

Economic Employer – Bangalore Tribunal ruling in IDS Software Solutions (India) Private Limited (“IDSI”)

In a recent decision on ‘economic employer’, the Bangalore Tribunal in IDSI has ruled that the entity that actually controls the service of an employee is the economic employer. Further, it ruled that the cross-charge of salary costs under the Secondment Agreement does not represent ‘fees for technical services’, thereby not warranting any deduction of tax at source.

The facts of the case and the ruling of the Tribunal have been discussed in the subsequent paragraphs.

Facts of the Case

IDSI, a wholly-owned subsidiary of IDS Inc, US (“IDS US”), is engaged in the business of software development.

For securing the services of certain personnel to assist in its business, IDSI entered into a Secondment Agreement (“Agreement”) with IDS US. Under the terms of such Agreement, IDS US seconded one of its employees to IDSI. Such employee (“Seconded Employee”) was appointed as a Managing Director of IDSI and was to act under the directions, control and supervision of IDSI. Also, IDSI was to indemnify

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3. Transfer Pricing: Challenges & Issues, Kuala Lumpur, Malaysia

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1. Executive briefings on Transfer Pricing in New Delhi
2. USIBC’s conference on US and India: Doing Business in Today’s Economy, in New Delhi
3. Executive briefings on Transfer Pricing in Bangalore and Chennai

IDS US from all claims, demands, etc. to which IDS US may be liable, consequent to any act or omission by the Seconded Employee. As per the Agreement, IDSI agreed to reimburse to IDS US, salary, bonus and other out-of-pocket expenses incurred by the Seconded Employee and paid by IDS US. IDSI was to reimburse such cost at actuals without any mark-up.

The tax on the Seconded Employee's remuneration was deducted and deposited under Section 192 of the Income tax Act, 1961 ("Act").

IDSI credited USD 39,226 to the account of IDS US out of total cross charge of USD 65,040. Subsequently, IDSI filed an application under Section 195 of the Act seeking permission to remit the balance USD 25,813 without deduction of tax due to the following reasons :

- That the Seconded Employee was an employee of IDSI and the salary received from IDS US in respect of services rendered in India was being offered to tax in India
- That the proposed remittance was in the nature of salary, on which tax had already been deducted and paid in India
- That there was no agreement for technical services between IDSI and IDS US

However, the Assessing Offer (AO) held that :

- Payments made by IDSI to IDS US cannot be considered as mere reimbursement so as to make them exempt from tax
- The proposed remittance cannot be considered as 'salary' because there is no employer- employee relationship between IDSI and IDS US
- Such remittance should be considered as "fees for

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technical services”

- Therefore, IDSI is liable to deduct tax under Section 195 of the Act at 10% of the remittance

IDSI filed an appeal before the Commissioner of Income tax (Appeals) [“CIT(A)”] against the order of the AO, contending that such payment was not liable to tax deduction under Section 195 of the Act due to following reasons :

- Payments to IDS US was only reimbursement of expenses and not an income
- There was employer-employee relationship between IDSI and the Seconded Employee and the proposed remittance was in the nature of “salary” for the services rendered by him to IDSI
- That the AO was not right in holding that the payment represented “fees for technical services”

The CIT (A) dismissed the above contentions raised by IDSI. Consequently, IDSI filed an appeal with Income Tax Appellate Tribunal (‘Tribunal’).

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Ruling of the Tribunal

The following issues were raised before the Tribunal:

- Whether an employer-employee relationship existed between IDSI and the Seconded Employee?
- Whether payment by IDSI to IDS US can be considered

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as “fees for technical services” under the Act?

- Whether the reimbursement of salary cost by IDSI to IDS US was subject to any tax withholding under Section 195 of the Act?

The Tribunal held as under:

Employer-Employee Relationship

The Seconded Employee was an employee of IDSI owing to the following :

- The Seconded Employee was appointed as the Managing Director in the meeting of the Board of Directors of IDSI, in accordance with the Articles of Association of IDSI
- The Secondment Agreement constituted an independent contract of service of the Seconded Employee insofar as IDSI was concerned, even though the said agreement was entered between IDSI and IDS US
- IDSI assumes the status of an “economic employer”, since the services were rendered by Seconded Employee to IDSI and the salary cost was borne by IDSI. *(for this Tribunal relied on Professor Klaus Voegel commentary on “International Hiring Agreements”)*
- The Seconded Employee was required to work under the directions, supervision and control of IDSI and devote the whole of his time, attention and skills to IDSI

Fees for Technical Service

The payment by IDSI to IDS US did not constitute “fees for

technical services “ owing to the following :

- The Seconded Employee worked under control and supervision of IDSI and IDSI could terminate the services of such employee at any time
- The clause in Agreement relating to “duties and obligation” of the Seconded Employee and “Indemnification” were out of place in a contract for providing technical services
- The Seconded Employee was to act as officer or authorized signatory or nominee or in any other lawful personal capacity and a technical person cannot be required to act in a non-technical capacity
- The Agreement specifically provided that nothing therein shall be construed as warranty of the quality of the Seconded Employee

Tax Withholding

- IDSI had already deducted tax from remuneration paid to the Seconded Employee; accordingly, no tax was required to be deducted on the reimbursement of salary cost by IDSI to IDS US

BMR comments and analysis

The ruling of the Bangalore Tribunal reiterates the concept of “economic-employer” on the basis of control, supervision of employee and economic dependence, as was held by the Delhi Bench of the Tribunal in the case of HCL Infosystems Ltd (76 TTJ 505)

The issue whether there could have been an exposure for IDS US of a Service PE on account of secondment of the employee to India was not specifically raised by the Authorities below. Therefore, the Tribunal did not have any

occasion to consider the Supreme Court Ruling in the case of Morgan Stanley on this issue.

AWARDS AND RECOGNITION

BMR is India Transfer Pricing Firm of the Year at ITR's Asia Awards 2008

BMR has emerged as the India Transfer Pricing Firm of the year at the International Tax Review's Asia Awards 2008, held on November 26, 2008, in Singapore. BMR received this award for the second consecutive year, and was chosen over three of the Big 4 Firms.

For more details, please click [here](#).

BMR is Tier 1 Firm in ITR's World Tax Guide 2009

In the latest World Tax Guide 2009 brought out by the international Tax Review, BMR has been ranked a Tier 1 Firm.

This ranking is based on a rigorous process that involves research among all participating Firms, and interviews with their representatives.

For more details, please click [here](#).

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Taxand Global Conference 2009

The 2009 Global Taxand Conference will be held at The Westin Diplomat Resort and Spa in Miami, Florida, from February 18 to 20, 2009. The conference, hosted by Alvarez & Marsal Taxand, LLC, the US member Firm of Taxand, will feature informative speakers and engaging plenary sessions addressing the clients' latest tax issues.

For more details, please click [here](#).

Transfer Pricing Asia 2009: Complexities Demystified, Kuala Lumpur, Malaysia

Intelligence Business Networks, Malaysia, will organize a two-

day conference titled "Transfer Pricing Asia 2009: Complexities Demystified" to help attendees demystify the complexities of the Transfer Pricing practice.

For more details, please click [here](#)

Transfer Pricing: Challenges & Issues, Kuala Lumpur, Malaysia

Taxand Malaysia, the Malaysian member Firm of the Taxand network, in association with Malaysian International Chamber of Commerce and Industry (MICCI) will organize a seminar "Transfer Pricing: Challenges & Issues" on February 10, 2009 in Kuala Lumpur, Malaysia.

For more details, please click [here](#)

RECENT EVENTS

Executive briefing on Transfer Pricing in New Delhi

As part of the Thought Leadership series, BMR, in association with IMA, will organize an Executive Briefing on Transfer Pricing in Troubled Times, in New Delhi on January 27, 2009.

For more details, please click [here](#).

USIBC's conference on US and India: Doing Business in Today's Economy, January 10, 2009, in New Delhi

US-India Business Council, supported by BMR, organized a legal conference on "US and India: Doing Business in Today's Economy" on January 10, 2009 in New Delhi, India.

For more details, please click [here](#).

Executive briefings on Transfer Pricing in Bangalore and Chennai

As part of the Thought Leadership series, BMR organised an Executive Briefing on Transfer Pricing in Troubled Times, in Bangalore and Chennai on December 3, 2008.

For more details, please click [here](#).

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