

TAX FLASH NEWS

30 March 2021

Reimbursement of certain expenditure by an Indian branch to a Singapore company is not liable for deduction of tax at source

Recently, the Pune Bench of Income-tax Appellate Tribunal (the Tribunal) in the case of BYK Asia Pacific Pte. Limited¹ (the taxpayer) dealt with the issue of tax deduction at source (TDS) on reimbursement of certain expenditure by the Indian branch to a Singapore entity. The Tribunal held that two fundamental conditions must co-exist in order to fall within the domain of reimbursement, the first is that one-to-one direct correlation between the outgo of the payment and inflow of the receipt must be established and the second is that the receipt and payment must be of identical amount. The Tribunal held that the reimbursement of seminar, training, printing, staff welfare expenditure have satisfied both the above conditions and therefore, tax was not required to be deducted under Section 195 of the Income-tax Act, 1961 (the Act). Consequently, the disallowance under Section 40(a)(i) is not applicable.

With respect to Information Technology (IT) expenditure, to find out its correlation with the income earning activity of the taxpayer and in order to decide the correct nature of transaction, the matter was remanded back to the assessing officer.

Facts of the case

The taxpayer is a Singapore based entity having branches in several countries, including a branch office (BO) in India. It has a parent company in Germany. The Indian BO is engaged in providing technical support services in the Asia Pacific region to the customers of its parent company in Germany. It is primarily engaged in providing services in the field as BYK Group's additives used by Indian customers in their products. The Indian BO allows the customers of parent company to test the effect of the formulations on the customer's products at its testing facilities and provides technical support to such customers. The Indian BO also provides technical analysis and troubleshooting exercises for the queries raised and technical problems faced by the customers in the Asia Pacific region.

The Indian BO does not charge any service fee from the customers to whom technical services are provided. It is the Singapore HO that reimburses the Indian BO with all actual expenses incurred with 10 per cent mark-up. The Indian BO has treated itself as Permanent Establishment (PE) of the Singapore HO and offered for taxation the amount it received as mark-up on the cost of services provided.

During the Assessment year 2016-17, the taxpayer claimed deduction towards certain expenses namely seminar expenses, IT expenses, training expenses, staff welfare expenses and printing expenses paid to the Singapore HO without deducting tax at source. The taxpayer contended that the amount paid was in the nature of 'reimbursement of expenses' and not fees for technical services (FTS). The AO disallowed the said expenditure under Section 40(a)(i) of the Act for non-deduction of tax at source. The DRP upheld the order of the AO. Aggrieved, the taxpayer filed an appeal before the Tribunal.

Tribunal's decision

On a perusal of provisions of Section 195, it indicates that the deduction of tax at source is warranted, *inter alia*, on 'any other sum chargeable' under the provisions of the Act. The chargeability under the provisions of the Act pre-supposes some profit element involved in the receipt. If the recipient simply recovers the amount spent by it without any profit element, such a receipt, being reimbursement, cannot be characterised as any 'sum chargeable under the provisions of this Act' and hence would be immune from tax deduction at source. The Tribunal observed that two fundamental conditions must co-exist in order to fall within the domain of reimbursement.

- The first is that one-to-one direct correlation between the outgo of the payment and inflow of the receipt must be established and the second is that the receipt and payment must be of identical amount. The first condition gets satisfied when there is a directly identifiable amount which is spent

¹ BYK Asia Pacific Pte. Limited v. ACIT (ITA No.2110/Pun/2019 – Taxsutra.com

on behalf of another and later on it is recovered as such from the latter. It means that incurring of the expenditure, at the stage of incurring itself, is known to be for the benefit of the other and not the payer.

- The second condition gets satisfied when the receipt back of the amount originally spent is not laced with any mark-up inasmuch as exact amount incurred is recovered. Per contra, receipt of a fixed amount, which may be more or less than the actual outgo, cannot be designated as 'reimbursement'.

Seminar expenses

The narration in the invoice indicates that seminar was conducted in Germany which was attended by certain customers of parent company who operate from India in association with the taxpayer. It was observed that there was a back-to-back transaction and then eventually the taxpayer was charged by the Singapore HO with the equal amount. It shows that at the time of incurring expense, it was very well known that it was being incurred for and on behalf of the Indian BO. There was an identifiable amount incurred for the taxpayer, which was recovered as such without any mark-up from the taxpayer. The transaction was without any mark-up and was accordingly in the nature of reimbursement of costs in the hands of the Singapore HO. The invoice raised evidences that the expenses were incurred by a third party and the taxpayer was charged with the amount without any markup.

Training, printing and staff welfare expenses

The taxpayer's share in such expenses representing three persons from the Indian BO which has been recovered as such by the Singapore HO without any mark-up. Here again there was a one-to-one correlation between the amount spent by the Singapore HO and that recovered from the Indian BO without any mark-up. This expenditure also satisfies the conditions of 'reimbursement' and hence did not require any deduction of tax at source at the time of making payment.

Once it was held that TDS was not necessary, there cannot be any question of disallowance under Section 40(a)(i).

IT expenditure

German entity rendered IT Services, inter alia, to the Indian BO on a regular basis and a monthly charge was raised there against. IT expenditure were payment for receipt of intra-group services. The taxpayer allows the customers of German entity to test the effect of the formulations on the customers' products at its testing facilities. It provides the customers with the basic guidelines as to how to use the formulations on German entity and provide technical support to the

customers. Thus, the nature of work done by the taxpayer was that of providing technical analysis and testing of its parent company's additives used by Indian customers in their products.

The question as to whether or not TDS was required in the instant case on this payment cannot be decided without examining the nature of IT expense and its correlation with the income earning activity of the taxpayer. In order to decide the correct nature of transaction, the matter was remanded back to the file of AO for examining the true nature of transaction and thereafter determine whether or not tax is deductible at source under Section 195 of the Act and consequential disallowance under Section 40(a)(i), if any.

Our comments

The issue with respect to deduction of tax on reimbursement of expenses to non-resident has been a subject matter of debate before Courts/Tribunal.

On the issue of reimbursement, the Delhi Tribunal in the case of DLF Projects Ltd² held that tax is not required to be deducted on reimbursement of manpower expenditure to the foreign company in the absence of any income element. The tax should be deducted under Section 195 only on the mark-up and not on the reimbursement of actual cost to a non-resident. However, the Delhi Tribunal in the case of SMS Iron Technology Pvt. Ltd.³ held that the payment made by the taxpayer cannot be termed as reimbursement of expenditure since the taxpayer has not produced any agreement, debit notes or working of such reimbursement. It may be noted that reimbursements should be backed up by third party documentation, i.e., an agreement, debit note, etc.

The Mumbai Tribunal in the case of Roche Diagnostics India Pvt Ltd.⁴ held that tax is not deductible on reimbursement since it was supported by the copies of invoices, third party transaction details, Form 15CA and Form 15CB which indicated that the payments were in the nature of reimbursements.

The Pune Tribunal in the present case has laid down two fundamental conditions to be satisfied to conclude that the payment is in the nature of reimbursement i.e. one-to-one direct correlation between the outgo of the payment and inflow of the receipt and the receipt and payment must be of identical amount. In the present case, these conditions were satisfied and therefore, the Tribunal held that TDS provisions were not applicable and no disallowance should be made under Section 40(a)(i).

² DCIT v. DLF Projects Ltd (ITA No. 5178/Del/2014)

³ SMS Iron Technology Pvt. Ltd v. ITO (ITA No. 4480 to 4486/Del/2014)

⁴ Roche Diagnostics India Pvt Ltd. v. ACIT- ITA No. 1537/Mum/2016 (AY-2011-12)

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