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ITAT rules reimbursed salary costs of seconded employee are not FTS

Decision adds to the number of conflicting decision on this subject

The Pune Income Tax Appellate Tribunal (ITAT) ruled on 8 July 2019 that payments received by a foreign company from an Indian associated entity as a partial reimbursement of salary costs for a seconded employee were not "fees for technical services" (FTS) and, hence, were not taxable in India in the hands of the foreign company.

Facts of the case

The taxpayer (a company tax resident in France) had entered into an agreement with an Indian associated entity to second one of its senior employees to the Indian entity. The employee was appointed by the Indian entity as its Chief Executive Officer (CEO), with managerial, administrative and supervisory responsibilities.

The seconded employee was appointed in accordance with the terms and conditions specified in the offer of appointment from the Indian entity, containing provisions for payments in respect of basic salary, housing assistance, conveyance allowance, child education allowance, special allowance, etc. The employee qualified for the benefits of the provident fund and superannuation schemes of the Indian entity and his leave entitlement was determined in accordance with the rules of the Indian entity.

Part of the employee's salary was paid in France by the taxpayer and subsequently reimbursed by the Indian entity without any mark-up. The Indian entity deducted tax at source from the total salary paid to the employee, including the amount reimbursed to the taxpayer. The taxpayer contended that the amount received from the Indian entity was a "reimbursement of expenses," not FTS, and hence was not chargeable to tax in India.

The Indian assessing officer (AO) determined that the taxpayer provided technical services to the Indian entity through its staff and issued an order including the reimbursed amount as taxable FTS in the hands of the taxpayer. The taxpayer filed objections against the order with the Dispute Resolution Panel (DRP).

The DRP held that the employee made available to the Indian entity his technical knowledge, experience and skill that was of an enduring nature. Accordingly, the amount should be regarded as FTS within section 9(1)(vii) of the Income-tax Act, 1961 (ITA) and royalty income under article 13 of the France-India tax treaty. The taxpayer appealed the DRP's decision to the Pune Bench of the Income Tax Appellate Tribunal (ITAT).

Decision of the ITAT

The ITAT observed that the employee was working as the CEO of Indian entity under the control, supervision or direction of that entity and that his remuneration was fixed by the Indian company. No evidence had been produced to demonstrate that the employee was working under the control, supervision or direction of the taxpayer.

In accordance with explanation 2 to section 9(1)(vii) of the ITA, the definition of FTS does not include income of the recipient chargeable under the head "salaries." The ITAT held that the word

"recipient" in explanation 2 meant the real recipient of the payment and not the literal recipient. The real recipient of the payment made by the Indian entity was the employee who was taxed on the total salary, including the amount paid by the taxpayer and, hence, the same amount cannot be taxed again via assessment on the taxpayer.

The ITAT distinguished the 2014 decision of the Delhi High Court in Centrica India Offshore Pvt. Ltd. by observing that in that case, money paid by the Indian entity accrued only to the overseas entity and may or may not have been paid to the secondees depending upon the terms of the contract. In the case at hand, the money never accrued to the taxpayer.

As a result, the ITAT held that the amount received by the taxpayer from the Indian entity was not chargeable to tax in the hands of the taxpayer. It was a reimbursement of costs and not within the scope of FTS as defined in section 9(1)(vii) of the ITA.

Comments

The taxability of foreign companies for amounts received as reimbursement of the salary costs of seconded employees has long been a matter of litigation in India. The Indian tax authorities have been taxing such reimbursements either by treating them as FTS or by taking the position that the secondment creates a service permanent establishment of the foreign company in India.

The ITAT's decision is welcomed, as it distinguishes the Delhi High Court decision in Centrica, which subsequently was upheld by the Supreme Court. However, the current case did not address the "lien over employment" issue discussed in Centrica, that was one of the key aspects discussed by the High Court in deciding the issue in favor of the tax authorities. In the Centrica case, the High Court observed that:

- The seconded employees retained their entitlement to participate in the overseas entity's retirement and social security plans and other benefits, and their salaries were payable by the overseas entity, which reclaimed the money from Indian entity;
- Whilst the agreement between the Indian company and the overseas entity granted the Indian company the right to terminate the secondment, the Indian company had no right to terminate the original underlying employment relationship between the secondee and the overseas entity;
- The payment was not in the nature of reimbursement, but rather, payment for services rendered. The employment relationship between the overseas entity and the Indian taxpayer from which the overseas entity's independent obligation to pay the secondees arose continued and the overseas entity was under no obligation to use the payments received from the Indian company to pay the secondees; and
- The money paid by the Indian company accrued to the overseas entity, which may or may not have used the money to fund the payments to the secondees, based on the overseas entity's contractual relationship with the secondees.

The Bombay High Court in the case of Marks & Spencer Reliance India Pvt. Ltd. (ITA No. 893 of 2014) had upheld the decision of the ITAT that merely supplying employees or assisting the Indian entity in the business did not constitute making available technical or consultancy services. Further, once the Indian entity has withheld tax on the salaries of seconded employees, that same salary income cannot be subject to withholding tax a second time when the income is remitted by the Indian entity to the foreign entity. However, neither the aspect of direction and control of the seconded employees nor the aspects covered by the Delhi High Court's judgement in Centrica was discussed in the Marks & Spencer case.

The Delhi ITAT, in its 2018 decision in the case of AT & T Communication Services (India) P. Ltd., distinguished the High Court decision in Centrica and held that such reimbursements were not FTS as the seconded employees were working under the control and supervision of the Indian entity and were not furthering the business of the overseas entity. More recently, the Chennai ITAT in a 29 March 2019 decision, found in the case of Nippon Paint (India) Pvt. Ltd. that such reimbursements were taxable because the seconded employees temporarily exchange experience and skill, and do not lose the employer-employee relationship of the parent organization even after the secondment has ended.

As can be seen, there is a plethora of conflicting decisions on this subject. The actions of the Bangalore ITAT in constituting a Special Bench to formulate a consistent position that tribunals should adopt on the taxability of reimbursements for the costs of seconded employees in the hands of the overseas entity are welcome and may provide some much-needed clarity on this issue.

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