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TAX FLASH NEWS

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The seconded employee does not constitute a service PE in India under the India-Singapore tax treaty

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Yum Restaurants (Asia) Pte. Ltd.[1] (the taxpayer) held that the taxpayer, a Singapore company, does not constitute a Service Permanent Establishment (PE) in India under the India-Singapore tax treaty (the tax treaty) on deputation of its employee to an Indian company (YRIPL). The Tribunal referred to the deputation agreement and Commissioner of Income-tax (Appeal)'s [CIT(A)] order and observed that all the facts and circumstance of the case and clauses of the agreement indicate that deputed person was an employee of an Indian company and the taxpayer had simply acted as a conduit to pay salary to him in Singapore as his family was there in Singapore.

The Tribunal also held that the taxpayer does not constitute an agency PE on account of marketing activities carried out in India by YRIPL. Further the payment made to the deputed employee was not taxable as Fees for Technical Services (FTS).

Facts of the case

The taxpayer, a Singapore based company, engaged in the business of franchising various brands like Pizza Hut, KFC, etc. for the territories located at Asia Pacific region (including India). For the operation of restaurant outlets, the taxpayer entered into Technology License Agreement (TLA) for license of 'Technology' and 'System' with the Indian company (YRIPL). The Indian company in turn had appointed various franchisees for operating restaurants in India under its brand. In order to run its business, the Indian company had franchised different outlets and was also running own stores. Further, a marketing company in India was set up for undertaking Advertising, Marketing and Promotion (AMP) activities on behalf of the Indian company and its franchisees. The taxpayer was not a party to TLA which was exclusively entered between the Indian company and its marketing company.

As per the deputation agreement, the employee of the taxpayer was deputed to the Indian company.

The taxpayer offered the royalty income in India in pursuance of TLA on the basis of tax rates prescribed in the tax treaty. There was no dispute with respect to such royalty income. However, the Assessing Officer (AO) observed that the person working in the Indian company, was seconded to India. The reimbursement of salary of the said person was liable to tax in the hands of the taxpayer. The AO also observed that the furnishing of services by the seconded employee were technical in nature and taxable as FTS under Article 12 of the tax treaty.

The AO observed that the deputed person was the employee of the taxpayer and services were being provided to YRIPL on behalf of the taxpayer.

The AO also held that the taxpayer had a Dependent Agent Permanent Establishment (DAPE) in India on account of alleged marketing activities undertaken by the Indian company on behalf of the taxpayer. The marketing activities also benefit the taxpayer and hence the Indian company constitutes DAPE of the taxpayer in India.

The Commissioner of Income-tax (Appeals) [CIT(A)] held that the employee was under the control of the Indian company and was working for it. He was not the employee of the taxpayer and hence there was no right/lien over his employment and hence, there was no Service PE in India.

Tribunal's decision

Service PE

The Tribunal observed the following key points from the deputation agreement:

- The taxpayer shall not be responsible for the work of the deputed employee or assume any risk for the results produced from the work performed by the deputed employee while under deputation to YRIPL.

[1] DDIT v. Yum Restaurants (Asia) Pte. Ltd (ITA No.6018/Del/2012) – Taxsutra.com

- The deputed employee while under deputation to YRIPL shall not in any way be subject to any kind of instructions or control of the taxpayer.
- The deputed employee shall function solely under the control, direction and supervision of YRIPL and in accordance with the policies, rules and guidelines generally applicable to the employees of YRIPL.
- The taxpayer agrees to release and discharge the deputed employee from all obligation and rights whatsoever, including any lien on employment, if any, and from all actions, claims and demands towards the taxpayer.
- During the period of deputation, for administrative convenience, the taxpayer shall make payment towards salary, bonus and all other eligible benefits to the deputed employee as per the agreed terms (on behalf of YRIPL) at the time of the deputation and intimate YRIPL of the same.
- YRIPL shall be responsible for complying with the requirements of withholding tax under the Indian tax laws, on salary and other related entitlements paid to the deputed employee.

The CIT(A) had observed that the deputed employee was under the direct control and superintendence of YRIPL and the taxpayer had discharged the employee from all obligations and rights whatsoever, including lien on employment. The deputed employee was permanently moved to the payroll of YRIPL to continue his employment with YRIPL.

The tax department had failed to controvert the said findings of the CIT(A). In the absence of the same, it cannot be held that the taxpayer had a service PE in India.

Fixed place PE

The taxpayer has not undertaken any business in India hence the taxpayer does not have fixed place PE in India.

FTS

Under Article 12 of the tax treaty, the 'make available' clause needs to be fulfilled for the existence of FTS. In the absence of the same, the payment cannot be treated as FTS under Article 12 of the tax treaty.

The reimbursement received by the taxpayer from the Indian company on account of salary payment cannot be held as FTS. The employee seconded by the taxpayer was working as an employee of the Indian company and not as an employee of the taxpayer. The reimbursement of salary had no element of income. Since employee had already paid taxes in India on the aforesaid salary, the same amount being taxed as FTS in the hands of the taxpayer, would amount to double taxation.

Attribution of profits to the agency PE

The conditions specified under Article 5(8) dealing with an agency PE need to be satisfied for establishing agency PE in India. In the present case, none of the conditions specified in Article 5(8) of the tax treaty have been satisfied and hence it cannot be held that the taxpayer had any agency PE in India. The marketing activities undertaken by the marketing company in India were on behalf of the Indian company and its franchisees. In the absence of any link with the business of the taxpayer, no attribution is to be made from the contribution made by the Independent third-party franchisees.

Distinguished the decision of Centrica India Offshore Pvt. Ltd.

The decision of the Delhi High Court in the case of Centrica India Offshore Pvt. Ltd. was distinguishable on facts of the present case. In that case, the foreign company was providing services to the Indian company through seconded employees to ensure quality control and management of their vendors of outsourced activities, with the intention to provide staff with appropriate expertise and knowledge about process and practices implemented. Therefore, the decision of the Delhi High Court cannot apply to the facts of the present case.

Our comments

The issue with respect to constitution of a PE on deputation of foreign company's employees in India has been a subject matter of debate before the Courts/Tribunal.

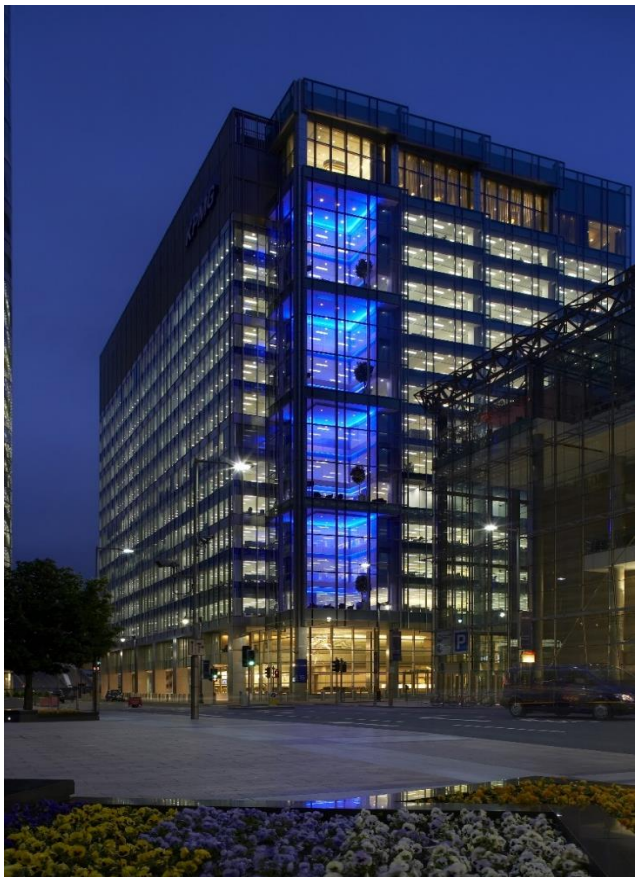
The Supreme Court in the case of Morgan Stanley & Co[2] and the Delhi High Court in the case of Centrica India Offshore Pvt. Ltd[3] laid down certain principles with respect to constitution of Service PE in India. The Supreme Court had given important observations that an employee of a foreign company when deputed to the Indian subsidiary, does not automatically become an employee of the Indian subsidiary. A deputationist has a lien on his employment with the foreign company. As long as the lien remains with the foreign company the said company retains control over the deputationist's terms and employment. Where the activities of the multinational enterprise entail it being responsible for the work of deputationists and they continue to be on the payroll of the multinational enterprise or they continue to have their lien on their jobs with the multinational enterprise, a Service PE can emerge.

[2] DIT v. Morgan Stanley & Co. [2007] 162 Taxman 165 (SC)
[3] Centrica India Offshore Pvt. Ltd. v. CIT [2014] 364 ITR 314 (Del)

In the instant case, based on the deputation agreement it was observed that the taxpayer had no right or lien over the employment of the deputed employee. The taxpayer had already released and discharged the deputed employee from all obligation and rights including any lien on the employment. Thus, the Tribunal held that the taxpayer had no Service PE in India.

With respect to an agency PE, the Tribunal held that marketing activities of the Indian company do not constitute taxpayer's DAPE in India. Further since the marketing activities do not have any link with the business of the taxpayer the attribution cannot be made.

The Tribunal also held that since the 'make available' conditions under the tax treaty were not satisfied, the payment cannot be treated as FTS.



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