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Reimbursement of salary and other administration costs under secondment agreement not Fees for Technical Services and not liable to tax withholding

In brief

In a recent decision in the case of Abbey Business Services (India) Pvt. Ltd.[1], the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) held that reimbursement of salary and other administrative costs to a foreign company under an agreement for secondment of staff does not constitute Fees for Technical Services (FTS) under the Income-tax Act, 1961 (the Act) and under the Double Tax Avoidance Agreement between India and the United Kingdom (tax treaty). As a result, such reimbursement would not be liable to withholding tax under section 195 of the Act.

Facts

- Abbey Business Services (India) Pvt. Ltd. (the assessee) is a subsidiary of a foreign company, Anitco Ltd.
- Anitco Ltd is a group company of Abbey National Plc, (Abbey Plc), a foreign company resident in the United Kingdom (UK).
- Abbey Plc outsourced certain processing activities and call centres to Msource India Pvt. Ltd. (Msource), a company in India.
- Abbey Plc entered into a consultancy agreement with the assessee for rendering specified services for consideration on a cost-plus arrangement.

[1] Abbey Business Services (India) Pvt. Ltd. *v.* DCIT [TS-532-ITAT-2012(Bang)]

Furthermore, in order to facilitate the outsourcing agreement, Abbey Plc entered into an agreement with the assessee for secondment of staff.

- As per the secondment agreement, the employees remained on Abbey Plc's payroll in order to protect employee pension and social security contributions in the UK. However, the employees were under the supervision and control of the assessee during the term of secondment.

- Abbey Plc incurred salary costs for the employees on secondment, on which tax was deducted at source under section 192 of the Act, and paid to the Indian Government. In addition to salary costs, Abbey Plc incurred other administrative costs related to the employees seconded.

- The assessee, in accordance with the terms of the secondment agreement, reimbursed Abbey Plc for salary and other administrative costs and claimed these reimbursements as deductible expense.

- During the course of assessment proceedings, the assessing officer (AO) did not accept the assessee's contention that the payment constitutes reimbursement, and concluded that since Abbey Plc was the employer of the secondees and was providing managerial services to the assessee, the payment constituted FTS under the Act. Tax was therefore liable to be withheld from such payments under section 195 of the Act. The AO disallowed the entire payment under section 40(a)(i) of the Act for not withholding tax. The assessee filed an appeal against this disallowance before the Commissioner of Income-tax (Appeals) (CIT(A)).

- The assessee had also received an order under section 201 of the Act in which reimbursement for administrative fees was held to be FTS under section 9(1)(vii) of the Act and Article 13(4) of the tax treaty. Consequently, since tax was not deducted from administrative costs, the assessee was held to be an assessee-in-default. However, for salary costs the assessee was not held to be an assessee-in-default since tax at source was withheld under section 192 of the Act by Abbey Plc.

- The CIT(A) considered the 201 order issued to the assessee and upheld the disallowance of the administrative costs incurred by the company for non-deduction of tax. However, relief in respect of salary cost was allowed. The assessee appealed against this disallowance to the Tribunal. No appeal was preferred by the Revenue against the relief allowed by the CIT(A).

Key issues before the Tribunal

- Were the payments made by the assessee to Abbey Plc reimbursement of expenses?

- Did payment made by the assessee to Abbey Plc constitute FTS under section 9(1)(vii) of the Act and Article 13(4) of the tax treaty?

- Were the payments made by the assessee to Abbey Plc liable for withholding tax under section 195 of the Act and consequently was the payment liable for disallowance under section 40(a)(i) of the Act?

Assessee's contentions

- The agreement was for secondment of staff from Abbey Plc to the assessee. It was not an agreement for services by Abbey Plc to the assessee.

- Under the terms of the agreement, and in substance, the assessee was the real and economic employer of the secondees during the term of secondment, as the secondees worked under the management, supervision, control and according to the instructions / directions of the assessee. The place and manner of performance of duty of the secondees were determined by the assessee. The assessee was responsible and accountable for ensuring that the secondees performed their duties properly. Furthermore, Abbey Plc was required to withdraw secondees if required by the assessee. In addition, the assessee specified the nature of work to be performed and the salary costs were borne by the assessee.

- Abbey Plc did not assume any risks for performance by secondees nor exercise any control, direction or supervision over them while they were on secondment.

- The mere fact that the employees were on the payroll of Abbey Plc will not lead

to the conclusion that Abbey Plc is the actual employer. The clause in the agreement which states that Abbey Plc will remain the employer of secondees and that remuneration and other benefits will be provided by Abbey Plc is only intended to protect the individual's pension and other social security contributions in the UK.

- The assessee relied on the OECD and several judicial precedents including that of the jurisdictional Tribunal in IDS Software Solutions India Pvt. Ltd.[2] to support its contention that where the legal employment remains with one employer and supervision and control remains with the other employer, the latter is recognised as the real or economic employer.

- The assessee contended that there was no consideration for rendering managerial, consultancy or technical services or provision of services under section 9(1)(vii) of the Act. The amounts were paid by Abbey Plc and later reimbursed at cost for business.

- Article 13(4) of the tax treaty requires satisfaction of two conditions for payments to be considered as FTS:

  - Payment is made for rendering technical or consultancy services,

  - Such services should make available technical knowledge, experience, skills, etc

- As the AO has categorised the services in question as managerial services, the first condition is not satisfied. Furthermore, the condition of making available of technical knowledge, experience, etc is also not satisfied. Accordingly it would not constitute FTS under the Tax Treaty.

- Abbey Plc does not have a permanent establishment (PE) in India**.**

- Since the administration costs were inextricably linked to secondment, they were similarly not liable to witholding tax.

[2] IDS Software Solutions India Private Limited *v.* ITO [2009]122 TTJ 410 (Bangalore ITAT)

Revenue's contentions

- Abbey Plc was the real employer. The assessee was the intermediary who was authorised by the real employer to exercise supervision and control over the seconded employees.

- The payments were not pure reimbursement as the employees were providing managerial services. Therefore, the payment would constitute FTS under section 9(1)(vii) of the Act, and the assessee was liable to withhold tax under section 195 of the Act. Since no tax was withheld, the payments were to be disallowed under section 40(a)(i) of the Act. Reliance was placed on the ruling of the Authority for Advance Rulings in AT & S (I) Pvt Ltd.[3].

Tribunal Ruling

Who should be considered as the real and economic employer

- Based on the definition of 'employer' and 'employee' in the Shorter Oxford Dictionary and Court decisions, the Tribunal held that the significant determination of employee-employer relationship is whether there was due control and supervision by the employer considering the nature of work.

- The Tribunal agreed that the terms of the agreement clearly proved that the economic interest, supervision, control, direction, manner, place, method of their work, right to issue directions, accept or reject employees for secondment was exercised by assessee.

- Therefore, based on agreement and relying on the principles laid down by Courts, it held that the assessee was the real and economic employer.

- Furthermore, in relation to the terms of agreement which stated that Abbey Plc will remain the employer, the Tribunal relied on the Supreme Court decision in the case of Ishikawajima–Harima Heavy Industries Ltd[4] and held that in construing a contract, terms and conditions are to be read as a whole. The

[3] AT & S (I) Pvt Ltd. *v.* CIT [2006] 287 ITR 421 (AAR)
[4] Ishikawajima-Harima Heavy Industries *v.* DCIT [2007] 288 ITR 406 (SC)

clauses were inserted with the intention of protecting employee welfare interest and should not be construed to show that Abbey Plc is the actual employer.

- The Tribunal thus held that the decision in the case of IDS Software Solutions Pvt. Ltd. (above) fully applied to the assessee's case. As such, it was held that since supervision, control over the secondees and the right to instruct them was with the assessee, though Abbey Plc was the legal employer, the assessee would be considered as the employer of the seconded employees.

Whether the payments were reimbursement

- The Tribunal noted that under the terms of the agreement, the assessee had agreed to reimburse the remuneration, pension contribution, expenses, statutory payments and any other sums incurred by Abbey Plc for each secondee. Additionally, based on the notes to the account, the break-down of administrative and general expenses, and the report by the independent accountant, the Tribunal held that the payments were pure reimbursement of salary and other costs. On the issue whether reimbursement of expenses can be regarded as income chargeable in the hands of non-resident, the Tribunal relying on various decisions,[5] held that since there is no income element it cannot be regarded as income chargeable under the Act.

On the issue of whether payments constitute FTS under the Act and the Tax Treaty

- The Tribunal held that FTS has been defined under the Act as a consideration for any managerial, technical or consultancy services, including provision of the services of technical or other personnel. In the case of the assessee, the agreement between the parties was for the secondment of staff and not for the rendering of services. Furthermore, since under the agreement the assessee had undertaken to reimburse Abbey Plc, the payment would not constitute consideration for services. On the issue of whether there was any provision of services of technical or other personnel, the Tribunal held that the use of the words "services of" in the expression mandated the rendering of some sort of work through the act of services of technical or other personnel. Since Abbey Plc had only seconded employees and not rendered any services, the requirement of provisions of services was not satisfied. Accordingly, the reimbursement would not constitute FTS under the Act[6].

- The Tribunal held that as the payments do not constitute FTS under the Act nor constitute income chargeable to tax, there is no need to examine the tax treaty. The Tribunal relied on the decision of the Supreme Court in the case of Azadi Bachao Andolan and Another,[7] which held that treaties cannot impose tax which is not levied under the provisions of Act.

- In any case, under the tax treaty, the term managerial service is not present in Article 13(4) of the tax treaty. Further, such services also do not satisfy the condition of 'making available' technology, process, skills, etc. Accordingly, such payments will also not constitute FTS under the tax treaty.

Whether payments made by the assessee to Abbey Plc were liable for withholding tax under section 195 of the Act and consequently to be disallowed under section 40(a)(i) of the Act

- As held above, the assessee is held to be the real and economic employer of the employees seconded.

- The reimbursements were without any profit element and therefore cannot be regarded as income chargeable in the hands of Abbey Plc.

- In view of this, the payments were not liable for withholding tax under section 195 of the Act. Consequently, no disallowance under section 40(a)(i) of the Act is warranted.

[5] Tisco *v.* UOI [2001] 2 SCC 41 (SC)
CIT *v.* Tejaji Farasram Khanwala Ltd. [1968] 67 ITR 95 (SC)
Cholamandalam MS General Insurance Co. Ltd., *In re* [2009] 309 ITR 356 (AAR)
Mahindra & Mahindra Ltd. *v.* DCIT [2009] 313 ITR (AT) 263 (Mum ITAT)
IDS Software Solutions India Pvt. Ltd. *v.* ITO [2009]122 TTJ 410 (Bang ITAT)

[6] IDS Software Solutions India Pvt. Ltd. *v.* ITO [2009]122 TTJ 410 (ITAT Bang)
ACIT *v.* Karl Storz Endoscopy India Pvt. Ltd. [ITA No. 2929/Del/2009].

[7] UOI *v.* Azadi Bachao Andolan [2002] 125 Taxmann 826 (SC)

Conclusion

This is a welcome ruling especially since it recognises that commercial exigencies may require employees to continue their legal employment with a foreign company, and that that by itself would not give rise to a service agreement. The Tribunal had thus clearly distinguished the concepts of legal employment *v.* economic employment, in line with the OECD position. This decision would be relevant not only where cross border secondments are involved but also to other kinds of reimbursement at cost.

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