Tenet Tax & Legal Private Limited

Tenet Tax Daily
November 1, 2013

Reimbursement to Foreign AE towards seconded employee salary is not FTS

Summary – The Mumbai ITAT in a recent case of Temasek Holdings Advisors (I) (P.) Ltd., (the Assessee) held that where assessee rendered investment advisory services to its foreign AE, reimbursement of salary that was paid by foreign AE to seconded employees would not be FTS. Assessee-company was not required to deduct tax under section 195 on reimbursement of salary of employees seconded by foreign AE, which had already deducted tax under section 192.

Facts

- The assessee, a wholly owned subsidiary of Singapore-company THPL, rendered investment advisory service to THPL. Based on this advice, THPL made investment in India. For rendering these services, the THPL paid a mark-up of 21 per cent besides reimbursement of certain expenses on actual basis.
- The Singapore-company seconded two employees to the assessee-company in India to assist the assessee to render investment advisory service to THPL, Singapore. As per the secondment agreement entered into between THPL and the assessee-company, the salary of these two employees was to be paid by THPL, and the assessee-company has to reimburse the cost of salary and other expenses relating to their employment which had been paid by THPL. Since the salary was paid by THPL, it deducted tax under section 192, and deposited the same in the Indian Government treasury. Being an international transaction, *i.e.,* reimbursement of the expenses to the THPL by the assessee-company, this issue was subject matter of the reference under transfer pricing. The TPO found these transactions at ALP. However, the Assessing Officer took an adverse view regarding the reimbursement of the salary by the assessee-company to THPL on the ground that TDS under section 195 had not been deducted, hence, disallowance under section 40(a)(ia) had to be made. He held that 'secondment agreements' were unregistered and date and place in the said agreements were not mentioned and, therefore, these agreements were a colourable device with an intention of avoiding tax liability on the expenses which had been claimed to be reimbursed.
- The margin of 21 per cent had been benchmarked by using TNMM as the most appropriate method with PLI as operating profit to operating cost. After detail process of selection in 'Prowess data' and selection criteria, it had selected six comparables in its transfer pricing study report with average margin of 13.85 per cent. Since this margin was lower than assessee's margin of 21 per cent on the transaction carried out with its parent company was considered to be at ALP. The TPO, however, out rightly rejected the assessee's comparables, firstly, on the ground that they were not in investment advisory services and secondly that the assessee had not carried out search by using the key phrase 'investment advisory services'. He was of the opinion that the data should have been accessed from the 'Capital line data base'. No proper reasoning has been given by the TPO as to why data from 'prowess' was not reliable and the 'capital line data' should have been taken.

Held

On issue of TDS on salary of seconded employees

- The services were provided by the Indian-company to the Singapore-company and not *vice-versa*. This aspect has to be kept in mind in the present case.
- Reasoning of the Assessing Officer is wholly vitiated for the reason that firstly, an agreement between the two parties need not necessarily be registered as there is no provision under the law that such secondment agreement entered into between the two parties needs to be registered under some Indian statutory law or any approval from the Government of India is required. Secondly, before the Commissioner (Appeals), the signed agreement was duly filed and in the said agreements, date had already been mentioned in the operating part of the agreement. If the Assessing Officer had any doubt about the authenticity of the agreement, he could have very well required the assessee to substantiate the same. This premise of the Assessing Officer for coming to the conclusion that the secondment agreement was a colourable device cannot be upheld.
- The second reason given by him was that the relationship between the THPL and the assessee-company was that of independent contractors and agreement should be governed in accordance with the laws of India and, accordingly, the amount reimbursed was nothing but a contractual payment. Even if the relationship between the assessee and THPL was that of independent contractor, and reimbursement of salary was some kind of a contractual payment, then also, it does not strengthen the case of the Assessing Officer, because the THPL paid the salary as per the secondment agreement, and that too after withholding the tax as per the provisions of section 192 and such a payment of salary had been reimbursed as per the secondment agreement only. The basic condition under the law for deducting the tax on such payment (which is nothing but salary) and depositing the same in the Government of India treasury stands fulfilled. Hence, this reasoning given by the Assessing Officer has no relevance at all.
- The third reasoning given by the Assessing Officer was that the assessee-company was beneficiary of such expenditure as it had inherent character of salary and by expending the said amount, the assessee had earned its business income and, accordingly, the same was business expenditure of the assessee. First of all, the assessee-company was not a beneficiary of the expenditure because the seconded employees had been paid salary by THPL who were working in India for the assessee-company and the assessee was merely reimbursing the same. By rendering this service to the THPL, the assessee was earning business income and salary paid was certainly a business expenditure on which TDS had already been deducted as the liability to withhold the tax on salary falls within the purview of section 192 only, which had been done in this case. There cannot be a double deduction of TDS once at the time of payment of the salary and again on the reimbursement made by the assessee by the THPL. Thus, there was no requirement for deducting the tax at the time of reimbursement, when already tax had been deducted at the time of payment of salary.

Reimbursed amount was not FTS

- Considering the arguments of the revenue that the payments made by the Indian company on account of reimbursement of salary of two employees and other costs, was in the nature of 'fees for technical services', being rendering of managerial and consultancy services within the ambit of section 9(1)(*vii*) and also under article 12(4)(*b*) of the India Singapore DTAA. In this case, the Singapore-company was not rendering any service to the Indian-company, *i.e.*, the assessee, rather it was a *vice-versa* case. The two seconded employees were working for Indian company and only for the Indian operation. They were not rendering services on behalf of the Singapore-company. Therefore, there was no question of rendering of managerial or consultancy services by the Singapore company either directly or through the seconded employees. Hence, provisions of section 9(1)(*vii*) do not get attracted in this case. Once it is a salary, then it cannot be a case of FTS as it is neither the case of the Assessing Officer nor of the Commissioner (Appeals) that it is in the nature of FTS. Even the 'make available clause' as stipulated in article 12(4) is also not applicable because the Singapore company was neither rendering any services to the Indian-company nor they were making available any kind of technical knowledge, experience, skill or proceeds to the Indian-company.

Comparables in respect of international transactions relating to investment advisory services

- On a perusal of TPO's own search for selection of comparables, it is seen that he himself has selected the comparables using the 'Prowess data'. He has also not established that by entering the key phrase 'investment advisory service', the selection of the functionally similar companies are available from the data. Be that as it may, eight comparables selected by the TPO, that these companies are either engaged as a broking company or merchant banker or asset management company. In case of stock broking companies, the main functions are marketing and prospecting for new clients, execution and settlement of the transaction and trading of shares which are mostly on own account or on behalf of the customers. The risk assumed is far more than the companies which are purely engaged in investment advisory services. The assets employed are also significant. In comparison to this, the company which is engaged in investment advisory services, only gives advise and are for different from the activities carried out by the stock brokers. Out of eight comparables, three comparables chosen by the TPO are purely stock broking company and, therefore, the same are not comparable on FAR analysis with that of the assessee-company and cannot be held as functionally comparable. The companies which are engaged in the 'assessment management' are basically responsible for mobilizing the funds from the investors by marketing the scheme. Their main functions are sales and marketing, investment and management of the funds mobilized under various schemes. They are responsible for providing management and administrative services mostly to the mutual funds and to deploy such funds. The risk is also assumed by such companies in the form of service liabilities, regulatory and reputational risk. Moreover, the asset management

companies are also regulated entities which are required to be licensed by SEBI. Thus, such companies also fail the test of FAR analysis with the investment advisory companies.

- Lastly, there are few companies which are doing entirely different activities, viz., 'I' which is a credit rating agency in India and 'B', which is mainly engaged in production off distribution of movies. Both these companies under any parameter or yardstick cannot be said to be functionally comparable with that of the assessee-company. Lastly, 'B' is mostly into making investment in the companies using its own fund and it is a leading player in distress and special situation advisor and investment-company. The overall function as per the profile of the company, cannot be said to have much functional similarity with that of the assessee-company. Accordingly, none of the comparables as selected by the TPO can be said to be comparable on FAR analysis and, therefore, none of the comparables can be included for the comparability analysis for benchmarking the transactions carried on by the assessee under TNMM.
- Considering the assessee's comparables, it is seen that some of them were found to be proper comparable by the TPO himself in the assessment year 2007-08 and also in the assessment year 2009-10. Without any proper reason or change in the functionality and any financial data, it cannot be held that the same companies are not comparable in the intermediary period of the assessment year 2008-09. The TPO has to bring some material on record to show that why these comparables which were good comparable in the earlier year also in and succeeding year, cannot be compared in this year.
- All the six companies shortlisted by the assessee are good comparables looking at the overall functions and also, that the same have been found to be so by the Department in the preceding and succeeding years. Accordingly, the entire adjustment made by the TPO cannot be sustained as the margin of the assessee at 21 per cent is at arm's length looking to the average margin of the six comparables. Accordingly, the adjustments made by the TPO are deleted.