

Tax Flash News

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The salary reimbursement of the seconded employees by the Indian subsidiary to the UK holding company is not taxable as fees for technical services

Executive summary

The taxability of payments made by the Indian companies to their foreign group companies for the secondment of employees has been a matter of debate from a long time. While taxpayers argue that the payment is in the nature of reimbursement on a cost-to-cost basis, the tax department has been treating such payments as Fees for Technical Services (FTS). Further, in several cases, the tax department has alleged that the presence of seconded employees forms a Permanent Establishment of the foreign company in India.

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Serco India Pvt. Ltd.¹ (the taxpayer) held that the amounts paid by an Indian subsidiary to the UK holding company on account of the secondment of employees are not taxable in the nature of FTS. The Tribunal observed that there was an employer-employee relationship between the Indian company and the deputed employees. It was proved that the Indian company was the legal and economic employer of the deputed employees. The tax was deducted by the Indian company on the salary payment to the deputed employees and it was also deposited with the government. Accordingly, the Tribunal deleted the disallowance made on account of non-deduction of tax at source. The Tribunal distinguished the decisions in the case of Northern Operating Systems Pvt. Ltd.² and Centrica India Offshore (P.) Ltd.³ on the basis of the facts of the case.

Facts of the case

- The taxpayer, a subsidiary of the UK company, is acting as a captive center to provide Information Technology (IT) and IT-enabled services to its group companies. The UK company, on the request of the taxpayer, seconded its certain employees on a full-time basis to work exclusively for the taxpayer.
- In terms of the salary reimbursement agreement, the UK company paid part-salary in foreign currency to such employees on behalf of the taxpayer for administrative and employees' convenience. Such salary was subsequently reimbursed by the taxpayer. The taxpayer had deducted tax on such salary payment under Section 192 and deposited the same with the government.
- The Dispute Resolution Panel (DRP), relying on the decisions in the case of Centrica India Offshore (P.) Ltd. and Northern Operating Systems Pvt. Ltd., held that the payment was in the nature of FTS. Thus, the taxpayer was liable to deduct tax at source under Section 195 on the reimbursement of the salary of seconded employees. Due to the non-deduction of tax at source, the DRP disallowed the payment under Section 40(a)(i).

Tribunal's decision

- In terms of the employment contracts and salary reimbursement agreement:
 - The taxpayer had complete control over the employees. The taxpayer had the right to terminate the employment of the seconded employees.

¹ Serco India Pvt. Ltd. v. DCIT (I.T.A. No. 1432/Del/2016) – Taxsutra.com

² C.C., C.E. & S.T. Bangalore v. Northern Operating Systems (P.) Ltd.

[2022] 138 taxmann.com 359 (SC)

³ Centrica India Offshore (P.) Ltd. v. CIT [2014] 44 taxmann.com 300 (Del)

- The UK company had no obligation to replace any of the employees. The employees had no legal recourse against the UK company. The employees did not have any lien on the UK company.
- The taxpayer was supposed to inform the UK company to pay certain amounts in foreign currency, as a part salary to the seconded employees. Thereafter, the UK Company would submit the reimbursement claim which was supposed to be cleared by the taxpayer.
- The obligation to pay salary and other emoluments was on the taxpayer only.
- Seconded employees were supposed to act as per the directions of the taxpayer and not the UK company.
- There was an employee-employer relationship with the taxpayer only. The taxpayer was a legal and economic employer of such employees.
- Accordingly, the payments made by the taxpayer to the seconded employees were chargeable to tax as 'salaries' in the hands of employees. It was not taxable as FTS because there was no agreement and/or any document to show that the UK company had provided any technical service to the taxpayer. Therefore, tax was correctly deducted at source under Section 192.
- As per the provisions of Section 195(1), income chargeable under the head 'salaries' is ousted from the purview of Section 195. Therefore, any person responsible for paying to any non-resident, any sum chargeable under the head 'salaries', is not liable to deduct tax at source under Section 195. Further, in this case, the taxpayer had deducted tax at 30 per cent of the total amount paid, whereas the TDS on FTS under Section 195 is at 15 per cent, and therefore, there was no loss of revenue.
- Disallowance under Section 40(a)(i) can be made only when twin conditions are satisfied. Firstly, the tax is deductible at source under Chapter XVII-B which includes Section 192. Secondly, such tax has not been deducted or, after deduction, has not been paid on or before the specified due date. In this case, the taxpayer had duly deducted tax at source under Section 192 and also deposited it with the government within the specified time. Thus, the provisions of Section 40(a)(i) does not apply to this case.
- Further, the Courts in various cases⁴ have held that even where tax has been deducted, under bona fide belief, under wrong provisions of TDS, the provisions of Section 40(a)(i) cannot be invoked. Even if there is a difference of opinion as to the deductibility of tax falling under different provisions, no disallowance can be made by invoking provisions of Section 40(a)(i).
- The Karnataka High Court in the case of Flipkart Internet Private Limited⁵ considered the decision in the case of Northern Operating Systems Pvt. Ltd. and held that the decision was rendered in the context of service tax, thus, not applicable to the case under the Act to determine whether the payment was FTS. The Court also distinguished the case of Centrica India Offshore (P.) Ltd. on the basis of facts.
- The Delhi Tribunal, in this case, distinguished Northern Operating Systems Pvt. Ltd. and Centrica India Offshore (P.) Ltd. on the basis of facts. The Tribunal observed that taxation depends upon the language of the charging section and what is brought to tax within the four corners of the charging section. The ratio decidendi of a case from one enactment, cannot be applied to an altogether different legislation. The issues and facts involved in the above two cases were distinct from the instant case. Thus, the ratio laid down in those cases cannot be applied in the instant case.
- CBDT Circular⁶ clarified that the payment of any sum shall be liable for deduction of tax, only under one section. The taxpayer had deducted tax under Section 192 on salaries paid and therefore in view of the Circular, it was not liable to deduct the tax under other section.
- The taxpayer also reimbursed such type of salary expenses of the employees to the UK company in previous as well as in subsequent years. In view of the decision of the Supreme Court in the case of Radhasoami Satsang⁷, following the 'rule of consistency', no disallowance under Section 40(a)(i) should be made for this year.
- The employees to whom the part salary was paid by the UK company on behalf of the taxpayer, had offered such salary amount as income by filing their returns of income in India. They had duly paid the income tax applicable and also filed return of income which were accepted by the tax

⁴ PCIT v. Boeing India Pvt. Ltd. [2023] 146 taxmann.com 131 (Del); ACIT v. AON Specialist Services (P.) Ltd. [2020] 116 taxmann.com 368 (Bang), CIT v. S. K. Tekriwal [2014] 46 taxmann.com 444 (Cal), Pr. CIT v. Future First Info. Services Private Limited [2022] 447 ITR 299 (Del)

⁵ Flipkart Internet Private Limited v. DCIT [2022] 448 ITR 268 (Kar)

⁶ CBDT Circular No. 720, dated 30 August 1995

⁷ Radhasoami Satsang v. CIT [1992] 193 ITR 321 (SC)

department. Therefore, by treating the salary amount as 'FTS' will jeopardize the rights of the taxpayer and its employees, and the UK company. It will also amount to double taxation.

- Accordingly, the Tribunal held that the reimbursement of salaries of the seconded employees working in India is not taxable as FTS. Consequently, the taxpayer was not liable to deduct tax at source under Section 195. The taxpayer correctly deducted the tax under 192 and therefore not liable for disallowance under Section 40(a)(i).

Our comments

The Supreme Court, in the case of Northern Operating Systems (in the context of the applicability of service tax), concluded that the employment of the seconded employee (in the stated facts) continued with the overseas employer. Thus, the court had held that the provision of seconded employees by the overseas employer to the Indian entity was liable for service tax. The Delhi Tribunal, in this case, has distinguished decisions of Northern Operating Systems Pvt. Ltd. as well as Centrica India Offshore (P.) Ltd. on the basis of facts of the case. The Tribunal also observed that the ratio of a case from one enactment, cannot be applied to an altogether different legislation. Issues and facts involved in the said two cases were distinct from the instant case. Thus, the ratio laid down in those cases cannot be applied in the instant case. It is important that the taxpayer should take into consideration all these decisions while dealing with secondment related aspects.



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