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Reimbursement of hotel and travelling expenses to non-resident not subject to withholding tax

The Karnataka High Court gave its decision that reimbursement to non-resident for hotel and travelling expenses incurred by seconded employees are not fees for technical services and accordingly, not liable for withholding tax.

Background:

- The taxpayer[1] is an Indian Company and has a UK group company (UK Co).
- The UK Co entered into an agreement with an Indian Company (I Co) to outsource the provisioning of certain services and call centers. Under the agreement, I Co was required to provide high quality service that supported the position of UK Co and its affiliates as well as to customers in UK.
- In order to ensure that the I Co renders high quality services and in order to facilitate the outsourcing agreement between UK Co and the I Co, UK Co entered into the following agreements with the taxpayer:
  - Consultancy agreement for services to be provided by the taxpayer; and
  - An agreement for secondment of staff (secondment of UK Co's employee to the taxpayer).
- During the Financial Year (FY) 2004-05, corresponding to Assessment Year (AY) 2005-06, for deputation of employees, the taxpayer made certain payments to the UK Co, part of which was salary reimbursement on which tax was deducted. The remaining expenses incurred by the taxpayer were for hotel and travelling expenses and hence, the taxpayer did not withhold tax from the same on the basis that it could not be treated as expenses for providing technical services.
- The Assessing Officer (AO) during audit proceedings held that the remaining amount (on which tax was not deducted) was towards payment of 'fees for technical services' under the Income-tax Act, 1961 (ITA) as well as under the India-UK tax treaty, on the following basis:
  - The employees of UK Co who were seconded to India were highly skilled technical personnel and the UK Co had agreed to provide training to some of the employees of I Co.
  - The claim of the taxpayer that there was no nexus between the UK Co and the provision of services by the expatriates, was incorrect as the employees were on the payroll of UK Co and UK Co was involved in providing technical services.
- In appeal proceedings, the matter reached the Karnataka High Court (HC).

[1]DIT v. Abbey Business Services India Pvt ltd (ITA no. 214 of 2014) (Karnataka HC)

Decision of the HC:

- The HC noted the following facts:
  - The taxpayer had entered into a secondment agreement for securing services to assist taxpayer in its business. This secondment agreement constituted an independent contract of services in respect of employment with the taxpayer.
  - The seconded employees had to work at such place as instructed by the taxpayer and had to function under the control, direction and supervision of the taxpayer and in accordance with polices, rules and guidelines applicable to the employees of the taxpayer.
  - The employees in their capacity as employees of the taxpayer had to control and supervise the activities of the I Co.
- Taking note of above, the HC held that:
  - The taxpayer for all practical purposes had to be treated as an employer of the seconded employees.
  - There was no obligation in law for deduction of tax at source on payments made for reimbursement of costs incurred by a non-resident enterprise.
  - The expenses incurred by the seconded employees which were reimbursed by the taxpayer were not liable for withholding tax under section 195 of the ITA as they were outside the purview of fees for technical services. Similar view had been taken by the Delhi High Court in an earlier case[2] in respect of salaries paid to foreign technicians on behalf of the taxpayer.
  - The HC dismissed the revenue authority's reliance on an earlier case[3] on the grounds that the issue involved in that case was whether the secondment of employees by the overseas entities fell within Article 12 of India-Canada tax treaty and Article 13 of the India-UK tax treaty, which embodied the concept of service permanent establishment. In the case under consideration, the issue of permanent establishment was not involved and hence, the said case (relied upon by the revenue authority) was not applicable to the facts of the current case.

  In view of the above, the HC held that the payment by the taxpayer for reimbursement of hotel and travelling expenses to the UK Co, were not in the nature of fees for technical services under the ITA as well as the India-UK tax treaty and hence, the taxpayer was not required to withhold tax from the payments made to UK Co.

Comment:

Withholding tax on payments made for reimbursements of expenses made by non-resident has been a subject of litigation. This ruling affirms the principle that reimbursement to non-resident for hotel and travelling expenses incurred by seconded employees are not fees for technical services and accordingly,

[2] DIT v. HCL Infosystem Ltd. [2005] 274 ITR 261 (Delhi HC)

[3] Centrica India Offshore Private Limited (2014) 44 taxmann.com 300 (Delhi HC)

not liable for withholding tax. Taxpayers with similar facts, could evaluate the impact of this ruling to the facts of their specific cases.

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