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Secondment arrangement: Salary reimbursements to AEs not taxable as fees for technical services (FTS) – Delhi High Court

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Summary

In a recent case[1], the Delhi High Court (HC) held that section 195 of the Income-tax Act, 1961 (Act) is not applicable on reimbursements of salary to foreign associated enterprises (AEs). The Hon'ble HC held that the taxpayer is the real and economic employer of the seconded employees (secondees) having supervision, control and management over these employees.

The HC distinguished its earlier decision in the case of Centrica India Offshore Pvt. Ltd.[2] (Centrica) based on the fact that unlike Centrica, which was a newly formed entity, taxpayer has been in existence since 2003 and the seconded employees do not possess any specific skill set that is not available with its Indian employees.

Facts of the case

- Taxpayer had entered into secondment agreement with its AEs in USA, Korea and Australia. During the assessment year (AY) 2015-16, the taxpayer reimbursed salaries and other costs related to the seconded employees to the respective AEs.
- On enquiry during assessment, taxpayer argued that such reimbursement was not taxable as fees for technical/included services (FTS/FIS) under the Act or the relevant tax treaty and hence, tax was not withheld on such amount.
- The Assessing Officer (AO) relied on Delhi HC's decision in case of Centrica *(supra)* and held that the taxpayer was required to withhold tax on the reimbursement of salaries of seconded employees. Accordingly, the AO disallowed the reimbursement under section 40(a)(i) of the Act.
- On appeal, the Dispute Resolution Panel (DRP) upheld the order of the AO.
- Subsequently, the taxpayer filed an appeal before Income Tax Appellate Tribunal (ITAT).
- With respect to reliance of the AO on the Delhi HC's decision in case of Centrica *(supra)*, the taxpayer argued that the facts of its case can be distinguished from that of Centrica on the premise that:
  - In case of Centrica, the Indian company was a newly formed entity, it did not have necessary trained human resources and experienced seconded employees were sent to India.
  - However, the taxpayer was established in 2003 and seconded employees do not possess any specific skill set that is not available with its Indian employees.

[1] Boeing India Pvt. Ltd [TS-790-HC-2022(DEL)]
[2] [2014] 364 ITR 336 (Delhi HC)

- Key observations of the ITAT based on review of the salary reimbursement agreement were:
  - Secondees had indicated their willingness to work for the taxpayer and that the AEs had consented to release them.
  - AEs would facilitate payment of salaries to the seconded employees in their home country on behalf of the taxpayer.
  - Secondees would work for taxpayer as employees, under its supervision, control and management.
- The ITAT held that based on the review of the salary reimbursement agreement, the secondees are employees of the taxpayer and hence, payment of salary to the AEs is in the nature of reimbursement.
- The ITAT distinguished the taxpayer's case from that of Centrica *(supra)* on facts since in the taxpayer's case the secondees are its employees. It also observed that the taxpayer withheld tax under section 192 of Act.
- It further relied on the Delhi ITAT's ruling in the case of AT&T Communication Services India Pvt. Ltd.[3], which distinguished the ruling in the case of Centrica *(supra)*. The Delhi ITAT held that the Indian company was not required to deduct tax under section 195 of the Act on payment to non-resident entity if the amount is in nature of salary.
- Accordingly, the ITAT held that tax is not required to be withheld under section 195 of the Act.
- Revenue preferred an appeal against the ITAT's order before the Delhi HC.

Decision of the Delhi HC

The Delhi HC upheld the order of the ITAT.

- It held that the ruling in case of Centrica *(supra)* is not applicable in this case since the ITAT has held that the taxpayer is the real employer of the secondees.
- The Delhi HC relied on the Supreme Court (SC) judgment in the case of A.P. Moller Maersk A S[4], wherein the SC held that once the character of the payment is found to be in the nature of reimbursement of the expenses, it cannot be income chargeable to tax under the Act.
- The Delhi HC further relied on its own decision in the case of Karl Storz Endoscopy India (Pvt.) Ltd.[5] wherein it was held that reimbursement of salary cost by Indian entity for seconded employees will not be regarded as FTS in lieu of the carve-out provided in definition of FTS[6] for income chargeable under the head salaries.

[3] ITA No.354/Del/2017
[4] Civil Appeal No.8040/2015
[5] ITA No.13/2008
[6] Explanation 2 to section 9(1)(vii) of the Act

Our comments

The taxability of seconded employees and implications for the Indian employer has been a vexed issue and this is a welcome ruling by the Hon'ble Delhi HC. The Court has once again highlighted the importance of contractual agreements and substance of the arrangement while deciding the taxability of secondment arrangements.

One of the crucial tests to determine the taxability in such secondment arrangements remains control and supervision over the secondees. Taxpayers may assess the impact of this decision on the facts of their case and evaluate the way forward.

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