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Secondment arrangement constitutes a permanent establishment

The Delhi Bench of the Indian Income-tax Appellate Tribunal rendered its decision that secondment arrangement constitutes a permanent establishment in India

Facts of the case:

- Teradata Operations Inc. (the taxpayer)[1] is a tax resident of the United States of America (USA) engaged in the business of providing data warehousing services in the form of their proprietary package called 'Teradata solution'.
- During Financial Year (FY) 2013-14, corresponding to Assessment Year (AY) 2014-15, the taxpayer rendered certain professional services and received royalty in respect of software licensed to its Indian group company, Teradata India Private Limited (TIPL). The taxpayer also received reimbursement in respect of employees seconded to TIPL, which included:
  - Cost of seconded employees; and
  - Relocation expenses i.e. visa expenses and other travel costs.
- The taxpayer was of the belief that the reimbursements received from TIPL (in respect of employees seconded to TIPL) were not taxable. During the audit proceedings before the Assessing Officer (AO), the taxpayer contended the following:
  - The employees were seconded to TIPL under a secondment agreement as per which they worked as employees of TIPL;
  - The seconded employees worked under the control and supervision of TIPL;
  - The salary was disbursed by the taxpayer in the USA only for administrative purposes and was reimbursed by TIPL on actual cost basis.
- The AO noted that there was a secondment agreement between the taxpayer and TIPL; and between the taxpayer and the seconded employees. However, there was no employment agreement between TIPL and the seconded employees. Further, the secondees continued to be employees of the taxpayer on the following basis:
  - The employees continued to make social security contribution in the USA;
  - The salary was disbursed in the USA bank account of the employees;
  - The employees continued under the taxpayer's employment and / or had lien on employment with the taxpayer;
  - In the absence of employer-employee relationship with TIPL, the employees could not be under the control and supervision of TIPL.
- Based on the above and based on the case of the jurisdictional High Court of Centrica[2], the AO in his draft order held that the taxpayer had a fixed place permanent establishment (PE) as well as a service PE in India. Accordingly, the reimbursement was business income of the taxpayer received on account of services rendered through the employees, liable to tax in India under Article 7 of the India-USA tax treaty, read with Section 9(1) of the Income-tax Act, 1961.

[1] 116 taxmann.com 404 (Delhi-Trib)

[2] Centrica India Offshore Private Limited (2014) 44 taxmann.com 300.

  - Fixed place PE: The premises of TIPL, where the seconded employees were stationed, were at the disposal of the taxpayer. Thus, the taxpayer had a fixed place PE in India in the form of the premises of TIPL;
  - Service PE: The seconded employees rendered services on behalf of the taxpayer in India and thus, the taxpayer had a service PE in India in view of the decision of the Supreme Court in the case of Morgan Stanley[3].
- On appeal, the Dispute Resolution Panel (DRP) upheld the AO's draft order and based on DRP's directions, the AO finalised the draft order.
- Aggrieved by the AO's final order, the taxpayer filed an appeal with the Delhi Bench of the Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT:

- The ITAT noted the following findings of the jurisdictional High Court in the case of Centrica[2], wherein existence of service PE on secondment of employees was upheld:
  - To determine existence of a service PE, substance of the employment relationship should be looked at and not the form;
  - The employment relationship between the secondee and the overseas entity was at no point terminated and the Indian entity did not have the right to modify the same. The employment with the overseas entity was permanent as compared to that of the Indian entity;
  - The fact that the payment from Indian entity was termed as 'reimbursement' or was not subject to mark-up, was not determinative of the nature of payment. Once it was established that there was provision of service, the payment would be for service.
- The ITAT in the current case noted that:
  - The taxpayer had seconded its employees to manage the affairs of TIPL and to provide technical knowledge;
  - The employees for all practical purposes remained employees of the taxpayer, even though they were stationed at TIPL's premises;
  - The employees continued to make social security contributions in the USA and their salaries were distributed to their USA bank accounts;
  - There was no agreement between TIPL and the employees.
- In view of the above, the ITAT upheld that the taxpayer had a PE in India as per the provisions of the India-USA tax treaty.
- With respect to the attribution of profits, the ITAT referred the matter back to the AO for verification of facts.
  - The ITAT rejected the taxpayer's contention that out of the reimbursement received, the cost base should be first deducted and then subsequently a mark-up should be charged on the remaining amount (which was nil in the case under consideration). The ITAT held that the taxpayer had rendered services through the PE and the income which accrued to the PE was the market value of the services (provided by the seconded employees), reduced by the cost of the services.

[3] Morgan Stanley & Co. [2007] 292 ITR 416.

Comments:

- Taxation aspects relating to secondment / deputation arrangements (such as existence of a PE and taxability of reimbursement of salary costs) have been litigative.
- This ruling has held that secondment arrangements resulted into a PE of the taxpayer in India and that reimbursement nomenclature was not determinative with respect to nature of payment. Taxpayers may want to evaluate impact of the said ruling on their arrangements.

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