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HIGH COURT RULES THAT SECONDED EMPLOYEES' SALARY COST REIMBURSED BY FLIPKART TO WALMART INC WILL NOT BE SUBJECT TO WITHHOLDING TAX IN INDIA

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Introduction

In the case of Flipkart Internet Private Limited v DCIT (International Taxation) and Others [Writ Petition Number 3619/2021 (T-IT)], the Hon'ble Karnataka High Court (HC) has provided a major relief to taxpayers in the context of secondment arrangements wherein the salary cost of seconded employees is reimbursed by the Indian entity to the foreign entity on a cost-to-cost basis (Judgment). The HC has held that such reimbursements will not be subject to Indian withholding tax (WHT) as the same are not taxable in India on account of there being no income element embedded therein. In doing so, the HC has reaffirmed the settled legal position that payments made to non-residents will not be subject to WHT if the said payment is not chargeable to tax in India.

Facts and Background

Secondment Arrangement: Flipkart Internet Private Limited (Assessee) is engaged in the business of providing information technology solutions and support services for the e-commerce industry. Walmart Inc., Delaware USA (Walmart Inc) had seconded certain employees (Seconded Employees) to the Assessee vide an Inter-company Master Services Agreement (Agreement). For administrative convenience, it was agreed that Walmart Inc would make payment of salaries to the Seconded Employees (Salaries) which in turn would be reimbursed to Walmart Inc by the Assessee.

Relevant Legal Provisions: In terms of Section 195 of the Income Tax Act, 1961 (IT Act), a payment made to a non-resident is subject to WHT only if the same is *chargeable to tax in India*. This is different from other provisions related to WHT (such as Section 194C, and Section 194J) wherein the WHT obligation is triggered on a gross basis. Section 197 of the IT Act allows the payee to approach the tax authorities (Tax Authorities) for *inter alia* a 'nil WHT' certificate whereby the payment can be made to such person without WHT. Similarly, in a case where only a certain portion of the payment is chargeable to tax in India, Section 195(2) permits the payer to approach the Tax Authorities to determine the appropriate portion of sum chargeable to tax for the purpose of WHT.

Assessee's Nil WHT Application: Since the Salaries were reimbursed by the Assessee to Walmart Inc on a cost-to-cost basis, the Assessee sought a 'nil WHT' certificate in terms of Section 195(2) of the IT Act. The same was rejected by the Tax Authorities by alleging the following - a) there was no employer-employee relationship between the Assessee and the Seconded Employees; and b) the services rendered/provided by the Seconded Employees were in the nature of 'technical services' under the IT Act as well as under the India-US double taxation avoidance

agreement (DTAA) and hence, the Salaries ought to be characterised as fees for technical services (FTS) which were subject to WHT on a gross basis.

Assessee's Writ Petition before HC: Aggrieved by the aforesaid rejection, the Assessee preferred a writ petition before the HC by contending *inter alia* that - a) WHT obligation under Section 195 was not triggered in the instant case as the Salaries were pure reimbursements and had no income element embedded therein; b) the reimbursement of Salaries could not be classified as FTS under Article 12 of the India-US DTAA as the 'make available' test was not met; and c) Section 9(1)(vii) of the IT Act – which defines FTS – would not apply in the instant case as the provisions of the applicable DTAA were more beneficial. [*Note: Article 12 of the India-US DTAA states that fees for included services (FIS) which make available to the person acquiring the services, technical knowledge, experience, skill, know-how, or processes, only would be amenable to tax (Make Available Test). A similar concept under the IT Act is contained in Section 9(1)(vii) which provides that any income in the nature of FTS payable by a resident shall be deemed to accrue or arise in India. The section defines FTS to mean any managerial, technical or consultancy services but does not include a 'make available' clause. Hence, in that sense, the scope of taxation of FIS under the DTAA is narrower vis-à-vis the scope of taxation of FTS under the IT Act.*]

Judgment

The HC decided the matter in favour of the Assessee by ruling that the reimbursement of Salaries by the Assessee to Walmart Inc will not be subject to WHT as the same is not taxable in India on account of there being no income element embedded therein. Key aspects of the Judgment are summarized below -

Maintainability of Assessee's 'Nil WHT' Application: The HC noted that judicial review of the impugned order could not be enlarged by considering fresh contentions since the issue of maintainability was not considered at the time of passing the order. Further, considering that determination under Section 195 or Section 197 by grant of certificate was tentative in nature, the Assessee ought to be permitted to invoke such provision and seek the certificate to avoid the consequences of non-deduction.

WHT under section 195 read with section 9(1)(vii) of the IT Act and Article 12(4) of the India-US DTAA: As stipulated under the IT Act, with respect to cross-border taxation, the provisions of the IT Act or applicable DTAA, whichever are more beneficial, shall apply. Since Article 12 of the DTAA was more beneficial in the instant case, Section 9(1)(vii) of the IT Act was held to be not applicable. Based on an examination of the Agreement, the HC noted that the services so provided did not satisfy the Make Available Test which is a *sine qua non* for taxability of services as FIS. The fact that the Seconded Employees had the requisite experience, skill, among others, was not by itself enough to satisfy the test.

Deduction on gross basis: The HC noted that since the trigger for WHT obligation under section 195 was that the payment should be *chargeable to tax in India*, the logic of WHT on the gross amount (as contained in other provisions of the IT Act as mentioned above) could not be extended to Section 195.

Secondment and reimbursement of costs: Based on an examination of the Agreement, the HC observed that the Tax Authorities' allegation that there was no employer-employee relationship between the Assessee and the Seconded Employees was erroneous. The Seconded Employees worked for the benefit of the Assessee and reported to the Assessee. The fact that Walmart Inc had the power to decide on the Seconded Employees' continuance after the secondment was held to not make any difference as it related to a service condition post the period of secondment and did not alter the relationship between the Assessee and the Seconded Employees.

Our Comments

Taxation of secondment arrangements in India has often been a subject matter of debate / litigation. In Centrica India Offshore (Private) Limited v Commissioner of Income Tax – I, New

Delhi [[2014] 227 Taxmann 368 (SC)], the Delhi High Court (later affirmed by the Supreme Court) had framed the issue for consideration as to whether the secondment of employees falls within provision of 'DTAA' which embodies the concept of 'Service PE'. In the present case, the HC distinguished the facts of that case to *inter alia* hold that a) the Assessee was the real employer and there was no 'Service PE' in India; b) there was a reimbursement in the true sense and cost payment among related entities was to be ignored; and (c) the services provided under the Agreement did not satisfy the Make Available Test under the India-US DTAA.

This ruling is the second major decision from a tax perspective in relation to seconded employees in recent times, the first one being the Supreme Court ruling in C.C., C.E. & S.T. – Bangalore (Adjudication) etc. v M/s Northern Operating Systems Private Limited [Civil Appeal Numbers 2289-2293/2021] in the context of service tax [referred to in the ERGO dated 21 May 2022]. This ruling solidifies - (a) the settled legal position that WHT under Section 195 would get triggered only if the payment is *chargeable to tax in India*; and (b) the fact that contractual documents play a key factor in identifying the true nature of the secondment arrangement.

At a time when India is vying to be the preferred destination for foreign investments / human resources, aspects such as secondment should be carefully evaluated to prevent unnecessary tax disputes. Every new ruling, on specific facts of the case, seems to leave issues for further deliberation around structuring secondment arrangements in India. A proactive approach to structuring secondment arrangements carefully and a periodic review of the same would go a long way in avoiding unnecessary debate or dispute with tax authorities and mitigating any unwarranted tax exposures in India.

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