Tax Insights

from India Tax & Regulatory Services

No withholding of tax under section 195 on reimbursement of payroll cost of seconded employees under secondment agreement to parent company

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In brief

In a recent ruling[1], the Ahmedabad Income-tax Appellate Tribunal (Tribunal) ruled that reimbursement of payroll cost of seconded employees, which did not have income element embedded in it and tax has been withheld as per section 192 (Salaries) of the Income-tax Act, 1961 (the Act), would fall outside the purview of section 195 of the Act. Accordingly, no withholding of tax on the reimbursement was required under section 195.

Further, the determination of a Service permanent establishment (PE) in such case would be merely academic, as the income and expenditure attributable to the Service PE would be same.

In detail

Facts

- The taxpayer[1] had entered into a secondment agreement with its parent company, where under the parent company had placed certain employees at the disposal and control of the taxpayer.
- During the survey carried out by the tax officer (TO), it was noted that the taxpayer had reimbursed the payroll cost for four different assessment years without withholding taxes under section 195 of the Act. However, it was also noted that the taxpayer had duly discharged its tax-withholding obligation under section 192 of the Act with respect to income chargeable in the hands of such employees for three years and by way of advance tax in one of the years.
- The TO held that as the employees continued to be employees of the parent company, the work done by these employees resulted in the creation of Service PE [under Article 5(2)(1) of the Double Taxation Avoidance Agreement entered into between India and USA (India-USA tax treaty)] of the parent company in India. Considering the above, the TO proceeded to hold that the amount paid by the taxpayer to its parent company, being the amount attributable to the Service PE, was taxable on gross basis and in the absence of details of expenditure, the entire sum would be taxable at the rate of 40% (being the rate of tax for foreign companies).
- The TO further went on to hold that alternatively, the said amount so paid by the taxpayer to its parent company would be taxable as fees for technical services (FTS)/ fees for included services (FIS) under section 9(1)(vii) of the Act/ Article

[1] [2017] 79 taxmann.com 459 (Ahmedabad –ITAT)

12(4) of the India-USA tax treaty.

Issues before the Tribunal

- Whether the taxpayer was under an obligation to withhold tax under section 195 of the Act on the amount of reimbursement of payroll cost to its parent company.
- Whether the reimbursement of payroll cost of seconded employees amounts to FTS/ FIS.
- Whether work done by the seconded employees constitute Service PE in India.

Taxpayer's contention

- The taxpayer contended that the reimbursement of payroll cost was "at cost" and did not involve any profit element taxable in the hands of the parent company. Accordingly, the taxpayer was not under any obligation to withhold tax under section 195 of the Act.
- Further, the reimbursement of payroll cost has been charged to tax in India in the hands of the seconded employees, and accordingly, the said payment should not be charged to tax again under section 195 of the Act.
- The said services provided by the seconded employees of the parent company did not "make available" technical knowledge, as per the provisions of Article 12 of India-USA tax treaty, and accordingly, the said reimbursement should also not be taxable as per the provisions of the India-USA tax treaty.

Revenue's contention

- As highly qualified employees were deputed with the taxpayer on its request and they continue to be in employment with the parent company, the assistance provided by these seconded employees constituted a Service PE of the parent company in India.
- Alternatively, the said reimbursement of payroll cost by the taxpayer to its parent company was FTS/ FIS in nature as per section 9(1)(vii) of the Act/ India-USA tax treaty. Accordingly, the taxpayer was liable to withhold tax under section 195 of the Act while making payment.

Tribunal's ruling

- When the income embedded in the reimbursement of payroll cost was taxable under the head "salaries" in the hands of the seconded employees and the taxpayer had complied with the provisions of section 192 of the Act, no separate liability of withholding of tax under section 195 of the Act could be fastened in the hands of the taxpayer reimbursing the parent company of the payroll costs.
- The fact that seconded employees continued to be in the employment of their parent companies was totally irrelevant for the determination of withholding tax of the taxpayer in the present case.
- Even if it was assumed that the deputation of the seconded employees constituted Service PE, there would not be any profit attributable to the Service PE in India under Article 7(1) of the India-USA tax treaty, as the aggregate of receipts attributable to Service PE was the same as the aggregate of the expenditure towards the payroll cost of deputed cost attributable to Service PE.
- When income embedded in payment was not taxable in the hands of the recipient, tax withholding liability was not triggered in the hands of the payer.
- That in the absence of evidence to show that any technical knowledge, skills, etc., were "made available" by the parent company, the said reimbursement of payroll cost did not tantamount to FTS/ FIS as per Article 12 of the India-USA tax treaty.

The takeaways

- The ruling reaffirms the position that no taxes are required to be withheld while making reimbursement of payroll cost, as no income is embedded in the hands of the recipient.
- On account of diverse decisions, in favour of the taxpayer[2] and in favour of department[3], it would be important to see how any further decisions on treatment of reimbursement of payroll cost is considered by other Courts/ Apex Court.
- The Tribunal has not brought out a clear conclusion on existence of Service PE pursuant to the secondment agreement.
- Tribunal has not discussed the Apex Court's ruling of Centrica[4] and Madras High Court ruling in case of Verizon[3].

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

[2] DCIT *v.* Temasek Holding Advisors (P.) Limited [(2014) 151 ITD 458 (Mumbai – ITAT)] Abbey Business Services (India) (P.) Limited *v.* DCIT [(2012) 53 SOT 401 (Banglore – ITAT)]

[3] Verizon Data Services India (P.) Limited *v.* AAR [2012] 346 ITR 489 (Madras)]

[4] Centrica India Offshore (P.) Limited *v.* CIT [2014] 227 Taxman 368 (SC)

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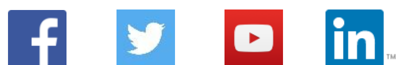

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