BEFORE THE AUTHORITY FOR ADVANCE RULINGS (INCOME TAX)
NEW DELHI

16th Day of August, 2012

A.A.R. No. 851 of 2009

PRESENT

Justice Mr. P.K.Balasubramanyan (Chairman)

Name & address of the applicant	:	Target Corporation India Pvt.Ltd. C-2, Block Manyata Embassy, Business Park, Special Economic Zone, Nagwara Hobli, Outer Ring Road, Bangalore - 560045
Commissioner concerned	:	Director of Income-tax (International Taxation) Bangalore
Present for the applicant	:	Mr. P.J.Pardiwalla, Advocate Mr. V.B. Patel, Advocate Mr. Vishweshar Mudigonda,CA Mr. Amartya Ghose, Manager Finance Mr. Sunmantra Dutt, Sr.Director-Global Finance
Present for the Department	:	Mr. R.S. Rawal, CIT(DR) Ms. Meera Srivastava, ADIT, Bangalore

R U L I N G

The applicant is a company incorporated in India. It is a fully owned subsidiary of a company incorporated in the United States of America (U.S.A). It entered into an agreement with its U.S. principal on 10.6.2007, to be effective from 1.4.2006, for seconding certain of the employees of the principal to the applicant subject to certain terms and conditions. The applicant is to request its American Principal to provide employees who have the required level of expertise required by it. The U.S. Principal would then second the employees for specified periods. This secondment

of the employees by the U.S. Principal was based on the U.S. principal's global mobility policy. The employees of the principal seconded to the applicant shall continue to have their payroll processed by the principal. But, the applicant was to reimburse the principal for those amounts and also pay the principal a service charge at $ 15 per employee per payroll cycle for processing the payroll of the seconded employees. The U.S. principal was to ensure that the employees acted in accordance with the instructions and directions of the applicant, that they would devote their whole time to the applicant and that all the responsibilities and risk for work undertaken by the employees will remain with the applicant during the secondment period. The applicant will have the right at any time to reject the seconded employees. The employee was to act on behalf of the applicant as may be required by it. If during the period, the US Principal wanted to terminate the secondment of any of the employees seconded, it was to do so only in prior consultation with the applicant. The terms and conditions of employment with the applicant as stated in the employment agreement between the applicant and the employee, was to remain in force during the secondment period. They were to maintain strict confidentiality with respect to all information regarding the applicant.

2. During the secondment period, the applicant was to reimburse the US Principal all remuneration payable to the employees and meet all official out of pocket expenses of the employees. It was agreed that the payment by the applicant to the US Principal was to be limited to actual costs incurred. During the period the role of the US Principal was restricted to that of a payroll service provider only. The principal was to endeavour to provide appropriate qualified employees.

3. Pursuant to this, certain employees of the US Principal were seconded to the applicant. Separate contracts were entered into with them. On these pleadings, the applicant approached this Authority seeking advance rulings on certain questions and this Authority allowed the application under section 245R(2) of the Act to give rulings on the following questions:

Secondment Charge

1. *Whether on the facts and circumstances of the case, the amount reimbursed or reimbursable by the applicant to Target Corporation, USA, under the terms of the secondment agreement dated 10.6.2007 is in the nature of income accruing to Target in respect of which, tax is liable to be deducted at source by the applicant under the provisions of Income-tax Act, 1961?*

2. *If the answer to the first question is in the affirmative, what is the rate at which tax is required to be deducted at source by the applicant?*

Payroll processing charge

1. *On the facts and in the circumstances of the case whether the payment proposed to be made by the applicant towards payroll processing charges is taxable as per the*

provisions of Double Taxation Avoidance Agreement ("DTAA") entered into between India and USA?

2. *On the facts and circumstances of the case whether the applicant is liable to withhold tax at source under section 195 of the Act ("the Act") on the payments proposed to be made by the applicant towards payroll processing charges?*

4. The applicant contends that what it pays to its US Principal under the Agreement is only reimbursement of the salaries of the employees seconded to it and processing charges for processing their payrolls and the payments are not liable to be taxed as fees for technical services in the hands of its US Principal, particularly in terms of the Double Taxation Avoidance Convention (DTAC) between India and the US. The seconded personnel are the employees of the applicant since they work under the direct control and supervision of the applicant and an employer employee relationship emerges between it and the employee during the secondment period and though the US Principal was paying their salaries and other benefits under the arrangement, the obligation to pay the salary was of itself. It had the right to prescribe the conditions of service and direct the employees to perform the duties as per its policy. It had the right to control and supervise the manner of their work and the right to issue directions. There was thus an employer-employee relationship between the applicant and the employee and the proposed payments are in the nature of reimbursement. The fact that the salaries are initially received by

the employees from the US Principal does not sever the employer-employee relationship between the applicant and the employee. The applicant was deducting the withholding tax from the salaries paid to the employees.

5. The Revenue has contended that the relationship of employer and employee is between the US Principal and the employees. In other words, the seconded employee continues to be the employee of the US Principal and never becomes the employee of the applicant in terms of the agreement. The salary and other benefits are paid by the US Principal and the right to terminate the employment rests with the US Principal. What is paid by the applicant to the US Principal is fees for technical services taxable as such. Alternatively, it is pleaded that a permanent establishment comes into existence as a service PE and the payments are in any view taxable as such.

6. It is noticed that the applicant is a fully owned subsidiary of the US Company. The employees sent to it were employed by the US company. Even after providing their services to the applicant, their salaries and other service benefits are paid by the US company. Thus, they never ceased to be the employees of the US company. In fact the agreement specifically says that the employees are sent to the applicant based on the principal's global mobility policy. The agreement specifically says that what is to be

paid to it by the applicant is all remuneration of the employees paid by the principal. The right of dismissal rests or continues to rest with the US Principal. The relationship of the employees with the US Principal never ceased so as to enable them to claim that they have become the employees of the applicant.

7. A sure test to find out whether there exists the relationship of employer and employees is to see whether the applicant has the right to terminate the employment of the seconded employees. The agreements relied on do not show the existence of any such power. The right to terminate the secondment is not the right to terminate the employment. The employees were admittedly employed by the US Principal and they were being paid their salaries by the US Principal. They are continuing to be paid their salaries and other service benefits by the US Principal even after secondment. Before the applicant can claim to establish that the employees have become its employees, it has first to show that the employees ceased to be the employees of the US Principal. One would search in vain to find cessation of such original employment. There is also a presumption in law of the continuance of a state of things shown to have come into existence. Here, the employment with the US Principal has come into existence. There is nothing to rebut the presumption that the same continues. On the other hand, the facts strengthen the presumption of continuance.

8. In a recent Ruling in AAR No.856 of 2010, this Authority has discussed the question to come to the conclusion that the employer-employee relationship is between the original employer, the US Company here, and the employee. The absence of a right to terminate the employment as distinct from the right to terminate the secondment was held to be significant. It was also noticed that the absence of an obligation in the applicant to pay the salaries of the employees was also a significant factor. It is not necessary to reiterate the reasons given in that Ruling. Suffice it to say that I adopt the reasoning therein to come to a conclusion on the facts of this case and on an interpretation of the agreements that the applicant does not become the employer of the seconded employees and what is paid by the applicant to the US Principal would not be reimbursement of salary, but fees for technical services or business profits, depending on a finding on that question. The payment of payroll processing charges cannot also be considered reimbursements.

9. Once it is held that the employees seconded are the employees of the US Principal, then the salaries and other emoluments paid to them by it are out of the obligation inhering in it as the employer. The applicant having no obligation to pay the salaries, what the US Principal collects from the applicant cannot be reimbursements. It is compensation or fees paid by the

applicant to the US Principal for making available to it the services of the employees of the Principal. Therefore, on question no. 1, it has to be ruled that what the applicant pays to the US Principal is not in the nature of reimbursement, but it is the income of Target, the US Principal.

10. I must notice here that the applicant has not sought a Ruling from this Authority whether payment would be fees for technical services or something else. No doubt question no.1 poses the aspect as to whether the secondment charges is income in the hands of the US Principal in respect of which tax is liable to be deducted at source under the Act. Except arguing that since it is reimbursement, it is not chargeable to tax under the Act and hence no withholding under section 195 of the Act is called for, the applicant has not set out any other submission. In this situation, I can only rule that the payment received by Target, the US Principal from the applicant is income in the hands of Target and while paying the amounts the applicant has the obligation to withhold taxes under section 195 of the Act.

11. There are no arguments raised in the application on the second question relating to the rate of tax to be withheld in respect of the secondment charge. The fact that no question has been raised in the alternative as to the nature of the amounts paid by the applicant to the US Principal, it does not appear to be proper to

render a Ruling on that question. That question can be decided now only by the authorities under the Act in the usual stream. Hence, on question no. 2 regarding secondment charge it can only be ruled that the withholding or deduction of tax has to be at the rate prescribed by the Act subject to the right of the applicant and its Principal to raise all their contentions before the assessing authorities.

12. On payroll processing charge, the applicant has posed two questions for ruling. One, whether that charge paid by the applicant to US Principal at 15 dollars per employee per pay roll is taxable in India as per the provisions of the DTAC between India and USA and whether the applicant is liable to withhold the tax at source under section 195 of the Act.

13. It is argued on behalf of the applicant that the payroll process charge is not fees for technical services in terms of Article 12 of the DTAC since US Principal is not making available any technical knowledge, experience, skills, know-how or process of the applicant. It is submitted that in view of this, Article 12 the payment or income would be taxable only in USA. On behalf of the Revenue, it is contended that it will be fees for technical services even going by Article 12 of the DTAC. It is sought to be argued that by making available the services its employees, US Principal, is making available technical knowledge, experience and

skills to the applicant. In the alternative, it is contended that the US Principal must be taken to have a permanent establishment in India when it seconds these employees to India for the purpose of carrying out the functions assigned to them. The ruling of this Authority in AAR no. 856/2010 is relied on in support.

14. It is seen that the employees seconded to the applicant are required to have a particular level of expertise in their respective roles. Neither the agreements nor the application, specified what are the duties to be performed by the seconded employees in India. Adequate details are also not available on the persons seconded or about the roles they have to perform in India. In this situation, I am of the view that it will not be proper and just to render a ruling on the nature of the employees in respect of whom processing charges are collected by the US Principal. I have already said that what is paid by the applicant to the US Principal is not reimbursement. I have also indicated that this Authority had not been called upon to give a ruling on the nature of the income in the hands of the US Principal if it was not reimbursement. In the absence of adequate material, I am of the view that it will be hazardous to give a ruling on this question as well, on the materials now available. It is true that arguments were addressed on the question, but in the absence of adequate facts, it is not proper to rule on this question. I leave open this question for a decision by

the assessing authorities as and when called upon to do so. Obviously, the applicant and the US Principal will have a full opportunity to put forward their contentions in this regard before the authorities under the Act.

15. Since no definite ruling can be given on question no. 1, relating to processing charge at this stage, on question no. 2 regarding processing charge, it can only be ruled that the applicant has the obligation to withhold tax under section 195 of the Act at the rates prescribed by the Act subject to any final adjudication on the chargeability or otherwise to tax this income by the assessing authority.

16. Accordingly, the ruling is pronounced on this, the 16th day of August, 2012.

(Justice P.K. Balasubramanyan)
Chairman