

GES NewsFlash

India — High Court upholds advance ruling – secondment results in provision of services



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Background

- The applicant Centrica India Offshore Private Limited (CIO), an Indian Company, is a wholly owned subsidiary of Centrica Plc, UK.
- Centrica Plc, and its other overseas subsidiaries in the UK and Canada, outsourced their back office support functions to third-party vendors in India.
- CIO was set up to provide a locally based interface between the overseas entities and the Indian service providers and received service charges at cost plus 15% under a service agreement with the overseas entities.
- A secondment agreement was simultaneously entered into between CIO and the overseas entities under which employees of the overseas entities were seconded to Centrica India.
- CIO was to bear all the costs of the monthly remuneration of the secondees, which the overseas entity would recharge to CIO on a monthly basis.
- CIO had approached the Authority for Advance Rulings (AAR) to determine the following:
 - Whether the amount paid by CIO to the overseas entities under the secondment agreement is in the nature of income accrued to the overseas entities.
 - If yes, whether tax is liable to be deducted at source by CIO on such payments.

AAR ruled against CIO and held that:

- Reimbursement of salary cost was in the nature of income accrued to the overseas entities
- Services rendered by the seconded employees were managerial in nature but would not be covered by Article 13.4 of the India-UK Double Taxation Avoidance Agreement (DTAA) or Article 12.4 of the India-Canada DTAA, which deals with fees for technical services;
- Consideration paid to the overseas entities were not “fees for technical services”
- The overseas entities constituted service PE under the relevant DTAA on

account of employees deputed by them under the terms of the secondment agreement;

- Tax is liable to be deducted at source on the amount paid/payable by CIO to the overseas entities

Aggrieved by the decision of the AAR, CIO filed a writ petition with the Delhi High Court.

Issues before the Delhi High Court

1. Whether secondment of employees by the overseas entities to CIO falls within Article 12 of the India-Canada DTAA and Article 13 of the India-UK DTAA; whether the overseas entities rendered “technical services”/included services under the respective Articles, such that a tax liability arose on account of provision of services.
2. To address the following arguments of CIO in the context of whether the AAR was right in holding that secondment of employees leads to a service PE for the overseas deputed entity:
 - There is no service PE since CIO is the economic employer while the overseas entities are only the legal employer.
 - The payment made by CIO represents a reimbursement, which does not form a part of the income of the overseas entities.
 - The payment is not the income of the overseas entities on account of the doctrine of diversion of income by overriding title.

Observations and Ruling of the Honorable High Court

The Delhi High Court decided against the petitioner on the following grounds:

Fees for technical services:

- The India-UK DTAA defines “fees for technical services” as “payments of any kind of any person in consideration for the rendering of any technical or consultancy services (including the provision of services of a technical or other personnel)”. In this case, the overseas entities have, through the seconded employees, provided “technical” services to CIO since the expression expressly includes the provision of services of personnel.
- Technical services does not limit itself only to technological services, but rather, extends to know-how, techniques, and technical knowledge.
- Article 12 of the India-Canada treaty incorporates fees for “included services.” While this includes technical services and consultancy service, the second qualification under the definition for technical knowledge to be made available is an essential and additional requirement of the DTAA. The activity of the secondees is to transfer their technical ability to ensure quality control vis-à-vis the Indian vendors, or in other words, make available their know-how of the field to CIO for further consumption. The secondment, if viewed from this angle, actually leads to a benefit that transmits the knowledge possessed by the secondees to the regular employees. Article 12 contemplates not only a formal transfer of intellectual property, but also other techniques and skills. The skills and knowledge required to ensure that the task entrusted to CIO – quality control – is carried out diligently falls within the relevant article of the said treaty.
- There is no distinction between the provision of services by the overseas entities and the mere secondment of employees, since the services provided by the overseas entities are the provision of technical services through the secondees.

Service PE:

- Seconded employees retained their entitlement to participate in the overseas entities retirement and social security plans and other benefits as applicable to them. The salary was also payable by the overseas entities.
- There was no document to substantiate that the secondees could terminate the secondment arrangement.
- Documents submitted did not reflect that the salary costs of the secondees is to be borne by CIO.
- Secondees cannot sue CIO for default in payment of their salary; no obligation is spelled out vis-à-vis CIO.
- CIO has the right only to terminate the secondment in its agreement with the overseas entities and not the services of the secondee vis-à-vis the overseas entities vide the original subsisting employment relationship, which remained independent and beyond the control of CIO.
- The concept of legal and economic employer as considered by Vogel was distinguished. The Court recognized that the secondees were originally employees of the overseas entities and not hired as a false façade, whose productivity is to be ultimately traced to CIO, and that they were seconded for a limited period of time to CIO to utilize their technical expertise.
- The employment relationship between the overseas entities and the secondees is at no point terminated, nor was CIO given any authority to even modify the continuing relationship.
- Salary ultimately paid through the overseas entity, which is not a mere conduit.
- CIO may have operational control over these persons and may be responsible for their failures, but these factors cannot displace the larger and established context of employment abroad.
- The services are not in the nature of stewardship, and the overseas entities continue to be the real employer.
- The decision of the Supreme Court in the case of Morgan Stanley supports the view of the AAR on service PE.
- The OECD Commentary on Article 15, which distinguishes a situation where the employee works exclusively for the enterprise in the state of employment and is released for the period by the enterprise in the state of residence, was clearly and critically not done in this case.
- The ruling in AT & S India Private Limited (AT & S) would be applicable to the case on hand, wherein it was held that the payments were not in the nature of a reimbursement. The nature of the transaction determines taxability or otherwise and not the nomenclature used to describe it or the absence of a markup on costs.
- The obligation of the overseas entities to pay the seconded employees is independent of the arrangement between the former and CIO and hence doctrine of “diversion of income by overriding title” would not apply to the payments made by CIO.

Deloitte's comments

The transfer of employment through a secondment arrangement has virtually been struck down by the court in the instant case. Deputations under such arrangements may result in a tax liability for the overseas entity on account of payments made on recharge of salary costs on secondments. Companies will be well advised to review their secondment arrangements in the light of the above ruling to determine whether the employees seconded to an Indian company result

in a taxable service by the seconding entity.

The High Court has held that the payments made by CIO to the overseas entities would fall within the provisions of Articles 12/13 on fees for technical services. At the same time, the Court, by rejecting the arguments put forth by CIO against service PE, appears to have indirectly concluded that secondment of employees would create one. In upholding the ruling of the AAR, the Court has not independently analyzed Article 5 on PE. It is pertinent to note that Article 5 of the respective DTAA specifically excludes constitution of PE with respect to services that are taxable under Articles 12/13 on fees for technical services. Hence, one may have to read this decision in tandem with the AAR ruling to get a complete picture.

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