*** IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 26.02.2014
Pronounced on: 25.04.2014

\+ **W.P.(C) No.6807/2012**

M/S. CENTRICA INDIA OFFSHORE PVTL. LTD. .....Petitioner

Through: Mr. N. Venkataraman, Sr. Adv. with Ms. K.G. Rajeshwari & Mr. R. Satish Kumar, Advs.

Versus

COMMISSIONER OF INCOME TAX-I & ORS. ..... Respondents

Through: Mr. Sanjeev Sabharwal, Sr. Standing Counsel with Mr. Ruchir Bhatia, Jr. Standing Counsel.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE R.V. EASWAR

MR. JUSTICE S. RAVINDRA BHAT
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1. The writ petitioner (hereafter called "CIOP") is aggrieved by the decision of the Authority for Advance Ruling ("the Authority") dated 14.03.2012, by which the latter held that payment by it under the agreement – with certain overseas entities is "income accruing" to overseas entities in view of the existence of a service Permanent Establishment (PE) in India and that tax is liable to be deducted at

source under Section 195 of the Indian Income Tax Act, 1961 ("the Act").

2. CIOP is a wholly owned subsidiary of Centrica Plc., a company incorporated in the United Kingdom ("UK"). CIOP is incorporated in India. British Gas Trading Ltd. ("BSTL") and Director Energy Marketing Limited, Canada ("DEML") are also subsidiaries of Centrica Plc. These overseas concerns are collectively referred to hereafter as "overseas entities". They are in the business of supplying gas and electricity to consumers across the U.K and Canada. The overseas entities outsource their back office support functions – for instance, debt collections/consumers' billings/monthly jobs to third party vendors in India etc. To ensure that the Indian vendors comply with quality guidelines, CIOP was established in India on 11.3.2008. It was to act as service provider to these overseas entities.

3. CIOP entered into service agreement with overseas entities to provide locally based interface between those overseas entities and Indian vendors. The scope and range of services so provided in terms of those agreements/understanding are: (i) management assistance for outsourced supplies in India and facilitating efficient interface back to U.S. business of Centrica Plc; (b) ensure that outsourced suppliers adhered to best practices and share them on e-2-e on optimal basis; (c) expert advice on widening scope of potential services in India to target work force through greater control and such other services as may be requested by Centrica Plc from time to time. It is stated that

in terms of the agreement, the petitioner is compensated on full costs, i.e. expenses adopted by it in the Profit and Loss Account plus a mark-up of 15%. The petitioner is an income tax assessee and has been filing returns and paying income tax on the income earned out of the service agreement. To seek support during initial year of its operation, CIOP sought some employees on 'secondment' from the overseas entities. For this purpose, it entered into an agreement with the overseas entities in which the latter seconded some employees for fixed tenure. It is stated that in terms of the secondment agreement – copy of which has been placed on the record, the employees so seconded work under CIOP's direct control and supervision. Conversely, the overseas entities are not responsible for any error or omission of the work of such employees. CIOP bears all risks and rewards associated with the work performed by such employees. To drive home this point, CIOP relies upon certain conditions in the secondment agreement, notably Sections 2.1(C), 2.2(A), 2.3(A) and 2.3(B). It is stated that the agreements fully require the petitioner to enter into a further individual agreement with each such employee (secondee) in terms of a pre-determined format.

4. CIOP highlights that the terms of these secondment agreements establish that the employees would work directly under the supervision and direction of its board and management. It is stated that the seconded employees came to India on deputation for short period. However, their family and financial matters remained in their home countries where they intended to ultimately return to after completion of the assignment. It was, convenient, for them, therefore,

to receive salaries overseas. An option available to such employees was to receive their salaries through India and later transfer their salaries overseas. However, to avoid this, the employees continued to remain on the payroll of the overseas entities who used to pay and disburse the salaries. The petitioner thereafter reimbursed such salary costs to the overseas employers. It is stated that this arrangement/salary reimbursed is purely on cost-basis. Reliance is placed upon Section 3.1 of the secondment agreement which in this respect reads as follows:

> *"(A) PLC shall charge CIO monthly for the actual documented costs and expenses that is incurred by PLC during the terms of this Secondment Agreement in respect of the Secondees during the Secondment (the 'Monthly charge').*
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> *(B) The monthly charge shall include:*
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> *(i) all direct costs of Secondee's base salary and other compensation;*
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> *(ii) costs of participation in PLC's retirement and social security plans and other benefits in accordance with applicable PLC policies; and*
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> *(iii) other costs but only if such other costs have been agreed between CIO and PLC."*

5. It is stated that the petitioner offers to tax the salaries paid to every seconded employee in India and that it will file Income Tax Returns in India after dispatching appropriate taxes. It therefore withheld taxes under Section 192 of the Act with respect to the salary paid or payable to the seconded employees. Likewise, service income received by the petitioner from overseas entities in terms of the service agreement is offered by it to tax under the Act. CIOP, a

resident Indian company, had sought advance ruling under Chapter XIX-B of the Act by its application dated 06.11.2009 on the following two questions:

> *"(i) Whether on the facts and in the circumstances of the case, the reimbursements made by the Petitioner to overseas entities of the actual costs of expenses incurred under Secondment Agreement is in nature of income accruing to the overseas entities?*
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> *(ii) If the answer to question No. 1 above is affirmative, whether tax is liable to be deducted at source by the petitioner under the provisions of Section 195 of the Income-tax Act, 1961?"*

6. CIOP urged, before the Authority, that in tune with the recognized international principles, it is the real and economic employer of the seconded employees, even though their legal employers were the concerned overseas entities. It was also urged that in terms of the secondment agreement, the overseas entities were not providing any service to the petitioner. Furthermore, the payment to the seconded employees by the overseas entities was purely out of convenience which was in turn reimbursed on cost-basis. The reimbursement made to such overseas entities was not taxable as income in India because the taxes were already paid in respect of the seconded employees in India. It was urged that the reimbursement to the overseas entities could not be considered as income under the time-tested doctrine of "diversion of income by overriding title". Thus, submitted the petitioner, the presence of the seconded employees did not create a permanent establishment

(PE) of such overseas entities under the Double Taxation Avoidance Agreement (DTAA).

7. The respondent income tax authorities countered the petitioner's submission by stating that the seconded employees were rendering monthly services to the petitioner and reimbursement to the overseas entities was in the nature of "fees for technical services" and covered under Section 9(1)(vii) of the Act as well as under the Double Taxation Avoidance Agreements applicable to U.K. and Canada. It was, therefore, contended that the overseas entities would have PE under the DTAA. The respondent argued that CIOP could only terminate the seconded agreement but could not terminate the contract of those seconded employees. This proved that it was not the real employer and that the overseas entities were the real and legal employers. Consequently, there was no charge on the petitioner through the overseas entities in respect of the obligation of payment of remuneration to the seconded employees. This, according to the respondent amounted to application of income and not diversion of income by the overriding title.

8. The Authority ruled against the petitioner, by the order impugned in the present case, on 14.03.2012, *inter alia*, holding that: (a) reimbursement of salary cost paid/payable by the petitioner to overseas entities under the terms of Secondment Agreement is in the nature of income accrued to the overseas entities; (b) the services rendered by seconded employees are

managerial in nature but such services will not come within the purview of Article 13.4 of the India–UK DTAA or Article 12.4 of India–Canada DTAA. Therefore, consideration paid by the Petitioner to the overseas entities cannot be held to be fees for technical services; (c) the overseas entities constitute service PE under the relevant DTAA on account of employees deputed by overseas entities to the Petitioner under the terms of Secondment Agreement; and (d) Tax is liable to be deducted at source under Section 195 of the Act on amount paid/payable by Petitioner to overseas entities under the Secondment Agreement

The material parts of the Authority's findings are extracted below:

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> *"12. What is the position in this case? The applicant was created as a subsidiary by the overseas entity for coordinating the services of various vendors in India to whom it has outsourced some activities needed by it. A service agreement was then entered into by the overseas entity with the applicant for this purpose. The applicant was to be paid the costs it incurred for doing the work plus 15% of it as profits or compensation. The applicant submits that it has offered this 15% to tax in India.*
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> *13. The applicant required to be guided in the processes and procedures of the overseas entity. For this, the overseas entity deputed or seconded some of its employees to the applicant to render their services in India. As we see it, those employees continue to be the employees of the overseas entity and they are paid their salaries and other perquisites or allowances by the concerned overseas entity. All their service benefits are given by the overseas entity. They, thus, remain the employees of their original employer. On a reading of the*

Secondment Agreement, it is seen that the right of the seconded employees to seek their salaries and other emoluments is against the overseas entity. They cannot claim it as of right against the applicant.

14. The right of dismissal of the employees vests in or rests with the overseas entity. Even though the control and supervision of the employees and their work is with the applicant, the applicant cannot terminate their employment. It can only terminate the secondment agreement of the employees.

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18. On the terms of the Secondment Agreement, it is difficult to find that the amount paid by the applicant to the overseas entities is reimbursement as sought to be emphasized by learned counsel for the applicant. Obligation to pay the salary rested with the overseas entities and the right of the employee to claim it is only against the overseas entities. The employee is conferred no right to claim the salary from the applicant nor is the applicant burdened with an obligation to pay that salary. It is difficult to accept the argument that what is paid by the applicant to the overseas entity in view of its sending its employees to the applicant for rendering service is reimbursement of the salary paid by the employer to them. Merely because the overseas entity is not charging the applicant anything more than what it has paid by way of salary and other emoluments to the concerned employee, that does not alter the situation. The fact that in the accounts of the applicant, this is entered as reimbursement of cost or it is not shown as income in the account of the overseas entity, cannot be conclusive of the question. What the Model commentary on Article 15 concerning the taxation of income from employment says is that where a comparison of the nature of services rendered by the individual with the business activities carried on by his former employer and by the enterprise to which the services are provided points to an employment relationship

that is different from the former contractual relationship, then certain additional factors may be relevant to determine whether the employer who receives the secondees could be treated as their employer. What we find in this case is that the overseas entity has created an Indian company as its subsidiary for ensuring that the services to be rendered to it by various Indian vendors are properly coordinated. The overseas entity wants their services to be consistent with its business and policies. The applicant having been newly constituted, was presumably not in a position to render help to the various vendors in the matter of fulfilling their obligations or in the matter of ensuring compliance with the processes and practices employed by the overseas entities. The Secondment Agreement is specifically based on the fact that CIO has asked the overseas entity to provide staff with knowledge of various processes and practices employed by the overseas entity and experience in managing and applying such processes and practices. On a look at the list of employees, it is seen that the persons seconded are concerned with managerial functions and they are to oversee the applicants' operations and to be overall responsible for its activities and functions. This, therefore, appears to be a case where some employees qualified in the processes and procedures of the overseas entity are lent to the applicant, the Indian entity, a subsidiary, to perform the functions envisaged for it. What is paid by the applicant to the overseas entity in view of this lending of service of certain employees, would really spell in the realm of compensation paid for managerial services. Of course, it remains for us to consider whether it is taxable and if it is, whether it is taxable in India.

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20. Here, the enterprise to which the employees are sent is the subsidiary of the original employer. The persons well versed in the processes and procedures of that employer are sent to the subsidiary to enable the subsidiary to perform the work for which it was created in accordance with the processes

and procedures of the original employer. The work is also really that of the employer, in the sense, that it is to coordinate the work of the vendors of the employer situated in the other State. It is a work needed by the original employer. On the terms of the agreement entered into by CIO with the overseas entity and the separate agreements entered into with the seconded employees, we have held that the obligation to pay the salary is that of the original employer and the right of the employees to claim that salary is against the original employer. The work of the employer in India, is not unconnected with the activity of their original employer, the overseas entity. On the other hand, it is part of it. In this situation, we are of the view that even if we are able to postulate two work relationships - we find it difficult to do so - the one responsible for the remuneration, the overseas entity, has to be found to be the employer.

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26. In the case on hand, as can be seen, the secondee employees are all rendering managerial services. They are General Manager, Operations Manager, Delivery Manager and Relationship Manager respectively. It is true, as pointed out by the Revenue, that even the separate agreements do not specify the nature of the services required to be provided by the employees. There is no material as of now to indicate that they are performing any technical functions or consultancy functions. They can be said to be managing the business of the subsidiary as requested by Centrica Plc., consistent with its aims. There is no acceptable argument except reliance upon a ruling by this Authority in Version Data Services India Private Limited (AAR No.865 of 2010). We may notice that the High Court of Madras has in a Judgment in Writ Petition No. 14921 of 2011, set aside the finding of this Authority on that question and has remanded the relevant question for a re-consideration. To that extent, the finality of the Version Ruling has now gone. So, the reliance placed on that Ruling by the Revenue is of no avail.

> *27. On the materials now available, it is not possible to hold that the managerial services being rendered in this case, will come within the purview of Article 13.4 of the India-UK Convention or Article 12.4 of the Indo-Canada Convention. Hence, the consideration paid by the applicant to the overseas entities for getting the services of these employees cannot be held to be fees for technical services. In view of the above, it is not necessary to consider the question whether the service is made available to the applicant."*

CIOP'S contentions

9. CIOP, the petitioner submits that the Authority fell into error in overlooking that there is a strong underlying master-servant relationship in the case of secondment whereas in service agreements, the relations between the parties is between two principals, i.e. the service provider is an independent contractor. In this regard, learned senior counsel relied upon the decision reported as *Kishore* v. *ESIC*, 2007 (4) SCC 579. It is submitted that in terms of the secondment agreement, the control of the petitioner over the seconded employee is complete in almost all aspects, such as – (i) dictating the scope and nature of work to be undertaken; (ii) right of supervision; (iii) right to issue instructions and directions; (iv) right to dictate that the seconded employees would not have any entitlement to seek salaries and other emoluments against the petitioner; (v) right to terminate the secondment agreement even though not the service itself.

10. Learned counsel differentiated between the concept of "legal employment" and "economic employment" and in this context relied upon the observations in 'International Hiring-out of Labour' by

Klaus Vogel as well as principles contained in the OECD Commentary on the Model Tax Convention. It was argued that a legal employer appoints someone and, therefore, has the right to terminate the employment. The economic employer, on the other hand, enjoys the fruits of the labour, possesses the authority to inspect and control and bears the risks and results of the work performed by the employee. The place of employment or work would also be that directed by the economic employer. The economic employer may not have the legal right to terminate the employment altogether, it would possess the right to terminate the contractual arrangement, i.e. the secondment agreement. The payment of salary of the seconded employee is charged from the economic employer. Learned counsel reiterated that an overall reading of Articles 2.1, 2.2, 2.3, 3.1 and 5.2 of the secondment agreement conclusively establishes that it was a real and economic employer of the seconded employees and that they were acting to its dictate in the performance of their job and not placed there to perform the tasks assigned by the overseas entities.

11. Reliance was placed upon the judgment reported as *CIT* v. *Eli Lilly and Co. India Private Limited*, (2009) 312 ITR 225 (SC), to say that the determinative factors for examining whether the home salary paid by the foreign company in foreign currency abroad can be held to be "deemed" or "accrued" or "assigned" in India depends on an in-depth analysis of facts and arrangements in each case. If the salary or remuneration paid by the foreign company is for rendition services in India then the payment fell within Section 9(4)(i) read with Section

192(1). Learned counsel relied upon a recent ruling of the Division Bench of this Court in *DIT* v. *M/s. E-Funds IT Solution,* ITA 735/2011. Similarly, reliance was also placed upon the ruling in *Morgan Stanley and Co., In Re*, 2006 (284) ITR 260 (SC). The petitioner submits that the substance and not the form of the arrangement should be looked into. The over-emphasis on a singular factor such as legal employment of the seconded employee and the right to terminate it by its overseas entities would distort the correct picture which is that effective and overall control is that of the petitioner. The mere secondment of such employees would not amount to rendition of services through them by the overseas entities.

12. It is urged that in terms of the service agreement with the overseas entities, the petitioner charges on cost plus mark-up at 15%; in turn it charges reimbursement due from the overseas entities as secondment agreement as salary costs in its books of accounts. This cost is included in the service receivable on cost plus 15% mark-up basis. Thus, the petitioner offers its income to taxation in India. Maintaining that the two arrangements, i.e. the secondment agreement entered into between the petitioner and the overseas entities on the principal-to-principal basis is distinct from the individual agreements entered into with the seconded employees, it is argued that whilst the former is a contract for service, the latter – by each individual seconded employee with the petitioner, CIOP are contracts for service. It is again reiterated that the overseas entities supplied gas and electricity to U.K. and Canada-based consumers. These overseas entities outsource their non-integral business to third

party vendors in India. The petitioner merely provides business support services in relation to such outsourced processes. The non-integral and non-revenue generating business of such overseas entities, therefore, constitute the integral revenue generating business activities of the petitioner. It can, therefore, by no stretch of imagination be said to carry-on business on behalf of the overseas entities. Nor can it be concluded that the overseas entities are renting their employees to other entities or providing managerial services to the petitioner. It was argued that the law declared in *Morgan* (supra) was misapplied. In this regard, learned counsel relied upon the following observations of the Supreme Court:

> "*As regards the question of deputation, we are of the view that an employee of MSCo when deputed to MSAS does not become an employee of MSAS. A deputationist has a lien on his employment with MSCo. As long as the lien remains with the MSCo the said company retains control over the deputationist's terms and employment. The concept of a service PE finds place in the U.N. Convention. It is constituted if the multinational enterprise renders services through its employees in India provided the services are rendered for a specified period. In this case, it extends to two years on the request of MSAS. It is important to note that where the activities of the multinational enterprise entails it being responsible for the work of deputationists and the employees continue to be on the payroll of the multinational enterprise or they continue to have their lien on their jobs with the multinational enterprise, a service PE can emerge.*"

13. It is submitted that without fulfilling both criteria, i.e. the foreign enterprise assuming responsibility for the deputed personnel's work and the employee being on the payroll or retaining their lien on

employment there would no service PE. In the present case, the first is significantly absent and as regards the second, the payment is made exclusively out of the petitioner's funds.

Respondent's contentions:

14. According to the respondent the secondment Agreement dated December 1, 2008 is premised on the following facts: (a) CIOP has asked the overseas entities to provide *staff with knowledge of various processes and practices employed by PLC and the experience in managing and applying such processes and practices,* and (b) subject to the provisions of this Secondment Agreement, the overseas entities nominated and CIOP accepted the secondees. The above facts, says the respondent, clearly show that the staff seconded to India (in the CIOP) must possess the knowledge of various processes and practices employed by the overseas entities and experience in managing and applying such processes and practices. It has also been stated in terms of the Service Agreement dated December 1, 2008 that CI OP has to provide the following advisory and support services – (a) Assistance in managing the partnership with outsourced suppliers in India and facilitating an efficient interface back to the UK businesses of the overseas entity; (b) Ensuring that outsourced suppliers follow best practices, share such best practices and that processes utilized in India and in e2e are optimized; (c) Expert advice on widening the scope of potential services delivered in India through a direct workforce with greater control; and (d) Such other services that may be requested by overseas entities from time to time.

15. Therefore, the scope of services contemplated by the Service Agreement and the capabilities required in the seconded employees, when seen together, according to the respondent, indicate that the arrangement is not a simple secondment which normally happens in enterprises operating in multiple locations to familiarize the employee with the operations being carried out in the other location. This is a case where operations in India require the expertise of employees of the non-resident companies and their ability to implement processes and practices in the applicant company. The objective of utilization of such services is to create and effective interface between the outsourced suppliers of the overseas entities, ensuring that those suppliers follow best practices etc. To that extent, there definitely arose technical expertise which the seconded employees had to possess to support the business of the overseas entities (although being seconded to the applicant company in India).

16. The respondent submits that it is also necessary to see if such services (in the form of expertise and capability of implementation) amount to 'technical services' under the provisions of the domestic tax act and the relevant provisions of the applicable treaties. Section 5 of the Act is the charging section and in case of non-residents clause (2) states as follows:

> *"(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which –*
> *(a) is received or is deemed to be received in India in such year by or on behalf of such person; or*
> *(b) accrues or arises or is deemed to accrue or arise to him in India during such year."*

17. The Revenue also relies on Section 9 of the Act, which provides for income which is deemed to accrue or arise in India. Section 9(1)(vii) of the Act states as follows:

"(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 utilized 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:

(d) [Provided that nothing contained in this clause shall apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before the 1st day of April, 1976, and approved by the Central Government.]

[Explanation 1. – For the purposes of the foregoing proviso, an agreement made on or after the 1st day of April, 1976, shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date.]

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".]

18. It is submitted that two of the overseas entities are tax residents of UK and one is a tax resident of Canada. The Revenue relies on the relevant provisions of the DTAA (in the case of the DTAA with UK, on Article 13 and in the case of DTAA with Canada, on Article 12). It then submits that an examination of the Secondment agreement and the materials on record show that the arrangement between CIOP and the overseas entities amounts to the latter providing managerial services. Here, it is argued that the term "managerial services" is not defined in Section 9 of the Act and as such resort may be had to the explanation of meaning rendered in various judicial precedents available. Yet, the expression 'management' should be interpreted in terms of its normal business or ordinary meaning. In this context, it is argued that the term management includes handling of manpower and their affairs. The expression 'managerial services' has also been interpreted as follows: (a) It signifies services for management of affairs or services rendered in performing management functions; and (b) A managerial service is towards the adoption and carrying out the policies of an organization. It is of a permanent nature for the organization as a whole.

19. Further, it is argued that the following services have been held to be managerial services: (a) Hiring and training commercial agents (OECD Report Treaty Characterisation Issues Arising from E-commerce); (b) Overall management and direction [Advance Ruling No. P 28 (242 ITR 208)]; (c) Development and administration of dealer network, sales and marketing, service etc. (d) Managing

financial operations, (e) Supplier development and materials management, including development if local suppliers.

20. The Revenue placed reliance on the decision of the Delhi High Court in the case of *CIT* v. *Bharti Cellullar Ltd.*, 319 ITR 139, where the scope of the meaning 'managerial service' was examined. The Court held as follows:

> *"We have already pointed out that the expression 'fees for technical services' as appearing in Section 194J of the said Act has the same meaning as given to the expression in Explanation 2 to Section 9(1)(vii) of the said Act. In the said Explanation the expression 'fees for technical services' means any consideration for rendering of any 'managerial, technical or consultancy services'. The word 'technical' is preceded by the word 'managerial' and succeeded by the word 'consultancy'. Since the expression 'technical services' is in doubt and is unclear, the rule of* noscitur a sociis *is clearly applicable. The said rule is explained in Maxwell on The Interpretation of Statutes (Twelfth Edition) in the following words:- "Where two or more words which are susceptible of analogous meaning are coupled together,* noscitur a sociis, *they are understood to be used in their cognate sense. They take, as it were, their colour from each other, the meaning of the more general being restricted to a sense analogous to that of the less general." This would mean that the word 'technical' would take colour from the words 'managerial' and 'consultancy' between which it is sandwiched. The word 'managerial' has been defined in the Shorter Oxford English Dictionary, Fifth Edition as:- 'of pertaining to, or characteriastic of a manager, esp. a professional manager of or within an organization, business, establishment, etc.' The word 'manager' has been defined, inter alia, as:-'a person whose office it is to manage an organization, business establishment, or*

public institutions, or part of one; a person with the primarily executive or supervisory function within an organization etc; a person controlling the activities of an organization etc.; a person controlling the activities of a person or team in sports, entertainment etc.'. It is therefore, clear that a managerial service would be one which pertains to or has the characteristic of a manager. It is obvious that the expression 'manager' and consequently 'managerial service' has a definite human element attached to it. To put it bluntly, a machine cannot be a manager."

21. The Revenue emphasizes the positions adopted by the secondees in the applicant company. The secondees are the General Manager, Operations Manager, Delivery Manager and Relationship Manager. It is urged that there can under the circumstances be no doubt that the said deputed or seconded employees were rendering managerial services to the Petitioner and as such the remuneration payable in respect of these secondees was in the nature of 'fees for technical services' in terms of Section 9(1)(vii) of the Act.

22. It is argued that Article 13 of the DTAA between India and UK defines the term 'technical services' as follows:

> *"Fees for technical services" means 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) which:*
>
> *(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3(a) of this article is received; or*
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> *(b) are ancillary and subsidiary to the enjoyment of the property for which a payment described in paragraph 3(b) of this Article is received; or*

(c) *make available technical knowledge, experience, skill, know-how or processes, or consist of the development and transfer of a technical plan or technical design*

The Revenue states that the term "managerial service" is not included in the scope of the term 'technical service' within the meaning of the term in Article 13 of the DTAA (revised treaty as entered into in 1993). However, it is urged that the Court should hold that the services of the deputed employees fall within the meaning of the term as contained in Article 13(3), which includes 'making available technical knowledge, experience, skill, know-how or processes.' In terms of the scope of work emerging from the Service Agreement and the Secondment Agreement it is clear that the seconded employees are being sent to India *with knowledge of various processes and practices employed by PLC and the experience in managing and applying such processes and practices.* This leaves no element of doubt that the seconded employees are making available their experience and skill in managing and applying the processes and practices. The whole objective of their secondment is to train and familiarize the staff in India so that once the secondment ceases, the staff in India can apply the processes and practices and that in itself would be sufficient to conclude that the condition of 'make available' is also satisfied.

23. It is also argued that the expression 'make available' has been interpreted by the Authority in some recent rulings, *Anaphram Inc.* (305 ITR 394), *Cushman and Wakefield (s) Pte. Ltd.* (172 Taxman 179), *ISRO Satellite Centre* (220 CTR 20) and others. The genesis of these decisions is that the recipient should be able to apply the same subsequently. It is contended that the secondees would be making available their expertise and skill to the Indian operations of the applicant company and hence the remuneration would clearly fall within the scope of 'fees for technical services' as contained in Article 12 of the DTAA between India and UK.

24. Referring to Article 12 of the DTAA between India and Canada, it is argued that the meaning of the expression 'fees for included services' is similarly couched as the term 'fees for technical services' under Article 13 of the DTAA between India and UK. Reliance is also placed on the decision of the Authority in the case of *AT&S India (P) Ltd.* (287 ITR 421) which occasioned the examination, (in respect of the DTAA between India and Austria) whether the services rendered under a seconded agreement would be in the nature of technical services so as to attract withholding tax provisions under Section 195 of the Act. The Authority held that the services were in the nature of 'technical services' and the reimbursements of salary and other costs were liable for deduction of tax at source. On the issue of reimbursements in that case, the Authority held that the contention that payments are only reimbursements of actual expenditure is not supported by any

evidence and there is no material to show what was the actual expenditure and what was claimed as a reimbursement.

Provisions of the DTAA between India and UK and India and Canada

25. Article 13 of the DTAA between India and UK provides as follows:

> *"ARTICLE 13 – Royalties and fees for technical services-*
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> *1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.*
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> *2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the law of that State; but if the beneficial owner of the royalties or fees for technical services is a resident of the other Contracting State, the tax so charged shall not exceed:*
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> *(a) In the case of royalties within paragraph 3(a) of this Articles, and fees for technical services within paragraphs 4(a) and (c) of this Article,-*
>
> *(i) During the first five years for which this Convention has effect;*
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> *(aa) 15 percent of the gross amount of such royalties or fees for technical services when the payer of the royalties or fees for technical services is the Government of the first-mentioned Contracting State or a political sub-division of that State, and*
>
> *(bb) 20 percent of the gross amount of such royalties or fees for technical services in all other cases; and*
>
> *(ii) During subsequent years, 15 percent of the gross amount of such royalties or fees for technical services; and*
>
> *(b) in the case of royalties within paragraph 3(b) of this Article and fees for technical services defined in paragraph 4(b) of this Article, 10 percent of the gross amount of such royalties and fees for technical services.*

XXXXXX XXXXXX XXXXXX

4. For the purposes of paragraph 2 of this Article, and subject to paragraph 5, of this Article, the term "fees for technical services" means 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) which:

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3(a) of this article is received; or

(b) are ancillary and subsidiary to the enjoyment of the property for which a payment described in paragraph 3(b) of this Article is received; or

make available technical knowledge, experience, skill know-how or processes, or consist of the development and transfer of a technical plan or technical design.

5. The definitions of fees for technical services in paragraph 4 of this Article shall not include amounts paid :

(a) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property, other than property described in paragraph 3(a) of this Article;

(b) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships, or aircraft in international traffic;

(c) for teaching in or by educational institutions ;

(d) for services for the private use of the individual or individuals making the payment ; or

(e) to an employee of the person making the payments or to any individual or partnership for professional services as defined in Article 15 (Independent personal services) of this Convention.

6. The provisions of paragraphs 1 and 2 of this Article shall not apply if the beneficial owner of the royalties or fees for

technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 (Business profits) or Article 15 (Independent personal services) of this Convention, as the case may be, shall apply.

7. Royalties and fees for technical services shall be deemed to arise in a Contracting State where the payer is that State itself, a political sub-division, a local authority or a resident of that State. Where, however, the person paying the royalties or fees for technical services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to make payments was incurred and the payments are borned by that permanent establishment or fixed base then the royalties or fees for technical services shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated.

8. Where, owing to a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for technical services paid exceeds for whatever reason the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Convention.

9. The provisions of this Article shall not apply if it was the main purposes or one of the main purposes of any person concerned with the creation or assignment of the rights in

respect of which the royalties or fees for technical services are paid to take advantage of this Article by means of that creation or assignment."

26. Similarly, Article 12 of the DTAA between India and Canada reads as follows:

"ARTICLE 12 : Royalties and fees for included services –

1. Royalties and fees for included services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties and fees for included services may also be taxed in the Contracting State in which they arise and according to the laws of that State; but if the beneficial owner of the royalties or fees for included services is a resident of the other Contracting State, the tax so charged shall not exceed :

(a) in the case of royalties referred to in sub-paragraph (a) of paragraph 3 and fees for included services as defined in this Article (other than services described in sub-paragraph (b) of this paragraph) :

(i) during the first five taxable years for which this Agreement has effect,

(A) 15 per cent of the gross amount of the royalties or fees for included services as defined in this Article, where the payer of the royalties or fees is the Government of that Contracting State, a political sub-division or a public sector company; and

(B) 20 per cent of the gross amount of the royalties or fees for included services in all other cases; and

(ii) during the subsequent years, 15 per cent of the gross amount of the royalties or fees for included services; and

(b) in the case of royalties referred to in sub-paragraph (b) of paragraph 3 and fees for included services as defined in this Article that are ancillary and subsidiary to the

enjoyment of the property for which payment is received under paragraph 3(b) of this Article, 10 per cent of the gross amount of the royalties or fees for included services.

XXXXXX XXXXXX XXXXXX

4. For the purposes of this Article, 'fees for included services' means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services :

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or

(b) make available technical knowledge, experience, skill, know-how, or processes or consist of the development and transfer of a technical plan or technical design.

5. Notwithstanding paragraph 4, fees for included services does not include amount paid :

(a) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property other than a sale described in paragraph 5(a);

(b) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships or aircraft in international traffic;

(c) for teaching in or by educational institutions;

(d) for services for the personal use of the individual or individuals making the payment; or

(e) to an employee of the person making the payments or to any individual or firm of individuals (other than a company) for professional services as defined in Article 14.

6. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for included services, being a resident of a Contracting State, carries on business in the other Contracting State in which the

royalties or the fees for included services arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right, property or contract in respect of which the royalties or fees for included services are paid is effectively connected with such permanent establishment or fixed base. In such a case the provisions of Article 7 or Article 14, as the case may be, shall apply.

7. Royalties and fees for included services shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority or a resident of that State. Where, however, the person paying the royalties or the fees for included services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the obligation to pay the royalties or the fees for included services was incurred, and such royalties or fees for included services are borne by that permanent establishment or fixed base, then such royalties or fees for included services shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated.

8. Where by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for included services, having regard to the use, right, information or services for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Agreement."

27. The material portions of the Secondment Agreement entered into by CIOP are also reproduced below:

"ARTICLE 2 TERMS OF SECONDMENT

2.1 Secondment

(A) At the request of CIO, PLC shall assign relevant individuals to perform the Duties at the Secondment Location for the Secondment Period, and to report to CIO in accordance with the Secondment Agreement, and in particular Attachment A thereto.

(B) CIO shall designate a Secondee to fill certain positions within CIO's Organization, integrate Secondee into CIO's and authorize Secondee to perform the Duties at the Secondment Location for the Secondment Period in accordance with the Secondment Agreement.

(C) CIO shall have the right to specify the scope and nature of Secondee's work and the results to be achieved, and to direct Secondee in the performance of the Duties.

(D) CIO shall require Secondee to enter into a Secondee Agreement in the form of Attachment B.

2.2 Conduct

(A) Secondee shall be integrated into CIO's organization for the Secondment Period and consequently shall be subject to

(1) The supervision and control of CIO;

(2) All applicable rules, regulations, policies and other practices established by CIO for its employees; and

(3) instructions and directions of CIO pursuant to Sections 2.2(A) (1) and (2)

(B) Secondee shall comply with the provisions of Section 2.2 (A) and

(C) Secondee shall perform the duties with due diligence and in a good competent professional and sale manner

in accordance with applicable laws and regulations, standards and practices, and the supervision and control of CIO.

2.3 Status of PLC and Secondees.

(A) PLC will not be responsible for the errors/ omission or for the work performed by the Secondees.

(B) CIO will bear all risk in respect of the work performed by the secondees and benefits from the outputs.

xxx xxx xxx

2.5 Remuneration

CIO will bear the cost of monthly remuneration and reimbursement of costs of secondees

2.6 PLC's Benefit Plans

Secondees will retain their entitlement to participate in PLC's retirement and social security plans and other benefits in accordance with applicable PLC policies.

The monthly cost of such participation and benefits will be borne by CIO.

Article 3: Costs

1.1 Monthly Charge

(A) PLC shall charge CIO monthly for the actual documented costs and expenses that are incurred by PLC during the term of this Secondment Agreement in respect of the Secondees during the Secondment (the "Monthly Charge")

(B) The monthly Charge shall include

i. all direct costs of Secondee's base salary and other compensation

ii. Costs of participation in PLC's retirement and social security plans and other benefits in accordance with applicable PLC, policies; and

iii. other costs but only if such other costs have been agreed between CIO and PLC.

xxx xxx xxx xxx

5.2 CIO's Right to Terminate the Secondment

(A) CIO may terminate this Secondment Agreement upon 30 days prior written notice to PLC.

(1) In the event of Change in control of PLC or any or its affiliates providing Secondee;

(2) If secondee repeatedly fails to comply with CIO's workplace rules, regulations and policies, or the directions given by CIO's management, or

(3) If Secondee after receiving notice of unsatisfactory performance fails to perform the duties in a manner that in CIO's reasonable judgment is satisfactory.

(B) CIO may terminate this secondment Agreement immediately without notice to PLC.

(1) If secondee engages in serious misconduct or violates any substantive or material laws, which in CIO's reasonable judgment significantly impairs secondee's ability to perform the duties or to live and work in the secondment location; or

(2) If secondee materially breaches the confidentiality obligations under this secondment agreement, or if applicable, the secondee Agreement.

Immediately after any termination without notice CIO shall notify PLC setting out the reasons for such termination.

PLC's Right to Terminate the Secondement

> *Secondee shall be assigned to CIO for the Secondment period and PLC will use all reasonable endeavors not to withdraw secondee during the secondment period except that PLC shall have the right to immediately withdraw secondee in case of Force Majeure, or a personal emergency concering the Secondee PLC shall promptly give notice setting out the general circumstances of such Force Majeure event or personal emergency.*
>
> *xxx* *xxx* *xxxx*"

28. CIOP relies on the concept of economic employment as opposed to legal employment and submits that the formal jural or legal relationship of employer and employee as between the seconded employee and the overseas entity is of no significance. It is argued that for all practical purposes, CIOP is the real employer, because the content of the work or employment, the entire direction and supervision over the seconded employees work and the pay and emoluments are borne by it. For convenience, the pay is disbursed by the overseas entity, but that amount is reimbursed to the overseas entity. Reliance is firstly placed on the concept of Economic employer, discussed by Klaus Vogel in 'Double Taxation Conventions', especially the following extracts:

> "*8. International hiring out of labour Paragraph 2 has given rise to numerous case of abuse through adoption of the practice known as International hiring out of labour. In this system, a local employer wishing to employ foreign labour for one or more periods of less than 183 days recruits through an intermediary established abroad who purports to be the employer and hires the labour out to the employer. The worker thus fulfills* prima facie *the three conditions laid down by paragraph 2 and may*

claim exemption from taxation in the country where he to temporarily working. To prevent such abuse, in situation of this type, the term "employer" should be interpreted in the context of paragraph 2. 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 setting this question, the competent authorities may refer not only to the above mentioned indications but to a number of circumstances enabling them to establish that the real employer is the user of the labour (and nor 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 or 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 utilized, or there is in other ways a connection between this remuneration and wages received by the employer;

- 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.

xxx *xxx* *xxx* *xxx*"

The Court also notes that the Model Tax Convention on Income and on Capital (Condensed Version, July 2010) in this context, states as follows:

"*8.14 Where a comparison of the nature of the services rendered by the individual with the business activities carried on by his formal employer and by the enterprise to which the services are provided points to an employment relationship that is different from the formal contractual relationship, the following additional factors may be relevant to determine whether this is really the case:*

- Who has the authority to instruct the individual regarding the manner in which the work has to be performed.

- who controls and has responsibility for the place at which the work is performed;

- remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided (see paragraph 8.15 below)

- who puts the tools and materials necessary for the work at the individual's disposal:

- who determines the number and qualifications of the individuals performing the work :

- who has the right to select the individual who will perform the work and to terminate the contractual arrangements entered into with that individual for that purpose;

- who has the right to impose disciplinary sanctions related to the work of that individual:

- who determines the holidays and work schedule of that individual."

29. The issue which arises for the consideration of the Court in this case is whether the secondment of employees by BSTL and DEML, the overseas entities, falls within Article 12 of the India-Canada and Article 13 of the India-UK DTAAs, which embody the concept of a service permanent establishment (a "service PE"). In terms of those articles, the Court must determine whether the overseas entities rendered "technical services" under Article 13 of the India-UK DTAA and "included services" under Article 12 of the India-Canada DTAA. In essence, the inquiry is whether any tax liability of the overseas entity arises for the provision of services to CIOP in India, such that the trigger in the DTAAs comes into play. This must necessarily depend on the phrasing of each DTAA, construed on its own terms, in light of general principles as determined by the Courts. Since the question of technical services has been considered by the DTAA, this takes precedence over the taxing regime under Section 9 of the Act.

30. 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, undoubtedly provided 'technical' services to CIOP, especially since

that expression expressly includes the provision of the services of personnel. The seconded employees, who work, so to say, for CIOP are *provided* by the overseas entities and the work conducted by them thus, i.e. assistance in conducting the business of COIP of quality control and management is *through* the overseas entities. The nature of the services – cast as "business support services" by CIOP – as also clearly within the hold "*technical or consultancy*". These services envisage the provision of quality service by vendors to the overseas entities, which CIOP, and the secondees, are to oversee. This requires the secondees to draw from their technical knowledge, and falls within the scope of the term. This reading of 'technical' services does not limit itself only to *technological* services, but rather, extends to know-how, techniques and technical knowledge. This is supported by clause 4 of Article 12 itself, which lists these various sub-categories. Indeed, the term 'technical' has not been defined in the DTAA, and must be accorded its broader dictionary meaning, unless limited by the parties to the instrument. The AAR in *Intertek Testing Services India Pvt. Ltd.* v. *CIT X*, (2008) 220 CTR (AAR) 540, considered this question in detail, and rightly held that

> "*What is meant by the expression 'technical'? Should it be confined only to technology relating to engineering, manufacturing or other applied sciences? We do not think so. The expression 'technical' ought not to be construed in a narrow sense.*"

This reading was supported by the Supreme Court, in the context of Section 9(1)(iv) of the Act in *Continental Construction Ltd.* v. *CIT*,

195 ITR 117. Further, the Court notes that the distinction to be drawn by CIOP between the provision of services by the overseas entities themselves and the 'mere' secondment of employees does not make a difference, since the services provided the overseas entities is the provision of technical services through the secondees – an instance envisaged under Article 13 itself.

31. The issue of Article 12 of the India-Canada treaty involves a more nuanced inquiry. Article 12 also incorporates fees for "included services". Whilst this includes "technical services or consultancy service" under clause 4, it states that 'fees for included services' "*means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services … make available technical knowledge, experience, skill, know-how, or processes or consist of the development and transfer of a technical plan or technical design.*" This second qualification for the technical knowledge etc. to be 'made available' is an essential, and additional, requirement under the India-Canada DTAA. This phrasing also finds mention in Article 13 of the India-UK DTAA, this requirement is disjunctive from the rest of the provision, unlike in the India-Canada DTAA. The India-UK DTAA states that 'fees for technical services' "*means 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) which … or make available technical knowledge, experience, skill know-how or processes, or consist of the development*

and transfer of a technical plan or technical design." In order for the amounts paid to the overseas entities in the transaction covered by the India-Canada DTAA, thus, it must not only be showed that technical services were performed, but that such knowledge etc. was 'made available.'

32. The mere rendition of service is not an "included service" that triggers tax liability. Instead, the enterprise must 'make available' the skill behind that service to the other party, i.e the Indian recipient. The definition, as it appears, is more restricted that in the India-UK DTAA. The question is whether the higher threshold, is met in this case. The service provided by the secondees is to be viewed in the context in which their secondment or deputation was necessitated. The overseas entities required the Indian subsidiary, CIOP, to ensure quality control and management of their vendors of outsourced activity. For this activity to be carried out, CIOP required personnel with the necessary technical knowledge and expertise in the field, and thus, the secondment agreement was signed since CIOP – as a newly formed company – did not have the necessary human resource. The secondees are not only providing services to CIOP, but rather tiding CIOP through the initial period, and ensuring that *going forward*, the skill set of CIOP's other employees is built and these services may be continued by them without assistance. In essence, the secondees are imparting their technical expertise and know-how onto the other regular employees of CIOP. Indeed, it is admitted by CIOP that the reason for the secondment agreement was to provide *support* for the initial years of operation, till the necessary skill-set is acquired by the

resident employee group. The activity of the secondees is thus 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 CIOP for future 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. Indeed, any other reading would unduly restrict the Article 12 of the DTAA, which contemplates not only a formal transfer of intellectual property, but also other techniques and skills ('soft' intellectual property, if it can be called as such) required for the operation of a business. The skills and knowledge required to ensure that the task entrusted to CIOP – quality control – is carried on diligently certainly falls within the broad ambit of Article 12.

33. This Court is also mindful of the broader context of a service PE in which this case operates. In that regard, COIP has advanced several arguments to negate any liability to deduct income tax under Section 195 of the Act. (1) there is no service PE, since CIOP is the economic employer, whilst the overseas entities are only the legal employers, (2) the payment made by CIOP to the overseas entities is only by way of reimbursement, which does not form part of the income of those entities, and in any case, (3) that payment is not the income of the overseas entities on account of the doctrine of 'diversion of income by overriding title'. The Court will address these arguments in turn.

34. To determine the existence of a service PE, CIOP argues that the Court must look towards the substance of the employment relationship and not the form. This is correct. In the present case, the seconded employees are to be integrated into CIOP, for the agreed period and are subject to its supervision and control. The rules, regulations, policies and other practices of CIOP for its employees were applicable to these employees too. The seconded employee's duties and functions were dictated by the instructions and directions of the CIOP. He/she had to perform the duties assigned with due diligence in accordance with the applicable laws and regulations, standards and practices and control of CIOP. The overseas entities were not responsible for any errors or omissions of such seconded employees or for their work. CIOP bore all risks in relation to the work of seconded employees, and reaped the benefit from the output. CIOP also bore the cost of monthly remuneration and reimbursement of cost to seconded employees. However, crucially, these seconded employees *retained* their entitlement to participate in the overseas entities' retirement and social security plans and other benefits in terms of its applicable policies, and the salary was properly payable by the overseas entitle, which claimed the money from CIOP. There was no purported employment relationship between CIOP and the secondees. None of the documents, including the attachment to the secondment agreements placed on record (between the secondees and CIOP) reveal that the latter can terminate the secondment arrangement; there is no entitlement or obligation, clearly spelt out, whereby CIOP has to bear the salary cost of these employees. The

secondees cannot in fact sue the CIOP for default in payment of their salary- no obligation is spelt out vis-à-vis the Petitioner. All direct costs of such seconded employee's basic salary and other compensation, cost of participation in overseas entities' retirement and social security plans and other benefits in accordance with its applicable policies and other costs were ultimately paid by the overseas entity. Whilst CIOP was given the right to terminate the secondment, (in its agreement with the overseas entities) the services of the secondee vis-à-vis the overseas entities – the *original* and subsisting employment relationship – could not be terminated. Rather, that employment relationship remained independent, and beyond the control of COIP.

35. The concept of a legal and economic employer, as considered by Vogel (relied upon by CIOP), is when "*a local employer wishing to employ foreign labour for one or more periods of less than 183 days recruits through an intermediary established abroad who purports to be the employer and hires the labour out to the employer.*" In this case, the *temporal* element of the three-way employment relationship is crucial. The secondees were – originally – employees of the overseas entities. They were not hired by that entity *as a false façade*, whose productivity is to be ultimately traced to CIOP. Rather, the secondees were *regular* employees of the overseas entities. There is no dispute with this fact. They have only been seconded or transferred for a limited period of time to another organization, CIOP, in order to utilize their technical expertise in the latter. The secondment agreement between CIOP and the overseas entity, and the agreement

between CIOP and the employees, envisages an end to this exception, and a return to the usual state of affairs, when the secondees return to the overseas entities. The employment relationship between the secondee and the overseas organization is at no point terminated, nor is CIOP given any authority to even modify that relationship. The attachment of the secondees to the overseas organization is not fraudulent or even fleeting, but rather, permanent, especially in comparison to CIOP, which is admittedly only their temporary home. Today, CIOP attempts to cast that employment relationship as a tenuous link because, for the duration of the secondment, CIOP pays the salary of these. Even here, the salary is ultimately paid *through* the overseas entity, which is not a mere conduit. Crucially, the social security, emoluments, additional benefits etc. provided by the overseas entity to the secondee, and more generally, *its* employees, still govern the secondee in its relationship with CIOP. It would be incongruous to wish away the employment relationship, as CIOP seeks to do today, in the face of such strong linkages. Whilst CIOP may have operational control over these persons in terms of the daily work, and may be responsible (in terms of the agreement) for their failures, these limited and sparse factors cannot displace the larger and established context of employment abroad.

36. In this context, the decision of the Supreme Court in *Morgan Stanley* (supra) offers support for the Authority's viewpoint, rather than the contrary stance. In that case, the Court considered various forms of PEs, agency, service etc, each of which contemplate a different characteristic and link between the deputed

employee/organization and the parent. In the context with which we are presently concerned, the following observations are critical:

> "*15. As regards the question of deputation, we are of the view that an employee of MSCO when deputed to MSAS does not become an employee of MSAS. A deputationist has a lien on his employment with MSCO. As long as the lien remains with the MSCO the said company retains control over the deputationist's terms and employment. ... It is important to note that where the activities of the multinational enterprise entails it being responsible for the work of deputationists and the employees continue to be on the payroll of "the multinational enterprise or they continue to have their lien on their jobs with the multinational enterprise, a service PE can emerge. ... A deputationist under such circumstances is expected to be experienced in banking and finance. On completion of his tenure he is repatriated to his parent job. He retains his lien when he comes to India. He lends his experience to MSAS in India as an employee of MSCO as he retains his lien and in that sense there is a service PE (MSAS) under Article 5(2)(1). We find no infirmity in the ruling of the ARR on this aspect. In the above situation, MSCO is rendering services through its employees to MSAS. Therefore, the Department is right in its contention that under the above situation there exists a Service PE in India (MSAS). Accordingly, the civil appeal filed by the Department stands partly allowed.*"

In fact, even the OECD Commentary on Article 15 of the Model Convention, on which learned counsel for CIOP has placed great reliance, interestingly notes that "*[t]he 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.*" This was clearly, and critically, not done in this case.

37. This brings the Court to the next issue, concerning reimbursement and the doctrine of diversion of income by overriding title. This Court notices that a case with almost identical circumstances, in *In Re: AT and S India (P) Ltd.*, MANU/AR/0016/2006, also came up before the AAR. There, an agreement between AT&S India and its parent, AT& Austria was entered into, by which AT&S Austria undertook to assign or cause its subsidiaries to assign its qualified employees to the AT&S India. These individuals were to work for AT&S India and receive compensation substantially similar to what they would have received as employees of AT&S Austria. They were engaged by AT&S India on a full time basis. The question before the AAR was identical to this case:

> "*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 IT 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 work under the direct control and supervision of the applicant?*"

In holding that the obligation under Section 195 would be triggered, the AAR held as follows:

"*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 latter'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 details. 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 nature of payments. The term "reimbursement" is not a technical word or a word of Article In Oxford English Dictionary, to reimburse means--to repay a person who has spent or lost money--and 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 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.*

To show that the real employer of such employees is the applicant and not the AT&S Austria, Mr. Chaitanya 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 1st Sept., 2005 till 30th Aug., 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."

38. The mere fact that CIOP, and the secondment agreement, phrases the payment made from CIOP to the overseas entity as 'reimbursement' cannot be determinative. Neither is the fact that the overseas does not charge a mark-up over and above the costs of maintaining the secondee relevant in itself, since the absence to mark-up (subject to an independent transfer pricing exercise) cannot negate the *nature* of the transaction. It would lead to an absurd conclusion if,

all else constant, the fact that no payment is demanded negates accrual of income to the overseas entity. Instead, the various factors concerning the determination of the *real* employment link continue to operate, and the consequent finding that provision of employees to CIOP was the provision of services to CIOP by the overseas entities triggers the DTAAs. The nomenclature or lesser-than-expected amount charged for such services cannot change the nature of the services. Indeed, once it is established, as in this case, that there was a provision of services, the payment made may indeed be payment for services – which may be deducted in accordance with law – or reimbursement for costs incurred. This, however, cannot be used to claim that the entire amount is in the *nature* of reimbursement, for which the tax liability is not triggered in the first place. This would mean that in any circumstance where services are provided between related parties, the demand of only as much money as has been spent in providing the service would *remove* the tax liability altogether. This is clearly an incorrect reasoning that conflates liability to tax with subsequent deductions that may be claimed.

39. So far as the decision in *M/s. E-Funds IT Solution*, goes, the judgment notes the distinction between stewardship activities of employees and deputationists, which had been highlighted in *Morgan Stanley*. The Division Bench in *E-Funds* highlighted that the nature of activity undertaken by the employee is determinative of whether it constitutes a service. In the present case, the overseas entities outsource their back office support functions like debt collections/consumers' billings/monthly jobs to third party vendors in

India. The seconded employees in the present case, oversee quality control of the work of such vendors. This work cannot be characterized as mere stewardship. What could have been left to CIOP to do is in fact being done through the seconded employees, whose expertise and training lends quality and content to the Indian entity. Therefore, it is held that the real employer of these seconded employees continues to be the overseas entity concerned.

40. The final issue concerns the 'diversion of income by overriding title'. Here, CIOP argues that the payment made to the overseas entity is not income that *accrues* to the overseas entity, but rather, money that it is obligated to pass on to the secondees. In other words, this money is overridden by the obligation to pay the secondees, and thus, is not 'income'. This is insubstantial for two reasons. One, in view of the above findings that: (a) the payment is not in the nature of reimbursement, but rather, payment for services rendered, (b) the employment relationship between the overseas entities and CIOP – from which the former's *independent* obligation to pay the secondees arises – continues to hold, no obligation to use money arising from *the payment by CIOP* to pay the secondees arises. The overseas entities' obligation to pay the secondees arises under a separate agreement, based on independent conditions, in relation to CIOP's obligation to pay the overseas entity. Assuming the agreement between CIOP and the overseas entity envisaged a certain payment for provision of services (and not styled as reimbursement). Surely no argument could be made that such payment is affected by the doctrine of diversion of income by overriding title. If that be the case, then, as held above, the

fact that the payment under the secondment agreement is styled as reimbursement, and limited on facts to that, without any additional charge for the service, cannot be hit by that doctrine *either*. The money paid by CIOP to the overseas entity *accrues* to the overseas entity, which may or may not *apply* it for payment to the secondees, based on its contractual relationship with them. This, at the very least, is independent of the relationship and payment between CIOP and the overseas entity.

41. Accordingly, for the above reasons, this Court holds that this writ petition is liable to be dismissed, and the ruling of the AAR stands. No order as to costs.

S. RAVINDRA BHAT
(JUDGE)

R.V. EASWAR
(JUDGE)

APRIL 25, 2014