

**Will the Profit Sharing Agreement between the applicant as an employee and the shareholders, attract GST in his hands? HELD The Profit Sharing Agreement between the applicant and various shareholders of SHA is an actionable claim and is as neither a supply of goods nor a supply of services covered under Schedule III to CGST Act and SGST Act and hence is not taxable to CGST or SGST.**

**AUTHORITY FOR ADVANCE RULING ORDER No. 19/AAR/2019 DATED 21st May, 2019**

**AUTHORITY FOR ADVANCE RULING**

**TAMILNADU ADVANCE RULING AUTHORITY,**

**PAPJM Buildings, II Floor, No.I, Greams Road, Chennai- 600 006.**

**PROCEEDINGS OF THE AUTHORITY FOR ADVANCE RULING U/s.98 OF THE  
GOODS AND SERVICES TAX ACT, 2017.**

**Members present are:**

1. Ms. ManasaGangotri Kata, IRS Joint Commissioner/Member,

Office of the Commissioner of GST & Central Excise, Chennai.

2. Thiru. KurinjiSelvaan V.S., M.Sc., (Agri.), M.B.A.,

Joint Commissioner (ST) / Member,

Office of the Authority for Advance Ruling, Tamil Nadu, Chennai-6.

GSTIN Number, if any/ User-id		UNREGISTERED
Legal Name of Applicant		VENKATASAMY JAGANNATHAN
Registered Address/Address provided while obtaining user id		No.32/69,CEEGBROS APARTMENTS,RAGAVEERA AVENUE,POES GARDEN, CHEENAI-600086
Details of application		GST ARA-01 Application Sl. No.06 dated : 14.02.2019
Concerned officer		State: The Assistant Commissioner(ST),  Mylapore Assessment Circle,  46, Pasumpon Muthuramalingam Salai,  Taluk Office Building,  R.A. Puram,  Chennai - 600 028.  Centre: Chennai North - Mylapore Division
Nature of activity(s) (proposed / present) in respect of which advance ruling sought		
A	Category	Service Provision
B	Description (in brief)	The Applicant is employed in Star Health and Allied Insurance Company Limited as Chairman and Managing Director.
Issue/s on which advance ruling required		Determination of liability to pay tax on any goods or services or both

Question(s) on which advance ruling is required

Will the Profit Sharing Agreement between the applicant as an employee and the shareholders, attract GST in his hands?

Note : Any Appeal against the Advance Ruling order shall be filed before the Tamil Nadu State Appellate Authority for Advance Ruling, Chennai under Subsection (1) of Section 100 of CGST ACT/TNGST Act 2017 within 30 days from the date on which the ruling sought to be appealed against is communicated.

At the outset, we would like to make it clear that the provisions of both the Central Goods and Service Tax Act and the Tamil Nadu Goods and Service Tax Act are the same except for certain provisions. Therefore, unless a mention is specifically made to such dissimilar provisions, a reference to the Central Goods and Service Tax Act would also mean a reference to the same provisions under the Tamil Nadu Goods and Service Tax Act.

Shri. Venkatasamy Jagannathan, No.32/69, CEEBROS Apartments, Ragaveera Avenue, Poes Garden, Chennai-600086 (hereinafter called the Applicant) is employed in Star Health and Allied Insurance Company Limited (hereinafter referred to as SHA) as Chairman and Managing Director and also a Stake holder in the said company. The applicant has preferred an application seeking Advance Ruling on the following:-^

Will the Profit Sharing Agreement between the applicant as an employee and the shareholders, attract GST in his hands?~

The Applicant has submitted the copy of application in Form GST ARA - 01 and also submitted the copy of Challan evidencing payment of application fees of Rs.5,000/-each under sub-rule (1) of Rule 104 of CGST rules 2017 and SGST Rules 2017.

2. The Applicant has stated that is not rendering any services to any outsider nor is a registered dealer. The Applicant has entered into a Profit Sharing Agreement (hereinafter referred to as PSA) on 25th day of May 2017 in which the applicant will get a profit for a strategic sale of equity shares over and above a specified sale price per equity share by a set of shareholders of SHA . The value of shares has increased since and a strategic sale is imminent. The applicant states that the arrangement of profit sharing is by virtue of his employment in SHA as a CMD. The value of shares of any corporate entity will be subject to an increase/decrease in its value based on a lot of parameters not limited to the perception of the market, supply and demand of the share , performance of the company etc. Hence, the applicant states that GST is not applicable on this profit sharing arrangement which will only arise from and out of his role as an employee of the company.

3. The Authorized Representative of the Applicant was heard on 22.02.2019 in the matter. They stated that the Profit Sharing Agreement is only due to the contribution of the applicant as Managing Director and hence it is under employer/employee activities which are exempt under GST. They stated that they will submit original appointment/Contract of employment, Board resolutions, IRDA approval of appointment and also Profit Sharing Agreement along with relevant rules and Section 34A under IRDA and any amendments over a period of time. In this case, the strategic sale is yet to take place. This agreement will terminate if the employment is terminated. The contribution of the MD (also one of the Original Share Holder) is acknowledged in this agreement.

4.1 The Applicant in their written submissions dt 26.02.2019, has stated that, he is employed with SHA as Chairman and Managing Director by virtue of his contract as mentioned in the Articles of Association of the Company under clause 123 of the Company and also vide an appointment letter dated 3rd August 2006 along with the terms and conditions attached to the appointment which is for a period of 5 years from 17.06.2005. The IRDAI has approved his appointment as CMD. His contract of employment for appointing /re-appointing to serve as a CMD for SHA is duly made through and approved by the Board of Directors of SHA. All the appointment/re-appointments are presented by the Board to IRDAI for its approval and are approved by IRDAI as per Section 34A of the Insurance Act, 1938 all emoluments payable to a Chairman cum Managing Director is required to be submitted for IRDAI's notice/ approval. His current appointment is till 17.06.2020. In 2007, sweat equity shares were allotted to him with the approval of IRDA.

4.2 By virtue of his employment, he has entered into an agreement dated 25th day of May 2017 that if not less than 51% of the equity shares are transferred in a strategic sale or on listing of the Shares after an IPO at a price of not less than Rs. 75/- per share, then the economic benefit arising of such sale or an IPO (the difference between the sale price and the base price of Rs.47 per share) will be passed on to him by the shareholders to the extent of the number of shares mentioned in the agreement (that is 93,45,151 and 23,36,288 in toto 1,16,81,439 number of equity shares or in the case of an IPO, the consideration payable

to

CMD by each party shall be the percentage of the holding of the parties on the total shareholding of SHA. The PSA has also been duly approved by the Board of the Company on 25th May 2017. The approval of the Shareholders was sought vide Twelfth Annual General Meeting held on 26th day of July 2017. SHA vide their letter dated 21/09/2017 have intimated him regarding the approvals of the Board, shareholders in the twelfth Annual General Meeting and IRDAI's acknowledgement vide their mail dated 28/08/2017. IRDAI in the said letter has mentioned that he will be entitled for additional payment in accordance with the terms of the PSA.

#### 4.3 The applicant has represented the following:

> Approval of IRDAI as required in Para 2 of the agreement, denotes the fact that the remuneration by way of profit sharing through the PSA is notified as per the provisions of section 34A of Insurance Act, 1938 as that available to the applicant as the CMD of the Insurer viz., SHA

> The agreement is not only among the shareholders and the applicant but is also with other employees of SHA, who the applicant nominates are eligible for the profit share, along with the applicant for additional Entitlement. This concludes that it is only by virtue of the employee contract with the employer and in their performance as an employee, they are being remunerated in this profit sharing.

> As per Para 4.2.1, on termination of employment with cause, the applicant will be forfeited of this right to receive remuneration under this agreement, on the date of termination. By virtue of the clause, it may be noted that the PSA is only based on the employment contract of the applicant with SHA

> The agreement is binding on all the other shareholders listed in Schedule I of the agreement including the applicant himself.

> This share in the profits can be perceived as remuneration for the efforts by the applicant and there can be no GST on efforts for performance rendered to the Company as an employee. Being remunerated for achieving good results through aggressive efforts by virtue of employment for the company will not tantamount to supply of goods or service under Schedule III of CGST Act.

> This profit sharing is in no way payable on a specific or a special piece of work other than his role as a CMD employed under the terms and conditions of the employment contract. The Strategic sale or an IPO is only an occurrence by itself in the normal course of functions/business of and by the Company itself and he is in no way assigned the specific task of going for a Strategic Sale or an IPO.

> Under the Circumstances, where employee in terms of Contractual agreement of employment, after obtaining the approval for being remunerated through the PSA from the Board of Directors, Annual General Meeting and IRDAI, the said Profit Sharing Agreement dated 25th May 2017 falls under Schedule III of CGST Act, wherein services by employee to employer in the course of or in relation to his employment is considered as neither a supply of goods nor a supply of services.

In light of the above, the applicant has requested a ruling about the confirmation of non-applicability of GST to the Profit Sharing Agreement.

5. The submissions of the applicant were examined. The applicant is employed in Star Health and Allied Insurance Company Limited (SHA), a general insurance company with focus on health insurance, as Chairman and Managing Director.

It is seen from the Memorandum of Association dt 03.06.2005 of the company that it is a company limited by shares and that the applicant is one of the 7 subscribers of such shares with 0.4% share. The applicant was appointed as the first Managing Director of the company appointed on 03.08.2006. Subsequently, the applicant was also allotted sweat equity shares in 2007 with the approval of IRDA. His appointment as Chairman cum Managing Director was also extended, with the current term upto two years from 17.06.2018. The applicant has entered into a 'Profit Sharing Agreement' dated 25th day of May 2017. It is seen that, -^

• The agreement is between Star Health Investments Private Limited (SHIPL) and Shri Essa Abdulla Al Ghurair, Shri Syed M Salahuddin (all together called as 'promoters'), IDBI Trusteeship Services Limited ('Investor'), Tata Capital Growth Fund, Alpha TC Holdings, Alpha FDI Holdings, APIS Growth, India Advantage Fund S4 I (all called 'New Investor'); Snowdrop Capital and the applicant.

- Schedule 2 to the agreement gives the shareholding of SHA on date of the agreement where the parties to the agreement have the shareholding of SHA as between Star Health Investments Private Limited (SHIPL) (37.51841%) and Shri Essa Abdulla A1 Ghurair (3.17778%), Shri Syed M Salahuddin (2.97907%) (all together called as 'promoters'); IDBI Trusteeship Services limited (15.04559%) ('investor') Tata Capital Growth Fund (52.78%) Alpha TC Holdings (9.22568%) , Alpha FDI Holdings (1.33032%), APIS Growth (9.94275%), India Advantage Fund (4.67026%) ( all called 'New Investor') and the applicant (2.77241%).
- Schedule 3 to agreement shows that the other party to the agreement , Snowdrop Capital is 43.708551% shareholder of SHIPL.
- Para 3.1 states that The agreement is to acknowledge the contribution made by the applicant to the growth of the company over several years
- Apart from Snowdrop Capital, each of the parties to the agreement is liable to pay a portion of the Entitlement Amount and Additional Entitlement amount to the applicant in the ratio of their shareholding in SHA.
- The amounts have to be given in the event of either a Strategic Sale where at least 51% of paid -up Equity Share capital of the Company is sold at a price not less than Rs 75 per equity share or in the event of an initial public offering where the mid-point of the price band as per the red- herring prospectus is not less than Rs 75 per equity share and subsequent listing on Stock Exchange.
- The Entitlement Amount and Additional Entitlement amount is dependent on the difference of the sale price to the base price of Rs 47 per equity share .
- The Additional Entitlement amount will be shared with such employees that the applicant may nominate
- On expiry of the applicant while in employment or termination without cause , the certain amount as determined in the agreement will go to his beneficiary, if the Fair Market Value on the relevant date is more than Rs 75 per equity share.
- In the event of termination with cause ( fraud, crime wilful failure etc. ) , the applicant will forfeit his rights and the other parties may nominate other employees to receive such benefits.
- In the event any of the party transfers any equity shares held by it the prospective buyer should also adhere to this agreement.~

The applicant has preferred this application seeking ruling on the applicability of GST on the Profit Sharing arrangement.

6.1 The applicant has contended that that this Profit Sharing Agreement is a remuneration to the applicant who is Chairman cum Managing Director, for the efforts by the applicant and that there can be no GST on efforts for performance will not be covered under SI no 1 of Schedule III of CGST Act

Schedule III to CGST Act states:-

Activities or transactions which shall be treated neither as a supply of goods Nor a supply of services

1. Services by an employee to the employer in the course of or in relation to his employment.

In the instant case the Profit Sharing Agreement is between various parties who are all current investors / shareholders of SHA and the applicant. However, the shareholders are not the company and they cannot and do not act on behalf of the company. Further, in the email communication to IRDAI by Shri Kannan Unni CM -Executive Director (Accounts) dt24.08.2017, it was stated that the shareholders have entered into a Profit Sharing Agreement with the CMD and that no amount will be paid by the company to CMD as per the Profit Sharing Agreement. Hence, it is clear that the Profit Sharing Agreement is between the shareholders and the applicant but not between the company and the applicant. Hence, this transaction will not be covered under SI no 1 of Schedule III as that SI No pertains to services by an employee to employer and not to the shareholders of the employer as is the case here.

6.2 In the instant case, the various parties to the Profit Sharing Agreement who are investors/shareholders of SHA have agreed to pay certain sum in the event of either a Strategic Sale where at least 51% of paid - up Equity Share capital of the Company is sold at a price not less than Rs 75 per equity share or in the

event of an initial public offering where the mid-point of the price band as per the red-herring prospectus is not less than Rs 75 per equity share and subsequent listing on Stock Exchange. The Entitlement Amount and Additional Entitlement amounts are dependent on the difference of the sale price at the time of the event to the base price of Rs 47 per equity share. There is an obligation on part of the other shareholders mentioned in the Profit Sharing Agreement to pay such amounts as per the profit share agreement signed by them with the applicant. The applicant has a claim to the specified amounts in the event of occurrence of the specified strategic sale or IPO. His claim is contingent on such events occurring. The applicant has a beneficial interest in the profits arising out of such a strategic sale or IPO. It can be said that the Profit Sharing Agreement is an 'actionable claim'.

6.3 Section 2 (1) of CGST Act states-

2. In this Act, unless the context otherwise requires,-

(1) "actionable claim" shall have the same meaning as assigned to it in section 3 of the Transfer of Property Act, 1882;

Section 3 of Transfer of Property Act, 1882 states:

"actionable claim" means a claim to any debt, other than a debt secured by mortgage of immoveable property or by hypothecation or pledge of moveable property, or to any beneficial interest in moveable property not in the possession, either actual or constructive, of the claimant, which the Civil Courts recognize as affording grounds for relief, whether such debt or beneficial interest be existent, accruing, conditional or contingent

In this case, the Profit Sharing Agreement gives the applicant a claim to the beneficial interest in the profits on the event of a strategic sale where at least 51% of paid -up Equity Share capital of the Company is sold at a price not less than Rs 75 or an initial public offering where the mid-point of the price band as per the red- herring prospectus is not less than Rs 75 per equity share and subsequent listing on Stock Exchange. Either of these events may not occur or both may not . In that case the claim is only contingent. However, actionable claims as defined in Transfer of Property Act can be contingent. The moveable property which is the amount of profit on such contingent event occurring are currently not in possession of the claimant i.e. applicant. Further, as per Clause 11 of the Profit Sharing Agreement , the agreement is governed by and interpreted in accordance with the laws of India and the courts of Mumbai, India shall have exclusive jurisdiction in respect of all matters arising from the agreement and the enforcement of any award of Arbitration may be sought in any court. Therefore, it is clear that Civil Courts recognise and can provide grounds for relief if and when the applicant makes a claim to such beneficial interest in future profits . Therefore, it is clear that this transaction between the applicant and the shareholders is an 'actionable claim' under Section 2(l) of CGST read with Section 3 of the Transfer of Property Act, 1882.

6.4 Schedule III to CGST Act states:-

Activities or transactions which shall be treated neither as a supply of goods Nor a supply of services

6. Actionable claims, other than lottery, betting and gambling.

Therefore, actionable claims other than lottery, betting, gambling are activities or transactions which shall be treated neither as a supply of goods nor a supply of services and hence do not attract GST as per CGST or SGST ACT. The Profit Sharing Agreement between the applicant and various shareholders of SHA is an actionable claim and is not relating to lottery, betting and gambling and hence, is covered under Schedule III to CGST Act and SGST Act as neither a supply of goods nor a supply of services and hence is not taxable to CGST or SGST.

7. In view of the above, we rule as under:

## **RULING**

The Profit Sharing Agreement between the applicant and various shareholders of SHA is an actionable claim and is as neither a supply of goods nor a supply of services covered under Schedule III to CGST Act and SGST Act and hence is not taxable to CGST or SGST.

DATE- 21/05/2019

Ms. Manasa Gangotri Kata, IRS

Member, CGST

Shri. Kurinji Selvaan V.S., M.Sc., (Agri.),  
M.B.A.,

Member , TNGST