed by them from their Director, in her individual capacity, under the category of Renting of Immovable Property service. In such a scenario, the stand of the Revenue that they were under no legal obligation to discharge service tax cannot be appreciated. Had it been paid by the Director in her individual capacity, the same would still be available as a credit to the appellant. Revenue at the time of receipt of service tax from the appellant never objected and accepted such service tax deposited by them. As such, I find that the denial of refund to the assessee, under Rule 5 of CCR, 04

is not justified. In as much as admittedly such service was used by the appellant in relation to their business activity and satisfied the essential requirement of use for rendering output service.”

In light of the above decision, it can be said that only services provided by director in capacity of director of the company shall be subject to RCM. For other services, liability to pay GST rests with the director. However, department may dispute this position considering the language of the Notification which makes no distinction between the nature of service and encompasses all services rendered by a director.

In order to sum-up the above discussion, the taxability of the services provided by a director shall be as follows-

Type of Director	Meaning/definition	GST Implications on services provided by them
Whole-time director	Section 2(94) of the Companies Act, 2013 defines the term ‘whole-time director’ as a director, who is in the whole-time employment of the company.	Not leviable to GST
Managing Director (employee)	<ul style="list-style-type: none"> • Section 2(54) of the Companies Act, 2013 defines ‘managing director’ as a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called. • <i>Employees' State Insurance Corporation Vs Apex Engineering Pvt. Ltd.</i>, reported at 1998 (1) SCT 63 (SC) & <i>Commissioner of Income Tax Vs. B.P. Dalmia</i> reported at (1993) 112 CTR (Cal) 400- 	Not leviable to GST

	Managing Director is an employee of the company.	
Executive Director	Rule 2(1)(k) of the Companies (Specification of definitions details) Rules, 2014 defines it to mean a whole Time Director as defined in Section 2(94) of the Companies Act, 2013.	Not leviable to GST
Non-executive Director (not employee)	Other than an executive director	RCM is applicable
Independent Director	Independent Director means an independent director referred to in Section 149(6) of Companies Act 2013.	RCM is applicable
Nominee Director (not employee)	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]	RCM is applicable

Conclusion

In view of the above discussions and conclusions drawn, it can be seen that Rajasthan AAR has laid down an incorrect interpretation of the law relating to the services provided by the directors serving as an employee to the company. In presence of such AARs, it is likely that other advance authorities and department will also take a similar position in future. Therefore, though advance rulings are binding only in respect of the applicant who has sought it and has only persuasive value for others, it is imperative for taxpayers to timely restructure such transactions to avoid any potential future liability.



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This article is for knowledge sharing purposes to educate industry, professionals and students to understand the concept of RCM applicability on payments to Directors in detail.



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