

Service Tax on Director Services to Companies



The new changes ushered by Finance Act, 2012 are a paradigm shift from the existing system where only services of specified descriptions were subjected to tax. In the new system, effective from 1st July, 2012, all services, except those specified in the negative list, will be subject to taxation. In addition to this, certain services have also been exempted through Mega Exemption Notification No. 25/2012-ST dated 20-06-2012. Due to the transition from positive list to negative list based taxation, many services which were hitherto outside the tax net, have now become taxable. One such service, which was out of tax net earlier but has become taxable now, is "services provided by a director of a company to the said company". Read on to know more...



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1. Introduction

The Finance Act, 2012 has ushered in a new system of taxation of services; based on Negative list with effect from 1st July, 2012. A negative list of services implies two things: firstly, a list of services which will not be subject to service tax; secondly, all other services other than mentioned in the negative list, which fall within the definition of the 'services' will become taxable. This can be contrasted from the method of taxation that was applicable till 30th June, 2012 based on a positive list, wherein a detailed description for each taxable service was provided and all other unspecified services were not eligible to tax.

Accordingly, with effect from 1st July, 2012, all services rendered in taxable territory except those specified in the negative list, will be subject to taxation in terms of newly inserted charging Section 66B of Chapter V of Finance Act, 1994. As per the Section 66D of said Chapter, seventeen services have been

included in negative list and thus exempt from service tax. In addition to this, certain services have always been exempted through Mega Exemption Notification No. 25/2012-ST dated 20-06-2012.

Due to the transition from positive list to negative list based taxation, many services which were hitherto outside the tax net, have now become taxable. One such service, which was out of tax net earlier but has become taxable now, is "services provided by a director of a company to the said company".

As we know, Directors are appointed by the shareholders for managing the day-to-day activities of the company, as it can function only through some human agency and it is impracticable for all the shareholders of a company, especially in case of a big public company to manage its affairs. The Directors are collectively known as "the Board of Directors" and they provide key services to the company in the course of its management.

2. Position of Taxability of Director Services up to 30th June, 2012

During this period, the taxation was based on a positive list, wherein detailed description for each taxable service was provided and all other unspecified services were not chargeable to tax.

Director Services were not specifically covered/included in any of the definition of the taxable service as defined in erstwhile Section 65(105) of the Finance Act, 1994. Central Board of Excise and Customs also vide Circular No. 115/09/2009 – ST dated 31st July, 2009 had examined the applicability of service tax:-

- i) Under 'Business Auxiliary service' on payments to Managing Director/Directors (whole time, or Independent) by the company, and
- ii) On Independent Directors who are part of the Board of Directors under 'Management Consultant service'.

As the services of director is an activity carried out by one person (director) for another (company) generally for consideration (remuneration) and as no exclusions regarding services of directors exist in the negative list mandated in Section 66D, and as well as in the mega exemption notification no 25/2012-ST dated 20-06-2012, the director services to companies are now taxable, except in some cases.

And it was clarified that remunerations paid to Managing Director/Directors of companies whether whole-time or independent when being compensated for their performance as Managing Director/Directors would not be liable to service tax. However, in case such directors provide any advice or consultancy to the company, for which they are being compensated separately, such service would become chargeable to service tax.

Accordingly, in view of the above circular, the services provided by the Managing Director/Directors in the capacity of Director were not eligible to service tax, up to 30th June, 2012.

3. Position of Taxability of Director Services from 1st July, 2012 Onwards

As stated earlier, with the advent of negative list regime from 1st July, 2012, the director services have become taxable. But, here it is important to understand the following issues:-

- a) Whether all director services are taxable. If not, then, which director services are taxable.
- b) Which payments or consideration to directors are taxable.
- c) Which person is liable to pay tax - Implications on Directors/Companies.

Now let us discuss each of above issues in detail:

3 a) Which Director Services are Taxable:

As per Section 66B of the Act, there shall be tax levied on the value of service other than those specified in the negative list provided or agreed to be provided in a taxable territory by one person to another.

Earlier, there was no definition of service. Now, service has been defined in Section 65 B(44) of the Act, which is being *inter alia* reproduced as under:-

"Service" means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include—

- (a)
- (b) a provision of service by an employee to the employer in the course of or in relation to his employment;
- (c)

As the services of director is an activity carried out by one person (director) for another (company) generally for consideration (remuneration) and as no exclusions regarding services of directors exist in the negative list mandated in Section 66D, and as well as in the mega exemption notification no 25/2012-ST

dated 20-06-2012, the director services to companies are now taxable, except in the following cases:

- Services provided by a Director who is an employee to the company (employer) in the course of or in relation to his employment.
- Director Services provided in a non taxable territory.
- Director Services provided without consideration.

Now let us discuss each of the above exceptions:

Exception 1:- Services provided by a Director as an employee in the course of or in relation to his employment: For understanding whether directors can be considered as employees of the company, let us briefly discuss the definitions/types of Directors as per Companies Act and SEBI regulations.

Section 2(13) of the Companies Act, 1956 defines a Director as including any person occupying the position of a Director, by whatever name called.

The Companies Act refers to the following two specific categories of Directors:

- Managing Directors; and
- Whole-time Directors.

Further, the Securities Contracts (Regulation Act, 1956, read with the rules and regulations made thereunder, requires every company desirous of listing its shares on a recognised Indian stock exchange, to execute a listing agreement with such Indian stock exchange. The Listing Agreement as prescribed by SEBI, provides for the following categories of Directors:

1. Executive Director;
2. Non-executive Director; and
3. Independent Director.

An Executive Director can be either a Whole-time Director of the company or a Managing Director.

In contrast, a non-executive Director is a Director who is neither a Whole-time Director nor a Managing Director. Independent Director is also a non executive director, but certain conditions are required to be met e.g. he should not hold more than 2% of the block of voting shares. Nominee directors appointed by institution that he has invested in, or lent money to the company, are also treated as Independent Directors.

As per Section 2 (26), a **managing director**, means a director who is entrusted with substantial powers of management which would not otherwise be exercisable by him. The powers so conferred are alterable by the company. He is also removable the same way as he was appointed irrespective of the fact that his appointment has been approved by the Central Government. But if

The payment of salary, allowances, PF contribution, perquisites, etc. to Managing Director and Whole-Time Directors being employees of the company in the course of or in relation to his employment; would not constitute a taxable service. However, any services provided outside the ambit of employment like advice or consultancy to the company outside the scope of employment for consideration would constitute a service, which was taxable prior to 1st July, 2012 also.

he is prematurely removed from office, he is entitled to compensation. It has been held in case of News Papers Proprietary Syndicate Ltd, Re, [1990] 2 Ch 349 that a managing director is an employee of the company, but not to the extent so as to be entitled to preferential payments.

The Supreme Court observed that a Managing Director can be regarded as a principal employer for the purposes of the ESI Act, 1948. *Employees State Insurance Corp. Vs. Appex Engineering P. Ltd., (1998) 1 Comp LJ 10: [1998] 1 LLJ 274 (SC).*

As per explanation given in Section 269 of the Companies Act, “**Whole Time Director**” includes a director in the whole time employment of the company.

Further, a managing director or whole time director cannot resign merely by giving a notice, as formal acceptance of the same is essential to make it complete and effective. This is because, they occupy two positions or possess two capacities, viz (i) one, that of director, and (ii) the other, that of a manager or officer of the company in the sense of whole-time employee. The notice or letter of resignation is therefore required to be approved or accepted by the company and the officer concerned has to be relieved of his duties and responsibilities attached to the office which he has resigned from (*Achutha Pal Vs. Registrar of Companies (1956) 36 Comp. Cas 598*). However, in case of ordinary director, formal acceptance of resignation is not needed. (*Abdul Hug Vs. Katpadi Industries Ltd. A.I.R 1960 mad. 483*).

Accordingly, in view of the above discussion, the managing director and whole time directors would normally be employees of the company. This view is also corroborated from the fact that the remuneration paid to whole time directors and Managing Director are regarded as income from salary and is subjected to TDS under Section 192 of the Income-tax Act, 1961 as amended.

Accordingly, the payment of salary, allowances, PF contribution, perquisites, etc to Managing Director and Whole Time Directors being employees of the company in the course of or in relation to his employment; **would not constitute a taxable service**. However, any services provided outside the ambit of employment like advice or consultancy to the company outside the scope of employment for consideration would constitute a service, which was taxable prior to 1st July, 2012 also.

Exception 2- Director Services provided in a non-taxable territory:

As per Section 66B of the Act, there shall be tax levied on the value of service if provided or agreed to be provided in a taxable territory.

The word taxable territory has been defined in Section 65B(52) as territory to which the provisions of Chapter V of Finance Act, 1994 as amended apply, i.e. Service Tax. As per Section 64, this chapter applies to all over India except State of Jammu and Kashmir. The word India has been defined in Section 65B(27) in a very vide manner. It not only includes territorial waters, continental shelf in India, exclusive economic zone, but also includes sea bed underlying the territorial waters and airspace above territorial waters. Taxability arises when the provision of service is made in a taxable territory. Section 66C empowers the Central Government to make rules for determination of place of provision of service. The Place for Provision of Service Rules, 2012 has been notified vide Notification No. 28/2012-ST, dated 20-6-2012.

As per Rule 3 of said Rules (general rule) which is applicable for director services, the place of provision of service shall be the location of the recipient of service i.e. the company. Accordingly, if the company is located in non taxable territory like Jammu and Kashmir, then service tax would not be leviable on the services provided by a director which may or may not be from a taxable territory.

Exception 3- Director Services provided without consideration:

As per Section 65 B(44) of the Act, "Service" means any activity carried out by a person for another for consideration.

As per Explanation (a) to Section 67 of the Act, "consideration" includes any amount that is payable for the taxable services provided or to be provided. Accordingly, if any director is providing services without any consideration, then such service won't

constitute a taxable service. This normally occurs in case of nominee directors, where generally the sitting fees is not paid.

As discussed above, the director services to companies are taxable except in above three situations. Accordingly, the director services provided by non executive directors/Independent Directors for a consideration to a company located in a taxable territory would normally be eligible to service tax.

3 b) Which payments to directors are taxable?

After discussing which director services constitute service, it is important to discuss about the amounts/consideration on which service tax is to be levied.

In this regard, the presentation namely "Budget 2012: Changes in Service Tax" dated 13-07-2012 of Ministry of Finance *inter alia*, states that tax is applicable on any monetary or non-monetary considerations like Director's fee, Commission/bonus, Company car/ travel reimbursements etc.

Now let us discuss each of the above items, in the light of our earlier discussions:-

i) Director Fees/Sitting Fees:-

Section 309(2) of the Companies Act, 1956 contemplates payment to a 'Director' of remuneration by way of a fee for attending meetings of the Board or Committees constituted by the Board.

In case of managing director and whole time director, the payment of sitting fee forms part of managerial remuneration and if amounts are payable in accordance to Schedule XIII, no such sitting fee is payable to them. Further Department Letter No. 3/1/90 CL-V, dated 18-07-1990 makes it very clear that sitting fee may be paid only to a director who is not a whole time director or a managing director. i.e. sitting fees may be paid to a non-executive director or Independent Director only.

As director fee/sitting fees is generally paid to non executive director, independent director who are not an employee of the company, such fee shall be taxable and such fee shall be liable to service tax.

ii) Commission/bonus

Any Commission/bonus accrued by company to the director shall be subjected to tax. However, it is important here to note that any commission/Bonus which has accrued to the managing director or whole time director as a result of services provided in the course of employment would not be subjected to service tax.

As regards where non-executive directors are concerned, some companies pay them the commission up to a limit as % of net profits subject to compliance with the provisions of the Companies Act, 1956. In the light of earlier discussions, the same would also be subject to service tax. However, as payment of bonus is regulated by Payment of Bonus Act, 1965 which mandates for payment of Bonus only to employees and as non-executive directors are not employees, they are not generally paid bonus. However if paid, same shall be taxable.

iii) Company car/travel reimbursements, etc.

The relevant Rule here is Rule 5(1) of the Service Tax (Determination of value) Rules, 2006 which states that where any expenditure or costs are incurred by the service provider in the course of providing the taxable service, all such expenditure or costs shall be treated as consideration for the taxable service provided or to be provided and shall be included in the value for the purpose of charging service tax on the said service.

As service tax is applicable on reimbursements of expenses incurred for rendering a taxable service, accordingly the reimbursements, if any, would also be taxable. However, any reimbursement relating to rendering of service as employee by managing director/whole time director would be exempt.

Accordingly, if any reimbursements of expenses have been made towards travel expenses, taxi charges, boarding, lodging in relation to attending of the board/audit committee meeting to the non-executive directors/independent directors, the same would be included as consideration for payment of service tax.

However, it is important to note here that in the event the expenditure/costs are incurred by such director as pure agent i.e all conditions given in Rule 5(2) of Service Tax (Determination of value) Rules, 2006 have been fulfilled, then such expenditures would be excluded from the value of taxable service.

Further, if the travel, boarding, lodging arrangements for directors are made directly by company and payment is also directly made by company to the Hotel, travel agency etc, then service tax may not be taxable as expenditure or costs are not incurred by the service provider in such case and no reimbursements are involved.

From 7th August, 2012 as the taxable director services have been covered under reverse charge, the Directors would not be liable for claim/deposit of service tax and other requirements of the service tax law even when a director receives payment in his personal capacity. Even the entities receiving fee in respect of directors nominated by them are not required to pay service tax on the same.

Apart from the above items which are stated in the presentation of the Ministry of Finance, service tax can be levied on the following items:-

iv) Services provided by executive director beyond employment:

If any services are provided by managing director or whole time director which are outside the ambit of employment like advice or consultancy to the company for consideration, the same would constitute a service. Such services would be taxable in case of non executive directors as well.

v) Non monetary considerations:

The term consideration includes not only the monetary considerations (i.e. received in money) but also to non monetary considerations as well. Accordingly, if the non- executive directors are compensated by any non-monetary consideration like supply of goods or services in return of provision of service etc , the value of the same needs to be determined as per Section 67 of the Act and Service Tax (Determination of Value) Rules, 2006 and tax on the same is to be levied.

3 c) Which person is liable to pay tax – Implications on Directors/Companies:

Recently, two notifications have been issued on 7th August, 2012 which have brought the taxable director services under reverse charge mechanism i.e. the service recipient (company) has been made as the person liable to pay service tax to the Government.

Reverse charge is encapsulated under Rule 2(1) (d) of the Service Tax Rules, 1994 read with Section 68(2) of the Finance Act, 1994.

The summary of both the notifications is given below:-

Notification No. 45/2012 - Service Tax dated 7th August, 2012

Vide this notification, an amendment has been made

in the notification No.30/2012-Service Tax, dated the 20th June, 2012 by including the services provided or agreed to be provided by a director of a company to the said company, as a service taxable under reverse charge mechanism. Further, the extent of service tax payable on the same by the service provider and the service recipient has also been stipulated as under:-

S. No	Description of service	% of service tax payable by person providing service	% of service tax payable by the person receiving the service
"5A	in respect of services provided or agreed to be provided by a director of a company to the said company	Nil	100%"

Notification No. 46/2012 - Service Tax dated 7th August, 2012

Vide this notification, the Rule 2(1) (d) of the Service Tax Rules, 1994, which defines "person liable for paying service tax" has been amended by inserting a new item (EE) after item E as under:-

"(EE) in relation to service provided or agreed to be provided by a director of a company to the said company, the recipient of such service;"

As a consequence of the above notifications, the burden of the payment of taxes in case of director services has been shifted from the service provider (Director) to the service recipient (Company). Further, the entire service tax is payable by such company.

Although no mention of date of applicability is there in the Notification No. 45/2012 – Service Tax, but as per Notification No. 46/2012- Service Tax, it has been mentioned that the amendment shall come into force on the date of publication in the official gazette i.e. 7th August, 2012.

Accordingly, though the director services have been brought into service tax net from the date of applicability of negative list regime i.e. 1st July, 2012, but the same has been included under reverse charge from 7th August, 2012. Accordingly, in respect of director services provided from 1st July to 6th August, 2012 the service provider i.e. Director would be liable to pay tax. However from 7th August, 2012 onwards the service recipient i.e. the company will be liable to pay tax.

While bifurcating the service in said periods the Point of Taxation Rules, 2011 need to be considered for determining the 'point' at which the taxable service

shall be deemed to be provided under Rule 6(1) of the Service Tax Rules.

The Point of Taxation Rules, 2011 state that the point of taxation shall be earlier of the following:-

- a) The time when the invoice for the service provided or agreed to be provided is issued
(Provided that where the invoice is not issued within time period specified in Rule 4A of Service Tax Rules, 1994 i.e. 30 days from date of completion of such taxable service, the point of taxation shall be the date of completion of provision of the service.) or:
- b) the time when the payment/advance by whatever name called is received to extent of such payment.

In respect of director services, normally the date of audit committee meeting or Board meeting would be the date of completion of taxable service. Accordingly, if invoice is issued by Director for consideration of director services within 30 days of date of said meeting the invoice date or the date of payment whichever is earlier would be the point of taxation. However, if the invoice is not raised within the said period, then the date of meeting or the date of payment of consideration whichever is earlier, would be regarded as point when the service would be deemed to be provided.

The position regarding liability of payment of service tax on Directors and Companies has been discussed in detail below.

i) Taxability of director services deemed to be provided during the period 1st July to 6th August, 2012.

a) Liability of Directors

During this period, as the taxable director services were not covered under reverse charge, accordingly, the Directors would be liable to claim the amount of service tax from the company apart from fee etc and deposit the same by due dates and also comply with all the other requirements of the service tax law.

The above position has been corroborated by draft circular F.No. 354/127/2012-TRU dated 27th July 2012, which states that when a director receives payment in his personal capacity, the same is liable to be taxed in the hands of the Director.

It is important to note here that the service tax would be exigible only if the gross taxable service income of the Directors during the financial year exceeds ₹ 10 lakh. Accordingly, if the said income of the Directors does not exceed this limit, which would normally be the case, then no service tax would be applicable.

However in the following cases, service tax would not be paid by Directors:-

As per draft circular dated 27th July, 2012, A director may also be appointed to represent an entity (including government) who has either invested in the company or is otherwise authorised to nominate a director. Where the fee is charged by the entity appointing the director and is paid to such entity, the services shall be deemed to be supplied by such an entity and not by the individual director. Accordingly, in such cases, the service tax would be paid not by director but by such entity, which had appointed the Director.

However, in the case of Government nominee directors where fee is charged by the Government appointing the director and is paid to Government, the services shall be deemed to be provided by the Government and liable to be taxed under the exclusion sub- (iv) of clause (a) of Section 66D of the Finance Act, 1994 i.e. support services by Government to business. Such services are liable to be taxed on reverse charge basis from 1st July, 2012 and therefore, tax is to be paid by the service recipient i.e. Company.

Further, if the directors are located in a non-taxable territory i.e. State of Jammu & Kashmir or outside India, then service tax is not payable by such director. However, if in this case the company is located in a taxable territory, the transaction would be covered under reverse charge from 1st July, 2012 and tax would be paid by the company.

Also, in cases where the company receiving the director services is located in non taxable territory, then such service won't constitute taxable service and thus the tax is neither payable by director nor the company.

b) Implication on Company receiving the service:

No service tax to be paid in respect of consideration to Directors located in taxable territory. However, in case of any payment towards taxable service to a Director, located outside India or in State of Jammu and Kashmir or in case of payment to Government against consideration of Government nominee director, the company is required to pay the full amount of service tax under reverse charge basis as per Section 2(1)(d) of the Service tax Rules, 1994 read with notification No 30/2012- Service Tax Dated 20th June, 2012. Further in this case, the threshold limit of ₹10 lakhs will not be applicable. However if in the above cases, the company

receiving the director services is located in non-taxable territory like State of Jammu & Kashmir, then no payment of service tax is to be made by such company.

Company liable to pay tax is required to comply with all the necessary compliances, such as obtaining service tax registration, payment of service tax, filing of tax return as applicable under the service tax law.

The service tax amount so incurred by companies under reverse charge would be extra cost of the companies. However, non-trading companies can take cenvat credit on the same as per cenvat Credit Rules, if it qualifies as eligible input service.

Further, vide General Circular no. 24/2012, dated 9-8-2012 of Ministry of Corporate Affairs, Government of India, it has now been stated that any increase in remuneration of Non-Whole Time Director(s) of a company solely on account of payment of service tax on commission payable to them by the company, shall not require approval of Central Government under Sections 309 and 310 of the Companies Act even if it exceeds the limit of 1% or 3% of the profit [under Sections 309(4)] of the company, as the case may be, in the financial year 2012-13.

ii) Taxability of director services deemed to be provided from 7th August, 2012 onwards.

a) Implication on Directors

From 7th August, 2012 as the taxable director services have been covered under reverse charge, the Directors would not be liable for claim/deposit of service tax and other requirements of the service tax law, even when a director receives payment in his personal capacity. Even the entities receiving fee in respect of directors nominated by them are not required to pay service tax on the same.

b) Implication on Company

The company other than those located in a non-taxable territory, would be required to pay service tax under reverse charge basis in respect of taxable services obtained from the directors for a consideration, irrespective of fact whether they are located within or outside the taxable territory or are nominee directors of Government/other entities. Further as discussed earlier, the threshold limit of ₹10 lakh is not applicable in reverse charge mechanism. In other words, even if the payment is ₹1, company is required to pay service tax on the same.

As discussed earlier, the Company is required to comply with all the necessary compliances, such as obtaining service tax registration, payment of service tax, filing of tax return as applicable under the service tax law.

The service tax amount so incurred by companies under reverse charge would be extra cost of the companies, however, non-trading companies can take Cenvat credit on the same as per Cenvat Credit Rules, if it qualifies as eligible input service.

Further, as stated earlier vide General Circular no. 24/2012, dated 9-8-2012, it has now been stated that any increase in remuneration of Non-Whole Time Director(s) of a company solely on account of payment of service tax on commission, shall not require approval of Central Government under Sections 309 and 310 of the Companies Act, even if it exceeds the prescribed limits, in the financial year 2012-13.

For ready reference, the persons liable to pay tax on the director services in various situations, is summarised in the table given below:

Particulars	TAX TO BE PAID BY	
	Services provided during 1st July to 6th August, 2012.	Services provided from 7th August, 2012 onwards.
Director located in a taxable territory receives consideration for taxable service in his personal capacity from a Co. located in a taxable territory.	Director	Company (under reverse charge)
Entity (other than Govt.) receives the consideration of fee against nominee director from a company located in a taxable territory.	Such Entity	Company (under reverse charge)
Govt. receives the consideration of fee against Govt. nominee director from a company located in a taxable territory.	Company (under reverse charge)	Company (under reverse charge)

Directors located in a non taxable territory providing taxable service to a Co. located in a taxable territory for consideration.	Company (under reverse charge)	Company (under reverse charge)
Company receiving the service for consideration located in non taxable territory.	No tax	No tax

Conclusion

The scope of service tax under the new regime of negative list has been enlarged with effect from 1st July, 2012, as many services which were hitherto outside the tax net, like “services provided by a director of a company to the said company”, have become taxable.

However, the positive take away here is that the director remuneration to executive directors i.e. managing director, whole time directors (being employees) which is the major component of consideration for director services, is still not eligible to service tax as “provision of service by an employee to an employer in the course of or in relation to his employment” has specifically been excluded from the definition of service under Section 65B (44). Accordingly, service tax would generally be applicable only in respect of payments to non-executive directors like Director/sitting fees, commission, certain reimbursements etc. and that too, if such services are provided to a company located in a taxable territory.

Further, the director services have specifically been covered under reverse charge mechanism from 7th August, 2012. Accordingly, the payment of service tax in case of taxable director services deemed to be provided on or after 7th August, 2012 is to be made by the company receiving such services. However, the service tax in respect of director services deemed to be provided from 1st July to 6th August, 2012 is normally required to be made by the director concerned, except in certain cases where the same would be paid by the company under reverse charge or the entity appointing nominee director and receiving some fee towards director services.

While determining the point of time when the relevant service period is deemed to be provided, the principles enunciated under the Point of Taxation Rules, 2011 need to be applied. ■