In Re: A.T. And S. India P. Ltd. vs Unknown on 6 November, 2006

RULINGS

Decided On: 06.11.2006

Appellants: In Re: A.T. and S. India P. Ltd.
Vs.
Respondent:

Hon'ble Judges:
Syed Shah Mohammed Quadri, J. (Chairman), A.S. Narang and A. Sinha, Members

Subject: Direct Taxation

ORDER

Syed Shah Mohammed Quadri, J. (Chairman)

1. This application under Section 245Q(1) of the Income-tax Act, 1961 (for short "the Act"), is by an Indian residentAT&S India Limited (hereinafter referred to as "the applicant"). The applicant is a subsidiary of AT&S Austria Technologie and Systemtechnik Aktiengesellschaft, Austria (for short "the AT&S Austria"), a company incorporated under the laws of the Republic of Austria. The applicant is carrying on the business of manufacturing of printed circuit boards. The applicant entered into various agreements with AT&S Austria. It entered into an agreement for information technology cost sharing with AT&S Austria on March 13, 2001a fact which is not relevant any more for the present discussion. Among others, two agreements which are material here are the foreign collaboration agreement dated August 17, 2000, and the secondment agreement dated September 17, 2002. Pursuant to the latter agreement AT&S Austria undertook to assign or cause its subsidiaries to assign its qualified employees to the applicant. They are to work for the applicant and will receive compensation substantially similar to what they would have received as employees of AT&S Austria or its subsidiaries. Such employees are to be engaged by the applicant on full time basis.

2. Though in the application the applicant set forth two questions to seek advance ruling of the Authority, at the initial stage of the hearing of the application, Mr. Chythanya, learned Counsel appearing for the applicant, withdrew the first question on February 1, 2006, and that is why the said information technology cost sharing agreement ceased to be relevant. Now the only surviving question is question No. 2 which reads as follows:

Whether pursuant to the secondment agreement entered into by the applicant with AT&S Austria, the payment to be made by the applicant to AT&S Austria, towards reimbursement of salary cost incurred by AT&S Austria in respect of seconded personnel, would be subject to withholding tax under Section 195 of the Income-tax Act, in view of the facts that (1) the payments are only in the nature of reimbursement of actual expenditure incurred by AT&S Austria, (2) AT&S Austria is not engaged in the business of providing technical services in the ordinary course of its business, (3) AT&S Austria is not charging the applicant any separate fee for the secondment and (4) the seconded personnel works under the direct control and supervision of the applicant?

3. In regard to question No. 2, the jurisdictional Commissioner (for short "the Commissioner") would submit that under the secondment agreement AT&S Austria has undertaken to provide the services of the qualified technical personnel employed by it to the applicant. They are being paid salary, bonus and other benefits by AT&S Austria and the applicant has to reimburse the cost incurred on such employees. It is, however, disputed that what the applicant pays to AT&S Austria is reimbursement of cost only and that it is not in the business of providing technical services. It is stated that AT&S Austria is a provider of technical services through personnel in its employment to the applicant and therefore any payment in lieu of such services falls within the meaning of fees for technical services (FTS) under Section 9(1)(vii) of the Act and Article 12 of the Double Taxation Avoidance Agreement (DTAA) between the Government of the Republic of India and the Government of the Republic of Austria and therefore, tax has to be deducted at 10 per cent, on gross basis. The payments under the agreement are in the nature of FTS, which accrues or arises in India if paid by a resident for utilizing such services in a business or profession carried on in India for the purpose of making or earning any income from any source in India. It is submitted that regardless of the claim of the applicant that payments under the agreement are merely reimbursement of cost, tax has to be deducted at source from such payments by the applicant. The applicant has to deduct tax at source under the provisions of Section 195 of the Act from the payments to be made to the non-resident who can file a return of income before the Assessing Officer and his claim, if any, will be decided after considering all the relevant facts. On December 15, 2005, the applicant filed a rejoinder disputing the contentions raised by the Commissioner and reiterating its case.

4. The Government of the Republic of India and the Government of the Republic of Austria have entered into an agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income on September 5, 2001, which is notified by Notification No. GSR 682(E), dated September 20, 2001 See [2001] 251 ITR (St.) 97 (hereinafter referred to as "the DTAA").

5. Mr. Chythanya has strenuously contended that pursuant to the secondment agreement on transfer of employees of AT&S Austria to the applicant, they have become employees of the applicant and this is evident from the employment agreements and the statement of tax deduction at source; a part of their salaries was being paid by the applicant and the balance was being paid by AT&S Austria on behalf of the applicant as a matter of convenience. Therefore, submits learned Counsel, payments are in the nature of reimbursement of actual expenditure incurred by AT&S

Austria which is not engaged in the business of providing technical services in the ordinary course of its business and it is not charging any separate fee for the secondment of employees who would work under the direct control and supervision of the applicant, so the payments cannot be treated as "fees for technical services" within the meaning of Explanation 2 to Section 9(1)(vii) of the Act. Referring to the Double Taxation Avoidance Agreement, it is argued that even under Article 12(4), payments to an employee of the person making payments are excluded from the purview of "FTS". Learned Counsel placed before us the commentary of Organization for Economic Co-operation and Development (OECD) on Article 15 of the Model Convention as also the commentaries by Klaus Vogel on Double Taxation Conventions in support of the plea that the real employer of the seconded employees is the applicant and not AT&S Austria.

6. Mr. T.N. Chopra, learned Counsel appearing for the Commissioner, has on the other hand vehemently argued that payments under the secondment agreement cannot be called reimbursements and that the payments fall within the meaning of royalty as well as fees for technical services under Section 9(1)(vii) of the Act. It is argued that the real question is being sidetracked by bringing in the employment agreements between the seconded employees and the applicant; from the letter of the applicant's counsel dated September 6, 2006, it is clear that the seconded employees are technical personnel with technical qualifications and therefore, the payments by the applicant to AT&S Austria for the services rendered by them evidently answer the definition of FTS in Explanation 2 to Section 9(1)(vii) of the Act as well as in Article 12(4) of the Double Taxation Avoidance Agreement. The so-called employment agreements are afterthought and are produced at a belated stage and that they are not in conformity with the secondment agreement; at any rate they do not override the secondment agreement. It is, further, submitted that question No. 2 has a limited scope and ambit and has to be answered in the light of Section 195 of the Act and as the payments are chargeable under the provision of the Act being in the nature of royalty/FTS, they are subject to withholding tax at the source.

7. In the light of the above contentions of learned Counsel for the parties two points need to be considered:

> (i) What is the scope of Section 195 of the Act?
>
> (ii) Whether payments by the applicant to the AT&S Austria under the secondment agreement are in the nature of reimbursement, royalty or FTS?

8. We shall first deal with the scope of Section 195 of the Act. It will be useful to read the relevant portion of Sub-section (1) of Section 195 of the Act which is in the following terms:

> Sub-section (1) of Section 195 of the Act:
>
> Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest or any other sum chargeable under the provisions of this Act (not being income chargeable under the head 'Salaries') shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in

> cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force.

9. A plain reading of the above provision shows that it imposes an obligation on every person responsible for paying to a non-resident, or to a foreign company, inter alia, any sum chargeable under the provisions of the Act, to deduct income-tax thereon at the rates in force at the time of payment thereof in cash or by the issue of a cheque or draft or any other mode. It is a common ground that the applicant is the person responsible for making payments under the secondment agreement and the recipient of the amount is a foreign company within the meaning of Section 195 of the Act. The issue that remains to be examined is whether the payments fall within the expression "any other sum chargeable under the provisions of the Act or they fall within the exemption under the head "Salaries".

10. We can with advantage refer to the decision of the hon'ble Supreme Court of India in Transmission Corporation of A.P. Ltd. v. CIT with regard to the scope of Section 195 of the Act. In that case, the appellant made certain payments to non-residents against the purchase of machinery and equipment and also against work executed by them. The appellant made payments to the non-residents without deduction of tax at source. The question arose whether the applicant was under an obligation to deduct tax at source from the payments under Section 195 of the Act. The hon'ble Supreme Court observed (page 594):

> The scheme of Sub-sections (1), (2) and (3) of Section 195 and Section 197 leaves no doubt that the expression 'any other sum chargeable under the provisions of this Act' would mean 'sum' on which income-tax is leviable. In other words, the said sum is chargeable to tax and could be assessed to tax under the Act. The consideration would bewhether payment of the sum to the non-resident is chargeable to tax under the provisions of the Act or not? That sum may be income or income hidden or otherwise embedded therein. If so, tax is required to be deducted on the said sum, what would be the income is to be computed on the basis of various provisions of the Act including provisions for computation of the business income, if the payment is a trade receipt. However, what is to be deducted is income-tax payable thereon at the rates in force.

11. To determine the aforementioned issue it would be useful to refer to the relevant portions of the secondment agreement. The recitals in the said agreement provide, inter alia, that pursuant to the foreign collaboration agreement dated August 17, 2000 (for short "the FCA") between the same parties they have agreed and set forth the terms and conditions of the secondment agreement. Now, the FCA says that the applicant has approached AT&S Austria to seek complete support through the full range of its expertise, manufacture technology, in order to participate in the Indian and foreign markets at terms and conditions mutually agreed and acceptable to both the parties and requested AT&S Austria to participate in the capital of the applicant. Article 4 of the FCA casts an obligation on AT&S Austria to provide all assistance and co-operation to the applicant in its venture of carrying on the business by providing appropriate support; technology and such other services as may be required in connection therewith. And Article 4.2 thereof requires AT&S Austria to offer the services

of its technical experts to the applicant, if requested, for working on the project being executed and such services shall he rendered by the technical experts from AT&S Austria subject to their availability and on such charges, terms and conditions as will be agreed between the parties.

12. Reverting to the secondment agreement, it provides that AT&S Austria shall assign or shall cause its subsidiaries to assign to the applicant certain qualified individuals employed by the former or one or more of its subsidiariesreferred to as the seconded personnelto work for the applicant who will be compensated on terms substantially similar to the compensation they would have received as employees of its subsidiaries. Article 2 thereof bears the heading "Secondment of Individuals and Management Services". Para. 2.4 of Article 2 which has a bearing on the question is in the following terms:

> Para. 2.4 of Article 2 of the secondment agreement:
>
> AT&S shall have the right at any time to remove any seconded personnel as long as it replaces such personnel with similarly qualified individuals.
>
> All seconded personnel sent by AT&S should comply with the company's regulations and management systems.

13. A plain reading of this clause shows that AT&S Austria retains the right over the seconded personnel and has the power to remove any seconded personnel from the applicant; the only condition attached to the exercise of this power is that it has to replace such personnel with similarly qualified individuals. Article 3 of the secondment agreement deals with "compensation and payment". This article says that the applicant is under an obligation to compensate AT&S Austria all costs in Euro that have arisen directly or indirectly from secondment of personnel. The connotation of compensation includes and is not limited to salary, bonus, benefits, personal travel, etc. Though from the meaning of that expression are excluded expenses and costs provided in Articles 4.1 and 4.2 of the secondment agreement, none the less Article 4.2 requires the applicant to reimburse AT&S Austria for all relocation costs of seconded personnel and their families when commencing and leaving their assignments and in addition the applicant has also to compensate AT&S Austria separately for round-trip air fares for such personnel. It may not be out of place to mention here that Article 4 deals with "Applicant's responsibilities". It is important to note that Article 3.2 of the agreement imposes an obligation on the applicant, at the request of AT&S Austria, to pay a part of each individual's compensation in rupees in advance provided that such advance payments do not exceed the total amount of compensation for each seconded personnel and that the remainder of such total amount of compensation has to be paid by the applicant to the AT&S Austria. However, the annual compensation is subject to changes upon both parties' written agreement. It is provided under Article 6 that the parties have understood and agreed that during the term of that agreement AT&S Austria shall have no liability whatsoever for any acts or omissions of the seconded personnel and that the applicant releases and agrees to indemnify AT&S Austria from and against any and all such liability.

14. From the above analysis of both the agreements it is clear that pursuant to the obligation under the FCA, the AT&S Austria has offered the services of technical experts to the applicant on the tatter's request and the terms and conditions for providing services of technical experts are contained in the secondment agreement which we have referred to above in great detail. Though the term "reimbursement" is used in the agreements, the nature of payments under the secondment agreement has to satisfy the characteristic of reimbursement and that the term "reimbursement" in the agreement will not be determinative of the nature of payments. The term "reimbursement" is not a technical word or a word of Article In Oxford English Dictionary, to reimburse meansto repay a person who has spent or lost moneyand accordingly reimbursement means to make good the amount spent or lost. However, under the secondment agreement the applicant is required to compensate AT&S Austria for all costs directly or indirectly arisen from the secondment of personnel and that the compensation is not limited to salary, bonus, benefits, personal travel, etc. though salary, bonus etc. and the amounts referred to in para. 4.2 of the secondment agreement form part of the compensation. The premise of the question that the payments are only in the nature of reimbursement of actual expenditure incurred by AT&S Austria is not tenable for reasons more than one. First it is not supported by any evidence as no material (except the debit notes of salaries of seconded personnel) is placed before us to show what actual expenditure was incurred by AT&S Austria and what is being claimed as reimbursement; secondly, assuming for the sake of argument that the debit notes represent the quantum of compensation as the actual expenditure it would make no difference as the same is payable to the AT&S Austria under the secondment agreement for services provided by it. It would, therefore, be not only unrealistic but also contrary to the terms of the agreement to treat payments under the said agreement as mere reimbursement of salaries of the seconded employees who are said to be the employees of the applicant.

15. To show that the real employer of such employees is the applicant and not the AT&S Austria, Mr. Chythanya invited our attention to various employment agreements entered into between the applicant and the seconded employees and also the certificate of deduction of tax at source on their global salary. All the employment agreements are similarly worded. We have carefully gone through the employment agreement between the applicant and Mr. Markus Stoinkellner. The duration of the employment is from September 1, 2005, till August 30, 2008. In Article 3 thereof salary of the employee is noted as the remuneration, perquisites and other entitlements as detailed in appendix A. However, appendix A does not specify any amount. All that it says, is that the salary will be as fixed and agreed between the employee and the company from time to time and that such salary may be paid either in India or outside India but the total salary shall not exceed the salary fixed as above, but no fixed salary is mentioned in the employment agreement. Other perquisites and entitlements are: travel expenses, transport, boarding, lodging; and annual leave of 30 days per year; and home leave which the employee will be entitled to once. The applicant shall have to organize an economic class return flight tickets to go on home leave. The employment agreement also provides that the employee will be responsible for meeting all requirements under Indian tax laws including tax compliance and filing of returns and the applicant is authorized to deduct taxes from the compensation and benefits payable.

16. We shall straightway refer to the following commentary of OECD on Article 15, relied upon by Mr. Chythanya:

> ...In this respect, it should be noted that the term 'employer' is not defined in the Convention but it is understood that the employer is the person having rights on the work produced and bearing the relative responsibility and risks. In cases of international hiring out of labour, these functions are to a large extent exercised by the user. In this context, substance should prevail over form i.e. each case should be examined to see whether the functions of employer were exercised mainly by the intermediary or by the user . It is therefore up to the Contracting States to agree on the situations in which the intermediary does not fulfill the conditions required for him to be considered as the employer within the meaning of paragraph 2. In settling this question, the competent authorities may refer not only to the abovementioned indications but to a number of circumstances enabling them to establish that the real employer is the user of the labour (and not the foreign intermediary):
>
> the hirer does not bear the responsibility or risk for the results produced by the employee's work;
>
> the authority to instruct the worker lies with the user;
>
> the work is performed at a place which is under the control and responsibility of the user;
>
> the remuneration to the hirer is calculated on the basis of the time utilised, or there is in other ways a connection between this remuneration and wages received by the employee;
>
> tools and materials are essentially put at the employee's disposal by the user;
>
> the number and qualifications of the employees are not solely determined by the hirer.

17. He also referred to the following passage from commentaries by Klaus Vogel on Double Taxation Conventions:

> The question of who is the employer arises particularly in situations in which the employee is sent abroad to work for a foreign enterprise as well. In such cases, the determination of employer rests on the degree of personal and economic dependence of the employee towards the enterprises involved. Accordingly, the foreign enterprise does not qualify as an employer merely because the employee performs services for it or because the enterprise was issuing to the employee instructions regarding his work, or places tools, etc., at his disposal (of Hinnekens. L. Intertax 331 (1988)). The situation is different if the employee works exclusively for the enterprise in the State of employment and was released for the period in question by the enterprise in his State of residence BFH 114 (1986) re Germany's DTC with Spain.

18. On the basis of the above extracts, Mr. Chythanya would submit that the real employer is the applicant and not AT&S Austria. While we have no difficulty in agreeing with the criteria summed up by the learned authors in the abovequoted passages, we are afraid we cannot accede to the contention of learned Counsel. We have referred to the terms of the foreign collaboration agreement and secondment agreement. From the above terms, it is obvious that AT&S Austria is to provide services of its employees on terms and conditions agreed to between the parties. The secondment agreement provides that a part of the salary of the seconded personnel will be paid by the applicant in Indian rupees and the remaining part shall be paid by the applicant to the AT&S Austria in Euro. The employees would go back to AT&S Austria on the expiry of the assignment though while working with the applicant the seconded personnel sent by AT&S Austria are required to comply with the regulations and management system of the applicant. During the period the said seconded employees will be working under the applicant, AT&S Austria has power to recall any one of them and replace them with other employees. It is also clear that the applicant cannot pay any amount over and above the salary fixed by AT&S Austria to the employees in India. From the facts and circumstances and the reasons mentioned above we cannot but conclude that the role of AT&S Austria is not of a mere employment agent and that in effect the seconded personnel remain the employees of AT&S Austria. Keeping the criteria mentioned in the above quotations, we have no hesitation in concluding that AT&S Austria and not the applicant is the real employer of the seconded employees whose services have been lent to the applicant on the terms and conditions settled between the applicant and AT&S Austria even though while working under the applicant they would have to abide by the employment agreement.

19. We have already indicated above that pursuant to the FCA, AT&S Austria has undertaken to render services and accordingly lent the services of the seconded employees on payment of compensation by the applicant, details of which have already been referred to above. It remains to be seen whether providing such services falls within the meaning of "royalty" or "fees for technical services" as defined in Section 9(1) of the Act and Article 12 of the Double Taxation Avoidance Agreement.

20. Section 9 of the Act deals with "income deemed to accrue or arise in India". Section 9(1)(vi) and (vii) which are relevant for our purpose read as under:

> Section 9. Income deemed to accrue or arise in India.(1) The following incomes shall be deemed to accrue or arise in India-...
>
> (vi) income by way of royalty payable by-
>
> (a) the Government; or
>
> (b) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

> (c) a person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India:...

Explanation 2.For the purposes of this clause, 'royalty' means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head 'Capital gains') for-...

(vii) income by way of fees for technical services payable by-

(a) the Government; or

(b) a person who is a resident, except where the fees are payable in respect of services utilized in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India:...

Explanation 2.For the purposes of this clause, 'fees for technical services' means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'....

21. Article 12 of the Double Taxation Avoidance Agreement deals with "Royalties and fees for technical services". The terms "royalties" and "fees for technical services" are defined respectively in Clauses (3) and (4) of Article 12 of the Double Taxation Avoidance Agreement as under (page 107):

> Article 12 : Royalties and fees for technical services....
>
> (3) The term 'royalties' as used in this article, means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.
>
> (4) The term 'fees for technical services' as used in this article means payments of any amount to any person other than payments to an employee of a person making

payments, in consideration for the services of a managerial, technical or consultancy nature, including the provision of services of technical or other personnel....

22. After carefully reading the above provisions we find it unnecessary to dilate on the aspect of "royalties" because the payments do not even prima facie fall within the meaning of the term "royalties" as defined in Explanation 2 to Clause (vi) of Sub-section (1) of Section 9 of the Act and Article 12(3) of the Double Taxation Avoidance Agreement.

23. We shall proceed to consider the definition of FTS (fees for technical services) as given in Explanation 2 to Section 9(1)(vii) of the Act, noted above. The said expression is defined to mean any consideration including any lump sum consideration for the rendering of any managerial, technical or consultancy services including the provision of services of technical or other personnel but does not include, among others, the consideration which would be income of the recipient chargeable under the head "Salaries". It should be noted that any consideration paid for rendering of a managerial, technical or consultancy services which include provision of services of technical or other personnel, falls within the meaning of fees for technical services subject to one exception, that is when the consideration would be income of the recipient chargeable under the head "Salaries".

24. The term "fees for technical services" as defined in Clause (4) of Article 12 of the Double Taxation Avoidance Agreement means payments of any amount to any person other than payments to an employee of a person making payments in consideration for the services of a managerial, technical or consultancy nature including the provision of services of technical or other personnel. The exception provided in the said definition of FTS is payments to an employee of a person making payments in consideration of services. Here, on the facts of this case, though at first blush salaries paid by the applicant to the seconded employees would appear to fall outside the ambit of the definition of FTS. On a close examination this impression will be dispelled. We have held above that the applicant is not the real employer of the seconded employees. The subject-matter of payments is not merely the salaries of such employees, which have suffered tax, but compensation which, as noted above, takes in its ambit other items also which AT&S Austria is entitled to receive from the applicant under the secondment agreement. And further the recipient of the consideration of compensation is AT&S Austria and not the seconded employees and the compensation is not the income of AT&S Austria chargeable under the head "Salaries". The fact that the employees of AT&S Austria have received their salaries from the applicant and have paid tax under the head "Salaries" is of no consequence. From the above discussion, it follows that the payments, referred to as compensation in the secondment agreement, paid to AT&S Austria by the applicant, are for rendering "services of technical or other personnel" and the exception to the definition cannot be called in aid.

25. The first premise of the question has been found against the applicant. The second premise that AT&S Austria is not engaged in the business of providing technical services in the ordinary course of its business cannot be accepted because we are not shown the memorandum of association of that company to find out as to what business it is authorized to carry on and what is the real business of AT&S Austria. In any event as per the FCA and the secondment agreement, AT&S Austria has undertaken to provide technical services and that would negative the claim of the applicant.

Inasmuch as we have already held above that the payments which AT&S Austria would be receiving, are in the nature of fees for technical services, it is not material for the purpose of the question whether AT&S Austria is charging any separate fee for the secondment of the employees. In our view the fourth and the last premise that the seconded personnel work under the direct control or supervision of the applicant would not militate against holding that the compensation paid by the applicant to AT&S Austria, is in the nature of fees for technical services.

26. For the reasons mentioned above, we rule on the aforementioned question that the payments made by the applicant to AT&S Austria are in the nature of fees for technical services within the meaning of Explanation 2 to Clause (vii) of Sub-section (i) of Section 9 of the Act and Article 12(4) of the Double Taxation Avoidance Agreement and therefore they would be subject to withholding of tax at source under Section 195 of the Act.