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Payment to a Hong Kong based company for the services of seconded employees is taxable as fees for technical services under the Income-tax Act

Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Food World Supermarkets Ltd.[1] (the taxpayer) held that a payment made to a foreign company for the services of the deputed personnel under the secondment agreement is taxable as Fees for Technical Services (FTS) under the Income-tax Act, 1961 (the Act).

The Tribunal observed that the concept of income included positive as well as negative income or nil income. In the case of payment being FTS or royalty as per Section 9(1) of the Act, it is irrelevant whether any profit element is included in the income or not.

Facts of the case

- The taxpayer is an Indian company engaged in the business of ownership and operation of a supermarket chain in India. The taxpayer entered into an agreement with Diary Farm Company Ltd. (DFCL), a Hong Kong based company, engaged in the identical business activity as that of the taxpayer.
- In terms of the said agreement, DFCL agreed to assign its employees to the taxpayer and consequently five employees/expatriates were deputed. The taxpayer agreed to engage these employees to assist it in its business operation.
- It was also agreed between the parties that the salary to their assigned personnel would be paid by DFCL, which was subject to Tax Deduction at Source (TDS) under Section 192 of the Act. The taxpayer reimbursed DFCL towards the salary paid to the assigned personnel without deduction of tax at source.
- The Assessing Officer (AO) held that a remittance made by the taxpayer constitutes as FTS under Section 9(1)(vii) of the Act. The same is chargeable to tax on a gross basis. Therefore, the taxpayer was liable to deduct tax under Section 195 at 10 per cent. Accordingly, the AO treated the taxpayer as 'an assessee in default' under Section 201(1) of the Act for not withholding tax at source. The AO also determined the interest under Section 201(1A) of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Tribunal's ruling

Taxability as FTS under the Act

- On referring to the details of the seconded employees in the agreement, it indicates that all five secondees were not ordinary employees or workers but they were deputed on high level managerial/executive positions, which indicates that they were deputed because of their expertise and managerial skills in the field.
- The secondment agreement was between the taxpayer and DFCL, and the secondees assigned to the taxpayer were not a party to the agreement. Further, the secondees were assigned by DFCL and there was no separate contract of employment between the taxpayer and the secondees

[1] Food World Supermarkets Ltd. v. DDIT (ITA Nos. 1356 & 1357/Bang/2013) – Taxsutra.com

- The secondees were under the legal obligation as well as employment of DFCL and assigned to the taxpayer only for a short period of time. In the absence of any contract between the taxpayer and the secondees, the parties cannot enforce any right or obligation against each other. The secondees can claim their salary only from the parent company and not from the taxpayer. Thus, the expatriates were performing their duties for and on behalf of DFCL.

- Once it was found that the secondees were rendering managerial and highly expertise services to the taxpayer, the payment for such services would fall under the ambit of FTS as defined in Explanation 2 to Section 9(1)(vii) of the Act.

- An identical issue has been considered and decided by the Delhi High Court in the case of Centrica India Offshore (P.) Ltd.[2]. The High Court while dealing with the definition of FTS under Article 13(4) of the India-U.K. tax treaty held that the services of the personnel deputed under the secondment agreement were in the nature of managerial consultancy services to the taxpayer.

- The Delhi High Court while deciding the issue in the case of Centrica has observed that the term 'including the provision of services of technical or other personnel' is common in both the definitions provided under the Explanation to Section 9(1)(vii) of the Act as well as in Article 13(4) of the India-U.K. tax treaty. Moreover, the definition of FTS under Section 9(1)(vii) of the Act and Article 13(4) of India-U.K. tax treaty are similar, except that one extra word 'managerial' in the definition under the Act. Further, the Special Leave Petition (SLP) filed against the judgement of the Delhi High Court has been dismissed by the Supreme Court in Centrica India Offshore (P.) Ltd.[3]. Therefore, the view taken by the High Court has attained finality.

- The concept of income includes positive as well as negative income or nil income. In the case of payment being FTS or royalty as per Section 9(1) of the Act, it is irrelevant whether any profit element is included in the income or not. It is not only a matter of computation of total income when the concept of profit element in the payment is relevant.

- If the payment being FTS or royalty is made to a non-resident, then the concept of total income becomes irrelevant and the provisions of Section 44D of the Act recognise the gross payment chargeable to tax. Thus, all the payments made by the taxpayer to a non-resident on account of FTS or royalty is chargeable to tax irrespective of any profit element in the said payment or not.

- However, there is an exception to this rule of charging the gross amount when the non-resident is having a fixed place of business or /Permanent Establishment (PE) in India and the amount is earned through the PE; then the expenditure incurred in relation to the PE for earning the said amount is allowable as per the provisions of Section 44DA of the Act. Therefore, in view of the judgement of the Delhi High Court in the case of Centrica, the payment made to foreign company partakes the character of FTS as per the definition under Explanation 2 to Section 9(1)(vii) of the Act.

- The decisions relied upon by the taxpayer in the case of IDS Software Solutions[4] and Abbey Business Solution[5] would not help the case of the taxpayer when there is a direct judgement of Delhi High Court on this point.

Service PE

- The Tribunal observed that there is no tax treaty between India and Hong Kong and under the provisions of the Act, there is no concept of a service PE. The taxpayer relied on the decision of the Supreme Court in the case of Morgan Stanely and Co Inc.[6] wherein while analysing the definition of PE under Section 92F(iii) of the Act, the Supreme Court observed that the intention of the Parliament in adopting an inclusive definition of PE covers the service PE, agency PE, software PE, construction PE, etc.

- Since this plea has been taken by the taxpayer for the first time before the Tribunal and there is no tax treaty between India and Hong Kong, the concept of a service PE requires a proper examination of all the relevant facts as well as provisions on the point whether it constitute a service PE in India or not.

- Accordingly, the issue was remitted to the file of the AO for adjudication of the issue of whether the secondment of employees, constitute service PE and accordingly the provisions of Section 44DA would be applicable.

Our comments

Taxability of payments relating to the secondment of employees to India by a foreign entity has been a subject matter of litigation before the Courts and the Tribunal. In the instant case, the Bangalore Tribunal relying on the decision in the case of Centrica India Pvt. Ltd. held that payment made to a foreign

[2] **Centrica India** Offshore (**P**.) **Ltd**. v. CIT [2014] 364 ITR 336 (Del)
[3] **Centrica India** Offshore (**P**.) **Ltd**. v. CIT [2014] 227 Taxman 368 (SC)

[4] IDS software Solution Software India Pvt. Ltd. v. ITO [2009] 122 TTJ 410 (Bang)
[5] Abbey Business Services (India) Pvt. Ltd. [2012] 53 SOT 401 (Bang)
[6] CIT v. Morgan Stanley and Co. Inc. [2007] 292 ITR 416 (SC)

company for the services of the deputed personnel under the secondment agreement is taxable in India as FTS under the Act.

This case is dealing with a company based in Hong Kong with which India does not have a tax treaty. However, the Tribunal observed that the definition of FTS under Section 9(1)(vii) of the Act and Article 13(4) of the India-U.K. tax treaty is similar except that one extra word ‘managerial' in the definition under the Act. Further, the issue was remitted to the AO for adjudication of whether the secondment of the employees constitutes a service PE and accordingly the provisions of Section 44DA would be applicable.

www.kpmg.com/in

Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

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