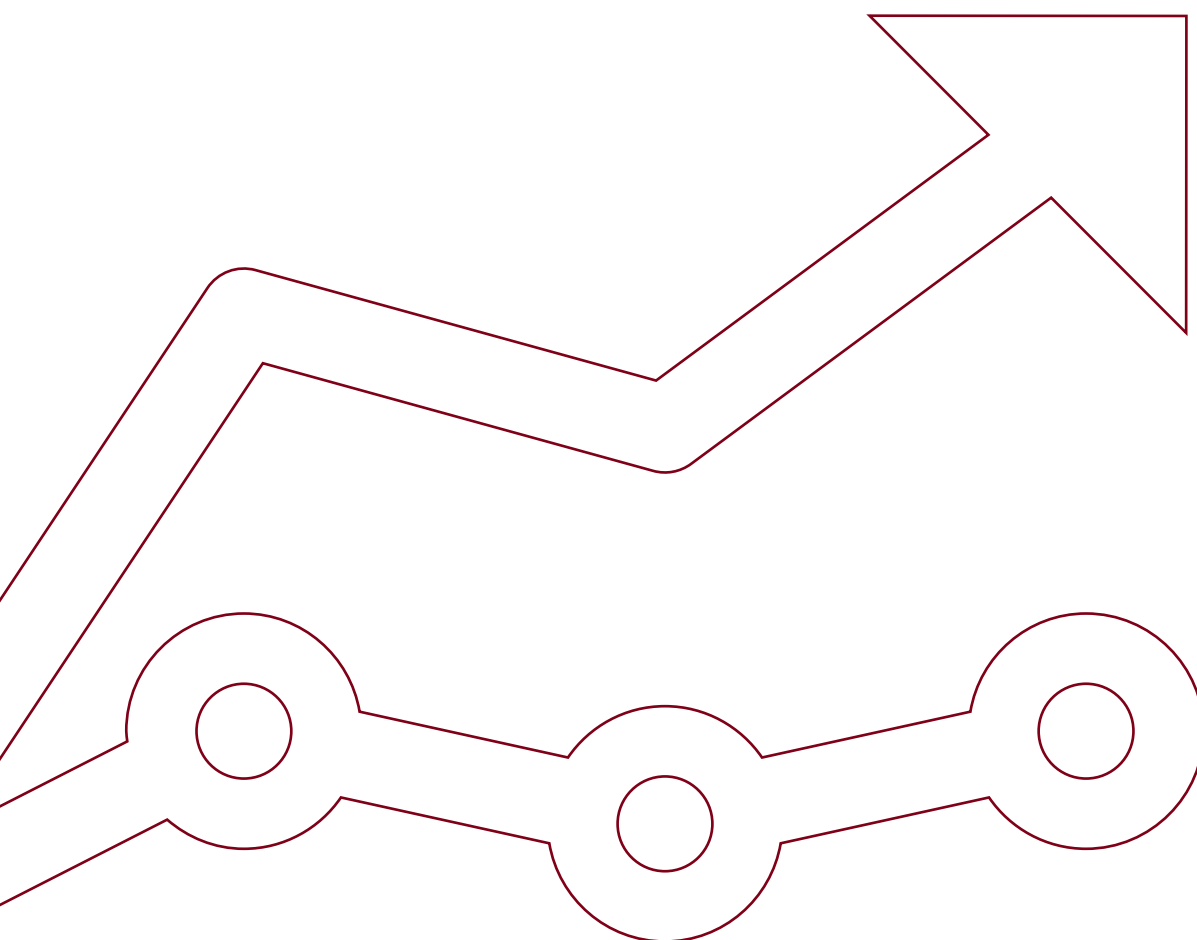

Reimbursements–Tax Dilemmas Explained

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1. *Foreword*

- 1.1. With the globalisation of businesses being on the rise, interdependence amongst group companies has increased substantially. MNCs often find themselves engaged in multiple transactions with and on behalf of each other. Transactions are frequently undertaken to achieve cost-efficiency and not necessarily with the intention of making a profit. Some of the prevalent practices include allocation of common costs such as those related to IT and procurement, cross-charge of personnel and other types of cost-sharing arrangements. Such recoupment of expenses is commonly known as 'reimbursement'.
- 1.2. Taxability of reimbursement has been a matter of considerable debate in India from the perspectives of both Direct Tax and Indirect Tax. In addition, Transfer Pricing rules may also need to be complied with if such transactions are undertaken between associated enterprises (AEs). Where these are intra-group reimbursements, it is generally the intention of the companies to achieve a tax-neutral position on these transactions, especially in the absence of a profit element. On the other hand, the tax authorities generally contend that such payments are taxable for a variety of reasons, relying on India's strong source rule of taxation.
- 1.3. This report seeks to address some typical issues relating to taxability of reimbursements in light of the prevalent tax legislation and the courts' rulings in India.



2. *Meaning of ‘reimbursement’*

2.1. The term ‘reimbursement’ has not been defined in the Income-tax Act, 1961 (IT Act). It is also not defined in the Central Goods and Service Tax Act, 2017 (CGST

Act), although references of the term can be found within the concept of a ‘pure agent’. It has been defined in various dictionaries, as given below:

Black’s Law Dictionary (second edition)	To pay back; to make return or restoration of an equivalent for something paid, expended or lost; to indemnify or make whole
Oxford Dictionary	Repay (a sum of money spent); repay or compensate (a person)
Cambridge Learner’s Dictionary	To pay money back to someone, especially money that they have spent because of their work
P. Ramanathan Aiyar Law Lexicon	Repayment of what is spent; to reimburse is to repay what is expended; restoration of an equivalent for something paid or expended

2.2. According to these dictionary meanings, reimbursement can be considered repayment of what has already been spent or incurred. Therefore, it should not be considered a reward or compensation for a service rendered. The determinative factor to be considered is the obligation of a party to bear expenses.

2.3. The **Bangalore Tribunal**, in the case of **Bovis Lend Lease (I) P Ltd vs ITO**, noted that the following parameters are essential for a payment to be regarded as reimbursement:

- The actual liability to pay should be of the person who reimburses the money to the original payer.
- The liability should be clearly determined. It should not be an approximate or varying amount.
- The liability should have crystallised. In other words, the reason given that payments that were never required but were made just to avoid a potential problem may not qualify.
- There should be a clear ascertainable relationship between the paying and reimbursing parties. Therefore, alleged reimbursement by an unconnected person may not qualify.

- The payment should first be made by somebody whose liability it never was and the repayment should then be made to that person to square off the account.
- Three parties should exist in a case of reimbursement—a payer, a payee and a reimbursor (i.e., the person reimbursing the amount to the payer).

2.4. In view of this broad understanding, let us seek to analyse some of the Direct Tax-, Transfer Pricing- and Indirect Tax-related issues arising under various types of transactions with respect to reimbursement.



3.

Overview of relevant legal provisions

A. Direct Tax



Taxability

- 3.1. The IT Act seeks to levy Income-tax in respect of the “income” of every person. The term ‘income’ has been exhaustively defined to include various types of gains, profits, accretion, value addition, etc. In the absence of any profit-related element, a receipt cannot be generally classified as income. In this scenario, any reimbursement cannot be treated as income, and therefore, should not be subject to Income-tax, unless specified otherwise.

Withholding Tax

- 3.2. While analysing Withholding Tax-related obligations on reimbursements, broadly speaking, two kinds of situations arise—(a) where an expense is incurred by a service provider in his or her own capacity in the course of rendering services, and (b) where an expense is incurred by the service provider on behalf of a service recipient. Both these situations need to be independently tested under the Withholding Tax provisions of the IT Act.

Withholding Tax on payments to residents

- 3.3. The Withholding Tax provisions dealing with certain types of payments¹, such as salary and commission, emphasise on payment of ‘income’. Hence, the presence of an income element in these types of payments appears to be a pre-requisite for application of Withholding Tax. As stated above, reimbursement of cost incurred does not constitute income in the hands of the recipient. Accordingly, in the context of reimbursement of payment of commission, it was held² that in the absence of any income-related element, no tax needs to be withheld on such reimbursement.
- 3.4. On the other hand, Withholding Tax-related provisions dealing with contractual payments, payment of Fees for Technical Services (FTS), etc.³ use the expression ‘any sum’, and hence, it appears that the payer has the obligation to withhold tax on the gross amount.

- 3.5. In this context, the **Central Board of Direct Taxes (CBDT)** has issued a Circular⁴ to clarify situations where tax will be deducted on the gross amount. For example, FAQ no. 30 of this Circular clarifies that for contractual and FTS payments, reimbursements cannot be deducted out of the bill amount for Withholding Tax purposes. However, the **Tribunals**⁵ have held that this Circular is only applicable in a situation where a single invoice is raised for the gross amount (i.e., inclusive of reimbursements), and where two separate invoices are raised—one for service fees and the other for reimbursement of, for instance, out-of-pocket expenses—tax should be deducted on service fees.

Withholding Tax on payments to non-residents

- 3.6. Payment made to a non-resident that is chargeable to tax in India under the IT Act is subject to Withholding Tax⁶. Therefore, for the Withholding Tax provision to apply, it is imperative to first determine whether the payment is chargeable to tax in India in the hands of the non-resident.
- 3.7. In a landmark judgement, the **Supreme Court of India**, in the case of **GE India Technology Center P Ltd. vs CIT**, held that the obligation to withhold tax should be limited to the appropriate proportion of such income chargeable to tax under the IT Act. According to the Court, one cannot state that the obligation to withhold tax arises the moment there is a remittance. If we were to accept such a contention, it would mean that income is said to arise or accrue in India on any payment. Such an interpretation would mean effacement of the expression “sum chargeable under the provisions of the Act”.
- 3.8. Therefore, plain reimbursement to a non-resident is not his or her income chargeable under the IT Act, and consequently, should not attract Withholding Tax provisions. However, one needs to evaluate the facts and circumstances in every transaction, as is apparent from several rulings on the subject.

1. Sections 192 to 194LD, Section 194H

2. DCIT vs Zee Entertainment Enterprises Ltd (Bombay High Court)

3. Section 194C, 194J, 194DA, 194EE, 194F, 194-IA, 194-IC and 194LA

4. Circular No. 715 dated 8 August 1995

5. ITO vs Dr. Willmar Schwabe India P Ltd (Delhi Tribunal); ACIT vs Premier Marine Foods (Cochin Tribunal); DCIT vs Choice Sanitaryware Industries (Rajkot Tribunal)

6. Sections 192 and 195 of the IT Act



- 3.9. Section 92 of the IT Act provides that any income arising from an international transaction will be computed in regard to the arm's length price.
- 3.10. Section 92B defines the term 'international transaction' exhaustively to include "a mutual agreement or arrangement between two or more AEs for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises..."
- 3.11. In view of the above, a reimbursement- or recovery-related transaction of expenses at cost constitutes an international transaction, subject to Transfer Pricing regulations. Moreover, this transaction needs to be reported under clause 19 of Form 3CEB (Accountant's Report), which requires reporting of any international transaction with the AE not reported in any other clause, including a transaction that has a bearing on the profits, income, losses or assets of the taxpayer.
- 3.12. In the past, certain taxpayers did not report their reimbursement transactions in Form 3CEB. As mentioned above, reimbursement is an international transaction. Therefore, it ought to be reported even if it does not include a profit element.
- 3.13. An analogy can be also drawn from the decision of the **Mumbai Tribunal**⁷, wherein it was held that the taxpayer was not right in reporting the recoupment received from the AE only as a note in Form 3CEB. This should have been reported in the relevant clause to Form 3CEB. The recoupment was received, since the taxpayer had incurred losses, while the agreement with the AE for import of the product allowed a minimum margin of 4%. The Transfer Pricing Officer (TPO) was directed to consider recoupment for determination of the arm's length price, since it was an international transaction.
- 3.14. Therefore, in view of stringent penal provisions for non-reporting of transactions and non-maintenance of documentation, it is prudent for taxpayers to report such transactions and maintain relevant data to justify the arm's length's nature of their transactions.

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Form 3CEB reporting—a must

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Selection of most appropriate method

- 3.15. Earlier, prior to the introduction of Rule 10AB in the Rules, i.e., before the introduction of the 'Other Method' as the sixth method for determination of the arm's length price, the Comparable Uncontrolled Price Method (CUP Method) was generally selected as the most appropriate mode of establishing the arm's length nature of reimbursement transactions. This was typically based on the premise that reimbursement transactions:
- are undertaken on a cost-to-cost basis (i.e., not on a mark-up basis).
 - represent expenses or charges incurred by one AE on behalf of another (mainly for administrative convenience).
 - do not entail a service element.
 - do not require any significant functions to be performed, noteworthy risks to be assumed or important assets to be deployed.
- However, after introduction of the Other Method (which was meant to be applicable from the Assessment Year 2012-13 onwards), there was some debate on what the most appropriate method should be for such reimbursement-related transactions, i.e., should it continue to be the CUP Method or should it be the Other Method?
- 3.16. Typically, in a reimbursement transaction, the primary requirement for application of the CUP Method (i.e., for the same or almost the same property or service for which there is a charge) is usually not met. This is because of the fundamental difference between the underlying nature of such transactions with third parties and the subsequent transaction of cross-charge to the group entity. It may not however be possible to make adjustments for such fundamental differences. Accordingly, use of the CUP Method may not be appropriate.
- 3.17. For a relatively less stringent comparison, the Other Method (which is also a "price" based method and a variant of the CUP Method) may be resorted to. Unlike the CUP Method, Rule 10AB which governs the applicability of Other Method, does not emphasise on comparability of "property transferred or services provided" and can thus be interpreted more liberally. The Other Method, therefore, appears to be the more appropriate method in these cases.

7. Nobel Biocare India P Ltd vs DCIT (Mumbai Tribunal)



- 3.18. Under the CGST Act, a transaction will attract GST only if it qualifies as a 'supply' (as defined). The term 'supply' has been defined⁸ to include all forms of supply of goods or services, such as sale, transfer, barter, license, or lease made or agreed to be made for a consideration in the course of or in furtherance of business. The term 'supply' also seeks to include within its purview transactions in goods or services between related parties or distinct persons (including the offices of an entity in different states with separate GST registrations), when provided with or without consideration.
- 3.19. Therefore, it appears that for an activity to be treated as a 'supply' it should be a transaction in either goods or services. While 'goods'⁹ have been defined as movable property, the definition of services¹⁰ includes within its ambit 'anything other than goods', which widens the scope of the term and has the effect of including within its purview a wide variety of activities. Additionally, by virtue of a deeming fiction¹¹, the CGST Act clarifies that if a supplier agrees to an obligation to engage in an act, such activity will be construed as a service.
- 3.20. In view of this position, reimbursements can be made, subject to tax only if it can be established that these are made towards provision of goods or services.
- 3.21. Moreover, reimbursements should qualify as a consideration¹², i.e., the payment should be in respect of, in response to or for inducement of supply in a contractual framework.
- 3.22. This leads to the suggestion that a reimbursement will be subject to tax only if the payment has been made in exchange (on account of a contractual liability) for the positive act of a supply of goods or services. In sum, the test for provision of goods or services for a consideration should be satisfied for reimbursements to be subject to the GST.

Goods or services procured as a pure agent

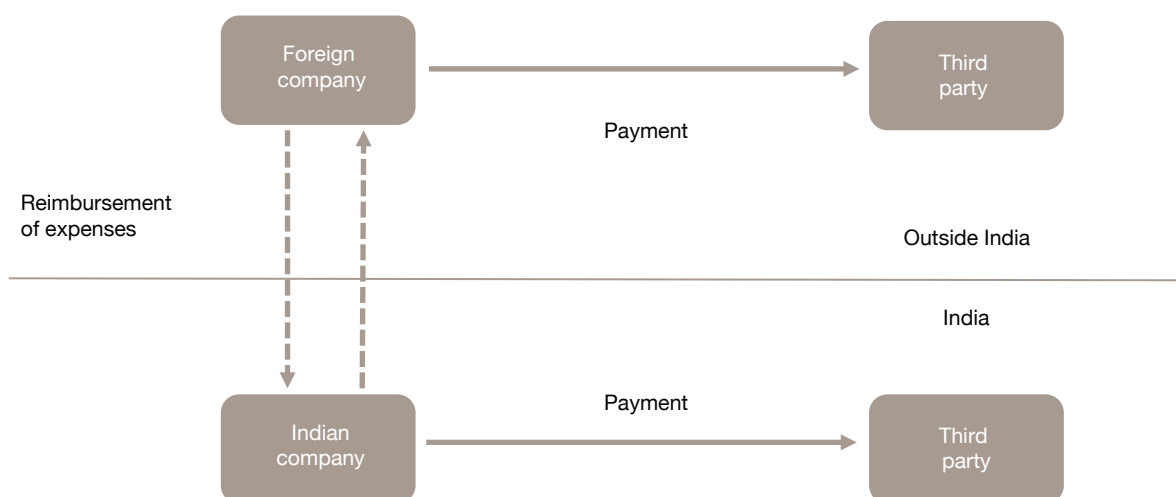
- 3.23. As in the case of legislation relating to Service Tax, the CGST Act also provides that tax is to be payable on the value of services, including incidental expenses charged by the supplier to the recipient, for the purpose of payment of tax. However, the law makes an exception to this rule by incorporating the concept of 'pure agency'¹³.
- 3.24. A supplier may be known as a 'pure agent' when he enters a contract with the recipient in order to incur expenditure or costs in the course of, and in addition to supply of goods or services to the recipient on his or her own account. In view of the fact that the supplies are procured on behalf of the recipient, the pure agent should not hold a title or use such supplies for his or her own interests and should only recoup from the recipient the actual amount incurred (i.e., without any mark-up).
- 3.25. In order to qualify as a pure agent, the supplier has the obligation to (a) substantiate that the supplies procured are in addition to supplies made on his or her own account, (b) the payment is made to the vendor as an agent of the recipient and (c) the payment is indicated separately on the invoice issued by the supplier.
- 3.26. An in-depth analysis of the contractual arrangement between the parties and the nature of the activity being undertaken (against which reimbursement is being made) becomes critical in taking a decision about whether such reimbursement should be subject to GST.



8. Section 7 of the CGST Act
9. Section 2(52) of the CGST Act
10. Section 2(102) of the CGST Act
11. Schedule II of the CGST Act
12. Section 2(31) of the CGST Act
13. Rule 33 of the Central Goods and Services Tax Rules, 2017

4.

Reimbursement by, to and through a non-resident



A. Direct Tax



- 4.1. Various **Courts**¹⁴ have held that the amount received by the taxpayer by way of reimbursement cannot be regarded as income, particularly if it was found that the taxpayer had received no money in excess of the expenses he or she had incurred. In the absence of the profit element, the Courts have been of the view that such payments are reimbursements that are not taxable in India. Consequently, no Withholding Tax needs to be applied on such payments.
- 4.2. However, a contrary view has been adopted by the **Tribunals** in some cases¹⁵, wherein it was found that the Indian companies were availing services from a third party overseas, but payment for these services were being routed through their foreign group companies, which claimed such receipts to be plain reimbursements. In such cases it was observed that had the Indian companies directly incurred such expenses, and therefore Withholding Tax Provisions should have applied to these. Therefore, it is clear that just because a transaction is routed through a foreign group company this cannot alter the nature of the payment made as reimbursement. In such

cases, the Indian companies were held to be liable to Withholding Tax on their payment to their foreign group companies.

- 4.3. Therefore, it appears that while deciding on the alleged taxability of reimbursement, Tribunals have gone ahead and analysed the nature of underlying expenses. And if underlying expenses were liable to Withholding Tax, which was not applied, the reimbursement was held to be subject to it. Interestingly, these principles have yet to be tested before the higher courts.

“ Important to evaluate taxability of underlying expenses ”

14. CIT vs Siemens Aktiengesellschaft (Bombay High Court); CIT vs IDFC Investment Advisors Ltd (Bombay High Court); DIT vs WNS Global Services (UK) Ltd (Bombay High Court) ; DCIT vs UPS Jetair Express (Mumbai Tribunal)

15. C.U. Inspection (I) P Ltd vs DCIT (Mumbai Tribunal); DCIT (TDS) vs Kodak India P Ltd (Mumbai Tribunal); Ershisanye Construction Group India P Ltd vs DCIT (Kolkata Tribunal)

Reimbursements paid

- 4.4. In the case of reimbursement paid by an Indian entity to its foreign AE, if it is able to demonstrate the existence of a back-to-back arrangement with sample copies of invoices, the transaction of reimbursement is generally not subject to intense scrutiny under Transfer Pricing audit proceedings. However, it is important to note that where payments are, in effect, for services rendered by AEs or as global cost allocations, taxpayer are expected to demonstrate actual receipts of services and the benefits derived.

Benchmarks

- 4.5. There have been contradicting views regarding the need to benchmark reimbursement transactions. In the past, certain taxpayers had taken a view that since their expenses were reimbursed on a cost-to-cost basis, no independent benchmarking was required. Demonstrating the reasonableness of allocation keys applied was largely regarded as adequate.
- 4.6. This issue was discussed in the case of **CIT vs Cushman and Wakefield India P Ltd.** wherein the **Delhi High Court** rejected the argument that mere cost recharge without a mark-up does not require a benchmarking analysis. The High Court specifically observed that whether the cost charged by the AE was inflated (or not) needs to be tested by undertaking a benchmarking analysis. It emphasised on maintenance of documentary evidence to demonstrate receipt of service, the basis of the cost incurred, the activities for which they were incurred, benefits directly related to such acts, etc., for provision of validity of claims and determination of the arm's length price.
- 4.7. Interestingly, the Supreme Court has admitted the taxpayer's Special Leave Petition (SLP) against this decision on the issue of whether benchmarking with similar transactions is necessary for reimbursements.
- 4.8. A similar view was endorsed by the **Special Bench** of the **Bangalore Tribunal**¹⁶, wherein it was held that a reimbursement-related transaction has to be at arm's length.

Benefit test

- 4.9. While justifying that a transaction of reimbursement is at cost, it is also critical to demonstrate that this reimbursement has arisen out of a business need and is 'wholly and exclusively' connected with the taxpayer's business. The need to demonstrate the 'benefit test' was also upheld by the **Delhi High Court** in the case (mentioned above) of **Cushman and Wakefield**.

Reimbursements received

- 4.10. Over the past few years, the audit approach has changed, specifically with respect to recovery transactions (i.e., reimbursement received by Indian taxpayers). If such recoveries are for some services being provided by the Indian taxpayers to their overseas AEs, there is an expectation that the Indian taxpayer earns a mark-up on the value of such recoveries.

Reimbursement not warranting mark-up

- 4.11. Thus, pure reimbursement of third party costs, where an Indian taxpayer does not add any value (i.e., it is not a service transaction), the arm's length nature of such a transaction is generally accepted, even without a mark-up.
- 4.12. The **Delhi Tribunal**¹⁷ has made salient observations with regard to 'pass through cost'. In a particular case, the Indian company (i.e., the taxpayer) was incurring significant costs on placement of advertisements for and on behalf of its clients. However, the remuneration model followed by the taxpayer did not have provision for any mark up on booked advertisements.

In light of the Organization for Economic Co-operation Development's (OECD's) guidelines and the facts of the case, the Delhi Tribunal observed that such third-party payments do not represent the value-added functions of the taxpayer. Therefore, these should not be considered for the purpose of determining the operating profitability of the Indian company. The Tribunal accepted that in this case, a mark-up was only to be applied on costs incurred by the taxpayer in performing the agency's functions and not on the cost of rendering advertising space on behalf of its AEs (which is a third-party cost).

The judgment followed the principles enunciated in the OECD's Transfer Pricing Guidelines, which clearly state in paragraph 7.36 that while applying the cost plus method, the return or mark-up should only be appropriate to the costs incurred by the intermediary in performing its agency function, rather than for its performance of the services.

- 4.13. Similarly, the **Hyderabad Tribunal**¹⁸ deleted a mark-up on reimbursement received from AE as travel and visa processing charges, observing that

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“...there could not be any markup on such expenses and particularly in the absence of any material on record that unreasonable credit facility has been extended to the AEs of the taxpayer for such reimbursement of costs”.

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16. Aztec Software vs ACIT (Bangalore Tribunal)

17. DCIT vs Cheil Communications (I) P Ltd (Delhi Tribunal)

18. Avineon India P Ltd vs DCIT (Hyderabad Tribunal)

The Tribunal observed that the TPO had not been able to furnish any material to establish that reimbursement of expenses were excessive.

- 4.14. In another case, the **Kolkata Tribunal**¹⁹ deleted an adjustment by accepting the taxpayer's contention of recovery of expenses being excluded (on cost to cost basis) from the cost base for determining arm's length price of BPO services absent service rendition and involvement of profit element. Furthermore, with regard to the taxpayer's claim for exclusion of the amount received towards sale of call manager phones, it held that this was insignificant compared to the volume of transactions, and therefore had no impact on the taxpayer's profit and loss account.
- 4.15. The **Delhi High Court**²⁰ upheld the Tribunal's order directing the AO and TPO to exclude reimbursement of costs (without mark-up) from the AE for spare infrastructure capacity while working out the taxpayer's operating cost. The High Court observed that the Tribunal had examined the agreement

with the AE to come to a definite factual conclusion regarding reimbursement of the infrastructure costs without any mark up.

- 4.16. In another interesting case, the **Mumbai Tribunal**²¹ set aside the adjustment on account of mark-up on costs incurred by a third party for determining the arm's length price. In this case, the taxpayer coordinated with third parties on behalf of the AE for services in connection with custom clearance of high-value package services and routed these payments through its balance sheet. The Tribunal observed that the taxpayer merely provided coordinating services and did not incur any direct costs or perform any direct functions, deploy assets or undertake risks. Accordingly, payment made by the taxpayer to third parties for and on behalf of the AE is not to be included in its total costs for determining its profit margin, since these were merely a 'pass through cost' and no element of service was involved.

C. Indirect Tax



- 4.17. As stated above, there can be numerous instances where foreign group entities cross-charge their related Indian entities, for example, in the following instances:
- Salary discharged by a non-resident entity to an expatriate seconded to India (where the expatriate is employed by the resident entity)
 - Cost-sharing arrangements
 - Centralised procurements undertaken by an entity for its group companies
 - Expenditure incurred due to administrative convenience, e.g., as hotel or travel expenses incurred by the visiting employees of an Indian company
- 4.18. In each of these cases, the underlying activity and transactional framework (if any) should be analysed to determine whether the reimbursement can be treated as consideration for supply of goods or services. Where the reimbursement is towards taxable supply of goods or services by a provider outside India to a recipient in the country, the latter is required to pay GST on such supplies if the place of supply is deemed to be within India.
- 4.19. On the recipient paying the GST and on fulfilment of the prescribed conditions, it will be eligible to claim input tax credit, to be set off against its output tax liability.



19. Oracle (OFSS) BPO Service vs DCIT (Kolkata Tribunal)

20. CPA Global Services P Ltd vs Pr.CIT(Delhi High Court)

21. FedEx Express Transportation and Supply Chain Services (I) P Ltd vs DCIT (Mumbai Tribunal)

5.

Payment under cost-sharing arrangements

Background

- 5.1. Cost-sharing or cost-contribution agreements typically refer to an arrangement between a number of companies, generally a part of one group of companies, wherein certain functions such as finance, HR, IT and R&D are carried out centrally by one entity, but with all the participating entities being its beneficiaries. The lead entity cross charges the beneficiaries, based on the usage or benefit they derive from the central functions. This practice is widely prevalent across industries, since it brings about synergies and cost-efficiency.

A. Direct Tax



- 5.2. From the perspective of Income Tax, the issue that arises is whether allocation or sharing of costs is taxable in the hands of the recipient entity.
- 5.3. The **Supreme Court of India**²², while analysing the taxability of pro-rata IT costs recharged to Indian agents by a foreign shipping company, held that once the character of the payment was found to be in the nature of reimbursement of expenses, it could not be charged to tax in India. In this case, the foreign shipping company had furnished its calculation of total costs and their pro-rata division among the agents (which was done without any mark-up). Moreover, the TPO had accepted that the payment was at an arm's length price.
- 5.4. In one case²³, the taxpayer (a non-resident company) conducted extensive research activities and communicated the latest inventions, information, processes, etc., to its group companies. The taxpayer imparted information, processes and inventions under the agreement, and the expenses incurred in relation to communication of this information were proportionately reimbursed by the Indian subsidiary. The **High Court** held that the amounts received by the taxpayer were by way of recoupment of expenses incurred on its research department, which it maintained in London. The research carried out by the taxpayer was for the benefit of all concerned, including the Indian subsidiary. The expense of the research, which was utilised by the subsidiaries as well as head office organisation, was shared. Therefore, the payments received by the taxpayer were held to be in the nature of reimbursements not constituting income in its hands.
- 5.5. In another case²⁴, the group companies of an entity shared the cost of basic R&D, based on an allocation key under a cost-contribution agreement. The group entities were allowed royalty-free unlimited access to research results and the IPR generated was owned by the entity undertaking the R&D (i.e., the applicant). The **Authority for Advance Rulings (AAR)** held that reimbursement received by the applicant towards R&D costs was not taxable in India and noted that the resources were pooled by all the group entities for common benefit (and not for conferment of any right on the applicant). It also held that since all the participating group entities had the right to reap the benefits of research, the payment made towards their own share of R&D costs could not be taxed in India. Similar views have been expressed by **Tribunals** in other judgments²⁵.
- 5.6. Similarly, cost-sharing arrangements for recoupment of other expenses such as software license costs and intranet charges²⁶ have been held to be not taxable in the hands of the entity initially incurring such expenses. Even in the context of reimbursement of rental expenses where office premises were shared, the **Delhi Tribunal**²⁷ held that Withholding Tax provisions were not applicable in the absence of any lessor-lessee relationship.

22. 293 CTR 1 (Supreme Court)

23. CIT vs Dunlop Rubber Company Ltd (Calcutta High Court)

24. ABB Ltd (AAR)

25. Asst. CIT vs Modicon Network P Ltd (Delhi Tribunal), Emersons Process Management India P Ltd vs Addl. CIT (Mumbai Tribunal)

26. CSC Technology Singapore Pte Ltd vs ADIT (Delhi High Court)

27. Asst. CIT vs Result Services P Ltd (Delhi Tribunal)

5.7. However, a contrary view was expressed by the **AAR**²⁸, wherein payment under a cost-sharing arrangement for recoupment of research costs was held to be in the nature of royalty. It was observed that cost allocation was dependent on rendering of services by an entity and the receipt of service by other entity. The payment was only incurred when the process or scientific experience was used by a member. It was therefore held that this did not entail sharing of costs or reimbursement of expenditure on research, but constituted payment for use of research and was taxable as royalty.

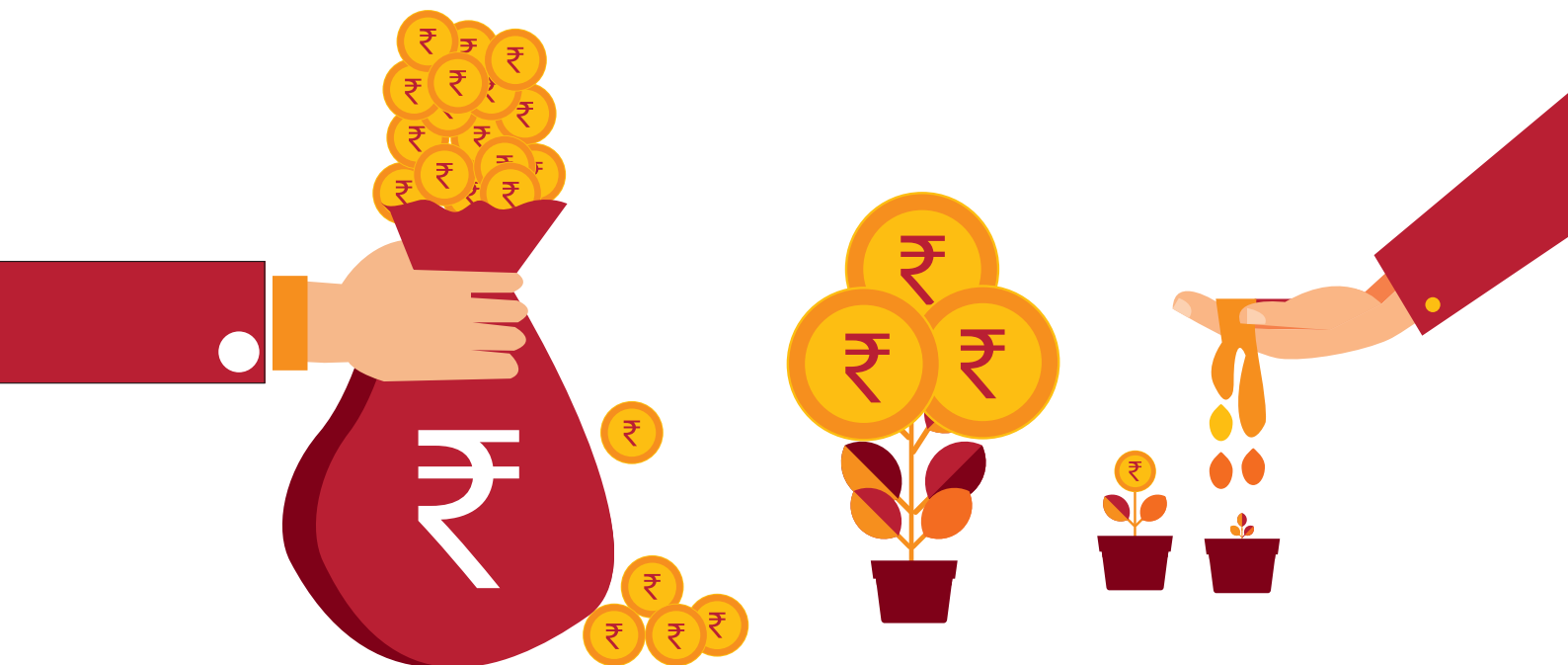
5.8. From the facts given above, it is clear that taxability depends on the facts and circumstances of each arrangement and there is a need to evaluate various underlying factors such as the basis of allocation, the value addition by the entity pooling the costs and the benefits derived by the participating entities. It is also important to maintain strong documentary evidence to demonstrate that the amount paid is in the nature of reimbursement.

B. Transfer Pricing



5.9. A transaction relating to a cost-contribution or cost-sharing arrangement is recognised separately under TP regulations (and not as reimbursement). Accordingly, it needs to be reported in clause 17 of Form 3CEB, which requires reporting of transactions conducted by mutual agreement or an

arrangement for allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to one or more enterprises.



28. A Systems (AAR)



- 5.10. As stated above, under cost-sharing arrangements, a lead group company may:
- Undertake a common function, the benefit of which is received by its various group entities
 - Centrally procure goods or services for itself and other companies in the group, e.g., by obtaining software licenses to be used by the entire group
- 5.11. While in several cases the Courts have analysed the taxability of Service Tax on cost-sharing arrangements, these have largely been in the context of examining classification of the arrangements under the specified service categories prevalent prior to 1 July 2012. Therefore, the principle emerging from these precedents is that there should be a relationship of service provider and service recipient between the lead group company and the recipient in order for the a cost-sharing arrangements to be made taxable.
- In one case, the IT systems and leased lines of an Indian taxpayer was managed centrally by the IT department of its group company located outside India. The cost of management of IT for the group, was recharged to all the companies on an agreed upon basis. A dispute arose whether the taxpayer was liable to pay Service Tax under reverse charge for the period April 2006 to May 2008. The **Mumbai Tribunal**²⁹ held that there was an element of service being rendered by the group company outside India vis-à-vis the group, including the taxpayer, and there was a clear relationship of a service provider and service recipient. In view of this, the Tribunal concluded that the taxpayer was liable to pay Service Tax under reverse charge.
- 5.12. On the other hand, where a lead group company was engaged in procuring goods or services on behalf of the group, the Courts held that there was no element of service between the lead procuring entity and the group, and therefore Service Tax may not apply in such a scenario. In one of the cases, the Mumbai Tribunal held that the cost recharged to group entities would not be subject to Service Tax³⁰, since the taxpayer had entered contractual arrangements with participating group companies to procure services on their behalf and consequently share the cost of these. In this context, the Tribunal held that the taxpayer acted in the capacity of an agent of the participating group companies while procuring goods and services on their behalf. Furthermore, it went on to conclude that the taxpayer was acting in the capacity of a pure agent, and therefore, the costs recharged to the group entities would not be subject to Service Tax. This approach is in line with the historical European Union VAT judicial precedent on non-taxability of classic cost-sharing arrangements.
- 5.13. In a particular case, the **Delhi Tribunal**³¹ held that since there was no element of service, the reimbursement would not be subject to Service Tax, since the taxpayer procured infrastructure facilities from a third party and subsequently apportioned the expenditure between the group companies. It was held that the taxpayer did not provide infrastructure facilities to the group companies and the facilities were availed from a third party and were received from it by the group companies. The taxpayer merely made a payment on behalf of the group and subsequently recovered the amount from the group. Accordingly, the Tribunal held that there was no element of service, and therefore, the reimbursement would not be subject to Service Tax.
- 5.14. The ratio of these rulings, although rendered in the context of Service Tax law, can be equally relevant under the prevalent GST regime. To reiterate, it needs to be tested whether (or not) (a) there is an intention to provide services so that there is a relationship of service provider and service recipient between the parties and (b) the lead group entity is merely making payment on behalf of other entities and therefore satisfying the 'pure agent' criterion. Moreover, adopting a simplistic view that all cost-sharing arrangements are in the nature of services may lead to a situation where expenses such as electricity, which are otherwise not subject to the GST, may be included in the value of the supply and be subject to the GST.



29. Vishay Components (I) P Ltd vs Commissioner of Central Excise (Mumbai Tribunal)

30. Reliance ADA Group P Ltd vs Commissioner of Service Tax (Mumbai Tribunal)

31. HT Media Ltd vs Commissioner of Service Tax (Delhi Tribunal)

6.

Reimbursement of cost vs service rendered at cost

6.1. At times, there can be a thin line of distinction between reimbursement of cost vs a service that is rendered at cost. For example, services

of a technical nature may be rendered, the compensation for which was agreed on at cost earlier.

A. Direct Tax



6.2. From the standpoint of Income Tax, taxability may arise if services are in the nature of FTS even though recovery is restricted to the extent of the actual expenses incurred³². In one such case, the **Mumbai Tribunal**³³ noted that even if the consideration was received at cost, it affected the cost of the services to the service recipient and not the character of the payment. On a similar fact pattern, the **AAR**³⁴ held that the income is to be taxable, irrespective of

whether or not the service provider profits. A similar conclusion was reached by the **AAR** in another case³⁵ while analysing the taxability of recoupment of market research expenses. It held that even if the fees charged by the parent company was equivalent to the expenses incurred by it in providing such services and there was no profit element, this would still be a case of *quid pro quo* for the service fees and not a reimbursement.

B. Transfer Pricing



6.3. Transactions relating to provision of services at cost are not treated as reimbursement under Transfer Pricing regulations. Accordingly, this should be reported in clause 13 of Form 3CEB, which requires transactions pertaining to provision of services to be reported.

market support services and incurred significant reimbursement costs (approx. 80% of the total cost), which it recovered from group companies at cost without any mark up. In order to calculate the net profit, the TPO made adjustment by considering such reimbursed expenses as a part of the cost. The Tribunal upheld the action of the TPO and held that reimbursements ought to be considered while computing the profitability of a taxpayer, thereby upholding the rule that the taxpayer should earn a mark-up on such cost.

Reimbursement warranting a mark-up

6.4. Where a recharge does not pertain to reimbursement of third-party costs (incurred by a taxpayer on behalf of the AE for administrative convenience), but where the Indian taxpayer has, in fact, performed value addition or was responsible and accountable for the service provided by the third party, then a mark-up can be insisted on.

The Tribunal distinguished the case of Cheil Communications and pointed out that in this case the taxpayer was not bearing any risk, whereas in the present case, the taxpayer (and not the AE) was the one who was bearing all the risk and was rendering overall marketing support services to its AE.

6.5. Interestingly, the **Delhi Tribunal**³⁶ took a contrary view in its earlier ruling in the case of Cheil Communications. In this case, the taxpayer provided

32. Bovis Lend Lease (I) P Ltd vs ITO (Bangalore Tribunal), Shell India Markets P Ltd (AAR)

33. Cotecna Inspection India P Ltd vs ACIT (Mumbai Tribunal)

34. Timken India Ltd (AAR)

35. Danfoss Industries P Ltd (AAR)

36. Seagram Manufacturing P Ltd vs ACIT (Delhi Tribunal)

6.6. The **Bangalore Tribunal**³⁷ rejected the taxpayer's contention for exclusion of expense-related reimbursement in operating costs or revenue and held that relevant expenses were incurred in connection with provision of services to the AE. It also observed that the fact that expenses were taken directly to the balance sheet without routing it through the profit and loss account cannot change the nature and purpose of the expenses.

6.7. Similarly, the **Hyderabad Tribunal**³⁸ held that implementing ERP systems for an AE group does not constitute pure cost reimbursement, but is a cost-sharing exercise, and accordingly, the cost warrants a mark-up.

C. Indirect Tax

- 6.8. As discussed above, the existence of a service provider and a service recipient relationship between the parties is a critical aspect in determination of whether a transaction is in the nature of a service at cost or reimbursement of cost.
- 6.9. If it can be established (based on the facts) that the payment was made towards expenditure incurred on behalf of the recipient, this reimbursement may be excluded from the purview of the GST if the supplier satisfies the conditions of a "pure agent", as explained above.

“ Investigation of existence of 'service' element ”



37. AXA Business Services P Ltd vs DCIT (Bangalore Tribunal)

38. Kirby Building Systems (I) Ltd vs ACIT (Hyderabad Tribunal)

Computation under presumptive taxation – whether reimbursement is to be included

Background

- 7.1. The taxability of reimbursements in cases where the income of a foreign entity is to be computed under special presumptive provisions has been a debated issue. Typically, under these provisions³⁹, gross receipts need to be considered for computation of taxable income under a presumptive mechanism.
- 7.2. Here, the question that arises is whether reimbursements are to be included in the gross receipts for the purpose of computing deemed income. Let us look at some key court rulings that have elaborated on this controversy:

A. Direct Tax



- 7.3. The Supreme Court of India recently had occasion to consider the argument of non-applicability of presumptive provisions (i.e., section 44BB—deeming provision dealing with non-resident's income in connection with business of exploration, etc., of mineral oils) for a batch of appeals on expenses reimbursed by service recipients to foreign service providers. The Supreme Court⁴⁰ rejected the taxpayers' argument regarding reimbursement and held that the mobilisation and demobilisation fees paid to the foreign service provider formed a part of the gross receipts (for the purpose of computing the deemed income). The Court observed that a fixed sum as mobilisation and demobilisation fees was stipulated in the contract, regardless of the actual expenditure incurred by the taxpayer.

In relation to reimbursement of the cost of lost tools, the Supreme Court held that the amount was not covered by the presumptive provisions. Interestingly, the Court also summarily dismissed the other grounds which, inter alia, involved reimbursement of other expenses including catering, boarding and lodging, and customs duty, without specifically adjudicating on these at length. A review petition filed before the Supreme Court to reconsider these issues has been recently dismissed.

- 7.4. Prior to the Supreme Court's decision (given above), the **Delhi Tribunal**⁴¹ held that the nexus of the expenses being reimbursed with the main activities of the taxpayer is an important parameter that needs to be considered. In the absence of a profit element and no direct nexus with activities mentioned in section 44BB, the reimbursement should not be included in the gross

receipts of the taxpayer. According to the Delhi Tribunal, it is elementary that any sum to be assessed under this section must be connected with the activities mentioned in the particular section. In another case⁴², the Delhi Tribunal noted that reimbursement of expenses was based on expenditure actually incurred by the taxpayer for providing boarding and lodging facilities to the employees of the service recipient. Since these expenses were incurred by the taxpayer on behalf of the service recipient, it was held to be in the nature of reimbursement and was not taxable under section 44BB.

- 7.5. Similarly, in the context of recovery of statutory levies (such as Service Tax and Customs Duty) and their inclusion in the gross receipts, the **High Court**⁴³ held that Service Tax collected by the taxpayer cannot be included in the gross receipts, since Service Tax is neither paid for provision of services and nor does it include an element of income. The taxpayer merely collects the Service Tax to pay it to the Government. A similar view was reiterated in some other judicial pronouncements⁴⁴, although a contrary view has also been expressed by a **Delhi Tribunal**⁴⁵. In some other cases, the **Tribunals**⁴⁶ held that in the event Service Tax and/or VAT have been separately charged in the bills and accounted for, such sums would not form part of the gross receipts, but if the sum has been included in the consolidated amount of the bill (i.e., no bifurcation is provided), then Service Tax and/or VAT should form a part of the gross receipts for the purpose of presumptive taxation.
- 7.6. In sum, considering that the decision of the Supreme Court is the law of the land, it will be interesting to see how the tax authorities and lower courts interpret its decision as far as taxability of reimbursements under presumptive provisions is concerned.

39. Sections 44B, 44BB, 44BBA and 44BBB

40. *Sedco Forex International Inc. vs CIT* (Supreme Court)

41. *ACIT vs Pride Foramer France SAS* (Delhi Tribunal)

42. *Sedco Forex International Drilling Inc. vs DCIT* (Delhi Tribunal)

43. *DIT vs Mitchell Drilling International P Ltd* (Delhi High Court)

44. *DIT vs Schlumberger Asia Services Ltd* (Uttarakhand High Court); *Swiwar Offshore Pte Ltd vs ADIT* (Mumbai Tribunal); *Western Geco International Ltd vs Asst. CIT* (Delhi Tribunal); *Islamic Republic of Iran Shipping Lines vs DCIT* (Mumbai Tribunal); *Orient Overseas Container Line Ltd vs Addt. DIT* (Mumbai Tribunal); *Hanjin Shipping Co. Ltd vs ADIT* [ITA No. 8672/Mum./2010]

45. *DDIT vs Technip Offshore Contracting BV* (Delhi Tribunal)

46. *B.J Services Company Middle East Ltd vs DIT* (Delhi Tribunal); *Mannesmann Demag Launchhammer vs CIT* (Hyderabad Tribunal)

8.

Reimbursement of out of pocket expenses (OPE)

Background

- 8.1. In an agreement for provision of services, certain expenses such as travel, lodging, accommodation, etc., are usually incurred by the service provider while providing services. These expenses can be reclaimed contractually from the service recipient as reimbursement in the form of out of pocket expenses.

A. Direct Tax



- 8.2. As discussed earlier, in the absence of any profit element, a receipt cannot be generally classified as income. Therefore, a position may be taken that such reimbursements towards OPE are not taxable in the absence of an income element. In another case, the **Delhi Tribunal**⁴⁷ held that reimbursement of actual OPE cannot be regarded as income, and therefore, no tax needs to be deducted on such reimbursement.
- 8.3. In the context of reimbursement of OPE, the courts⁴⁸ have held that reimbursement of OPE is incidental to an agreement to provide technical services, and therefore, do not constitute FTS. However, contrary to this view, some courts⁴⁹ have held that reimbursement of OPE in relation to FTS derives its character from the nature of the FTS, since such payments are considered expenses incurred in the process of providing technical services.
- 8.4. On the other hand, Withholding Tax is not required if the taxpayer (service recipient) directly incurred the travelling and hotel expenses on foreign technicians and this amount was not reimbursed to the service providers.⁵⁰ However, if the expenses have been reimbursed they cannot be separated from the fees because these were incurred in the course of earning the fees.
- 8.5. Consequently, considering the CBDT Circular and judicial precedents discussed above, it may be plausible to contend that no Withholding Tax should be applied on OPE if it is separately identified in the invoice. However, in the case of an FTS, since contrary views have been expressed it would be advisable to evaluate the contractual arrangements amongst the parties to determine the liability to withhold tax on the OPE.



47. HNS India VSAT Inc vs DDIT (Delhi Tribunal)

48. Mannesmann Demag Launchhammer vs CIT (Hyderabad Tribunal); CIT vs Tata Engg. & Locomotive Co. Ltd (Bombay High Court)

49. Cochin Refineries Ltd vs CIT (Kerala High Court); Ashok Leyland Ltd vs DCIT (Chennai Tribunal); SRK Consulting Engineers & Scientists vs CIT (AAR); CSC Technology Singapore Pte. Ltd vs ADIT (Delhi Tribunal)

50. Mahindra & Mahindra Ltd vs DCIT (Mumbai Tribunal)

B. Indirect Tax



- 8.6. The CGST Act prescribes that the value of taxable supply should include incidental expenses charged by the supplier to the recipient for the purpose of payment of tax. As a result, OPE such as travel and accommodation incurred during provision of goods or services should be included in the value of the supplies and be subject to the GST.
- 8.7. The only exception to this rule is when the expenditure is incurred by a supplier on behalf of a recipient as a 'pure agent', i.e., the prescribed conditions for it to qualify as a pure agent have been satisfied. In this case, the OPE is not subject to the GST.
- 8.8. In this regard, it is worthwhile to refer to the landmark judgement of the **Supreme Court** in the case of the **Union of India vs Intercontinental Consultants and Technocrats P Ltd.**, where Supreme Court examined the provision for valuation under Service Tax law to determine whether reimbursable expenses should be included in the value of the services for payment of Service Tax. The valuation-related provision in force under Service Tax law provides that where provision of service is

for a consideration in money terms, the value of such service (for the purpose of payment of tax) is the gross amount charged by the service provider for the service. The Court held that since reimbursement of expenses is not for provision of services, but only to recover expenses incurred in the course of providing services, Rule 5 of the Service Tax Valuation Rules (which prescribe that such reimbursements should be included in the value of the service) is *ultra vires*, and therefore, the value to be considered for the purpose of payment of Service Tax should not be more than *quid pro quo* for receipt of services. However, the Court acknowledged that with effect from 14 May 2015, the definition of 'consideration' includes reimbursable expenses, and therefore, reimbursement may be included in the value of services, for payment of tax with prospective effect.

- 8.9. Therefore, in the context of the CGST Act, this judgment may no longer hold good, since the valuation-related provision under the Act now specifically provides that GST is to be payable on the transaction value of supply of goods or services. The term 'value' has been defined to include incidental expenses for this purpose.

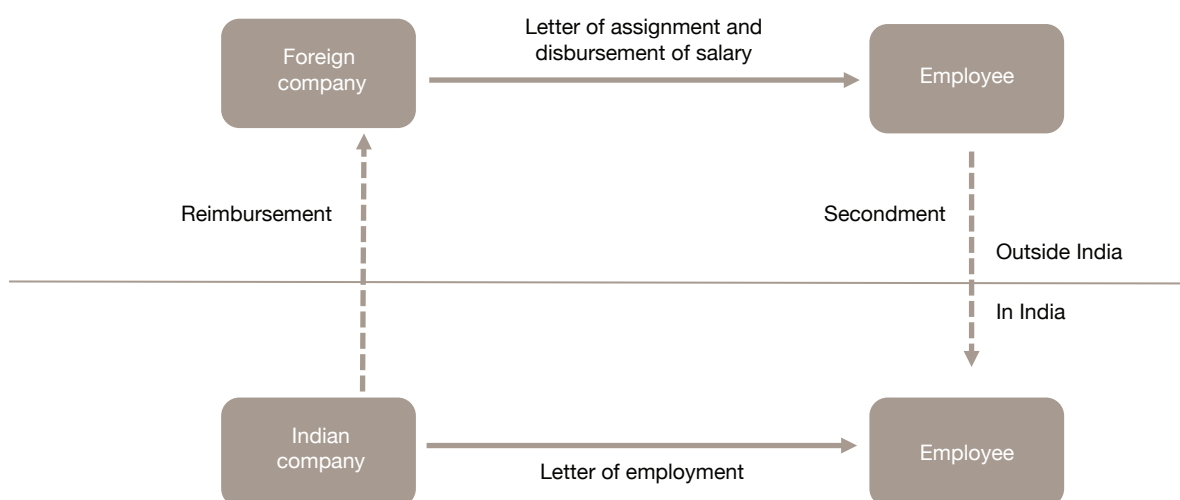


9.

Reimbursement of cost of salary in secondment arrangements

Background

- 9.1. The Indian subsidiaries of foreign MNCs often seek to utilise the skills and experience of a global talent pool through inbound secondment or deputation of foreign personnel to India. In a typical secondment arrangement, the overseas entity secondes such individuals to India. After this, the Indian entity takes on the individual onboard by issuing a letter of employment. The Indian entity is responsible for payment of the salary of the individual and applies Withholding Tax to it. Overseas entities frequently facilitate payment of salaries to the overseas accounts of the seconded employees. This is purely for administrative convenience. In this case, salary costs are reimbursed by the Indian entities to the overseas ones.



Direct Tax



- 9.2. In the recent past, secondment arrangements have been under the scanner, primarily due to whether the presence of secondees triggers Permanent Establishment-related exposure for foreign companies and/or whether the foreign companies' receipts can be taxed as FTS.
- 9.3. An important factor to consider here is about which entity supervises and has control over such secondees. In a landmark judgement, in the case of **Centrica India Offshore P Ltd. vs CIT**, it was held by the **Delhi High Court** that reimbursement of salary costs to an overseas entity is liable to tax as 'FTS', since by seconding its employees it is providing technical knowledge and skills, and assisting the taxpayer in the latter's quality control and management functions. The court held that

this payment is, in essence, compensation for managerial services provided. An SLP filed by the taxpayer before the Supreme Court against the High Court judgement was summarily dismissed⁵¹. Technically, dismissal of the SLP by the Supreme Court, especially in a 'non-speaking manner' neither confirms the High Court's judgment nor makes it a law of the land; it only means that the Supreme Court has refrained from adjudicating this case.

Here, the secondees retained a right of lien on his employment with the overseas entity, which had the right to terminate his employment, and the Indian entity had no control on him in terms of employment, continuation of employment, etc. This was an important aspect considered by the Court.

51. vide order dated 10 October 2014

- 9.4. Interestingly, in another case, the **Mumbai Tribunal**⁵² held that reimbursement of salary costs for seconded employees was not chargeable to tax in India. Similarly, the **Bombay High Court**⁵³ held that reimbursement by the Indian JV of the salary cost of seconded individuals to its UK JV partner did not constitute FTS according to the India-UK Tax Treaty. On this point, the Court relied on the narrow definition of FTS given in the India-UK Tax Treaty.
- 9.5. By placing emphasis on the concept of supervision, direction and control, the **Bangalore Tribunal**⁵⁴ held that reimbursement of salary to an overseas

entity is not subject to Withholding Tax, since the taxpayer had total control and supervision over the seconded employees and is for all practical purposes considered their employer.

- 9.6. The dispute surrounding taxability of reimbursement of salary costs in a secondment-related scenario has been continuing. However, a lot depends upon how such arrangements are put in place. It is therefore imperative for the parties to have robust documentation that distinctly specifies the understanding and arrangement, and can be provided to the authorities should the need arise.

B. Transfer Pricing



- 9.7. The Transfer Pricing principles discussed above on reimbursements also apply to a secondment-related scenario. The **Mumbai Tribunal**⁵⁵ held that payment received by a Singapore company from its India AE towards reimbursement of salaries for seconded

employees did not constitute an FTS under the IT Act as well as the India-Singapore DTAA. In view of this, it observed that payment by an Indian AE constitutes 'pure' reimbursement of salary costs, and therefore, deleted the mark-up on reimbursement of salary.

C. Indirect Tax



- 9.8. The following scenarios may arise when an expatriate from a foreign group company is seconded to an Indian entity:
- The individual is employed by the Indian entity and is subject to the benefits and regulations applicable to an employee in India. In such a case, the employee works under the control and supervision of the Indian entity and not the foreign group company.
 - Indian entity appoints the foreign group company for a specific service or activity, in the course of which an expatriate is deployed to India, but continues to work under the supervision and control of the foreign company.
- 9.9. The first scenario was the subject of litigation under the erstwhile Service Tax law. The issue in dispute was whether services qualified as manpower recruitment services and if the recipients were required to pay Service Tax on these under the reverse charge mechanism.
- 9.10. This matter has been adjudicated by the **Supreme Court**⁵⁶, **High Courts**⁵⁷ and **Tribunals**⁵⁸. In such cases, the Courts have observed that the Indian company (i.e., the taxpayer) paid the salaries of the employees in India, deducted tax and contributed to their statutory social security benefits such

as Provident Fund. Moreover, control over and supervision of the expatriate employee was always with the taxpayer. Therefore, since there was an employer-employee relationship between the expatriate and the Indian entity, it could not be said that manpower recruitment services were provided by the foreign company. Reimbursement of salary by the taxpayer Indian company to the foreign company and for the activities undertaken by the expatriate during the course of his or her employment was made by the Indian entity at cost in its capacity as the employer.

- 9.11. Similarly, under the CGST Act, reimbursement of the salary cost of such an employee to the overseas entity is undertaken by the Indian entity in its capacity as the employer. Since the services provided by an employee to an employer are specifically excluded from the purview of the GST, reimbursement of the salary cost of the employee may not be subject to this tax.
- 9.12. However, in the latter scenario, where the employee continues to be employed by the foreign company and the objective of the arrangement between the companies is to provide manpower or services to the Indian company (due to which the employee of the foreign entity is seconded to India), the nature of the services and the consequent GST-related liability on such services needs to be assessed.

52. Morgan Stanley (Asia) Singapore Pte Ltd vs DDIT (Mumbai Tribunal)

53. DIT vs Marks & Spencer Reliance India P Ltd (Bombay High Court)

54. IDS Software Solutions India P Ltd vs ITO (International Taxation)(Bangalore Tribunal)

55. Morgan Stanley Asia (Singapore) Pte Ltd vs DDIT (Mumbai Tribunal)

56. Commissioner vs Kronhe Marshall P Ltd (Supreme Court); CIT vs Volkswagen (I) P Ltd. (Supreme Court)

57. Commissioner of Service Tax vs Arvind Mills (Gujarat High Court)

58. Johnson & Johnson P Ltd vs Commissioner of Central Excise & ST (LTU) (Mumbai Tribunal)

10. Documentation

- 10.1. As is apparent from the details given above, the issue about taxability of reimbursement is highly contentious and litigative. And since parties generally desire a tax-neutral position on reimbursements, it is imperative they maintain robust documentation to substantiate their actual conduct in the arrangement or transaction. It is important to remember that more often than not, the Courts have been guided by documentary evidence produced to arrive at a decision on taxability.
- 10.2. If expenses are routine in nature and are incurred for administrative convenience on behalf of the AE, the taxpayer should maintain documentation in support of the expenses it has incurred, the benefit (if any) derived by the AE, rationale for incurring the expenses, etc.
- 10.3. The relevance of documentary evidence has been emphasised by the **Delhi Tribunal**⁵⁹, wherein due to the absence of relevant documents, the adjustment on salary reimbursement was upheld. The **Mumbai Tribunal**⁶⁰ has also upheld the relevance of documentary evidence, wherein the matter was remanded to the AO to determine the arm's length price of reimbursement after considering evidence produced by the taxpayer. Furthermore, the **Delhi Tribunal**⁶¹ held that reimbursement for a software license constitutes royalty in the absence of proper documentation.
- 10.4. Some examples of documents to be considered in the context of transactions or arrangements involving 'reimbursements' are listed below:
- Written agreement between the parties
 - Invoices or debit notes raised by the parties
 - Agreement entered by lead company with third parties and invoices raised by the third parties towards reimbursable expense incurred by the lead company
 - An accountant or auditor's certificate to substantiate that there is no profit element in the amount reimbursed by the Indian service recipient to its foreign group company or parent
- In a cost-sharing agreement between group companies, documents to substantiate basis of allocation of costs, i.e., the allocation key and an agreement between the parties to share costs
 - For reimbursement of salary costs in secondment arrangements:
 - Letter of assignment issued by foreign company to individual secondees
 - Employment contract issued by Indian company to individual secondees
 - Agreement between the foreign company and the Indian company to facilitate payment of salaries to the individual secondees
 - Salary slips of secondees and proof of taxes withheld by the Indian company
 - Debit notes raised by the overseas company on the Indian company for cross-charges

“ Robust documentation the differentiator ”



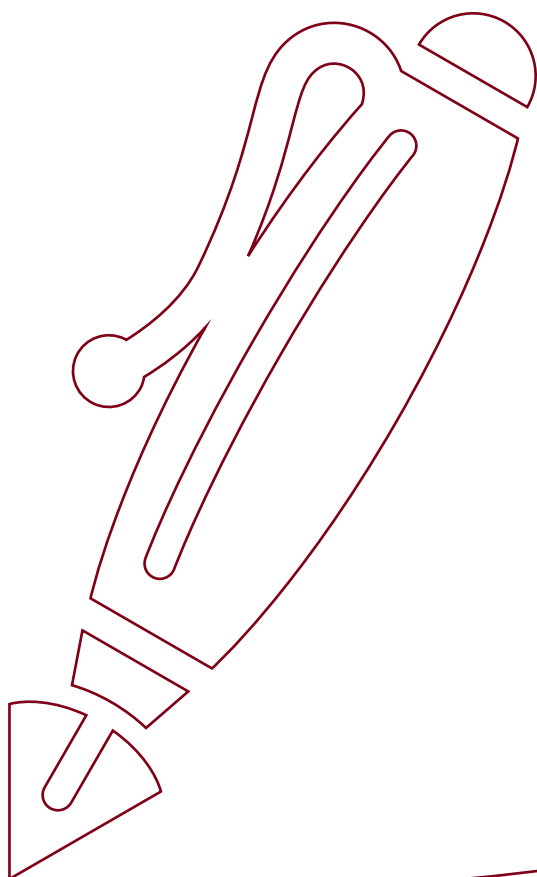
59. JT International India P Ltd vs DCIT (Delhi Tribunal)

60. Tata AutoComp Systems Ltd vs ACIT (Mumbai Tribunal)

61. SMS Iron Technology P Ltd vs ITO (Delhi Tribunal)

11. *Takeaways*

- 11.1. To sum up, there is very little debate or controversy on what constitutes 'reimbursement'. Several dictionary meanings and principles laid down by the courts help in fostering an understanding of this concept.
- 11.2. The challenge, however, lies in determining the taxability of such reimbursements. While there are a plethora of rulings now from the Indian judiciary, which provide directional guidance, uncertainty still persists. Issues generally arise due to the different interpretations of the taxpayers, the tax authorities and the courts, based on the facts of every case.
- 11.3. There is no thumb rule for determining taxability of reimbursements in India. The solution lies in maintaining meticulous documentation that records the intention of the parties and the purpose and nature of expenditure incurred. The initial burden, of course, lies on the taxpayers, to prove the bonafides of payments on the basis of the documentation they have maintained and the actual conduct of their business.
- 11.4. MNCs seeking to achieve a tax-neutral position on their intra-group reimbursement-related transactions should continue to focus on such arrangements from the perspective of Direct Tax, Transfer Pricing and Indirect Tax and closely monitor legal developments in India in these areas.



12. *References*

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3.	ITO vs Dr. Willmar Schwabe (I) P Ltd	3 SOT 71 (Delhi Tribunal)
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18.	CSC Technology Singapore Pte Ltd vs ADIT	50 SOT 399 (Delhi High Court)
19.	Asst. CIT vs Result Services P Ltd	52 SOT 598 (Delhi Tribunal)
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21.	Bovis Lend Lease (India) P Ltd vs ITO	127 TTJ 25 (Bangalore Tribunal)
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23.	Cotecna Inspection India P Ltd vs ACIT	56 taxmann.com 220 (Mumbai Tribunal)
24.	Timken India Ltd, in re	143 Taxman 257 (AAR)
25.	Danfoss Industries P Ltd, in re	268 ITR 1 (AAR)
26.	Sedco Forex International Inc vs CIT	87 taxmann.com 29 (Supreme Court)
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34.	Orient Overseas Container Line Ltd vs Addt. DIT	35 taxmann.com 342 (Mumbai Tribunal)

35.	Hanjin Shipping Co. Ltd vs ADIT	ITA No. 8672/Mum./2010 (Mumbai Tribunal)
36.	DDIT vs Technip Offshore Contracting BV	29 SOT 33 (Delhi Tribunal)
37.	B.J. Services Company Middle East Ltd vs DIT	77 taxmann.com 218 (Delhi Tribunal)
38.	Mannesmann Demag Launchhammer vs CIT	26 ITD 198 (Hyderabad Tribunal)
39.	Hero Motocorp Ltd vs ACIT	36 taxmann.com 193 (Delhi Tribunal)
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41.	Cochin Refineries Ltd vs CIT	222 ITR 354 (Kerala High Court)
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47.	DIT vs Marks & Spencer Reliance India P Ltd	ITA No. 893/2014 (Bombay High Court)
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59.	Seagram Manufacturing P Ltd vs ACIT	69 taxmann.com 385 (Delhi Tribunal)
60.	AXA Business Services P Ltd vs DCIT	(IT (TP) A. No. 334/Bang/2013 IT (TP) A. No. 484/Bang/2013 IT (TP) A. No. 965/Bang/2014 Bangalore Tribunal)
61.	Kirby Building System (I) Ltd vs ACIT	52 taxmann.com 409 (Hyderabad Tribunal)
62.	Morgan Stanley Asia (Singapore) Pte Ltd vs DDIT	95 taxmann.com 165 (Mumbai Tribunal)
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65.	Vishay Components (I) P Ltd vs Commissioner of Central Excise	8 GSTL 196 (Mumbai Tribunal)
66.	Reliance ADA Group P Ltd vs Commissioner of Service Tax	43 STR 372 (Mumbai Tribunal)
67.	HT Media Ltd vs Commissioner of Service Tax	7 GSTL 364 (Delhi Tribunal)
68.	Union of India vs Intercontinental Consultants and Technocrats P Ltd	10 GSTL 401 (Supreme Court)
69.	Commissioner vs Kronhe Marshall P Ltd	44 STR J153 (Supreme Court)
70.	Commissioner vs Volkswagen (I) P Ltd	42 STR J145 (Supreme Court)
71.	Commissioner of Service Tax vs Arvind Mills	35 STR 496 (Gujarat High Court)
72.	Johnson & Johnson P Ltd vs Commissioner of Central Excise & ST (LTU)	52 STR 159 (Mumbai Tribunal)

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