

# Note

## Clarification on applicability of Service Tax on sitting fees/commission payable to Non-Whole Time Directors: Finance Ministry and MCA make the provisions clear

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## Note

**The Finance Act, 2012** made an increase in the percentage of “**Service Tax**” on taxable services from existing ten percent to twelve percent. According to the said act service tax is to be levied at a rate of twelve percent on the value of all services other than those which have been specified in the negative/exempted list in the act. This condition is also applicable when the annual revenue exceeds rupees ten lakh. The Non-Whole Time Directors of a company were not included under the ambit of the negative list of the Finance Act and thus, sitting fees/commission payable to them by the company was exposed to the levy of service tax at the specified rate.

For the first time such taxes were levied on the sitting fees and this was already creating a chaos in the industry as to who would be liable to pay such taxes- whether the director himself or the company? There were lots of interpretations by one and all. Now, if such service tax is to be paid by the company itself, it will be deemed to be a part of remuneration under section 198 of the Companies Act, 1956 (the Act) and accordingly will result in the increase in the remuneration payable to such director. This action could in return exceed the remuneration amount specified under section 309 (4)(b) of the Act which stipulates as follows:

*“A director who is neither in whole-time employment of the company nor a managing director may be paid remuneration-*

- a) By way of a monthly, quarterly or annual payment with the approval of the Central Government; or*
- b) By way of commission if the company by special resolution authorizes such payment:*

**Provided** that the remuneration paid to such director, or there is more than one such director, to all of them together shall not exceed-

- i. One percent of the Net Profits of the company, if the company has a managing or whole-time director or a manager;*
- ii. Three percent of the Net Profits of the company in any other case.”*

**Provided** further that if the company wants to make such payments it can do so with the approval of the Central Government in a general meeting.

Thus, it is necessary to acquire the approval of the government to make such payments and this had resulted in a dilemma regarding this matter. It was evident that if the payment is made by the company there exists a chance of attracting the above provisions of the Act and the company will be required to acquire the approval of the Central Government for each and every incident which will lead to an increase of the ceiling percentage. This will be a tough job for the company as well as for the individual director in question and pose many practical problems. This had also created an enormous cloud of confusion in the industry as a way out from this situation was



## *Note*

needed very quickly. To the relief of all stakeholders both the department of Finance Ministry and Ministry of Corporate Affairs (MCA) came up with the relevant clarifications.

### **Direction of the Finance Ministry**

The Ministry of Finance (Department of Revenue) vide its notification number 45/2012<sup>1</sup> dated August 7, 2012 directed that the service tax payable on the sitting fees/commission of the directors are to be paid by the company. In other words, the company as the receiver of the service that has been rendered service by the director will bear the liability of the service tax payable for such service received by the company. Thus, the tax is to be paid on the **“reverse charge basis”**.

### **Clarification by the Ministry of Corporate Affairs**

The Ministry of Corporate Affairs (MCA) came up with a clarification regarding the matter vide its General Circular Number 24/2012<sup>2</sup> dated August 9, 2012. The notification depicts clearly that if sitting fees/commission paid to the Non-Whole Time Director(s) which subsequently increases the remuneration of such director(s) shall not require any approval of the Central Government which is required under section 309 and 310 of the Act even if it exceeds the ceiling of one percent and three percent respectively of the company for the Financial Year 2012-13.

### **Inference**

The response of both the Ministries came at the right time and this is a welcome step taken. This has clarified all the confusion and the queries of the industry and has enabled proper justification of the situation. The amount of tax so collected does not actually reach the hands of the director(s) who are paid such fees/commission but inflates their remuneration. This has further marked the start of a good practice regarding sections 309 and 310 of the Companies Act. Therefore, such payment of service tax by the company will not pose any accounting or legal problems for themselves which is justified and well thought by the department. This will also promote an ethical environment within the industry.

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<sup>1</sup> <http://www.servicetax.gov.in/notifications/notfns-2012/st44-46-2012.pdf>

<sup>2</sup> [http://www.mca.gov.in/Ministry/pdf/General\\_Circular\\_24\\_2012.pdf](http://www.mca.gov.in/Ministry/pdf/General_Circular_24_2012.pdf)