

GST reverse charge on Director Remuneration

What happened?

- ▶ Rajasthan Authority for Advance Rulings ('AAR') had made a ruling in the case of *Clay Craft India (P) Ltd* in February 2020 that salaries paid to directors would be subjected to GST under the reverse charge mechanism even if the director is treated as an employee by the Company.
- ▶ Similar ruling was made by the Karnataka AAR in September 2019 in the case of *Alcon Consulting Engineers (I) Pvt. Ltd.*

So what?

- ▶ The treatment adopted by the AAR would imply that GST under the reverse charge mechanism should be paid by the companies for services rendered by directors.
- ▶ This would be required even if the remuneration paid is in the nature of salary to an employee, and accounted in the books of account of the company as salary expense.
- ▶ In other words, there would be an immediate cashflow to the company of an additional 18% over and above the director's salary. Depending on the company's nature of business, the company may be eligible to avail input tax credit of this GST remitted.

That doesn't sound right

Neither to us. This is why:

- ▶ Any transaction involving services rendered by an employee to employer in the course of employment would not be considered as a supply.
- ▶ Once a transaction is not treated as supply, an entry mentioning the reverse charge liability would not constitute an obligation to pay GST under reverse charge.

Ok, so what do we do?

- ▶ Ensure that a contract of employment is executed between the director and the company. The contract needs to be approved by the Board of Directors and necessary approvals are to be taken by the shareholders in general meeting, wherever applicable.
- ▶ Run the payroll for the directors along with the other employees. Wherever possible, directors may contribute to provident fund along with other employees.

Recent ruling by AAR

- ▶ Rajasthan Authority for Advance Ruling (AAR) had in the month of February 2020 issued a ruling consequent to the application made to it by Clay Craft India Ltd.

“The consideration paid to the directors by the applicant will attract GST under reverse charge mechanism as it is covered under entry no. 6 of Notification no. 13/2017 CT(R) dated 28.06.2017”

Facts of the case

- ▶ The applicant in this case had submitted the following facts relating to its business before the AAR:

Board of directors consist of six directors. All the directors are working in the company at different levels of management

These directors are treated at par with any other employee of the company. They are compensated by way of regular salary and other allowances

The Company is deducting TDS on their salary and PF laws are also applicable to their services.

The Company claims that in all practical purposes, these directors are the employees of the Company and are working as such besides being director of the Company.

The Company wanted to know whether work done by directors as employee would get covered under reverse charge mechanism.

The Company is already paying GST under reverse charge on commission paid to directors.

Contention of the GST authorities

- ▶ The ruling was made by the AAR considering the below comments of the Jurisdictional Officer:

Salary paid to directors are not covered under clause 1 of Schedule III

Consideration paid to directors is in relation to the services provided by the Director to the Company

Remuneration is paid for the services supplied by the Director to the Company and hence same is liable to tax under reverse charge basis.

Entry 6 of notification no. 13/2017 – CT(R) dated 28/06/2017 specifies that the central tax leviable under section 9 of CGST in case of services supplied by a director of a company to the Company is to be paid on reverse charge basis by the Company.

Analysis and conclusions of the AAR

- ▶ Following analysis and conclusions were made by the AAR:

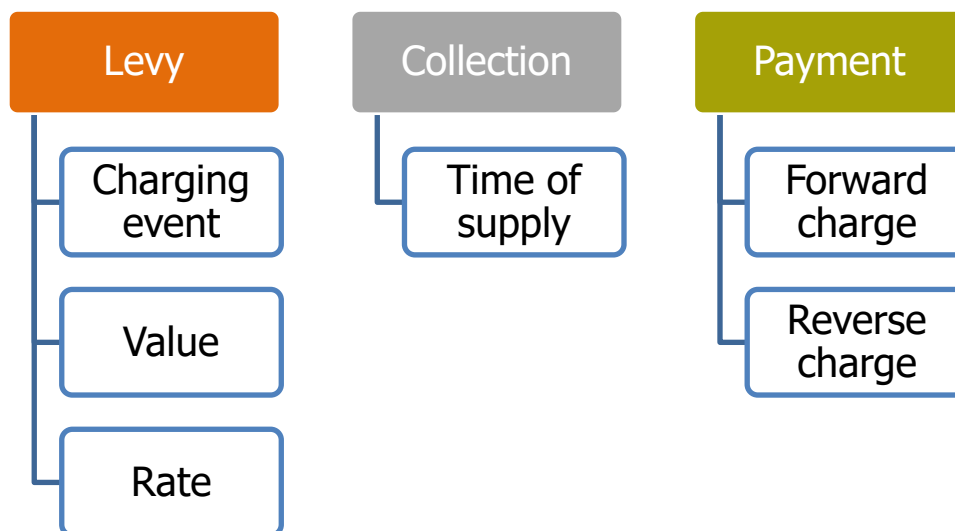
Consideration paid to directors is not covered under schedule III, as the directors are not the employees of the Company.

Services supplied is liable to reverse charge under notification 13/2017.

Notification no. 13/2017 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.

Analysis of the charging section

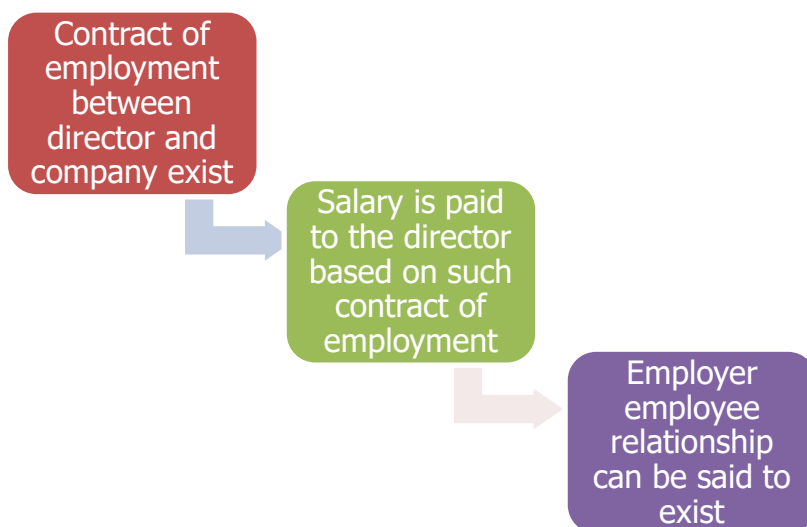
- ▶ The charging section 9 of the Central Goods & Services Tax Act, 2017 ('the CGST Act') can be analysed as given below:



- ▶ From the above as given in section 9, it is to be understood that the reverse charge mechanism is merely a method for payment of tax.
- ▶ Before concluding whether a transaction requires payment of GST under reverse charge, it is to be decided whether there is a levy and thereafter about the time of supply.
- ▶ A transaction listed as liable to reverse charge is not the deciding factor whether GST needs to be paid. It would be liable to be paid as reverse charge only if there is a levy on such transaction.

Analysis of transaction – remuneration paid to directors

- ▶ In case of remuneration paid to directors, the charging event is the supply of services by the directors.
- ▶ The services supplied against which the consideration is represented by way of fixed remuneration and which is as result of contract of employment between the Company and the director, it can be reasonably be concluded that the said director is supplying services to the company in the capacity of an employee.



- ▶ Once it is established that the nature of the transaction is that of an employer and employee, next it is to be identified whether the same qualifies as a 'supply' under the provisions of the GST.
- ▶ Schedule III explicitly states that, "*Service by an employee to the employer in the course or in relation to his employment shall be treated neither as supply of goods nor as supply of services*"
- ▶ Further, the section 7 of the CGST Act dealing with the levy of CGST states that "*activities or transactions specified in Schedule III shall be treated neither as a supply of goods nor as a supply of services*"

General observations

- ▶ The ruling made by the Rajasthan AAR was primarily based on the view that a distinct identity to the services provided by the director is given in the notification 13/2017 listing the services liable to reverse charge.
- ▶ According to the interpretation by the AAR, once a service is listed in the reverse charge notification, it is not to be seen whether the service constitutes a supply or not. Both the jurisdictional officer and the AAR was of the view that directors are not the employees of the company and hence the remuneration paid is not covered under Schedule III.

How to deal with this situation

- ▶ Even though a ruling was made by the Rajasthan AAR, the said ruling is binding only on the applicant. However, a similar ruling was also made by the Karnataka AAR, in case of Alcon Consulting Engineers (I) Pvt. Ltd. In the month of September 2019.
- ▶ Hence, a general trend can be seen treating the remuneration paid to directors interpreted as not being in the nature of salary paid by employer to employee.
- ▶ Until a clarification is issued on this matter, the same is open for multiple interpretations. Hence, in order to avoid litigations, it is recommended to adopt the below actions in order to justify the view point of the companies treating the same as salary:
 - ▶ A contract of employment be executed between the director and company. A resolution of the Board be passed appointing the director as an employee.
 - ▶ The contract should specify the nature of employment, roles and responsibilities, and the amount of remuneration to be paid monthly by way of salary.
 - ▶ The remuneration be included in the payroll information processed by the company for other employees in order to treat the employment at par with other employees not in the capacity of director.
 - ▶ Wherever possible the director can contribute to provident fund along with other employees.

Notice to the reader

In relation to this publication you may contact:

George Joseph, Managing Partner
Cell : +91 97464 00575
Email: gj@gja.co.in

P. Rajagopal, Partner
Cell : +91 93886 09990
Email: pr@gja.co.in

Umesh Bhat, Partner
Cell : +91 98472 74567
Email: umeshbhat@gja.co.in

Reuben Joseph, Partner
Cell : +91 98952 09307
Email: reuben.joseph@gja.co.in

N. Vijayakumar, Principal (IDT)
Cell: +91 94463 62533
Email: vjkumar@gja.co.in

Allen Joseph, Partner
Cell : +91 90483 06882
Email – allen.joseph@gja.co.in

Raphael Sharon, Partner
Cell : +91 99462 03087
Email: raphael.sharon@gja.co.in

Shaji Varghese, Partner
Cell : +91 98470 44030
Email: shaji.varghese@gja.co.in

C M Cheriyan, Partner
Cell : +91 90376 66896
Email: cherian.cm@gja.co.in

Swathi Bhojak, Consultant (Co. Law)
Cell : +91 90370 20811
Email: swathi.bhojak@gja.co.in

Godwin Thomas, Manager, Risk Advisory
Cell : +91 94968 36346
Email: godwin.thomas@gja.co.in

37/2038, 1st Floor, Muttathil Lane
Kadavanthra,
Cochin – 682 020, Kerala

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