

**THE CHAMBER OF TAX CONSULTANTS**

**INTERNATIONAL TAXATION COMMITTEE**

**STUDY CIRCLE MEETING**

**WEBINAR ON  
TAXATION OF EXPATRIATES**

**SPEAKER: CA KUSH VATSARAJ, VATSARAJ & CO**

**CHAIRPERSON: CA SUSHIL LAKHANI, SUSHIL LAKHANI & ASSOCIATES**

***11<sup>TH</sup> AUGUST, 2021***

# COVERAGE

- ❖ Residential Status
- ❖ Scope of Income & Taxation
- ❖ Taxability of Specific Components of Salary
- ❖ Withholding Taxes & Other Issues

# RESIDENTIAL STATUS

# INBOUND & OUTBOUND EMPLOYEES

- ❑ Employees working in a country other than their native country are commonly referred to as an “expatriate” or “expats”
- ❑ The word “expatriate” is not defined under the Indian Tax laws.
- ❑ Usually it refers to an employee working abroad and who comes to work in a country for a short period (say between 6 months and 5 years). They do not intend to become permanent residents.
- ❑ Foreign nationals who come to work in India would be Inbound Expats.
- ❑ Outbound Employee would be Indian residents who leave India for the purposes of employment overseas
- ❑ The Outbound Employee would be considered an Expat in the Host Country where he/she is going to be working.

# RESIDENTIAL STATUS UNDER THE ITA

(1) An individual is said to be resident in India in any previous year, if he—

(a) is in India in that year for a period or periods amounting in all to one hundred and eighty-two days or more ; or

(b) [\*\*\*]

(c) having within the four years preceding that year been in India for a period or periods amounting in all to three hundred and sixty-five days or more, is in India for a period or periods amounting in all to sixty days or more in that year.

*Explanation 1.*—In the case of an individual,—

(a) being a citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship as defined in clause (18) of section 3 of the Merchant Shipping Act, 1958 (44 of 1958), or for the purposes of employment outside India, the provisions of sub-clause (c) **shall apply in relation to that year** as if for the words "sixty days", occurring therein, the words "one hundred and eighty-two days" had been substituted;

(b) being a citizen of India, or a person of Indian origin within the meaning of *Explanation* to clause (e) of section 115C, who, being outside India, comes on a visit to India in any previous year, the provisions of sub-clause (c) shall apply in relation to that year as if for the words "sixty days", occurring therein, the words "one hundred and eighty-two days" had been substituted *and in case of such person having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year, for the words "sixty days" occurring therein, the words "one hundred and twenty days" had been substituted.*

# RESIDENTIAL STATUS UNDER THE ITA

For Indian Citizens or PIOs including those who are visiting India or leave India during the year for employment

Income other than foreign source income	Stay in India during the year is	Residential Status	
Not relevant	<b>First Condition: 183 days</b> or more	<b>Second Condition:</b> Resident in 2+ out of last 10 FYs <b>AND</b> Stay in India 730+ days over last 7 FYs	If both are YES – <b>Resident</b> If one or both are NO – <b>RNOR</b>
exceeds INR 15 lakhs	<b>120+ days</b> but less than <b>183 days</b> <b>AND</b> Was <b>365+ days</b> in total over the last 4 years	Resident & Not Ordinarily Resident ( <b>RNOR</b> )	
	Less than <b>120 days</b> <b>OR</b> Was less than <b>365 days</b> in total over the last 4 years	Non Resident ( <b>NR</b> )	
is less than INR 15 lakhs	less than <b>183 days</b>		

# RESIDENTIAL STATUS UNDER THE ITA

For other than Indian Citizens & Persons of India Origin & Indian citizens or PIOs who leave India during the year for purposes other than employment.

Income other than foreign source income	First Condition: Stay in India during the year is	Second Condition	Residential Status
Not relevant	<b>183 days</b> or more	Resident in 2+ out of last 10 FYs <b>AND</b> Stay in India 730+ days over last 7 FYs	If both are YES – <b>Resident</b> If one or both are NO – <b>RNOR</b>
	<b>60+ days</b> but less than <b>183 days</b> <b>AND</b> Was <b>365+ days</b> in total over the last 4 years		
	Less than <b>60 days</b> <b>OR</b> Was less than <b>365 days</b> in total over the last 4 years	Not applicable	Non Resident ( <b>NR</b> )

# RESIDENTIAL STATUS UNDER THE ITA

## “Stateless Persons”

- **Section 6(1A):** *Notwithstanding anything contained in clause (1), an individual, being a citizen of India, having total income, other than the income from foreign sources, exceeding fifteen lakh rupees during the previous year shall be deemed to be resident in India in that previous year, if he is not liable to tax in any other country or territory by reason of his domicile or residence or any other criteria of similar nature.*

*Explanation.—For the removal of doubts, it is hereby declared that this clause shall not apply in case of an individual who is said to be resident in India in the previous year under clause (1).*

- **Section 2(29A):** *"liable to tax", in relation to a person and with reference to a country, means that there is an income-tax liability on such person under the law of that country for the time being in force and shall include a person who has subsequently been exempted from such liability under the law of that country;*

# RESIDENTIAL STATUS UNDER THE ITA

Explanation 1, the 60 days & 365 days condition shall not apply to an Indian citizen who leaves the country for the purpose of employment outside India or as a member of a crew on an Indian ship.

- i) Need not be unemployed earlier – *British Gas India Pvt. Ltd., In re [2006] 285 ITR 218 (AAR)*. The requirement of Explanation 1 is **“leaving India for the purposes of employment outside India”** not **“leaving India for employment”**.
- ii) Individual who **leaves India** on deputation covered by Explanation 1 – *Ram Sagar Choudhary vs. III ITD [1989] 31 ITD 21 (B'lore)*
- iii) *ITO Vs. Abbott Industries (31 ITD 183) (Mum)(SB)* and *ITO Vs. K.Y. Patel (33 ITD 714)* – **“employment outside India”** refers to **“posting”** outside India permanently or temporarily. Foreign tours do not imply employment outside India.
- iv) **“employee”** covers cases of consultants and technicians for Section 80RRA (SC in *Aditya Birla [1988] 170 ITR 137*)

# PERIOD OF STAY IN INDIA – COUNTING DAYS

- (a) Gautam Banerjee case (ITA No. 2374 of 2004- Mumbai) – arrived at midnight at Indian airport and Tribunal held not to be included.
- (b) The day of arrival is to be **excluded** for calculating number of days – *Fausta C. Cordeiro [2012] 53 SOT 522. (Mumbai ITAT); Manoj Kumar Reddy [2009] 34 SOT 180 (Bangalore) & [2011] 12 taxmann.com 326 (Karnataka)*
- (c) Only day of departure to be considered as “in India” – Jaipur ITAT (No. 1230 dt. 22.8.86) (ITO v Dr. R. K. Sharma)
- (d) Both days should be counted as “in India” – Advance Ruling (233 ITR 462)
- (e) **OECD Commentary**: both days (arrival & departure) to be included, all days spent in the country to be considered, including holidays, non-working days, whether before or after the work, sick days etc. Days in transit and any day spent wholly outside the country to be ignored.
- (f) As per Klaus Vogel – both days to be included

# PERIOD OF STAY – VISITS TO INDIA

- **Issue 1:** Whether the term "visit" would include in case of Indian Citizens, during their period of their overseas assignment would include any category of visits i.e. official visits, business visit or personal visits?
- **Issue 2:** Can 60 days be substituted with 182 days where individual being outside India comes on to visit to India and then repatriates back to India (for good) in later part of the year after completion of the assignment ?

**Smita Anand (AAR 1091 of 2011)** – Benefit of Explanation 1(b) not available to employee who shifts back to India on giving up employment in the same year

- **Issue 3:** Whether the number of days an outbound individual visits India should be excluded for the purposes of calculating the number of days?

**Manoj Kumar Reddy [2009] 34 SOT 180 (Bangalore) & [2011] 12 taxmann.com 326 (Karnataka)**

# RESIDENTIAL STATUS & DTAA<sub>s</sub>

- ❑ Most DTAA<sub>s</sub> do not prescribe residential status (exception e.g. India-UAE, India-Hong Kong DTAA<sub>s</sub>)
- ❑ A person can be a resident of two countries i.e. a dual resident (specially in the year of departure / arrival)
  - In such cases, a hierarchical tie-breaker test is often prescribed
  - Japan DTAA, no tie-breaker, directly MAP
- ❑ In absence of a DTAA, a person may be taxable in both countries
  - Unilateral relief may be granted
- ❑ The relevant DTAA that is to be applied is based on where the employee is a resident and not where the employer is resident

# TIE BREAKER TEST/RULE

- To resolve cases of Dual Residence the 'Tie-breaker' Rule that applies is generally as follows:
  - ❖ Permanent Home
  - ❖ Centre of vital interests (Personal & economic relations)
  - ❖ Habitual Abode
  - ❖ Nationality
  - ❖ Mutual Agreement Procedure

**These tests are to be applied sequentially**

# SPLIT RESIDENCY

- **OECD Model Commentary on Article 4(2) [para 10]**

*"The facts to which the special rules will apply are those existing during the period when the residence of the taxpayer affects tax liability, which may be less than an entire taxable period. For example, in one calendar year an individual is a resident of State A under that State's tax laws from 1 January to 31 March, then moves to State B. Because the individual resides in State B for more than 183 days, the individual is treated by the tax laws of State B as a State B resident for the entire year. Applying the special rules to the period 1 January to 31 March, the individual was a resident of State A. Therefore, both State A and State B should treat the individual as a State A resident for that period, and as a State B resident from 1 April to 31 December."*

- **ITAT decision in the case of Raman Chopra v DCIT [2016] 69 taxmann.com 452 (Del)**

Assessee came to Indian in July 2010. Was resident of USA as per US tax laws and as per the DTAA for April-June 2010. Assessee was also ROR for FY 2010-11, ITAT held that applying tie breaker test due to dual residency

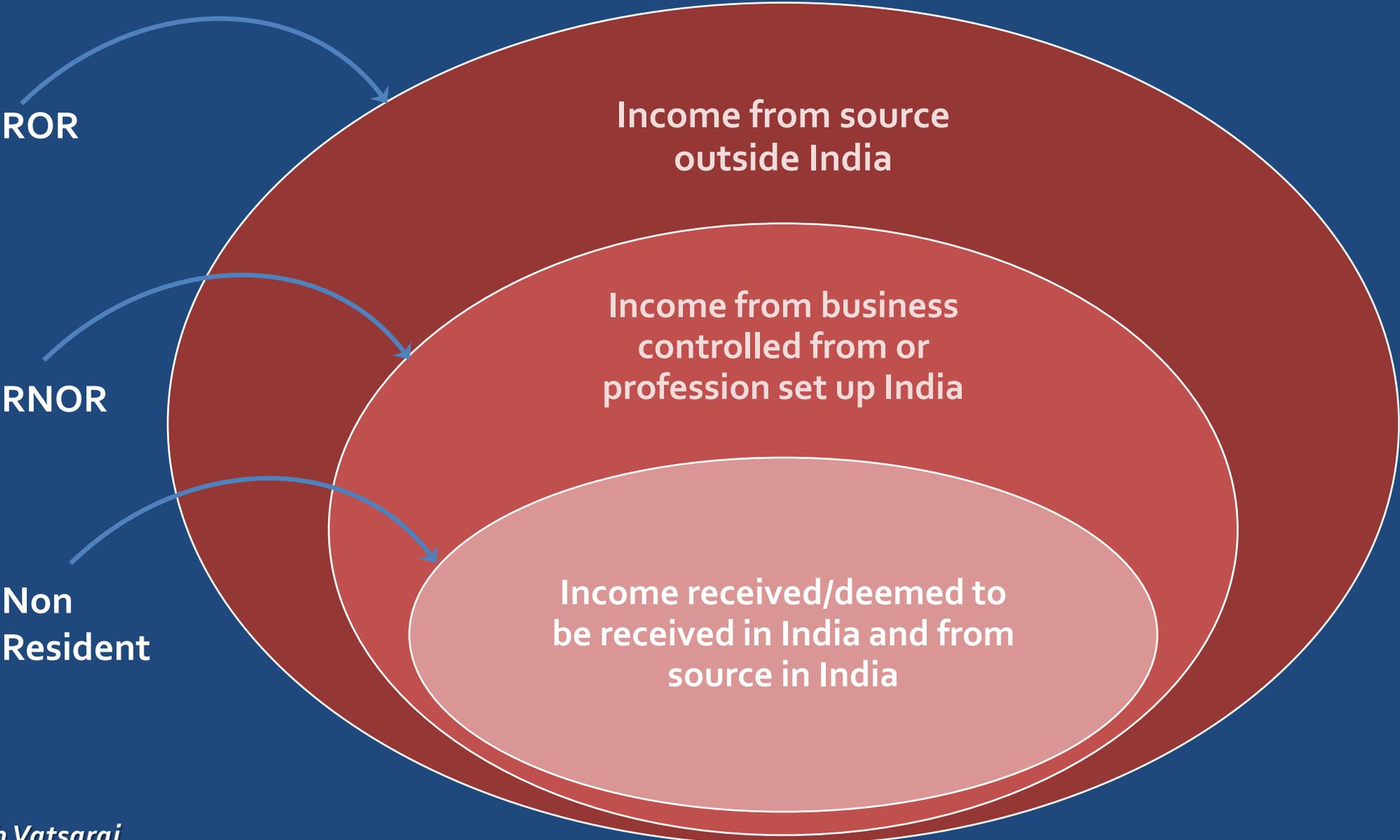
Similar view held in by Bangalore ITAT in DCIT vs. Sanjeev Kumar Ranjan (ITA No. 1655/Bang/2017)

# EXPATS & COVID-19

- In May 2020, CBDT committed to issuing a “*circular excluding the period of stay of these individuals up to the date of normalization of international flight operations, for determination of the residential status for the previous year 2020-21*”. Doctrine of “**legitimate expectations**” (Supreme Court in **Ram Pravesh Singh v. State of Bihar**)
- Circular 2/2021, March 2021 – no exclusion. Referenced OCED April 2020 guidance, not Jan 2021
- Resolution of dual residency through DTAA. Applications can be made to CBDT which would consider if “*general relaxation can be provided for a class of individuals or specific relaxation is required to be provided in individual cases*”.
- Impact on “accidental residents”, especially those from countries with lower or no income-tax
- Inclusion of involuntary stay period – ***CIT v Suresh Nanda [2015] 375 ITR 172 Delhi HC***

# SCOPE & TAXATION

# SCOPE OF TOTAL INCOME BASED ON RESIDENCY



# SECTION 9 & 15 OF ITA

***What will be taxed?*** Section 9(1)(ii) – Salary earned in India is taxable, i.e. if it is payable for service rendered in India or also for the rest/leave period which is both preceded & succeeded by services rendered in India and forms part of the service contract of employment.

***When will it be taxed?*** Section 15 – salary due from an employer or former employer (whether paid or not), advance salary when paid (even if not due), and arrears of salary paid by or on behalf of current or former employer (if not already taxed).

***For Non-Residents or RNORs, when salary is due outside India, but paid in India***

- **Held taxable on receipt** – ACIT v Shri Ellis Rozzario ( ITA no 2918/ 2009 - Del) & DCIT v. Mr. Eric Moroux (ITA No. 1174 / 2005- Del)
- **Held taxable on due basis** – Texas Instruments (90 taxmann.com 353 Delhi AAR), Bholanath Pal v. ITO (23 taxmann.com 177 – Bang. ITAT), Utanka Roy (Cal. HC 82 taxmann.com 117) and DIT v. Prahalad Rao (Kar HC, 10 taxmann.com 238)
- Salary received in Indian NRE account for services rendered outside India, place of accrual and receipt held to be outside India, hence not taxable in India – Deepak Kumar Todi (Kolkata ITAT) (ITA No. 1918/Kol/2017)

# TYPES OF EMPLOYMENT MODELS

- Secondment (Economic Employer Model): Expatriate employee effectively becomes an employee of the Indian entity, his salary costs are borne by the Indian entity, who is responsible for all the acts/omissions of the employee. Indian employer reimburses salary to foreign employer
- Salary in respect of only Indian services rendered is taxable (unless ROR)
- Indian employer has the onus of TDS compliance, even if salary is paid outside India.
- TDS on reimbursements – *is it FTS or pure reimbursement?*
- PE risk arises for foreign employer – *is the expat is undertaking any activity for the foreign employer?*

# TYPES OF EMPLOYMENT MODELS

- **Deputation (Service Model)**: Under this model, the expatriate employee is on the payroll of the foreign entity and is considered to provide services to the Indian entity, on behalf of the foreign entity, while in India. Payment by Indian entity to foreign employer is a service fee.
- Salary only in respect of services rendered in India is taxable (unless ROR)
- Foreign employer has the onus of TDS compliance, even if salary is paid outside India – *CIT v Eli Lilly & Co. (India) (P.) Ltd. [2009] 312 ITR 225 (SC)*
- A fixed place PE or service PE would be created subject to specific DTAA provisions.
- In absence of PE, the payment of fees to the foreign employer would be considered FTS, and WHT requirements as per domestic law or DTAA would apply

# TYPES OF EMPLOYMENT MODELS

- **Payroll Transfer:** Expat is given fresh employment in India by an Indian Company and he relocates to India for taking up the said employment, either for short term or long term. Salary in respect of Indian services rendered is taxable (unless ROR). Indian employer has the onus of TDS compliance, even if salary is paid outside India.
- **Dual Employment (Employee of both):** Remuneration is paid by both employers for services rendered in their respective country. Only that part of the remuneration that is commensurate to services rendered in India taxable. However, if the Expat is ROR, entire income is taxable in India & FTC of foreign tax will be available

# EXPAT OF INDIAN CO VS FOREIGN CO IN INDIA

Expatriate Employee of an Indian company	Expatriate Employee of Foreign Company (Deputed to PE/ Project in India or for rendering service to Indian entity)
<p>Remuneration taxable u/s 5 as income accrues or arises or is received in India</p> <p><i>Where services are rendered outside India, mere receipt of salary in India is not "receipt" as "constructive receipt" was outside India – Arvind Singh Chauhan Vs. ITO 42 taxmann.com 285 – Agra ITAT</i></p>	<ul style="list-style-type: none"><li>• Sec 9(1)(ii) – Income is deemed to accrue in India <b>for services 'rendered' in India</b> including rest periods.</li><li>• Indian salary plus foreign salary is taxable in India for the duration services are rendered in India.</li><li>• Duration of employment is <b>not relevant</b>.</li></ul>

# EXAMPLE OF OUTBOUND EMPLOYEE

- ❑ Mr A, an Indian citizen is an employee of I Co and is sent to I Co's subsidiary in Country X, F Co on secondment basis. He renders his services in Country X.
- ❑ Taxability of Mr A's income

	ROR	RNOR	NR
Salary received in Country X for services rendered in Country X	✓	✗	✗
Salary received in Country X for services rendered in India	✓	✓	✓
Salary received in India for services rendered in Country X & India	✓	✓	✓

- ❑ What happens if Mr A's salary pertaining to employment period in Country X i.e. salary accrued outside India, is then remitted to India subsequently?
  - *Tanjore Permanent Bank Ltd [1994] 207 ITR 924 (Mad)*

# CERTAIN EXEMPTIONS/ CARVE OUTS

	Exemption u/s 10(6)(vi) of ITA	Under DTAA (OCED MTC Art. 15)
<b>Stay in India is</b>	≤ 90 days in the year	<183 days for <i>12-month period commencing or concluding in the year</i>
<b>Employee is</b>	Not a citizen of India	Resident of Treaty partner country
<b>Employer is</b>	Foreign enterprise – not engaged in trade/business in India	A Foreign Resident
<b>Treatment of Salary in India</b>	Salary not deductible from the employer's income chargeable under ITA	Remuneration is paid by or on behalf of the NR employer & not borne by PE in India

## Other Exemptions u/s 10

- 10(6)(ii) – Remuneration as part of embassy, consulate, trade representation, etc. subject to reciprocity and no other engagement in India
- 10(6)(viii) – Expats also entitled to ship stay exemption
- 10(6)(xi) – Employee of Government of Foreign State for Training in India – subject to certain conditions
- Exemption from certain allowances u/s 10(14) and perquisites u/s 10(10CC)

# OECD MTC – ARTICLE 15(1) & (2)

1. Subject to the provisions of Articles 16, 18 and 19, **salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State.** If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.
2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State **shall be taxable only in the first-mentioned State if:**
  - a) the recipient is present in the other State for a period or periods **not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned,** and
  - b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and
  - c) the remuneration is not borne by a permanent establishment which the employer has in the other State

# OECD MTC ARTICLE 15(1) & (2)

- ❑ Primarily salary is taxable in the Country of Residence (say Foreign country) unless, the employment is exercised in the other country (say India). [Article 15(1)].
- ❑ If the employment is exercised in India, then salary is also taxable in India subject to three conditions being cumulatively satisfied.
- ❑ Remuneration “derived” from employment – thus taxation right continues even if received before or after presence
- ❑ Article 15 applies only to private sector employees. It **does not apply** to:
  - ❑ Directors Fees
  - ❑ Artistes & Sportsperson remuneration.
  - ❑ Pension
  - ❑ Salary & pension of Government employees
  - ❑ Payments to students, professors & foreign teachers in some cases

# OECD MTC ARTICLE 15(3)

Previous Draft	Amended Draft (2017 MTC)
<p>Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic, <u>or aboard a boat engaged in inland waterways transport</u>, may be taxed in the Contracting State <b>in which the place of effective management of the enterprise is situated.</b></p>	<p>Notwithstanding the preceding provisions of this Article, remuneration derived <b>by a resident of a Contracting State</b> in respect of an employment, <b>as a member of the regular complement of a ship or aircraft</b>, that is exercised aboard a ship or aircraft operated in international traffic, <u>other than aboard a ship or aircraft operated solely within the other Contracting State</u>, <b>shall be taxable only in the first-mentioned State.</b></p>

# INTERPRETATION OF CERTAIN TERMS

## EMPLOYER

- *An employer is someone to whom an employee is committed to supply his capacity to work and under whose directions the latter engages in his activities and whose instructions he is bound to obey” (Klaus Vogel)*
- *A key consideration will be which enterprise bears the responsibility of risks produced by individual's work. ( OECD)*
- *Distinction between “contract of service” and “contract for service” (OECD Commentary)*
- *Performance of duties subject to directions, instructions and superintendence of the employer and various other tests laid down by Indian Courts.*
- ***(Lakshminarayan Ram Gopal (25 ITR 449); Piyare Lal Adishwar Lal (40 ITR 17); Ram Prashad (86 ITR 122))***

# INTERPRETATION OF CERTAIN TERMS

*The SC in Lakshminarayan Ram Gopal vs. Govt. of Hyderabad [1954] 25 ITR 449 (SC) and in Ram Prashad vs. CIT [1972] 86 ITR 122 (SC) laid down the following tests to distinguish between an employee and an agent:*

*(a) Servant or agent? whether employer exercises a supervisory control in respect of the work entrusted to that person.*

- A servant acts under the direct control and supervision of his master.*
- An agent is not subject to direct control or supervision of the principal, though he is bound to exercise authority in accordance with all lawful orders and instructions which may be given to him from time-to-time by his principal.*

***But this test is not universal in its application in every case.***

*(b) A person who is engaged to manage a business may be a servant or an agent according to the nature of his service and the authority of his employment. Generally it may be possible to say that the greater the amount of direct control over the person employed, the stronger is the conclusion in favour of his being a servant.*

*(c) Similarly, greater the degree of independence, greater the possibility that relation is of principal & agent.*

# WHOSE EMPLOYEE IS IT ANYWAY?

❑ **Economic Employer v/s Legal Employer** – OECD MTC Commentary: “a key consideration will be on which enterprise bears the responsibility or risk of the results produced by the individuals work.”

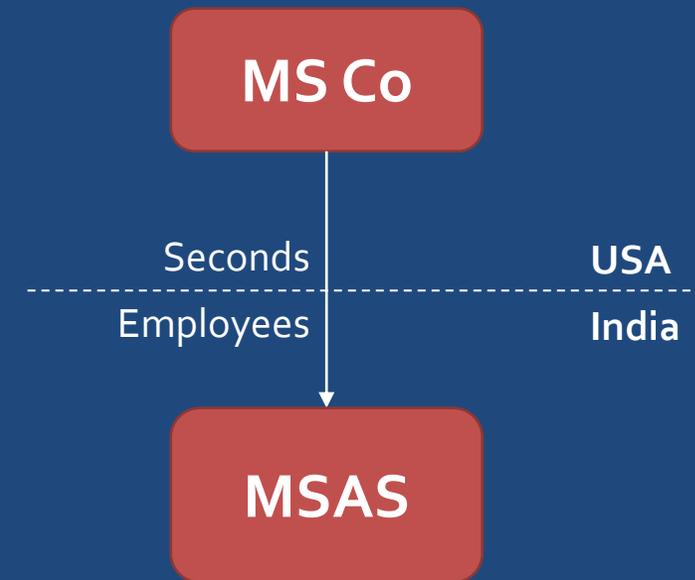
## ❑ **Judicial Precedents**

- IDS Software Solutions (2009 –TIOL-82-BANG)
- HCL Info systems 274 ITR 261 (Del)
- Abbey Business Services (India) (P.) Ltd v DCIT [2012] 23 taxmann.com 346 (Bangalore – Trib.)
- Verizon Data Services India (AAR)
- AT&S (287 ITR 421)
- Centrica India Offshore Pvt. Ltd. [2012] 249 CTR11(AAR) & [2014] 44 taxmann.com 300 (Delhi)
- Target Corporation India Pvt. Ltd. [2012] 348 ITR 61 (AAR)

# WHOSE EMPLOYEE IS IT ANYWAY?

- Employees of Morgan Stanley USA were seconded to Indian sub-co
- Some employees performed stewardship role on behalf of MS Co, others were providing services directly to MSAS
- SC held that Service PE was created because:
  - Seconded Employees continue to be on the payroll of the MS Co
  - MS Co was responsible for the work done by the seconded employee
  - Seconded employee continues to have lien over its employment with the MS Co
  - Any Disciplinary action against the seconded Employee cannot be taken by the MSAS without the consent of the MS Co
- As far as stewardship related secondment was concerned – it doesn't constitute a PE

DIT v Morgan Stanley & Co. Inc.  
[2007] 292 ITR 416 (SC)



# INTERPRETATION OF CERTAIN TERMS *(continued...)*

## Meaning of “employment exercised in other contracting state” i.e. source country

- Place where “Services Performed” [US Model Technical Explanation/ Commentary]
- Place where the employee is **physically present** when performing [OECD Model Commentary]
- remuneration for period he visited home country for work related to host country employer not taxable in India under Art 15(1) of India-France DTAA – **Gallotti Raoul v ACIT (61 ITD 453 – Mum ITAT)**
- Time or place of payment of Salary and place where results exploited irrelevant. The term used in Art 15(1) is “derived”
- Interesting view of Western Cape Division of Tax Court of South Africa (**TCIT 14218**) – The court, thus, concluded that the “source” of the remuneration received, for services rendered outside South Africa, is the same as the remuneration derived from services rendered inside South Africa. In *CIT vs. Indo Oceanic Shipping Co. Ltd. [2002] 114 Taxman 722 (Mum.)*, the High Court held that the place where the contract was entered into was not important for determining whether employment was outside India.

# MEANING OF “BORNE BY PE”

## Judicial Precedents :

- **Allocable to PE** – DHV Consultant BV In Re (2005) 277 ITR 97/147 Taxman 521 (AAR)
- **PE commercially liable or actually pays for the expense** – (*Ensco Maritime Ltd vs DCIT (2004) 91 ITD 459 (Del)*, *CIT v. Dalhousie Properties Ltd. (19E4)149 ITR 708/19 Taxman 5 (SC)*)
- **If the expenditure has direct and proximate relationship with the business receipts, whether paid by PE directly or reimbursed to other entity, will be considered as borne by PE (Covers presumptive taxation also)** – DHV Consultants BV 227 ITR 97 (AAR)); Lloyd Helicopters International Pty. Ltd., [2001] 249 ITR 162 (AAR); International (P.) Ltd. v. CIT (2001) 249 ITR 162/115 Taxman 334 AAR; *Sedco Forex International Inc v. CIT (2005) (147 Taxman 389)(SC)*
- **What if the Profit are deemed to be taxed on Gross basis, It was held that it is considered that remuneration is deducted** – *B Nakazono v. Ast. CIT (2003) 1 SOT 31 (Del)*, *Zarubezhneft v. Ast. CIT (2007) 17 SOT 1 (Delhi - Trib.)*
- **Expense is actually paid** – *CIT v. Elitos S.P.A (2005) 145 Taxman 210 Allahabad. HC*

# TAXABILITY OF CERTAIN COMPONENTS OF SALARY STRUCTURE OF AN INBOUND EXPAT

- Per Diem Allowance
- Equalization Pay
- Hypothetical Taxes
- Social Security and Pension
- Certain Benefits
- ESOPs

# TAXABILITY OF CERTAIN COMPONENTS OF SALARY STRUCTURE OF AN INBOUND EXPAT

- Per Diem Allowance
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# PER DIEM ALLOWANCE

Conditions for claiming exemption u/s 10(14)(i) r.w. Rule 2BB :

- The allowance must be granted to meet expenses in the performance of the duties of an office;
- The allowance is granted to an employee on tour or transfer;
- The allowance is granted to meet the ordinary daily charges;
- The said charges are incurred on account of absence from his normal place of duty; and
- The exemption is available only to the extent to which the expense is actually incurred.
- Evidence of expenditure – CIT vs. Larsen & Toubro Ltd. [2009] 313 ITR 1 (SC)
- Point to Note: The allowance must be granted as a reimbursement rather than a personal advantage.

**Relevant for Inbound and outbound expat !!!!**

# PER DIEM ALLOWANCE – JUDICIAL PRECEDENTS

- CIT vs. S. G. Pgnatale [1980] 124 ITR 391(Gujarat) – expenses given as **reimbursement of the money which would be required by the expatriate to spend for his stay in India rather than a personal advantage** was not a "perquisite" within the meaning of section 17(2) and/or "salary" within the ambit of section 17(1)(iv), it would not be taxable.
- SC in the case of CIT vs. Goslino Mario [2000] 241 ITR 312 held that where the employees were required to stay away from their homes, daily allowance given to them to incur expenditure, **wholly, necessarily and exclusively for the purpose of duties and such expenditure was in nature of reimbursement**, the same will not be taxable
- SC in CIT vs. Morgenstern Werner [2003] 259 ITR 486 held that daily allowance received by an employee and incurred by him on account of **absence from normal place of duty** was not taxable in his hands
- AAR in Hindustan Powerplus (271 ITR 433) held **living expenses, furnished house, airfare and per diem for rest period, home travel, car etc.** exempt u/s 10(14)(i) in hands of foreign deputees

# TAX EQUALIZATION (TAX PROTECTED EMPLOYMENT CONTRACT)

Particulars	Original In Home Country		While on assignment in Host Country			
			W/o Equalization		With Equalization	
Salary		100,000		100,000		100,000
Tax Equalization Pay		–		–		8,333
<b>Total Salary</b>		<b>100,000</b>		<b>100,000</b>		<b>108,333</b>
<b>Tax Host Country @ 40%</b>		–		<b>40,000</b>		<b>43,333</b>
Tax in Home Country @ 35%	35,000		35,000		37,917	
Less: FTC*	–		(35,000)		(37,917)	
<b>Tax Payable Home Country</b>		<b>35,000</b>		–		–
<b>Net Salary post Tax</b>		<b>65,000</b>		<b>60,000</b>		<b>65,000</b>

\* FTC is restricted to the amount of Home Country Tax. The excess Host Country tax lapses.

# HYPOTHETICAL TAXES

- Expatriates are often paid their Home Country salary plus specific assignment related allowances / perquisites.
- The employer “deducts” tax on the employee’s Home Country salary as per home country tax structure. This tax is called Hypothetical Tax (“Hypo Tax”). Hypo Tax is not actual tax.
- The Hypo Tax withheld from the expatriate's normal pay and is retained by the employer as a "tax reserve". The company would then pay all applicable home and host country taxes on employment income (including taxes on expatriate benefits) during the assignment.
- The amount will be partially funded by the Hypo Tax recovered by the employer from the employee. In some cases the actual tax amount will be lower than Hypo tax. The benefit will be enjoyed by the employer.
- In most countries (including India) tax liability of employee borne by employer will be treated as employee’s income. This calls for grossing up while calculating host country tax liability

# HYPOTHETICAL TAXES

Particulars	Ref	With Hypo Tax	W/o Hypo Tax
Gross Salary in Home Country	A	100,000	100,000
Hypothetical Tax @ 25%	B	25,000	-
<b>Net Home Country Income</b>	<b>C (A - B)</b>	<b>75,000</b>	<b>100,000</b>
Assignment Specific Allowance	D	25,000	25,000
<b>Salary received</b>	<b>E (C + D)</b>	<b>100,000</b>	<b>125,000</b>
Host Country Incremental Tax (paid by employer)	F*	7,143	-
<b>Taxable Income</b>	<b>G (E + F)</b>	<b>107,143</b>	<b>125,000</b>
Tax in Host Country @ 30%	H	32,143	37,500

\*This is calculated as:  $\frac{\text{Income Paid} \times \text{Host Country Tax Rate} - \text{Hypo Tax}}{1 - \text{Host Country Tax Rate}}$

- Hypo tax reduced from salary does not constitute income in the hands of the expatriate and therefore cannot be treated as part of the employee's taxable salary – Jaydev Raja 357 ITR 292 (Bom)
- Whether to reduce hypo tax from base salary or perquisite irrelevant & academic – Lukas Fole (35 SOT 8) (Pune ITAT) & Jaydev Raja. However, there will be an impact e.g. on calculation of PF contribution or HRA
- Exemption u/s 10(10CC) of tax borne by employer – Sedco Forex International Drilling Inc. (TS-603-HC-2012) and Yoshio Kubo (357 ITR 452 (Del)
- If 10(10CC) is availed, there would be a disallowance of expense under Section 40(a)(v) of the ITA, in the corporate tax return of the employer to this extent.

# SOCIAL SECURITY CONTRIBUTIONS

- Social Security in India is governed mainly by the EPF Act, 1952
- The EPFA was modified in Nov, 2008 and its scope was extended to “International Workers”
- EPFA will apply to Expats working for an Indian employer to which EPFA applies
- If India has a Social Security Agreement (SSA), the Expat can obtain a Certificate of Coverage from home country govt., EPFA will not apply since IW will be considered a “detached worker”
- Taxability of PF contributions will be similar to entire salary amount after applying Chapter VI-A
- If the IW is from a country with which India has an SSA, he may withdraw accumulated balance on ceasing to be an employee of an establishment to which EPFA applies.
- Else, the IW can only withdraw the balance on retirement post attaining age of 58 or under the exigent circumstances/ contingencies provided for under the EPFA.

# TAXABILITY OF SOCIAL SECURITY CONTRIBUTION OF HOME COUNTRY FOR EXPATRIATE

## Mandatory contribution - tax deductible / not taxable – '*diversion by overriding title*'

- *CIT, Delhi – XVII v. NHK Japan Broadcasting Corporation* [Civil Appeal No. 1712 of 2009 (SC)]
- *ACIT vs Harashima Naoki Tashio*, ITA No. 4634/De
- *ACIT vs Eric Matthew Gottesman* (2007) 15 SOT 301 (Del)
- *ACIT, Circle 47(1) vs Hideki Ishihara* in ITA No. 1906/Del/08
- *ITO vs Lukas Fole* (2009) 124 TTJ (Pune) 965
- *Gallotti Raoul vs ACIT 61 ITD (Bom.) 453*

Not  
Taxable

## Voluntary contributions

- By employer – taxable on accrual
  - L.W. Russel (1963) 53 ITR 91
  - Dr. Jan Nuyten (1999) 112 Taxmann 238
- By employee – not tax deductible / taxable

Taxable

# TAXABILITY OF SOCIAL SECURITY CONTRIBUTION OF HOME COUNTRY FOR EXPATRIATE

## Guiding Principles

- Contributions should be Compulsory / mandatory nature
- The employer should be authorized to deduct the social security contribution from the monthly remuneration payable to the employee
- Certain penal implications for default
- No vested right conferred on an employee
- Contributions are required to be made by all employees compulsorily.
- Overriding title on income from remuneration
- It should not be a “company framed scheme”
- Guarantee the workers and their families against all types of risks susceptible to reduce the earning power.
- Home country income-tax laws allow full deduction of social security contributions and only net income is subjected to tax

# EMPLOYER'S CONTRIBUTION TO PENSION

Employer's contribution to the Pension Funds is not taxable in the year of contribution as it does not vest in employee till a much later date:

- *CIT vs. L W Russell [1964] 53 ITR 91 (SC)*
- *Yoshio Kubo vs. CIT, 2013 [2013] 357 ITR 452 (Delhi)*
- *CIT vs. Vinay Bharat Ram [1981] 129 ITR 128 (Delhi)*
- *CIT vs. Cama Motors Pvt. Ltd. [1998] 234 ITR 699 (Guj)*
- *CIT vs. Bharat Ram Charat Ram P. Ltd. [1986] 157 ITR 199 (Delhi)*

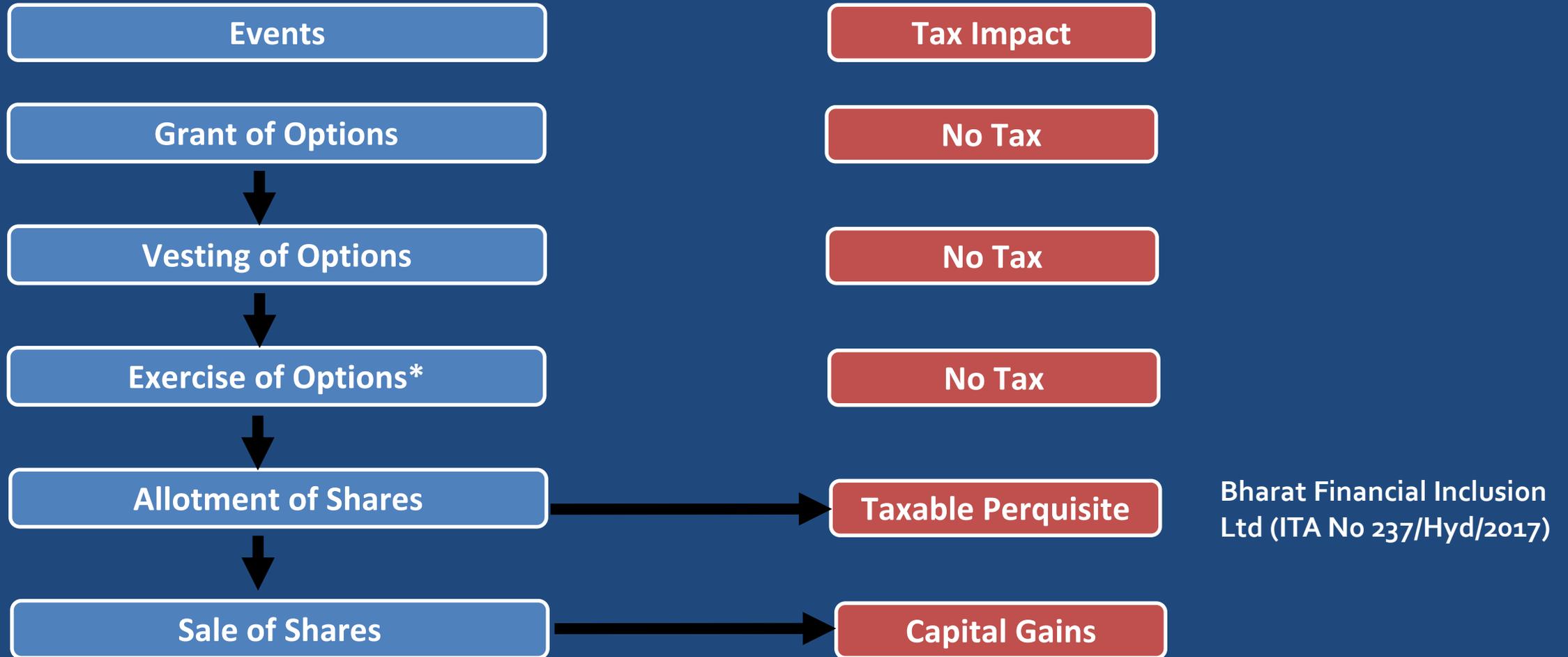
However the employers' contribution would be taxed at the time of receipt of the retirement benefits to the extent it relates to services rendered in India as per the ITA (subject to treaty provisions)

# TAXABILITY OF CERTAIN OTHER BENEFITS

(Yoshio Kubo vs CIT 36 Taxman.com Delhi HC)

- Payment of **Medical Insurance** by employer for the expat employee – not perquisite
- Payment by employer of tax consultants fees for filing expat's returns not perquisite as tax was to be borne by employer
- Tax refund received by expat employee not income in his hands as tax was to be borne by employer and thus the refund was a loan to employee

# TAXATION OF ESOPs



Bharat Financial Inclusion Ltd (ITA No 237/Hyd/2017)

\* Relevant from valuation perspective

# TAXATION OF ESOPs

- **ESOPs to employees of Indian Sub-Co of foreign parent held taxable as perquisite** – Microsoft (235 ITR 565 AAR)
- **Whether entire value of ESOP received by RNOR is taxable in India?** *Robert Arthur Keltz [2013] 59 SOT 203 (Delhi - Trib.)* held that proportionate stock option benefit, which is relatable to the service rendered in India is taxable in India.
- **Proportionate value of ESOP continues to remain taxable in country of employment even if employee has shifted to another country** (*James Mullen Vs. Her Majesty the Queen, Tax Court of Canada*)

OECD Commentary: If the shares are in relation to a particular employment then the same should be taxed in the country where such employment was exercised

- **ESOP tax payment deferral for employees of eligible start-ups** – now payable within 14 days of (a) 48 months from end of relevant AY (effectively 5 years), (b) sale of ESOP or (c) leaving employment. **TDS requirement also deferred similarly.**

# WITHHOLDING TAXES & OTHER ISSUES

- Withholding Taxes
- Foreign Tax Credit
- Conversion of Foreign Currency Salary
- Procedural Requirements
- Disclosures

# WITHHOLDING TAXES

- **Is tax required to be deducted at source from salaries of expatriates working in India even in cases where such salaries were paid abroad?** Yes, the Supreme Court in the case of Eli Lilly & Company (India) Pvt. Ltd. [2009] 312 ITR 225 has ruled that salary payable for services rendered in India should be subjected to tax deduction at source/ withholding tax provisions, even on that part of the salary which is paid overseas.
- **Is Section 192 to be interpreted to impose a liability to collect tax which is eventually not payable at all?** Andhra Pradesh High Court in the case of Rajagopal (P.V.) vs. Union of India (233 ITR 678), held that “a scheme cannot be abused by collecting more than the tax leviable and driving the assessee to wait indefinitely for refunds.” AAR in its ruling in the case of British Gas [2006] 287 ITR 462 held that the Indian Company was not required to withhold taxes on the salary paid in India to employees deputed to UK if it is satisfied that such salary is taxable in UK and not in India.

# WITHHOLDING TAXES

- **TDS u/s 192 not applicable to Overseas Allowance paid by Indian company to employees seconded by foreign company** (CIT Vs. Petroleum India ( 29 taxmann.com 250—Bombay HC)
- **Can Interest/ penalty be levied on the employer who fails to deduct tax at source, if the employee has paid tax by the way of advance tax or self-assessment tax?** If all conditions of proviso to Section 201 are satisfied, no interest/penalty are leviable. SC in *Hindustan Coca-Cola Beverages Pvt. Ltd. vs. CIT [2007] 293 ITR 226* held that penalty cannot be levied on the employer who fails to deduct tax at source, if the employee has paid tax by the way of advance tax or self-assessment tax.

# WITHHOLDING TAXES

## ➤ **Are Reimbursement of expatriate's salary payments in the nature of FTS?**

- (a) Whether the deputation/secondment is a stand-alone arrangement or is it part of a larger collaboration that requires the Foreign Company to provide technical support to the Indian Company?
- (b) Whether the Indian Company has power to select and terminate the expatriate employee?
- (c) Whether duration of the assignment is determined by the Indian Company and the Foreign Company does not have any right to recall the expatriate?
- (d) Whether the Indian Company has exclusive control and supervision of the expatriate including right to instruct and right to the work performed by such expatriates?
- (e) Whether employment will be performed at the place which is under the control and responsibility of the Indian Company?

# WITHHOLDING TAXES

## ➤ **Are Reimbursement of expatriate's salary payments in the nature of FTS?**

- e) Whether the Foreign Company takes any responsibility in respect of work done by the expatriate and indemnifies the Indian Company from all claims, demands, etc. and provides any warranty of the quality of the seconded employee or whether responsibility, risk and reward of the work done by the expatriate remain with the Indian Company?
- f) Whether the remuneration payable to the expatriate is commensurate with the services rendered to the Indian Company? Whether the Indian Company has any right to vary the remuneration?
- g) Whether amount to be reimbursed to Foreign Company is backed by adequate supporting & is without any profit element?

# WITHHOLDING TAXES

## ➤ Are Reimbursement of expatriate's salary payments in the nature of FTS?

Held FTS	Held Not FTS
<ul style="list-style-type: none"> <li>• AT&amp;S India Pvt. Ltd. [2006] 287 ITR 421 (AAR)</li> <li>• Verizon Data Services India Pvt. Ltd. [2011] 337 ITR 192 (AAR)</li> <li>• Centrica India Offshore Pvt. Ltd. [2012] 249 CTR 11 (AAR)</li> <li>• Target Corporation India Pvt. Ltd. [2012] 348 ITR 61 (AAR)</li> </ul>	<ul style="list-style-type: none"> <li>• ADIT vs. Mark &amp; Spencer Reliance India Pvt. Ltd. [2013] 27 ITR(T) 448 (Mum ITAT)</li> <li>• Cholamandalam MS General Insurance Co. Ltd. [2009] 309 ITR 356 (AAR)</li> <li>• IDS Software Solutions vs. ITO [2009] 32 SOT 25 (Bengaluru)(URO)</li> <li>• Tekmark Global Solutions LLC [2010] 131 TTJ 173 (Mumbai)</li> <li>• ACIT vs. Karl Storz Endoscopy India Pvt. Ltd. (ITA No. 2929(Del)/2009)</li> <li>• Cerner Healthcare Solutions Pvt. Ltd. vs. ITO (ITA No.627(Bang)/2011)</li> <li>• Caterpillar India P Ltd. vs. DDIT (ITA No.630(Bang)/2010)</li> <li>• Ariba Technologies India Pvt. Ltd. vs. Dept. of Income-tax (ITA No. 616(Bang)/2011)</li> <li>• Abbey Business Services (India) (P.) Ltd. [2012] 53 SOT 401 (Bengaluru)</li> <li>• CMS (India) Operations &amp; Maintenance Co. (P.) Ltd. [2012] 135 ITD 386 (Chennai)</li> <li>• Temasek Holdings Advisors (I) P. Ltd. vs. DCIT [2013] 60 SOT 134 (Mum ITAT)</li> </ul>

# WITHHOLDING TAXES

Obligations on Foreign Company where they have issued ESOP to Indian employees

- (i) Employer (Foreign Co) would be required to obtain TAN in India
- (ii) If Foreign Co has not obtained TAN, to avoid continuing default, Indian employee should file return of income showing said income
- (iii) Where ESOP are issued for and on behalf of Indian Subsidiary, the Indian Co can comply with TDS obligations on behalf of the Foreign company (AAR No. 15 of 1998) 102 taxman 74.

# FOREIGN TAX CREDIT

- Can the **employer consider the relief available** to the employee under the relevant DTAA while deducting TDS from salary payments?
- Should an **employer consider FTC** while deducting tax at source on salary income paid to resident employees who are on assignment outside India?
  - Andhra Pradesh High Court in the case of Rajagopal (P.V.) vs. Union of India (233 ITR 678), held that “a scheme cannot be abused by collecting more than the tax leviable and driving the assesseees to wait indefinitely for refunds.”
- **Entitlement to DTAA benefits is contingent upon valid TRC & Form 10F**
- **Filing Form 67 along with proof of taxes paid in foreign country**

# CONVERSION RATE FOR SALARY EARNED IN FOREIGN CURRENCY

## Rule 26 vs Rule 115

- *Rule 26: For the purpose of deduction of tax at source on any income payable in foreign currency, the rate of exchange for the calculation of the value in rupees of such income payable to an assessee outside India shall be the telegraphic transfer buying rate of such currency as on the date on which the tax is required to be deducted at source under the provisions of Chapter XVII B by the person responsible for paying such income.*
- *Rule 115: The rate of exchange for the calculation of the value in rupees of any income accruing or arising or deemed to accrue or arise to the assessee in foreign currency or received or deemed to be received by him or on his behalf in foreign currency shall be the telegraphic transfer buying rate of such currency as on the specified date.*

# PROCEDURAL REQUIREMENTS

- ❑ **PAN:** All inbound employees must obtain a PAN by making an application to the tax authorities.
- ❑ **Return Filing:** All Inbound employees must file their ITR in prescribed form on or before the due date u/s 139(1). The income tax payable as per the tax return must be computed and paid before the return is filed. Form 67 is a pre-requisite for claiming FTC.
  - **An employee claiming short stay exemption u/s 10(6)(vi) or under DTAA – *is ITR required?* Absence of specific exemption and judicial precedents {XYZ / ABZ Equity Funds vs. CIT (2001) [250 ITR 194]; VNU International B.V., (2011) [334 ITR 56]; Deere and Company (2011) [337 ITR 277]; Castleton Investment Ltd. (2012) [348 ITR 537]; and SmithKline Beecham Port Louis Ltd.(2012) [348 ITR 556]}**

# PROCEDURAL REQUIREMENTS

## □ NOC (Section 230):

### ▪ Inbound Expats not domiciled in India on leaving India

- Every person, who is not domiciled in India and who has come to India in connection with business, profession or employment, is required to obtain a NOC (Form 30B) from the tax authorities before departing from India.
- Expat will have to furnish undertaking obtained from the employer (Form 30A) that the tax payable by such person shall be paid by the employer.

### ▪ Outbond Expats hitherto domiciled in India

- A Indian domiciled individual leaving India must furnish Form 30C with prescribed particulars to and obtain NOC that all taxes due have been paid.
- If he does not have PAN (since income was less than minimum taxable amount) he has to file Form 31 and obtain NOC in Form 33.

# FOREIGN ASSETS DISCLOSURES

- Schedule FA - Details of Foreign Assets and Income from any source outside India
- Only to ROR assessee – implications under Black Money law for employer & employee
- Applicable to both Indian as well as Foreign Citizens
- Declaring Foreign Assets & Interests in which includes:
  - Foreign bank accounts (Peak value during the year)
  - Foreign depository accounts, custodial accounts
  - Financial interest in any entity, equity interest, debt interest
  - Details of cash value of insurance/annuity contracts
  - Details of immovable property or other capital assets located outside India
  - Details of any account located outside India in which the assessee has signing authority
  - Details of interest in Trusts (settlor, beneficiary, trustee, etc.)

# Thank you!

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