PHOENIX LEGAL

Bi-Monthly Tax Newsletter

May 2022 - June 2022

DIRECT TAX

No TDS on reimbursement to non-resident entity for salary paid by it to its employees seconded to India

The Karnataka High Court (**HC**), in the case of Flipkart Internet Private Limited (**Flipkart India/ taxpayer**) v. Deputy Commissioner of Income Tax[1], considered whether tax should be deducted at source (**TDS**) on salary reimbursement to a non-resident entity for its employees seconded to the Indian company.

The taxpayer, an Indian company, was engaged in the business of providing information technology solutions and support services to e-commerce entities. Walmart Inc. (majority shareholder in Flipkart India) (**Walmart**) and Flipkart Singapore had entered into a 'master service agreement' pursuant to which four Walmart employees were seconded to Flipkart India. Walmart and the seconded employees had also entered into a 'global assignment agreement' for their secondment to Flipkart India. Seconded employees' salary continued to be paid by Walmart in their home country which was subsequently reimbursed by Flipkart India on cost-to-cost basis. In this regard, the taxpayer submitted an application under Section 195 (2) of the Income Tax Act, 1961 (**IT Act**) requesting for salary reimbursement to Walmart without deduction of TDS and for a nil withholding tax certificate.

The assessing officer (**AO**), rejecting the application of the taxpayer, directed the taxpayer to deduct TDS on the salary reimbursement to Walmart because: (a) there was no employer-employee relationship between Flipkart India and seconded employees; and (b) the services rendered by seconded employees were taxable as 'fees for technical services' (**FTS**) under the IT Act and Double Taxation Avoidance Agreement between India and US (**DTAA**).

In an appeal against the AO order, the HC quashed the AO's order and for coming to its decision the HC took note that: (a) pursuant to Section 90 of the IT Act, to determine taxability of the payments made to Walmart, the provisions of the IT Act and DTAA which are more beneficial to the taxpayer should be applied; and (b) the test of 'make available' provided under Article 12 of the DTAA, which is an essential condition for determining taxability of payments as FTS, was not being met because of the type of services rendered by the seconded employees to Flipkart India.

The HC judgment: (i) held that payments made by an Indian company to a non-resident entity to reimburse salary paid by non-resident entity to its employees seconded to India, if not taxable as FTS under DTAA, will not be taxable in India and hence no TDS is required to be deducted; and (ii) directed the tax authorities to issue a nil withholding TDS certificate to the taxpayer.

Reimbursement of support service expenses by Indian company not taxable as FTS under Double Taxation Avoidance Agreement between India and US (DTAA)

The Income Tax Appellate Tribunal (**ITAT**), a quasi-judicial authority to hear appeals against the decisions of income tax authorities, in the case of Russell Reynolds Associates Inc. (**petitioner/ taxpayer**) v. Deputy Commissioner Income Tax (International Taxation)[2], held that reimbursement of 'support service' expenses by an Indian company will not fall under the definition of FTS under DTAA and hence will not be taxable in India.

Before the decision of the ITAT, there were conflicting court decisions on this issue.

The petitioner, a US based company, was engaged in the business of providing to its client's human resource advisory services, of recruiting and retaining senior level executives and assisting them on mitigating the risks associated with senior level appointment. The taxpayer entered into a 'service agreement' for providing managerial support services and 'cost reimbursement agreement' for reimbursement of training expenses, respectively, with Russell Reynolds Associated India Private Limited (**RRAIPL**). Additionally, a 'licensing agreement' was also executed with RRAIPL for allowing RRAIPL to use the petitioner's intellectual property rights (**IPR**), such as trademarks/ trade names.

[1] Writ Petition No. 3619/2021 (T-IT)

[2] ITA Nos. 1165/Del/2019 and 1166/Del/2019

The taxpayer filed its income tax returns (**ITR**) offering royalty income received from RRAIPL under the 'licensing agreement' for use of IPR to tax under Article 12(3) of the DTAA. The AO passed an assessment order under Section 143(3) of the IT Act wherein: (a) the consideration received under the 'service agreement' for providing managerial support services; and (b) reimbursement of training expenses under the 'cost reimbursement agreement', were made taxable under Article 12(4)(b) of the DTAA as FTS.

The Commissioner of Income Tax (**CIT**), disagreed with assessment of the AO and held that the services provided under the 'service agreement' do not fulfill the 'make available test' under Article 12(4)(b) of the DTAA but fall under the definition of FTS under Article 12(4)(a) i.e., services are ancillary and subsidiary to the application and enjoyment of right under Article 12 (3) of the DTAA.

The ITAT dismissed the order of both the CIT and AO and held that: (i) the services rendered by the employees cannot be considered as FTS under Article 12(4) of the DTAA as the services provided are managerial support services and not 'technical or consultancy services' which is an essential condition for applicability of Article 12(4) of the DTAA. Hence, the consideration received by the taxpayer under the 'services agreement' for providing managerial support services was not taxable as FTS; and (ii) for applicability of Article 12(4)(a) of the DTAA, the royalty paid to the taxpayer under Article 12(3) should be ancillary and subsidiary to the application or enjoyment of right, property or information. In this case, the royalty paid to the taxpayer under the 'licensing agreement' was only for allowing RRAIPL to use IPR of the taxpayer and was not necessary for effective application or enjoyment of right, property or information. Hence, Article 12(4)(a) was also not applicable.

The ITAT's decisions comes as a huge relief and settles the position of law as there were conflicting decisions of ITAT on this issue.

INDIRECT TAX

Levy of integrated goods and service tax (IGST) on ocean freight amounts to 'double taxation'

The Supreme Court (**SC**), in the case of Union of India v. Mohit Minerals and others[3], struck down the levy of IGST under reverse charge mechanism levied on the ocean freight component included in the cost insurance freight (**CIF**) import transactions.

The SC held that Notification No. 8 of 2017 (notifying central goods and service tax (**CGST**) rates of various services) and Notification No. 10 of 2017 (notifying services to be taxed on reverse charge basis) are in violation of the principle of composite supply under goods and service tax (**GST**) and therefore amounts to 'double taxation'. The SC also observed that not all recommendations made by GST council are binding under the Constitution and that the Centre and State Governments are equally empowered to legislate on GST.

Secondment of employees falls under the pur-view of 'supply of manpower' under Section 65(105) (k) of the Finance Act, 1994

The SC, in the case of C.C.E. & ST v. Northern Operating Systems Pvt. Ltd.[4], while following the concept of 'Substance over Form' held that the arrangement of secondment of employees by overseas group companies to Indian affiliates, where the seconded employees remained on the payrolls of the overseas companies and worked under supervision and operational control of Indian affiliate, was nothing but was an arrangement to 'supply of manpower service' under the provisions of Section 65(105) (k) under the Finance Act, 1994 (the erstwhile service tax law) and would be subject to levy the service tax.

Fixed rate of deduction of 1/3rd of total consideration of land value deemed unconstitutional

The Gujarat High Court, in the case of Munjaal Manishbhai Bhatt v. Union of India[5], read down paragraph 2 of Notification No. 11 of 2017 (**the Notification**) which imposed a mandatory rate of deduction on consideration of value of land, as being arbitrary and consequently, violative of Article 14 of the Indian Constitution. It also observed that where the actual value of the land can be ascertained, the mandatory 1/3rd deduction is *ultra vires* the Central Goods and Services Tax Act, 2017 and actual value should be adopted. 1/3rd deduction should apply only in cases, where actual value cannot be ascertained.

[3] Civil Appeal No. 1390 of 2022.
[4] 2022-VIL-31-SC-ST
[5] Special Civil Application No. 1350 of 2021.

Notice pay not subject to Service Tax

The Customs, Excise and Service Tax Appellate Tribunal, Bangalore in its final order, in the case of M/s XL Health Corporation India Pvt. Ltd. v. Commissioner of Central Tax, Bengaluru South Commissionerate[6], held that 'notice pay' as collected from employees who quit their job without notice or do not serve the term of their contract, cannot be considered as a 'taxable service' and therefore, service tax cannot be levied on such a transaction.

Notification/ Circular

Central Board of Indirect Taxes and Customs (CBIC) brings uniformity in procedure relating to sanction, post-audit and review of refund claims

CBIC through Instruction No. 03/2022 dated June 14, 2022 simplified the procedure relating to sanction, post-audit and review of refund claims. Post audit of tax refund is to be considered for refund claims amounting 1 lakh or more. It also provides for setting up of a post-audit cell.

CBIC issues standard operating procedure (SOP) for National Company Law Tribunal (NCLT)

The CBIC through Instruction No. 1083/04/2022 dated May 23, 2022 issued an SOP for NCLT cases with to ensure that there is timely recovery of GST which is payable by Companies which are undergoing liquidation under the Insolvency and Bankruptcy Code. GST and customs authorities have been categorized as operational creditors under these Instructions.

[6] Service Tax Appeal Nos. 20648 and 20649 of 2019.

New Delhi
Phoenix House, 254
Okhla Industrial Estate, Phase III
New Delhi -110020
Tel : +91 (0) 11 4983 0000
Email : delhi@phoenixlegal.in

Mumbai
Vaswani Mansion, Office No. 17 & 18,
3rd Floor, 120 Dinshaw Vachha Road
Churchgate, Mumbai – 400 020.
Tel : +91 (0) 22 4340 8500
Email : mumbai@phoenixlegal.in

Disclaimer

The information contained in this document is intended for general information only and does not constitute legal advice. Readers are advised to seek specific legal advice on any matters discussed above. For any clarification on issues discussed above please contact Jatin Arora at jatin.arora@phoenixlegal.in and Abhishek Saxena at abhishek.saxena@phoenixlegal.in.