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Consideration received for providing technical personnel taxable as fees for included services under India-US tax treaty

In brief

The Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in its recent decision in the case of Avion Systems Inc.¹ (the assessee), has held that services in the nature of providing technical personnel to Lucent Technologies Hindustan Pvt. Ltd. (Lucent) who are under employment with the assessee 'make available' technical expertise and hence, the consideration paid by Lucent will be taxable as fees for included services (FIS) under the India-US Double Taxation Avoidance Agreement (the tax treaty).

Facts

- The assessee is a US based company, specialised in providing highly qualified technocrats and technology relating to telecom sector and higher solutions in telecom engineering services.
- Lucent is an India based company engaged in manufacturing and commissioning of telecom equipment in India.
- The assessee entered into an agreement with Lucent for providing qualified technocrats for a telecom project which it had received under a contract from Reliance Telecom.

¹ Avion Systems Inc v. DDIT [TS-370-ITAT-2012 (Mumbai)]

- The salaries of the technical persons were reimbursed by Lucent to the assessee which in turn disbursed the salaries to the personnel. Lucent paid a mark-up of 6% to the assessee over and above the reimbursement of salary.
- The assessee had no permanent establishment (PE) in India.
- On the analysis of various clauses of the agreement between the assessee and Lucent, the assessing officer (AO) held that the consideration for supply of manpower is taxable as FIS under Article 12(4)(b) of the tax treaty on account of the following:
 - the supplied manpower (temporary worker) were the employees of the assessee working under supervision and control of the assessee to execute the contract for Lucent;
 - the agreement was not for mere supply of manpower but was for outsourcing of contract taken by Lucent;
 - the assessee was responsible for the contract related responsibilities like selecting required materials, guarantee of raw material selected, etc;
 - rights like intellectual property belonged to Lucent.
- The Commissioner of Income-tax (Appeals) (CIT(A)) upheld the order of the AO.
- Aggrieved by the orders of the lower authorities, the assessee preferred an appeal before the Tribunal.

Issue

- Whether the personnel provided by the assessee to Lucent were the employees of the assessee or not?
- Whether fees received by the assessee for locating and deputing technocrats to Lucent can be taxable as FIS in terms of Article 12 of the tax treaty?

- If the consideration was taxable as FIS, whether the net receipts of the agreement should be taxed after reducing the amount due to the technocrats which were in the nature of pure reimbursements?

Assessee's contentions

- The assessee's main business activity is supply of manpower, IT staffing and consultancy.
- The agreement between the assessee and Lucent was on principal-to-principal basis and was mainly for locating and sourcing experts and technical personnel located outside India and deputing the experts for temporary employment with Lucent.
- The deputed personnel were not under employment with the assessee and had earlier worked on various projects for Lucent.
- The assessee was not involved in selection or performance of such temporary personnel and the time-sheets of the working hours were maintained by Lucent.
- Salary of these personnel were paid to the assessee only to reimburse them according to their working hours and what the assessee used to get in lieu thereof was a fee computed at 6% of the salary.
- The deputed personnel worked under the control and supervision of Lucent without any corresponding reporting obligation to the assessee.
- The assessee was not involved directly in the execution of the contract with Reliance Telecom or providing any kind of technical and consultancy service during the execution of the contract.

- Alternatively, even if the deputed employees were considered as employees of the assessee, the assessee have not made available any technology as stipulated in Article 12(4) of the tax treaty².

Revenue's contentions

- Lucent had entered into agreement with the assessee for supplying highly qualified technocrats for its telecom project as the assessee is a leader in telecom engineering having full-fledged qualified engineers.
- In the assessment order, extensive reference was made to the various clauses of the agreement to deduce the fact that the assessee had in fact made available technology and technical personnel to Lucent.
- The deputed technical personnel were employees of the assessee and if these expatriates were Lucent's ex-employees then there was no need for hiring them through the assessee.

Tribunal ruling

- The Tribunal noted that as per the agreement, Lucent is executing various contracts for installing and commissioning telecom equipment. In order to handle activities of installation, testing and integration of telecom equipment

at various sites (services), it did not have enough personnel and therefore, it required the services of experienced personnel for performing the services.

- The assessee has requisite experts and technical personnel of desired experience and expertise in telecom related technology and has provided such personnel to Lucent as per the agreement.

Whether the technical personnel are employees of the assessee or simply outsourced to Lucent?

- Upon referring various clauses of the agreement, the following points were noted by the Tribunal:
 - Temporary workers were not the employees of Lucent;
 - Lucent did not take any kind of responsibility of any temporary worker provided by the assessee;
 - The assessee was responsible for all the personnel deployed to Lucent and the compliance of laws relating to employer-employee relationship, payment of salary, etc;
 - All the temporary workers/personnel were employees of the assessee and had given undertaking to Lucent as employees of the assessee;
 - The payment for the deployed personnel was to be given as per the work sheet provided by Lucent alongwith the fees of 6% of the invoice value.
 - One or two fray incidents of preference of technocrats by Lucent will not lead to a conclusion that these technical persons were not the employees of the assessee or were under the control of Lucent.
- The Tribunal reached a conclusion that the technical personnel were employees of the assessee.

² Reliance placed by the assessee on following cases:

- DDIT v. Tekmark Global Solutions [2010] 38 SOT 7 (Mum)
- DIT v. HCL Infosystems Ltd. [2005] 274 ITR 261 (Del)
- IDS Software solutions Ltd v. ITO [2009] 122 TTJ 410 (Bang)
- Intertek Testing Service India Pvt. Ltd. *In re* [2008] 307 ITR 418 (AAR)
- Worleyparsons Services Pvt. Ltd. *In re* [2008] 301 ITR 54 (AAR)
- Raymond Ltd. v. DCIT [2003] 86 ITD 791 (Mum)
- CESC Ltd. v. DCIT [2003] 87 ITD 653 (Kol)
- DDIT v. Scientific Atlanta Inc [2009] 33 SOT 220 (Mum)
- ADIT v. Bureau Veritas [2010] 131 TTJ 29 (Mum)
- Mahindra & Mahindra Ltd. v. DCIT [2009] 122 TTJ 577 (Mum)(SB)

Whether services provided come within the purview of Article 12 of the tax treaty?

- The Tribunal noted that the profile of the assessee clearly indicates the nature of its activities and the reason for Lucent to engage with the assessee is not because it is a recruiting agency but because it is one of the leaders in providing high technology solutions in the field of telecom sector.
- From various clauses of the agreement, it was evident that the contract with Lucent was for providing technical personnel and making available the expertise of the assessee/personnel in the field of telecom sector.
- The nature of services provided by the assessee is clearly covered within illustration 3³ of the memorandum of understanding to the tax treaty.
- The case laws relied by the assessee, particularly those involving deputation of the employees⁴, were clearly distinguished in the assessee's case. Hence, it was held that the services rendered by the assessee falls within the Article 12(4)(b)

of the tax treaty and the payments received from Lucent is taxable in India as FIS.

Conclusion

- In the decision, the factual examination of 'employer-employee' relationship has been carried out in the context of supply of personnel.
- The above decision of the Tribunal is an addition to the list of Tribunal decisions dealing with the issue of payment made with respect to employees deputed to Indian companies by overseas entities. Robust documentation is necessary and required to prove deputation arrangement is not an arrangement for provision of technical/consultancy services but a case where the Indian company is indeed the 'economic and real employer'. Moreover, deputation agreements are to be framed with utmost care and taxability of such consideration will depend on the facts of each case.

³ Example 3 – A US manufacturing has experience in the use of a process for manufacturing wallboard for interior walls of house which is more durable than the standard products of its type. The Indian builder wishes to produce for its own use. It rents a plant and contracts with US company to send experts to India to show engineers in the Indian company how to produce the extra-strong wallboard. The US contractors work with the technicians in the Indian firm for a few months. Are the payments to the US firm considered to be payments for 'included services'?

Analysis

The payments would be fees for included services. The services are of technical or consultancy nature; in the example, they have elements of both the type of services. The services make available to the Indian company technical knowledge, skill and processes.

⁴ Cases involving deputation of employees:

- Tekmark Global Solutions (above)
- IDS Software solutions Ltd (above)
- Intertek Testing Service India Pvt. Ltd. (above)
- CESC Ltd. (above)
- Scientific Atlanta Inc (above)
- Mahindra & Mahindra Ltd (above)

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