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TAX FLASH NEWS

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Applicability of TDS provisions on reimbursement of salaries of seconded employees

Executive summary

In multi-national organisations, the secondment of employees of foreign group companies to India is a regular practice. Such secondments can be for various business reasons i.e., managing Indian operations, implementing group policies, training, etc. These seconded employees generally retain their employment with the foreign company for continuity of the social security benefits in their home country. Thus, their salary (or a part thereof) is paid through the foreign company and reimbursed by the Indian company. Indian tax authorities have argued that these secondments are arrangements for the provision of services by the foreign employer through its employees and can be taxed in India as Fees for Technical Service (FTS). Also, the presence of these employees in India can create a Permanent Establishment (PE) in India of the foreign company.

Recently, Flipkart Internet Private Limited[1] (Flipkart) filed a writ petition before the Karnataka High Court (High Court) against the rejection of its Section 195(2) application for 'nil' withholding on remittance towards reimbursement of salaries of seconded employees. The High Court observed that the payment to the U.S. entity was not taxable as Fees for Included Services (FIS) under the India-USA tax treaty (the tax treaty) since services provided by the seconded employees did not satisfy the 'make available' clause and directed the tax department to grant 'nil' withholding certificate to Flipkart. In reaching to this conclusion, the High Court considered the Delhi High Court judgement in the case of Centrica India Offshore (P.) Ltd[2] (Centrica India) and Supreme Court judgement in the case of Northern Operating Systems Pvt Ltd[3] (NOS) and distinguished them on the facts of the case.

Facts of the case

- Flipkart entered into a Master Services Agreement (MSA) with Walmart Inc., a US based entity (Walmart), for the secondment of four of its employees.
- Flipkart issued a letter of appointment confirming the employment of seconded employees with it, sponsored their employment visa and made a contribution to Provident Fund. The seconded employees were paid a salary by Walmart (for administrative convenience), which was then reimbursed by Flipkart.
- Flipkart made an application under Section 195(2) requesting to allow the remittance of cost-to-cost reimbursements to Walmart for salary paid to the seconded employees, without tax deduction at source.
- The said application was rejected by the AO directing Flipkart to deduct tax at source on the following grounds:
  - There is no employer-employee relationship between Flipkart and the seconded employees.
  - The services rendered/provided by the seconded employees were in the nature of technical services, both under the Act as well as under the tax treaty.
  - Tax deduction under Section 192 on the salary payment does not result in a double deduction nor does it obviate the need to deduct tax under Section 195.
  - Since the payment was in the nature of FTS/FIS, it is taxable on a gross basis and there is no need to examine whether or not income is embedded in such payment.

[1] Flipkart Internet Private Limited v. DCIT (Writ Petition No. 3619/2021, dated 21 June 2022) – Taxsutra.com
[2] Centrica India Offshore (P.) Ltd v. CIT [2014] 227 Taxman 368 (SC)
[3] CCE v. Northern Operating Systems Pvt Ltd (Civil Appeal No. 2289-2293/2021) (SC)

- Flipkart filed a writ petition in the Karnataka High Court against the rejection of a nil deduction certificate.

High Court decision

Maintainability of the application of withholding tax certificate under Section 195(2)

- The tax department contended that the application under Section 195(2) is maintainable only in the event of composite payment and where a nil deduction certificate is sought for recourse is to be made under Section 197. In this context, the High Court observed that the scope of Section 197 is distinct from that of Section 195(2), Section 197 would come into operation on an application by the recipient of income, which was not the factual scenario in the present case.

- Further, it was argued that Section 195(2) does not apply in a situation where the sum is not chargeable to tax. The High Court did not agree with this argument.

Secondment and reimbursement of cost

- The relationship between Flipkart and the seconded employees during the period of secondment was of relevance. Accordingly, after the period of secondment or its termination, the fact that the US entity has the power to decide on the employees' continuance with the U.S. entity would not make any difference, as it would relate to a service condition post the period of secondment.

- Flipkart issues an appointment letter, the employee reports to Flipkart and Flipkart has the power to terminate the service of the employee. The mere salary payment by the US entity to the seconded employees would not alter the relationship between Flipkart and the seconded employees.

- It was argued that Flipkart was incorporated in 2012 and established an online marketplace for consumer goods and only in 2018 Walmart obtained the majority shareholding in it. Also, it is not a case where Flipkart is merely acting as a back office for providing support services to the overseas entity, whereby an overseas entity could be treated as an employer.

- Any conclusion on an interpretation of secondment as contained in the MSA to determine who the employer is and determining the nature of payment by itself would have no conclusive bearing on whether the payment made was for 'FIS' in light of the further requirement of 'make available'.

- The decision in the case of NOS relied on by the tax department was distinguishable on facts of the present case as the decision of the Supreme Court was rendered in the context of service tax. The main issue in that case was whether the supply of manpower was covered under taxable service. Whereas in the case of Flipkart, the main issue is whether the service falls under the purview of the 'make available' clause.

- The decision in the case of Centrica India relied on by the tax department was distinguished as being based on facts and material on record before the High Court. It was held that the findings of the High Court in the case of Centrica do not take away the requirement of establishing the employer-employee relationship, the fact of reimbursement and meeting of the 'make available' clause.

- The High Court in the case of Abbey Business Services India (P) Ltd[4] observed that the secondment agreement constitutes an independent contract of services in respect of employment with an Indian entity. The AO missed this aspect of the secondment agreement being an independent contract between seconded employees and Flipkart and had proceeded to consider the aspect of rendering of service as to whether it was 'FIS'. Accordingly, the AOs order was set-aside, and the tax department was directed to issue a 'nil tax withholding certificate under Section 195(2).

Our comments

There has been long-drawn litigation on the taxation of secondment arrangements in India on both direct and indirect tax fronts. Recently, the larger bench of the Supreme Court, in the case of Northern Operating Systems (in the context of the applicability of service tax), held that an employer-employee relationship exists between the seconded employee and the foreign employer, and the foreign employer can be said to be providing manpower supply services.

This decision has raised a question on the position in direct tax where several courts and tribunals have held that in the case of secondments, an Indian company can be treated as the employer of the seconded employees and consequently secondment arrangement can not be treated as a provision of services by the foreign employer through the seconded employees. A similar issue arose when the Delhi High Court, in the case of Centrica India, held the secondment arrangement to be a case of provision of services. The decision by Karnataka High Court has distinguished both the above judgements and hence should bring some certainty in the cases where the foreign company has the benefit of 'make available' in the FTS clause in the tax treaty between its home country and India.

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[4] DIT v. Abbey Business Services India (P.) Ltd. [2021] 279 Taxman 284 (Kar)

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