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Sharp Insights

The Ahmedabad bench of the Tribunal in the case of Burt Hill Design (P.) Ltd.[1] , has held that the cost reimbursement payment made by the taxpayer to its overseas holding company under an employee secondment agreement, is not chargeable to tax in India

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[1] Burt Hill Design (P.) Ltd. v. DDIT [2017] 79 taxmann.com 459 (Ahmedabad bench, Tribunal)

Background

- Burt Hill Design (P.) Ltd. ('the taxpayer') is an Indian company, engaged in the business of providing information technology services ('ITES').
- Pursuant to the Secondment Agreement entered into between the taxpayer and its overseas holding company (Burt Hill Inc. USA), certain employees were placed by the overseas holding company to function and act under the control, direction and supervision of the taxpayer.
- The salaries of the seconded employees were paid directly by the overseas holding company. The salary cost was claimed as a reimbursement from the Indian taxpayer.
- The taxpayer withheld tax under Section 192 of the Income Tax Act, 1961 ('the Act') from the salaries paid to the seconded employees. For one year, instead of deducting tax at source under Section 192, the taxpayer paid the advance tax on behalf of the seconded employees.
- The Assessing officer ('AO'), after examining the secondment agreement concluded that the work done by these employees has resulted in creation of a Service Permanent Establishment (Service PE) in India and is taxable on gross basis @ 40%.
- Without prejudice to the above, the AO alleged that the said payment is taxable as Fee for Included Services ('FIS')/ Fee for Technical Services ('FTS') under both [2]India-US tax treaty as well as [3]Act.
- The first appellate authority [Commissioner of Income Tax (Appeals) [CIT(A)] upheld the order of the AO for the AY 2009-10, treating the amount paid as fee for technical services. For the balance years, as the taxpayer had deducted tax at source on salaries, CIT(A) held that the taxpayer did not have any obligation to withhold tax under section 195 of the Act.

[2]Article 12(4) of Double Taxation Avoidance Agreement entered into between the Government of the Republic of India and the Government of the United States of America

[3]Section 9(1)(vii) of the Income Tax Act, 1961

Taxpayer's key contentions

- The taxpayer contended that payment made to the overseas entity is merely reimbursement of salaries paid to the seconded employees and that it did not involve any profit element taxable in the hands of the overseas entity.
- Taxpayer said there is also no loss of revenue as taxes due from salaries paid via tax deducted at source ('TDS')/ advance tax to the seconded employees were duly paid and all assessments were completed.

Revenue's key contention

- The department said that the seconded employees deputed to the office of the taxpayer in India were highly qualified technicians and were providing their services to the Indian company on its express request.
- The seconded employees continued to be on the payroll of the overseas holding company and thus the payment made by the taxpayer was for the services provided by the seconded employees on behalf of the overseas company.

- Work done by these seconded employees has resulted in creation of Service PE in India.
- Separately the above payments were also in the nature of managerial, technical and consultancy services and are taxable in India as 4FTS/FIS.

[4] Under Section 9(1)(vii) of the Income Tax Act, 1961 and Article 12(4) of India-US tax treaty

Ruling of the Tribunal

- For a payment taxable under the head 'Salaries', there is no withholding tax obligation under Section 195.
- The fact that whether the seconded employees continue to be on the payroll of the overseas entity is completely irrelevant for this purpose.
- A pure reimbursement of this kind does not constitute a taxable income. The profits attributable in the hands of the Service PE of the overseas entity, if any, is nil. [5]The obligation to withhold tax under Section 195 arises only when there is a sum chargeable to tax under the Act.
- The Tribunal also held that the said payment does not qualify to be FTS/FIS under the Act or the corresponding provision of the treaty.
- The Tribunal decided the matter in favour of the taxpayer and it was held that the subject payment is not liable for tax deduction under Section 195 and hence demand raised under section 201 is not legally sustainable.

[5] Supreme Court decision in the case of 'G E Technology Centre Pvt Ltd v. CIT' [2010] 327 ITR 456(SC) was relied upon by the Tribunal

Conclusion

Taxation of secondment arrangements have been a subject matter of continuing litigation by the Indian revenue authorities. The above ruling of the Tribunal is welcomed by the industry. The Tribunal has not specifically considered the ratio of the decision in the [6]'Centrica' case which is in the favour of the revenue. Accordingly, this matter may be further litigated at higher fora by the revenue.

[6]Centrica India Offshore (P.) Ltd. v. CIT [2014] 44 taxmann.com 300/224 Taxman 122 (Delhi H.C.) SLP against the decision of the H.C. was dismissed by the SC.

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