NR rendering support services to Indian affiliate via seconded employees constituted its service PE in India

Summary – The Mumbai ITAT in a recent case of Morgan Stanley International Incorporated., (the Assessee) held that where assessee, a foreign company seconded some of its employees to India to render their services to Indian subsidiary companies, those employees constituted assessee's service PE in India and salary cost of said employees reimbursed by Indian companies was taxable in India in terms of article 7 of Indian USA DTAA

Facts

- The assessee was a tax resident of USA and was providing support services to various Indian subsidiary companies.
- The assessee had seconded its five employees to India to render their services to the Indian companies under supervision and control of the Board of Directors of the Indian companies.
- The salary of said employees was paid by the assessee-company after deducting TDS under section 192. Subsequently, the entire salary paid by the assessee had been reimbursed by the Indian companies to the assessee.
- The assessee claimed that since the payment received was on account of reimbursement of expenses, it was not taxable in India as there was no element of income involved in it.
- The Assessing Officer opined that the payment received by the assessee for rendering the services through its employees was taxable in India as per article 12(4) of DTAA, being in the nature of 'fees for included services' (FIS). Accordingly, he added the entire amount of reimbursement of salary to assessee's taxable income.
- The Commissioner (Appeals) upheld the assessment order.
- On second appeal:

Held

- In the current global scenario the international business entities have extended their business worldwide and they have made their presence by establishing their own subsidiaries or group entities from whom they have business arrangement. These overseas entities depute their technical staff and human resources in the other countries, which are growing economies to support their global business functions and to ensure quality and consistency in their operations.
- Under a classic secondment agreement, the seconded employees who are under employment of non-resident parent company are deputed or transferred to subsidiary company in the overseas countries to work for special assignments which are more technical and managerial in nature. These seconded employees usually work under direct control and supervision of the subsidiary entities in their country. Since these seconded employees belong to the main parent entity, therefore, they continue to receive their remuneration and salaries with all social security and benefits from the

parent entity. The salary cost and remuneration are reimbursed by the subsidiary company to the parent entity. Strictly speaking on paper they remain the employees of the parent entities but they are under direct supervision and control of subsidiary entity, where their day-to-day activities are managed and governed by them and so much so they can be removed by them. Once the terms of secondment is over, they revert back to their parent company entity.

- In a way subsidiary entity is the economic employer of the seconded employee who ultimately bears the salary cost and exercise control over their work. Generally it is contended that reimbursement of cost cannot be treated as payment for FTS or FIS, unless there is an explicit agreement between the parties that technical services would be provided through these employees. The deputation of employees is mainly for the benefit of the subsidiary company to smoothly and efficiently conduct the business.
- However, such a reimbursement of salary cost by the subsidiary entity has been matter to huge controversy, as to what is the nature of such payment, whether it is 'fee for included services' or not. Other related controversy is that, on the basis of duration of the stay of seconded/deputed employees in the host countries, whether the non-resident parent entity constitute the service PE in the host country or not.
- In the present context the salary paid to the seconded employees by the parent company, the TDS has been already been deducted under section 192, which has been credited to the Government of India account. In case, if it is to be held that reimbursement of salary is nothing but payment for rendering technical services, then TDS has to be deducted under section 195.
- In the present case, it has to be seen, whether overseas entity, *i.e.*, the assessee is the real economic employer of the seconded employees, *i.e.*, the employees are maintaining their lien on employment with the original overseas and whether the assessee remains responsible for the work of seconded employees in India or not. The case of the assessee has been that, seconded employees were under direct control and supervision of Indian entity who were managing their activities on day - to - day basis and the assessee was only paying their salary for the employees convenience and benefit.
- In the instant case, one is proceeding on the premise that the seconded employees are the real employees of the assessee who have come to India to render services and once they are rendering services on behalf of assessee in India then, they constitute service PE in India. Such an establishment of PE under these circumstances have been dealt by the Supreme Court in the case of *DIT (IT)* v. *Morgan Stanley & Co.* [2007] 292 ITR 416/162 Taxman 165. The Supreme Court held that the employees of overseas entities to the Indian entity constitute services PE in India.
- Thus, from the aforesaid decision it is amply clear that such deputed employees if continued to be on pay rolls of overseas entities or they continue to have their lien with jobs with overseas entities and are rendering their services in India, service PE will emerge. It is therefore, held that the seconded employees or deputationist working in India for the Indian entity will constitute a service PE in India.

- If one accepts this concept that, by virtue of deputing seconded employees in India, the assessee has established a service PE, then whether such a payment made by Indian entity to the assessee (even though it is reimbursement of salary cost), would be taxable under Article 12(4) of India-US DTAA.
- Para 6 of Article 12 makes it amply clear that taxability of 'royalty' and 'fees for included services' shall not apply, if the resident of the contracting state (USA) carries on the business in other contracting states (India) in which FIS arises through PE situated therein, then in such case the provisions of article 7, i.e., 'Business profits' shall apply.
- In other words, if there is a PE, then royalty or FIS cannot be taxed under Article 12, albeit only under article 7 of the DTAA. It is an undisputed fact in this case, that DTAA benefit has been availed by the assessee and, therefore, treaty benefit has to be given to the assessee for granting relief. Now, if the taxability of such payment has to be examined and determined on the basis of computation of business profit under article 7, then the salary paid by the assessee would amount to cost to the assessee, which is to be allowed as deduction while computing the business profit of the PE in India.
- If logical conclusion of the decision of the Supreme Court in the case of *Morgan Stanley & Co.* (*supra*)and the decision of Delhi High Court in the case of *Centrica India Offshore (P.) Ltd.* v. *CIT* [2014] 364 ITR 336/224 Taxman 122/44 taxmann.com 300 is to be arrived at, then the seconded employees will constitute service PE of the assessee in India and in that case any payment received on account of rendering of service of such employees will have to be governed under article 7 as per unequivocal terms of para 6 of article 12 of DTAA.
- Thus, the payment made by the Indian entity to the assessee on account of reimbursement of salary cost of the seconded employees will have to be seen and examined under article 7 only, that is, while computing the profits under article 7, payment received by the assessee is to be treated as revenue receipt and any cost incurred has to be allowed as deduction because salary is a cost to the assessee which is to be allowed.
- Accordingly, the Assessing Officer is directed to compute the payment strictly under terms of article 7 and not under article 12 of the DTAA. In view of the aforesaid finding, the grounds raised by the assessee is treated as allowed.
- In the result, the appeal of the assessee is allowed.