

Salary received by an executive director is outside the purview of GST: Karnataka AAR

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Summary

The Karnataka Authority for Advance Ruling (AAR) has in a recent case held that salary/remuneration received by a director who is an employee (i.e. executive director) would be outside the purview of GST and hence not includible in the aggregate turnover for the purpose of obtaining registration under GST law.

However, the AAR held that the income received towards remuneration by a non-executive director of a private limited company, renting of commercial property and renting of residential property (even though it is an exempted supply) and the amount extended as deposits/loans/advances out of which interest is received is to be included in the aggregate turnover for registration.

Facts of the case

The Applicant¹ filed an application before the Karnataka AAR seeking an advance ruling on which of the following incomes is includible for the purpose of computing aggregate turnover for obtaining registration under the GST law:

- Partner's salary as partner of partnership firm
- Salary as director of a private limited company
- Interest received on loans/advances/deposits/fixed deposits/Debentures/post

office deposits/National Savings Certificate (NSC)/National Pension Scheme (NPS)/ PPF

- Rent received from renting and commercial property
- Dividend on shares
- Capital gain/loss on shares

Karnataka AAR's observation and order²

- **Salary received as director of a private limited company:** In the instant case, the applicant did not produce any documentary evidence to substantiate if he was an employee of the company or merely an

¹ Mr. Anil Kumar Agarwal

² Karnataka AAR Order No. KAR ADRG 30/2020 dated 4 May 2020

independent director. Thus, the AAR gave its response presuming both the possibilities.

- **Not to be included:** If the applicant is an executive director, salary/remuneration received by him shall not be included in the aggregate turnover as the same is outside the purview of GST³.
- **To be included:** If the applicant is a non-executive director, salary/remuneration received by him is taxable under reverse charge mechanism (RCM)⁴. Thus, the same shall be included in the aggregate turnover as value of taxable supply.
- **Rental income:**
 - **Rental income from commercial property** is a taxable supply received and is to be included in the aggregate turnover for registration.
 - **Rental income from residential property** is an exempted supply⁵. However, since the aggregate turnover includes exempted supplies, such rental income shall be included.
- **Interest income:** The interest earned from deposits/loans/advances is exempted service. Thus, actual amounts of

deposits/loans advances become the value of service and are to be included in the aggregate turnover for registration under GST laws.

- **Maturity proceeds of life insurance policies, dividend on shares and capital gain/loss on sale of shares:**
 - Income from shares shall not be included as the same is outside the purview of GST⁶.
 - The insurance premium is taxable under GST being the consideration for services provided by the insurance company. Therefore, on maturity of the policy there would not be any service involved between the policy holder and the insurance company. Hence this income is not to be included.

³ Schedule III to the CGST Act, 2017

⁴ Notification No. 13/2017-Central Tax (Rate) dated 28 June 2017

⁵ Entry 12 of Notification No. 12/2017 dated 28 June 2017

⁶ Section 2(52) and 2(102) of the CGST Act, 2017 respectively

Our comments

The present ruling is in sharp contrast to the recent ruling pronounced by the Rajasthan AAR⁷ wherein the AAR held that the directors cannot be regarded as employees of the company. Accordingly, the salary/remuneration paid to the directors shall be liable to GST under RCM.

Though this is a welcome ruling for businesses, existence of such divergent rulings creates confusion among taxpayers especially for those having business presence in more than one state. In a scenario, where the business entity is registered under the GST law in both the states, Karnataka and Rajasthan, the question arises as to which tax position needs to be adopted and potential exposure to litigation risk associated with it.

Even in the past, it has been observed that AARs of two different states have pronounced divergent rulings on the same issue/subject matter. At this juncture, it is imperative that the National Appellate Authority for Advance Ruling is made functional with immediate effect so that there is a uniformity in tax treatment at national level.

⁷ in the case of M/s Clay Crafts India Pvt. Ltd.

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