

GES NewsFlash

India — Seconded employees constituted a service Permanent Establishment in India for the foreign company



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Synopsis

Recently, the Delhi Tribunal has held that the deputation of employees on secondment basis constituted a service Permanent Establishment (PE) in India as the employees continued to remain as the employees of the tax payer despite their deputation to an Indian company. Further, the Delhi Tribunal has held that consideration received pursuant to the grant of Intellectual Property (IP) Rights was not “effectively connected” with such service PE of the tax payer in India.

Facts

- JC Bamford Excavators Ltd. (tax payer), a tax resident of UK, is a flagship company of JCB in UK, which owns, develops, and manufactures excavators sold under the JCB brand name.
- JCB India Ltd. (JCB India), an Indian company, is a wholly owned subsidiary of the tax payer.
- The tax payer entered into the following two agreements with JCB India:
 - Technology Transfer Agreement (TTA) 1 for grant of license to JCB India for transfer of IP Rights to manufacture, assemble, use, and sell licensed products.
 - International Personnel Assignment Agreement (IPAA) 2 for deputation of eight employees to JCB India on secondment basis (referred to as “the employees of the first category”).
- In terms of the TTA, other employees or personnel (referred to as “the employees of the second category”) of the tax payer occasionally visited India for doing stewardship activities and doing inspection and testing of the licensed products. No separate consideration was paid for undertaking the said activities.
- During the financial year (FY) 2005–06, the tax payer received consideration as royalties/fees for technical services (FTS) from JCB India for grant of the license. This amount was offered for taxation at the rate of 15% by treating the receipt as “Royalties and FTS” under Article 13(2) of the India-UK tax treaty.
- On perusal of the relevant clauses of TTA read with IPAA, the Assessing Officer (AO) observed that the tax payer was required to send its personnel to the plant of JCB India for solving problems relating to licensed products and IPAA was entered to formalize the broader terms set out in TTA for sending of technical people and other personnel of the tax payer to JCB

- India.
- Thus, based on review of the TTA and the IPAA, the AO held that:
 - Service PE was created in India as the deputation of the employees of the first category was for a period of more than 90 days.
 - The tax payer carried on business in India and royalties/FTS received from JCB India was liable to tax as “Business Profits” as it was effectively connected with the PE.
 - Services rendered by the employees of the second category did not constitute PE of the tax payer as the services were in nature of stewardship activities.
- On appeal by the tax payer, the Commissioner of Income-Tax (Appeals) [CIT (A)] observed that both the agreements should be considered as materially different and independent of each other. Further, the CIT (A) held that the tax payer did not have any PE in India as the employees of the first category deputed by the tax payer became the employees of JCB India and worked under the direction, supervision, and control of JCB India.
- Aggrieved by the order of the CIT (A), the revenue filed appeal before the tribunal.

Significant issues before the tribunal

- Whether the tax payer had any PE in India?
- Whether the consideration was taxable as “Business Profits” or as “Royalties/FTS” under the India-UK tax treaty?

Tribunal ruling

Whether the tax payer had any PE in India?

- The service PE article of the India-UK tax treaty was analyzed. The requisite conditions for constituting the service PE, such as rendering of managerial services, rendering of services in India, and presence in India for more than 90 days were clearly fulfilled. However, the only other condition namely whether the employees deputed by the tax payer continued to remain employees of the tax payer or became employees of JCB India needed to be analyzed.
- It was observed that in case the employees of the first category were held to be the employees of the tax payer, it would amount to rendering of services by the tax payer. However, if these deputed employees became the employees of JCB India, then it would mean that the services were not rendered by the tax payer through its employees or other personnel.
- The tribunal held that the first category of the employees, i.e., deputed employees continued to remain as employees of the tax payer despite their deputation to JCB India. While reaching such conclusion, following significant aspects were considered:
 - The IPAA was not an independent agreement in itself, but was in the nature of an addendum to TTA that formalized the terms for the supply of personnel by the tax payer to JCB India.
 - The IPAA provided that JCB India desired to utilize services of the tax payer’s employees on “secondment” basis. The term secondment in common parlance means that the employee remains an employee of his existing employer, but by virtue of some agreement between the employer and the third person, the employee has to perform the duties for the benefit of such third person. At no time the employee becomes employee of the host company.
 - As per the International Assignment Policy of the tax payer, on the termination of the expatriate’s posting, the tax payer would reemploy the seconded employees. Further, if during such deputation certain disciplinary matter arose, those would be looked into by the group director and not by the individual company to which such personnel were deputed.
 - No appointment letters given by JCB India were placed on record.

- The deputed employees which were sent on secondment basis to JCB India continued to be on the payroll of the tax payer and maintained their lien on their employment. Salary for these employees was the sole responsibility of the tax payer.
- There was no material to indicate that the tax payer terminated their services and they were employed by JCB India.
- As per the terms of the TTA, the employees of the tax payer during the time they were to be present on premises of JCB India were not be considered as employees of JCB India.
- The CIT (A) appeared to have been swayed by the visiting cards and Form 16 of such employees for coming to the conclusion that they became employees of JCB India.
- Based on the above observations, the tribunal held that the tax payer had a service PE in India by virtue of the deputation of the employees of the first category.

Whether the consideration was taxable as ‘Business Profits’ or as ‘Royalties/FTS under the India-UK tax treaty?’

- It needs to be decided as to whether the right, property, or contract in respect of which the royalties or FTS has been paid are “effectively connected” with the PE of the tax payer in India.
- The phrase “effectively connected with” has neither been defined under the Income-Tax Act 1961 nor the tax treaty. The words “effectively connected” are akin to “really connected.”
- The characterization of three components of amounts earned by the tax payer from JCB India viz.; the consideration for supply of IP Rights simplicitor, the consideration for rendering of services by the employees of the second category and the consideration for rendering of services by the employees of the first category need to be determined.

Consideration for supply of IP Rights simplicitor

- The service PE representing the deputationists had absolutely no role to play in relation to grant of IP Rights. The service PE was concerned only with the activities of rendering services after the grant of IP Rights.
- The amount of royalty received by the tax payer from the grant of IP Rights was in the nature of right or property and was not effectively connected with the service PE of the tax payer in India.
- Thus, it was held that the consideration was taxable as “Royalties” and not as “Business Profits.”

Consideration for use of services of the employees of the second category, i.e. stewardship activities

- Consideration for use of the employees of the second category was embedded in the consideration for use of IP Rights. It was held that such employees did not constitute a PE in India and thus there cannot be any question of income being effectively connected with a PE.
- Thus, it was held that the consideration was taxable as “FTS” and not as “Business Profits.”

Consideration for use of services of the employees of the first category, i.e., deputation of employees

- Consideration for use of services of the employees of the first category was in the nature of FTS.
- The effective connection is required to be seen between the PE and the “contract” from which such fees resulted and not from such fees for technical services per se. The “contract,” which is the source of income in the present case is the TTA and IPAA.
- The TTA read with the IPAA, under which such employees were sent to JCB India, was effectively connected with the service PE of the tax payer.
- Thus, it was held that the consideration was not taxable as “FTS,” but as “Business Profits.”

Comments

The tribunal in this decision has analyzed in detail the concepts of “service PE” and “effectively connected” with the PE. Based on the factual aspects, the tribunal held that deputation of employees resulted in a service PE in India for the tax payer. Further, it noted that “effective connection” is required to be seen between the PE and the “contract” from which such fees resulted and not from such fees for technical services per se.

Way forward

Tax payers may review their arrangements in the light of the above ruling to determine whether the employees seconded to an Indian company constitute a service PE and whether the consideration received from the Indian company was “effectively connected” to such PE.

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