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Tax alert: Salary received in India for services rendered in USA, not taxable

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The Hyderabad Bench of the Income-tax Appellate Tribunal (ITAT) has rendered its decision that while salary paid by an Indian company to its employee (who was non-resident of India) for services rendered in USA, but received in India, was taxable in India under the Income-tax Act, 1961, as per the provisions of Article 16 of the India-USA tax treaty, such salary is not taxable in India.

In a nutshell

Salary received in India by the employees of the Indian entity, seconded to the foreign entity, would be taxable in India under the provisions of section 5(2)(a) of the ITA.

As per earlier Supreme Court (SC) rulings, the provisions of a tax treaty under section 90 of the ITA would override the provisions of the ITA to the extent of inconsistency between the two, relating to chargeability to income-tax and ascertainment of total income.

Salary income received in India would be taxable under section 5(2)(a) of the ITA. However, because of the overriding effect of section 90 of the ITA, Article 16 of the India-USA tax treaty would prevail over the 5(2)(a) of the ITA and consequently, the salary received by the taxpayer in India for the services rendered in USA, would not be taxable in India.

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Background:

- The taxpayer[1], an individual and an employee of an Indian company (I Co), was sent on short-term assignment to its USA based group company (US Co) from 20 October 2017 and such short-term assignment continued till 18 October 2018 (~ 1 year) and thereafter, the taxpayer was directly employed by the US Co.
- During the Financial year (FY) 2018-19, corresponding to Assessment Year (AY) 2019-20, the taxpayer was absorbed into the US Co with effect from 18 October 2018 and was working in USA, physically present there and qualified to be a non-resident of India.
- During his short-term assignment to the US Co, the taxpayer was on the payrolls of I Co and his salary for the services rendered was credited to his Indian bank account by I Co after deducting tax at source.
- The taxpayer filed his return of income for AY 2019-20 on the following basis:
  - The taxpayer received gross salary from I Co in respect of which the tax at source (TDS) was deducted under section 192(1) of the Income-tax Act, 1961 (ITA) [relating to TDS on salaries].
  - On 18 October 2018 the employment of the taxpayer was terminated by I Co and the terminal benefits were paid to him.
  - He was a tax resident of USA and, therefore, eligible to avail the provisions of the India-USA tax treaty to the extent beneficial as provided under section 90 of the ITA [relating to availment of provisions of ITA or tax treaty whichever are more beneficial to taxpayer].
  - Accordingly, under Article 16(1) of India-USA tax treaty [relating to taxation of dependent personnel services] the income earned from services rendered in USA was only taxable in USA and not in India; and the tax deducted by I Co was refundable.
- During the course of audit proceedings, the Assessing Officer (AO), amongst others, disallowed the exemption claimed by the taxpayer under Article 16(1) of the India-USA tax treaty and made addition of the salary paid by I Co by holding that:
  - As the taxpayer was under the payrolls of I Co till his services were terminated (and he was appointed by the US Co), his employment was exercised only in India, was not entitled to claim the benefit of Article 16(1) of the India-USA tax treaty.
- The taxpayer file an its objections before the Dispute Resolution Panel (DRP) which did not allow the taxpayer's claim. Aggrieved, the taxpayer filed an appeal before the Hyderabad bench of the Income-tax Appellate Tribunal (ITAT) against the final order passed by the AO (based on DRP's directions).

Relevant provisions in brief:

- Section 5(2) of the ITA (relating to scope of total income)

  "…Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

  (a) is received or is deemed to be received in India in such year by or on behalf of such person ; or

  (b) accrues or arises or is deemed to accrue or arise to him in India during such year…"

- Article 16(1) of the India-USA tax treaty (relating to dependent personal services)

  "Subject to the provisions of Articles 17 (Directors' Fees), 18 (Income Earned by Entertainers and Athletes), 19 (Remuneration and Pensions in respect of Government Service), 20 (Private Pensions, Annuities, Alimony and

[1] Prasanth Nandanuru vs. ITO (International taxation)-2 [2023] 150 taxmann.com 183 (Hyderabad-Trib.)

Child Support), 21 (Payments received by Students and Apprentices) and 22 (Payments received by Professors, Teachers and Research Scholars), salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State."

Decision of the ITAT:

The ITAT noted that the only dispute was in respect of the salary paid by I Co and remitted to the Indian bank account of the taxpayer after deducting the TDS. In this regard, the ITAT noted / observed as follows:

- In an earlier ruling[2] of the Authority of Advance Ruling (AAR), the taxpayer (viz. the Indian entity) had sent two of its employees to its group company in UK on deputation. During the period of deputation, such employees continued to be on the payrolls of the Indian entity, and regularly received salary in India. The taxpayer (viz. the Indian entity) sought an advance ruling on the question as to whether the salary received in Indian was taxable or not.

  The facts of the case under consideration were similar to the facts of AAR's ruling and the ratio of that decision was applicable in the case under consideration.

Taxability under the ITA

- The AAR held that salary received in India by the employees of the Indian entity seconded to the foreign entity would be taxable in India under the provisions of section 5(2)(a) of the ITA. Hence, based on this ruling, in the current case also, the salary of the taxpayer would be covered by section 5(2)(a) of the ITA and hence taxable in India.

Taxability under India-USA tax treaty

- Under Article 4(1) of the India-USA tax treaty, the term 'resident of contracting state' includes a resident, and Article 16(1) of the India-USA tax treaty mandates that in respect of the salaries derived by a resident of USA in respect of an employment shall be payable only in USA. The taxpayer, therefore, because of residence in USA, was liable to income-tax in USA in respect of the salary derived by him because of his employment in USA.
- The liability of the taxpayer to pay taxes in USA was not in dispute. The AAR in the earlier discussed ruling had observed as follows:
  - Section 90 of the ITA empowers the central government to enter into agreements with foreign governments for granting tax relief and avoidance of double taxation. Section 90(2) of the ITA states that in relation to a person covered by such an agreement, the provisions of the ITA shall apply to the extent they are more beneficial to that person. In earlier rulings[3], the Supreme Court (SC) had held that the provisions of an agreement notified under section 90 of the ITA would override the provisions of the ITA to the extent of inconsistency between the two.
  - Since sections 4 and 5 of the ITA are subject to other provisions of the ITA, including section 90, the provisions of such an agreement would prevail over the provisions relating to chargeability to income-tax and ascertainment of total income.
  - Hence, it was open to the taxpayer to take recourse to Article 16 of the India-UK tax treaty, which would prevail over the provision of section 5(2)(a) of the ITA.
  - The salary paid to the taxpayer was not taxable in India, if the same had been offered for tax in the UK in pursuance of the India-UK tax treaty.

[2] British Gas India (P.) Ltd., In re [2006] 157 Taxman 225/287 ITR 462 (AAR)

[3] Union of India v. Azadi Bachao Andolan [2003] 263 ITR 706 (SC) and CIT v. P.V.A.L. Kulandagan Chettiar [2004] 267 ITR 654 (SC)

In view of the above, though the provision under section 5(2)(a) of the ITA fastened tax liability on the taxpayer, but, because of the overriding effect of section 90 of the ITA, Article 16 of the India-USA tax treaty would prevail over the 5(2)(a) of the ITA and consequently, the salary received by the taxpayer in India for the services rendered in USA was not taxable in India.

Comments:

Indian companies having worldwide offices / clients may send their employees overseas / outside India for various assignments. In such situations, while the services may be rendered outside India, the salary of the Indian employee may be paid in such employees' Indian bank accounts. Hence, where such employees qualify as non-resident under the provisions of the ITA, an issue may arise whether such salary payment would be taxable in India under the provisions of the ITA or of the relevant tax treaty between India and the country where the employee is deputed and qualifies to be a resident of such country.

The ITAT in this ruling, by relying on an earlier ruling has reiterated the following principles:

- When salary is received in India by the employees of the Indian entity seconded to the foreign entity, it would be taxable in India under the provisions of section 5(2)(a) of the ITA.
- As per earlier Supreme Court (SC) rulings, the provisions of a tax treaty under section 90 of the ITA would override the provisions of the ITA to the extent of inconsistency between the two, relating to chargeability to income-tax and ascertainment of total income.
- Salary income received in India would be taxable under section 5(2)(a) of the ITA. However, because of the overriding effect of section 90 of the ITA, Article 16 of the India-USA tax treaty would prevail over the 5(2)(a) of the ITA and consequently, the salary received by the taxpayer in India for the services rendered in USA would not be taxable in India.

Taxpayers with similar facts may evaluate the impact of this ruling along with the aforesaid SC ruling, to the specific facts of their cases.

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