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TDS not applicable on reimbursement of salary and other associated costs of deputed employees

In brief

In the case of CMS (India) Operations and Maintenance Co Pvt Ltd¹ (the assessee), the Income-tax Appellate Tribunal (the Tribunal) of the Chennai Bench held that tax withholding (TDS) is not applicable on the reimbursement of salary costs of employees sent on deputation by the non-resident company, as such reimbursements were on an actual cost basis. Further, the withholding tax obligations on employee salaries were met by the foreign company. Also, an appeal under section 248 of the Income-tax Act, 1961 (the Act) is maintainable even without filing an application for lower TDS, under section 195(2) of the Act.

Facts

- The assessee was engaged in the business of operations and maintenance of power plants. CMS Resource Management Company, (CMS RDC), the non-resident company, had deputed its employees to India to work for the assessee.
- The expenses of deputed employees were reimbursed by the assessee and claimed as reimbursement of manpower cost. The assessee had not withheld tax on such reimbursements for the assessment years (AY) 2002-2003 to 2006-2007.
- For the AY 2007-2008, the assessee, as a matter of prudence, had withheld tax at source on such reimbursements to CMS RDC. However, after paying the

¹ CMS (India) Operations and Maintenance Co Pvt Ltd v. ITO [TS-204-ITAT-2013 (CHNY)]

taxes, the assessee filed an appeal to the Commissioner of Income-tax (Appeals) under section 248 of the Act, claiming that no tax was required to be withheld on such payments.

- The assessing officer (AO) disallowed the expenditure, under section 40(a)(i) of the Act for AYs 2002-2003 to 2006-2007, on the basis that no taxes were withheld under section 195 of the Act on such payments.

Issues before the Tribunal

- Whether taxes were to be withheld on payments made to the non-resident in the nature of reimbursement of salary and other associated costs of the deputed employees?
- Whether the assessee's appeal under section 248 of the Act was maintainable without applying for lower withholding of taxes under section 195(2) for the AY 2007-2008?

Revenue's contentions

- Payments made by the assessee to CMS RDC were for rendering managerial services. Accordingly, such payments were taxable, as fees for technical services under section 9(1)(vii) of the Act.
- For the AY 2007-2008, the appeal filed by the assessee under section 248 of the Act is not maintainable, as the assessee ought to have made an application before the department for a lower withholding tax rate, as per section 195(2) of the Act.

Tribunal Ruling

For AY 2002-2003 to AY 2006- 2007

- Section 40(a)(i) of the Act stipulated disallowance of payments on which tax is deductible. Accordingly, the applicability of sections 192 and 195 of the Act needed to be evaluated for salary cost reimbursements.

Applicability of section 192 of the Act

CMS RDC had withheld tax on salaries paid to deputed employees, and the expatriates had filed their tax returns in India. This indicated that these employees were under the payroll of CMS RDC and could only be considered as employees of CMS RDC. Thus, the assessee was not liable to withhold tax under section 192 of the Act.

Applicability of section 195 of the Act

Section 195 of the Act is applicable on payments which should be a sum chargeable under the provisions of the Act. If the payments were covered within fees for technical services (FTS) under section 9(1)(vii) of the Act, the assessee could take the benefit of the beneficial provisions of section 90(2) of the Act, that is, the double taxation avoidance agreement (the tax treaty) between India and the USA.

As per the tax treaty between India and the US, technical services have to be 'made available' in order to be taxable as FTS. However, the agreement between CMS RDC and the assessee clearly indicates that no technical know-how was made available to the assessee. Thus, there was no obligation for the assessee to withhold tax under section 195 of the Act.

- Based on the above, and relying on similar cases,² disallowance made under section 40(a)(i) for the amount reimbursed to CMS RDC was not sustainable, since the assessee was not required to withhold tax on the manpower cost so reimbursed

For AY 2007-2008

- Section 248 of the Act does enable an assessee to file an appeal after the deduction of tax at source, claiming that no tax was required to be withheld on such payment.

Conclusion

This ruling would be a good defence to claim reimbursement of salary costs as an allowable expenditure, where such reimbursements are made to non-resident companies without tax withholding, subject to employees offering salary income from 'non-resident' employer to tax.

² Special Bench of Tribunal in ITO, International Taxation, Chennai v Prasad Productions Ltd [2010] 3 ITR(T) 58 (Chennai) (SB)/[2010] 125 ITD 263 (Chennai) (SB)/[2010] 129 TTJ 641 (Chennai) (SB); and Supreme Court in the case of Transmission Corporation of AP Ltd v CIT [1999] 239 ITR 587 (SC)/ [1999] 105 Taxman 742(SC)/ [1999] 155 CTR 489 (SC).

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Our offices

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<p>Ahmedabad President Plaza, 1st Floor Plot No 36 Opp Muktidham Derasar Thaltej Cross Road, SG Highway Ahmedabad, Gujarat 380054 Phone +91-79 3091 7000</p>	<p>Bangalore 6th Floor, Millenia Tower 'D' 1 & 2, Murphy Road, Ulsoor, Bangalore 560 008 Phone +91-80 4079 7000</p>	<p>Chennai 8th Floor, Prestige Palladium Bayan 129-140 Greams Road, Chennai 600 006, India Phone +91 44 4228 5000</p>	<p>Hyderabad #8-2-293/82/A/113A Road no. 36, Jubilee Hills, Hyderabad 500 034, Andhra Pradesh Phone +91-40 6624 6600</p>	<p>Kolkata 56 & 57, Block DN. Ground Floor, A- Wing Sector - V, Salt Lake. Kolkata - 700 091, West Bengal, India Telephone: +91-033 - 2357 9101/4400 1111 Fax: (91) 033 - 2357 2754</p>
<p>Mumbai PwC House, Plot No. 18A, Guru Nanak Road - (Station Road), Bandra (West), Mumbai - 400 050 Phone +91-22 6689 1000</p>	<p>Gurgaon Building No. 10, Tower - C 17th & 18th Floor, DLF Cyber City, Gurgaon Haryana -122002 Phone : +91-124 330 6000</p>	<p>Pune GF-02, Tower C, Panchshil Tech Park, Don Bosco School Road, Yerwada, Pune - 411 006 Phone +91-20 4100 4444</p>	<p>For more information contact us at, pwctr.knowledgemanagement@in.pwc.com</p>	

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