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Salary of non-resident employees recharged to project office for work performed outside India not taxable

The Delhi Bench of the Income-tax Appellate Tribunal rendered its decision that non-resident employees' salary (for work performed outside India) recharged by head office to its Indian project office is not chargeable to tax in India and hence, its payment is not subject to withholding tax in India.

Background:

- The taxpayer¹ a company registered in Netherlands established a Project office (PO) in India after it was awarded a contract with Punjab Road and Bridges Development Board in the Financial Year (FY) 2009-10, corresponding to Assessment Year (AY) 2010-11.
- The taxpayer filed its income-tax return of income for the said FY 2009-10, corresponding to AY 2010-11 declaring loss and claiming refund from its PO operations in India.
- During the course of audit proceedings, the Assessing Officer (AO) observed that the taxpayer claimed certain salary expenses without deducting tax at source. On being questioned, the taxpayer submitted that the salary of the employees which was attributable and was charged to PO's profit and loss account, was not chargeable to tax on account of the following:
 - The employees did not come / stay in India to provide the services for more than 183 days as defined in the India-Netherlands tax treaty (tax treaty).
 - No separate salary was paid to the employees in relation to these services, neither in India nor in Netherlands.
 - The payment was not received by them in India nor from any source in India. It was paid by the Head Office (HO) of the taxpayer situated in Netherlands to the consultants in Netherlands.
 - The deduction of salary was taken only on the base of time cost attributable to the PO and following Article 7 of the India-Netherlands tax treaty. Thus, in absence of accrue or arise in India, the tax had not been deducted from their salary.
- The AO did not accept the taxpayer's contention that the income did not accrue or arise in India on the ground that as per the contract, employees of the taxpayer had provided their services from India itself. Therefore, the salary paid to them was taxable in India as it accrued or arose in India. Accordingly, the AO disallowed the said payments for failure to withhold tax at source under section 40(a)(i) of the Income-tax Act, 1961 (ITA).

¹ Ecorys Nederland's B.V. v. ADIT (ITA no 6494/Del/2016) (Delhi ITAT)

- On appeal, the Commissioner of Income-tax (Appeals) [CIT(A)] upheld the AO's order.
- Aggrieved by the CIT(A)'s order, the taxpayer filed an appeal before the Delhi Bench of the Income-tax Appellate Tribunal (ITAT).

Relevant Provisions in Brief:

- Section 40(a)(i) of the Income-tax Act, 1961 (ITA) provides for disallowance of payments made to non-resident (chargeable under the provisions of ITA) without deduction of applicable withholding tax.
- Section 40(a)(iii) provides for disallowance of deduction claimed on account of salary (chargeable to tax in India) which is payable outside India or to a non-resident without deduction of applicable withholding tax.
- As per article 15 of the India-Netherlands tax treaty, remuneration received by a resident of one of the states (i.e. Netherlands in the current case) in respect of an employment exercised in the other State (i.e. India in the current case) shall be taxable only in the first mentioned state (i.e. Netherlands in the current case) if:
 - the recipient is present in the other State (i.e. India in the current case) for a period not exceeding 183 days in the fiscal year concerned; and
 - the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State (i.e. India in the current case); and
 - the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State (i.e. India in the current case)."

Decision of the ITAT:

- The ITAT noted the following:
 - The taxpayer had submitted that the salary was paid abroad by the foreign company to its employees and the HO had apportioned a part of the salary expenses to the taxpayer which the taxpayer had debited and reimbursed the HO without any mark-up. Therefore, the provision of section 40(a)(i) of the ITA were not applicable and if at all any provision was applicable the provision was section 40(a)(iii) of the ITA.
 - The Delhi High Court in an earlier case² on similar facts had held that:
 - As per Article 15 of the India-Netherlands tax treaty (relating to dependent personnel services) if the employees outside India, who were non-residents, had received salary even from an Indian company, then said salary was not chargeable to tax in India.
 - As per section 40(a)(iii) of the ITA, certain amounts were not allowed as deduction in computing the income chargeable under the head profits and gains of business or profession. It included those payments which were chargeable under the head salaries if the

² Mother Dairy Fruit Vegetables (P.) Ltd v. CIT (ITA no 980/2009) (Delhi HC).

same was payable outside India and if the tax was payable thereon. The provision was applicable only when the salary paid was chargeable to tax in India and the question of deduction of tax at source arose.

- The non-residents who never worked in India, never received salary from permanent establishment; and were paid their remuneration in foreign exchange in a foreign country, were not required to pay any tax in India.

The ITAT following the decision of the Delhi HC² held that the taxpayer was not liable to deduct tax at source from the salary paid to the non-resident and had not committed any default in not deducting tax at source from the reimbursement to the HO on account of salary expenses.

Comment:

This ruling reaffirms the principle that disallowance for salary payments under section 40(a)(iii) of the ITA can be made only if the same is chargeable to tax. Further, non-resident employees who never work in India, never receive salary from permanent establishment in India; and are paid remuneration in foreign exchange in a foreign country, are not required to pay any tax in India.



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