KPMG

TAX FLASH NEWS

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The reimbursement of salaries of seconded employees is not taxable as fees for technical services

Executive Summary

The taxability of payments made by the Indian companies to their foreign entities 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 cost-to-cost basis, the tax department has been treating such payment 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 Bengaluru Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Google LLC[1] (the taxpayer) held that the amounts received by the taxpayer on account of secondment of employees to its Indian company were not in the nature of FTS under the Income-tax Act, 1961 (the Act) and Fees for Included Services (FIS) under the India-USA tax treaty (tax treaty). Such payments were reimbursement on the cost-to-cost basis of the salary paid to the seconded employees. The Tribunal observed that seconded employees were working solely under the control and supervision of the Indian company. The taxpayer's role was merely to facilitate payment of salary on behalf of the Indian company. Further, the Indian company had deducted tax at source on the salary paid to the seconded employees.

Facts of the case

- The taxpayer, US company, seconded certain employees to its Indian subsidiary company. The Indian company paid to the taxpayer on account of the reimbursement of salaries of the seconded employees.

- The Assessing Officer (AO) observed that the taxpayer had provided technical services to the Indian subsidiary through certain employees who were experts in their respective domains. These services imparted/made available skill set to the manpower of the Indian subsidiary for execution of technical and managerial jobs. Thus, the payments received by the taxpayer were taxable as FIS under the India-USA tax treaty. The AO relied on the Delhi High Court's decision in the case of Centrica India Offshore (P.) Ltd[2].

Tribunal's decision

- The taxpayer had issued assignment letters to the seconded employees which provide that:
  - The seconded employees should work only for the Indian company and not for the taxpayer. Services provided by such employees were solely for the benefit of the Indian company.
  - The employees were required to report to the Indian company. The seconded employees will work under the supervision and control of the Indian company. Being an employer, salary of such employees will be incurred by the Indian company.
  - The taxpayer shall not be responsible and shall not assume any risk for the work undertaken by the seconded employees for the Indian company.

[1] Google LLC v. JCIT [IT(IT)A No. 688/Bang/2021] – Taxsutra.com

[2] Centrica India Offshore (P.) Ltd v. CIT [2014] 227 Taxman 368 (SC)

- The Indian company had duly deducted tax at source against salary and other allowances paid to such seconded employees and deposited the same with the government.

- The Indian company had obtained necessary registration for the said employees with Provident Fund and Foreigners Regional Registration Office and also made appropriate contributions towards social security benefits in India which forms part of their salary cost.

- The taxpayer had also produced the visa stamped by the authorities concerned in the case of seconded employees where it was clearly shown as 'employment visa'. In most of the cases the families of the seconded employees were in the US and due to convenience, salary of such employees was deposited in bank account of the employees in the US.

- Such salaries were reimbursed to the taxpayer on cost-to-cost basis. The taxpayer had produced reconciliation of the amount payable in respect of expat employees vis-a-vis the salary and other perquisites, etc. paid to such employees.

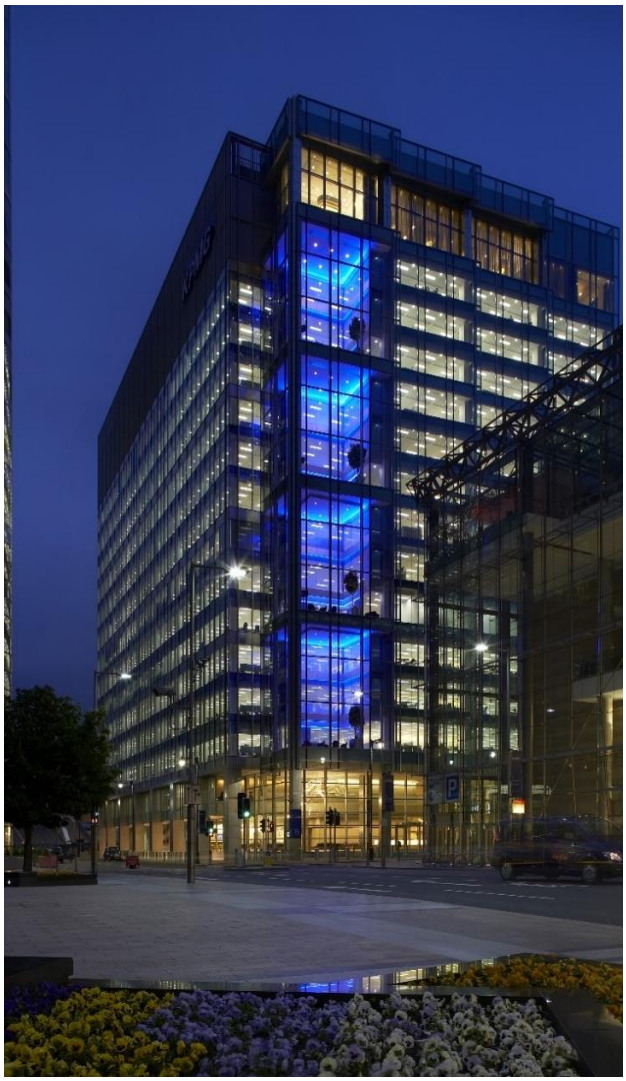
- In the real sense the payment made by the Indian company to the taxpayer was nothing but reimbursement of cost relating to remuneration.

- The seconded employees were working solely under control and supervision of the Indian company and not on behalf of the taxpayer during the period of secondment. The taxpayer's role was merely to facilitate payment of salary on behalf of the Indian entity.

- Relying on the decisions in the case of Flipkart Internet (P.) Ltd.[3], Biesse Manufacturing Company (P.) Ltd.[4] And Goldman Sachs Services (P.) Ltd.[5], the Tribunal held that the amounts received by the taxpayer on account of secondment of employees were not taxable as FTS under the Act and FIS under the tax treaty.

Our comments

The Supreme Court, in the case of Northern Operating Systems[6] (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 held that provision of seconded employees by the overseas employer to the Indian entity was liable for service tax. This Supreme Court decision was distinguished by the Karnataka High Court in the case of Flipkart on the aspect the Supreme Court was not evaluating whether the services were in the nature of FIS under the tax treaty. Thus, going forward it is important to take into consideration the Supreme Court's observations while determining the taxability of secondment transactions.



[3] Flipkart Internet (P.) Ltd. v. DCIT [2022] 139 taxmann.com 595 (Kar)
[4] Biesse Manufacturing Company (P.) Ltd. v. ACIT [2023] 146 taxmann.com 242 (Bang)
[5] Goldman Sachs Services (P.) Ltd. v. DCIT [2022] 138 taxmann.com 162 (Bang)

[6] CCE v. Northern Operating Systems Pvt Ltd (Civil Appeal No. 2289-2293/2021) (SC)

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