



Supreme Court ruling on the applicability of the TDS provisions on the overseas salary paid to the expatriates

Background

A large number of Multinational Companies depute their employees to work in India. Many a times, these employees remain on the payroll of the Foreign Company. The employees work for the Indian subsidiary/ JV Company of the said Foreign Company in India.

Since the Foreign Company has no presence in India, the tax on the salary paid to the employees outside India is being paid through advance tax/ self-assessment tax route by the expatriate employees.

Recently, the Supreme Court in the case of M/s Eli Lilly & Co. (India) Pvt. Ltd¹. has held that the salary paid outside India to the expatriates seconded to work with the Indian Company is subject to deduction of tax at source in India.

Facts

- M/s Eli Lilly & Co. (I) Pvt. Ltd. (“Indian Company”), a company incorporated in India is engaged in the business of manufacturing and selling pharmaceutical products in India.
- M/s Eli Lilly Inc, Netherlands (“Foreign Company”) seconded few expatriates to the Indian Company.
- The expatriates rendered services in India for the Indian Company and no work was performed for the Foreign Company.
- The expatriates were paid part salary by the Foreign Company outside India (“overseas salary”) and part salary was paid by the Indian Company in India.

¹ Commissioner of Income-tax, New Delhi vs. M/s Eli Lilly & Company (India) Pvt. Ltd [Civil Appeal No. 5114 / 2007 – Supreme Court]



- The Indian Company deducted tax at source (TDS) on the part salary paid to the expatriates in India. However, no tax was deducted on the overseas salary of the expatriates.
- The tax on the overseas salary was paid by the expatriates as advance tax / self-assessment tax.

Issues before the Supreme Court

Whether TDS provisions are applicable on the payment of overseas salary to the expatriates by the Foreign Company in respect of the services rendered in India?

Indian Company's Contention

- Each employer should deduct tax only on the salary paid by it, unless the employee declares the salary of one employer to other employer.
- The employer is not under an obligation to deduct tax on the salary paid by any other person even if such salary has a nexus with the services rendered by the employee with that employer.
- In the instant case, the overseas salary was not paid on behalf of or on account of the Indian Company. Therefore, the Indian Company is not liable to deduct tax on the overseas salary.
- The provisions of the Act are not applicable to the Foreign Company not having any presence in India.
- Further, there is no loss of revenue to the tax authorities as the expatriates had paid the Income tax liability on the overseas salary by the way of advance/ self-assessment tax.

Tax department's Contention

- The Act² imposes an obligation to deduct tax on every person responsible for payment of salary to an employee. This is irrespective of whether the employer is in India or outside India or whether the payment is made in India or outside India.
- Even in case the Indian Company is liable to deduct tax and not the Foreign Company, the Indian Company shall deduct tax on the entire salary of the expatriates i.e. Indian and overseas salary.
- The genuine and bonafide belief of the Indian Company to not to deduct tax on the overseas salary does not constitute a 'reasonable clause' for non-levy of the penalty under the Act.³

² Section 192

³ Section 271C read with Section 273B



The Supreme Court decision

Applicability of TDS provisions

The salary paid by the Foreign Company is for the services rendered by the expatriates in India and no work was performed for the Foreign Company. Therefore, the Indian Company was liable to deduct tax on the overseas salary.

Interest for shortfall in deduction of tax

The interest in respect of shortfall in deduction of tax can be levied for the period starting from the date when tax was liable to be deducted till the actual payment of tax. Further, for the said purpose, the date of payment of tax by the employer can be treated as the date of actual payment of tax.

Penalty for default in deduction of tax

The penalty under Section 271C of the Act should not be levied as the Indian Company had reasonable cause for non-deducting the tax on the overseas salary on account of the following:

- The non-deduction of tax at source took place on account of controversial addition and concept of aggregation of income (i.e. Indian salary and overseas salary both are subject to tax) was a nascent issue.
- The genuine and bona fide belief of the Indian Company for not deducting tax on the overseas salary substantiated by the fact that:
 - The Indian Company has not claimed a corporate tax deduction⁴ of the salary paid by the foreign company; and
 - The expatriate had paid advance/ self-assessment tax on the overseas salary.

Our Comments

This is a landmark ruling of the Supreme Court confirming that employer is liable to deduct tax at source on the salary paid to expatriates for services rendered in India.

Further, in case the expatriates are seconded to work for the India subsidiary/ joint venture, then Indian subsidiary/ joint venture should deduct tax on entire salary i.e. salary paid in India and overseas.

⁴ Section 40(a)(iii)

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