Tax-treatment and TDS, in respect of remuneration payable to an employee of an Indian Company, located abroad

Tax-treatment and TDS, in respect of salary, bonus and incentive, receivable by the CEO of an Indian Company, who is located abroad, viz. Singapore.

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By S.K.Tyagi

Sometime back, a client of mine which is a Company located in India, sought an Opinion whether there would be income-tax and TDS liability, in respect of salary, bonus and incentive receivable by its CEO, who is located in Singapore.

The relevant facts of the case, may be stated as follows :

1. The Company concerned is registered under the Companies Act, 1956 in India and the principal place of business of the Company is also in India.

2. The Company has got a number of subsidiaries and associate Companies located abroad.

3. Mr.X is the Chief Executive Officer (CEO) and Managing Director (MD) of the Company. Mr.X has entered into an employment agreement with the Company located in India and his terms of employment state that he is responsible for global business of the Company.

4. Mr. X is also permitted to be on the rolls of any subsidiary company of the Group, located in any geographical location and entitled to draw his salary from that subsidiary. Besides, Mr.X is also permitted to have multiple employment within the same Group of Companies.

5. Mr.X has the choice to draw his salary from any company of his choice, of which he will also be an employee.
6. Mr.X is a foreign national, to be specific, a resident of Singapore and he is not resident in India during any period of his service.
7. Mr.X will be rendering his services as CEO and MD of the Company from Singapore.

8. Mr.X would be entitled to receive salary, bonus and incentive from the Company.

9. Mr.X will draw his salary, bonus and incentive, etc only in Singapore.

10. The salary, bonus and incentive paid to Mr.X by the subsidiary located abroad, will be reimbursed by the Indian Company, and at the time of reimbursement of the aforesaid salary, bonus and incentive, no tax is deducted at source by the Indian Company.

In the light of the aforesaid facts, the queries raised are stated as follows :

1. What will be the tax-treatment of salary, etc, payable to Mr.X, if such payments are made by the Indian Company directly, without routing the same through its subsidiary company in Singapore ?

2. Whether Indian Company is required to deduct tax at source, in respect of reimbursement of the aforesaid expenses to its subsidiary company located in Singapore ?

3. Whether Mr.X will be liable to pay tax in India under the aforesaid circumstances ?

4. Whether reimbursement of salary cost by the Indian company to its overseas subsidiary, will imply that salary is paid in India, merely because Mr.X has an employment contract with the Company in India ?

5. Whether the provisions of section 195 or the Double Taxation Avoidance Agreement (DTAA) will be interpreted in terms of the fact that payment is made by an overseas entity or by an employment agreement with the company located in India ?

In order to answer the aforesaid queries, the relevant provisions of the Income-Tax Act, 1961 (the Act), the relevant provisions of the Double Taxation Avoidance Agreement (DTAA) between India and Singapore, the relevant circulars of the CBDT and the relevant legal precedents will be required to be considered.

For the aforesaid purpose, the following issues / aspects will be required to be examined :

1. Whether salary, bonus and incentive receivable by Mr.X in Singapore, will be liable to tax in India.

2. Whether any tax is required to be deducted at source, in respect of income / payment, which is not liable to tax in India.
3. Whether there would be any obligation on the Indian Company to deduct any tax at source from the payment, by way of salary, bonus and incentive to Mr.X.

4. Whether the Indian Company will be required to deduct tax at source, in respect of reimbursement of the aforesaid payment to its subsidiary located in Singapore.

All the aforesaid issues / aspects are discussed in detail as follows :

I. Whether the salary, bonus and incentive receivable by Mr. X in Singapore, will be liable to tax in India.

Before we proceed to deal with the issue whether the salary, bonus and incentive receivable by Mr.X in Singapore will be liable to tax in India under the Income-Tax Act, 1961, it will be necessary to examine the relevant provisions of the Act, as well as the DTAA.

In the present context, it will be relevant to refer to the provisions of section 90(2) of the Act, which is reproduced as follows :

"***90. Agreement with foreign countries or specified territories.***

(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee."

From the aforesaid provisions of section 90(2), it may be seen that in relation to the assessee to whom the provisions of the DTAA apply, the provisions of the Act shall apply to the extent they are more beneficial to him. In other words, such an assessee may choose to be taxed either under the provisions of the I.T.Act, 1961 or the DTAA, whichever is more beneficial to him.

In this connection, it will also be necessary to state that in case of conflict between the provisions of the I.T.Act, 1961 and the DTAA, the provisions of the DTAA will prevail. In this regard, the following legal precedents are also relevant :

1. *Union of India Vs Azadi Bachao Andolan [2003] 263 ITR 706 (SC)*

   It was, *inter alia,* held in this case that the total income specified in sections 4 and 5 of the Act chargeable to income-tax, subject to the provisions of an Agreement of the Central Government and the Government of a country outside India, for avoidance of double taxation contemplated

by section 90 to the contrary, if any. Such an Agreement operates as a bar on the power of the Government of India and the bar would operate on sections 4 and 5.

It was further held that no provisions of the DTAA can possibly fasten a tax liability, where the liability is not imposed by the Act. If tax liability is imposed by the Act, the Agreement may be resorted to for negativing or reducing it and in case of difference between the provisions of the Act and the Agreement, the provisions of the Agreement would prevail over the provisions of the Act and cannot be enforced by the appellate authorities and the Court.

2. *CIT Vs P.V.A.L.Kulandagan Chettiar [2004] 267 ITR 654 (SC)*
   It was held in this case that the provisions of the DTAA prevail over the provisions of the Income-Tax Act.

In view of the aforesaid reasons, it is clearly established that if the salary, bonus and incentive, receivable by Mr.X are not liable to tax in India under the provisions of the DTAA, then the same will not be liable to tax under the provisions of the I.T.Act, 1961, also.

We may now discuss, in detail, whether the salary, bonus and incentive receivable by Mr.X will be liable to tax under the I.T.Act, 1961 or the DTAA. The same are discussed in detail as follows :

A. Whether the salary, bonus and incentive, receivable by Mr.X, will be liable to tax under the Act.

In this connection, the relevant provisions of the Act are discussed as follows :

1. Section 5 – Scope of total income

In the present case, first of all, it will be necessary to examine the scope of total income, as provided under section 5(2) of the Act. For the sake of ready reference, section 5 of the Act, is reproduced as follows :

"***5. Scope of total income.***

(1) Subject to the provisions of this Act, the total income of any previous year of a person who is a 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 ; or

(c) accrues or arises to him outside India during such year :

***Provided** that, in the case of a person not ordinarily resident in India within the meaning of sub-section (6) of section 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India.*

(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.

Explanation 1.—Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.

Explanation 2.—For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India."

As per section 5(2), 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 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 to arise in India during such year.

In this connection, *Explanation 1* to section 5 is also relevant. As per the aforesaid *Explanation 1*, income accruing or arising outside India, shall not be deemed to be received in India, within the meaning of this section, by reason only of the fact that it is taken into account in the balance-sheet prepared in India.

In the light of the aforesaid provisions of section 5(2), it may be seen that –

(i) Salary received by a non-resident employee which he has earned outside India, cannot be deemed to be received in India

(ii) Further, as the aforesaid salary is earned outside India, the same cannot be treated as accruing or arising in India.

From the aforesaid discussion, it is clearly established that salary earned by a non-resident employee outside India cannot be treated as income received or deemed to be received in India. Besides, the aforesaid salary cannot also be treated as an income which accrues or arises to such employee in India.

However, in this context, the moot point will be whether the salary of a non-resident employee could be deemed to accrue or arise to him in India. For this purpose, it will be necessary to refer to section 9 of the Act.

2. Section 9 – Income deemed to accrue or arise in India.

In the present context, clause (ii) of sub-section (1) of section 9 is relevant. For the sake of ready reference, the same is reproduced as follows :

"***9. Income deemed to accrue or arise in India.***

(1) The following incomes shall be deemed to accrue or arise in India :—

(i) **********

(ii) income which falls under the head "Salaries", if it is earned in India.

Explanation.—For the removal of doubts, it is hereby declared that the income of the nature referred to in this clause payable for—

(a) service rendered in India; and

(b) the rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment,

shall be regarded as income earned in India ;"

From the aforesaid clause (ii) of section 9(1) of the Act, it may be clearly seen that salary will be deemed to accrue or arise in India if it is earned in India. Further, as per *Explanation (a)* to aforesaid clause (ii), income of the nature of salary shall be regarded as income earned in India, if the services by the employee concerned are rendered in India.

In the present case, the employee concerned is rendering his services outside India. Therefore, his income by way of salary cannot be deemed to accrue or arise in India.

It is, thus, clearly established that income by way of salary earned by an employee who is non-resident in India, will not be part of total income of such employee, as per the provisions of sections 5 and 9 of the Act.

3. Whether the other payments, viz. bonus and incentive, will also get the same tax-treatment as salary.

As could be seen from the aforesaid e-mail, Mr.X may also be paid annual bonus and special incentive. It will, therefore, be necessary to examine whether the aforesaid payment in the form of annual bonus and special incentive will also not be liable to tax in India.

For this purpose, in the first place, it will be necessary to refer to the definition of "*Salary*" under section 17(1) of the Act. For the sake of ready reference, section 17(1) of the Act is reproduced as follows :

"17. Salary", "perquisite" and "profits in lieu of salary" defined.

For the purposes of sections 15 and 16 and of this section,—

(1) "salary" includes—

(i) wages;

(ii) any annuity or pension;

(iii) any gratuity;

(iv) any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages;

(v) any advance of salary;

(va) any payment received by an employee in respect of any period of leave not availed of by him;

(vi) the annual accretion to the balance at the credit of an employee participating in a recognised provident fund, to the extent to which it is chargeable to tax under rule 6 of Part A of the Fourth Schedule;

(vii) the aggregate of all sums that are comprised in the transferred balance as referred to in sub-rule (2) of rule 11 of Part A of the Fourth Schedule of an employee participating in a recognised provident fund, to the extent to which it is chargeable to tax under sub-rule (4) thereof; and

(viii) the contribution made by the Central Government or any other employer in the previous year, to the account of an employee under a pension scheme referred to in section 80CCD;"

From the aforesaid definition of salary, it may be seen that it includes wages. Besides, it also includes any fees, commissions, etc, in addition to any salary or wages.

In the light of the aforesaid discussion, we may now examine the nature of annual bonus and special incentive, in relation to salary. The same are discussed as follows :

(a) Nature of payment of bonus

As the annual bonus payable in the present case is not covered under Payment of Bonus Act, 1965, we will have to examine the nature of such annual bonus on the basis of the Dictionary and other relevant sources. The same are discussed as follows :

(i) As per Advanced Law Lexicon by Shri P.R.aiyar, 3rd Edition, Book 1, bonus is not a regular part of wages, deferred or otherwise and in essence is an *ex-gratia* payment. But by statute or by agreement it can assume permanency and become part of wages – *A.Muniswami Vs.Vishwanath Nair, AIR 1957 Mad 773 and 777.*

(ii) As per *Investopedia*, a bonus is an additional compensation given to an employee above his / her normal wage. A bonus can be used as a reward for achieving specific goals set by the company, or for dedication to the company.

From the aforesaid definition of bonus, it may be seen that it is an additional compensation given to an employee, over and above his / her normal wage. Thus, it is a part of wages and accordingly, also a part of salary.

(iii) As per *Houston Chronicle*, bonuses are payments you make to employees that are not regular payments. Instead, these payments are based on department sales goals which are met, the percentage increase in assets brought to the company or revenue targets that are met. Bonuses are given to company management or other employees who are not directly responsible for selling the company's products or services. For example, some financial institutions use bonuses to encourage regional managers to bring in more assets managed by the firm.

From the aforesaid discussion it is quite clear that annual bonus is a part of wages and accordingly part of salary and therefore, payment of bonus will get the same tax-treatment as salary.

(b) Nature of payment of special incentive

In this context, it may be stated that there are several ways one can pay an employee and for that one does not have to choose just one method. One can combine payment options which may give the employee an *incentive* to work harder, produce more sales and generate more revenue.

In the light of the aforesaid discussion, the special incentive payable to an employee very much relates to his employment.

Therefore, the nature of special incentive will also be the same as that of salary.

In any case, as per *Explanation (a)* to section 9(1)(ii) of the Act, income of the nature of salary shall be regarded as income earned in India, if the services by the employee concerned are rendered in India.

As a corollary, Mr.X will be rendering his services outside India and the aforesaid services will only give rise to payment of salary, annual bonus and special incentive to him.

In the light of the aforesaid reasons, even the annual bonus and special incentive will get the same tax-treatment as salary in the hands of Mr.X and accordingly, they will also not be liable to tax in India.

In view of the aforesaid reasons, salary, bonus and incentive, receivable by Mr.X in Singapore, will not form part of his total income, as per the provisions of section 5, r.w.s. 9 of the Act.

Therefore, as a corollary, the aforesaid income by way of salary, bonus and incentive, receivable by Mr.X, will not be liable to tax in India.

B. Even as per the DTAA with Singapore, salary, wages and other similar remuneration are not taxable in India, in case services are rendered by an employee in Singapore

In the present context, it may also be appropriate to examine the relevant provisions of the Double Taxation Avoidance Agreement (DTAA) entered into between India and Singapore.

In this context, it may also be stated that the provisions of the DTAA override the provisions of the Income-Tax Act, 1961.

The present case is covered under Article 15, relating to **dependent personal services** of the aforesaid DTAA. For the sake of ready reference, the aforesaid Article 15 is reproduced as follows :

"ARTICLE 15 - Dependent personal services

1. Subject to the provisions of Articles 16, 18, 19, 20 and 21, 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 th aggregate 183 days in the relevant fiscal year; 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 or a fixed base which the employer has in the other State.

3. In the case of a recipient who satisfies all the conditions under sub-paragraphs (a), (b) and (c) of paragraph 2, if his remuneration is deductible as an expense against fees for

technical services (dealt with under Article 12) derived by his employer and the employer has no permanent establishment in the other Contracting State, the remuneration may, notwithstanding the provisions of paragraph 2, be taxed in that State. In such case, the tax so charged shall not exceed 15 per cent of the gross amount of the remuneration.

4. Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic by an enterprise of a Contracting State shall be taxable only in that State."

Before we examine the provisions of Article 15, the scope of Articles 16, 18, 19, 20 and 21 may be examined. It will be appropriate to refer to the headings of the aforesaid Articles, which are listed as follows :

(i) Article 16 relates to Directors' fees.

(ii) Article 18 relates to remuneration and pension in respect of Government services

(iii) Article 19 relates to non-Government pensions and annuities.

(iv) Article 20 relates to students and trainees, and

(v) Article 21 relates to teachers and researchers.

It is, therefore, clear that none of the aforesaid Articles 16, 18, 19, 20 and 21, will apply in the present case.

We may now examine the scope of Article 15 in the present case. The same is examined as follows :

1. Paragraph 1 of Article 15

As per paragraph 1 of Article 15, 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.

In the present context, it will, therefore, be necessary to examine the meaning of the term "*Exercise of employment*". In the first place, it may be stated in this regard that employment is exercised in the State in which services are performed. Besides, the location of income from employment is where the tax-payer performs his duties of employment, since it is the performance of such duty which produces employment income – *FCT Vs French 11 ATD 288*. This principle has been incorporated in section 9(1)(ii) of the Indian Income-Tax Act, 1961. If the salary is earned in India, it is deemed to arise in India. Further, as per *Explanation* to section 9(1)(ii), if the services are rendered in India, then the income from

salary shall be regarded as income earned in India. As a corollary, if the services are not rendered in India, then income from salary cannot be regarded as income earned in India and accordingly, the same will not be liable to tax in India.

Besides, the general rule is that income from employment is taxable in the State where employment is actually exercised. It is exercised in the place where the employee is physically present when performing the activities for which the employment income is paid.

In the present case, Mr.X will be rendering the services relating to his employment in Singapore. Therefore, even as per paragraph 1 of Article 15, payment to him by way of salaries, wages and other similar remuneration, will not be liable to tax in India.

2. Even as per paragraph 2, the aforesaid payment by way of salaries, wages and other similar remuneration to Mr.X will not be liable to tax in India.

In this regard, it may be stated that as per paragraph 2 of Article 15, the remuneration derived by a resident of a Contracting State (viz. Singapore), in respect of an employment exercised in the other Contracting State (viz. India), shall be taxable in the first-mentioned State, viz. Singapore, if the conditions laid down in clauses (a), (b) and (c) of paragraph 2 of Article 15 are cumulatively fulfilled.

However, as already stated, Mr.X, a resident of Singapore, will not be exercising his employment in India. Therefore, the provisions of paragraph 2 of Article 15 of the aforesaid DTAA will not apply in the present case.

It may be clarified here that the provisions of the aforesaid paragraph 2 will apply only if Mr.X exercises his employment in Indi, which is not so in the present case.

3. The meaning of the expression "Salaries, wages and other similar remuneration" used in Article 15.

We may now examine the meaning of the terms salary, wages and other similar remuneration. The same are discussed as follows :

(i) Salary

Salary is recompense for services rendered. "*Salary*", according to *Shorter Oxford Dictionary* means "*to recompense, reward, pay something due*". Besides, according to the Indian Income-Tax Act, all payments made to the holder of an office or employment is treated as salary. If the payment is to be regarded as salary, it must be due from an employer and the person making it does it in his capacity as an employer. Thus, payment must be related to the employment.

(ii) Wages

Wages means recompense in connection with manual services - *Gestatner Duplicators (P) Ltd Vs CIT [1979] 1 Taxman 1 (SC) : 117 ITR 1 (SC).*

As per the Supreme Court, in the case of *Gestatner Duplicators (P) Ltd Vs CIT [1979] 1 Taxman 1 (SC) : 117 ITR 1 (SC),* conceptually there is no difference between salary, wages, both being recompense for work done or for services rendered, though ordinarily the former expression is used in connection with services of non-manual type, while the latter is used in connection with manual services. The expression "*wages*" does not employ that compensation is to be determined solely on the basis of time spent in service; it may be determined by the work done; it could be estimated in either way. In other words, whatever be the basis on which such recompense is determined, it would all be salary.

(iii) Other similar remunerations

Remuneration ordinarily means reward, recompense, pay, wages or salary for services rendered – *Accountant General Vs N.Bakshi AIR 1962 SC 505*. It is a term of wider import than *"wages*" and includes "*recompense", "reward*" or "*payment" – CIT Vs Calcutta Stock Exchange Association Ltd [1959] 36 ITR 222 (SC).*

The word "*other*" when following the term "*remuneration*" must receive an *ejusdem generis* interpretation and in this context may mean the recompense for services rendered partaking the character of salary or wages.

In the light of the aforesaid reasons, the amounts receivable by Mr.X, by way of salary, annual bonus and special incentive will be covered under the aforesaid Article 15.

Therefore, the aforesaid amount receivable by Mr.X, by way of salary, annual bonus and special incentive, will be liable to tax in India.

In view of the aforesaid discussion in paragraphs A and B, it is clearly established that the salary, bonus and incentive, receivable by Mr.X in Singapore, will not be liable to tax either under the provisions of the Income-Tax Act, 1961 or under the provisions of the DTAA between India and Singapore.

II. Whether any tax is required to be deducted at source, in respect of income / payment which is not liable to tax in India.

In the present context, it may be stated that tax is required to be deducted at source, in respect of any payment to a non-resident under section 195 of the Act. In this regard, the relevant part of section 195(1) of the Act, is reproduced as follows :

"195. Other sums.

(1) Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest (not being interest referred to in section 194LB or section 194LC) or section 194LD or any other sum chargeable under the provisions of this Act (not being income chargeable under the head "Salaries") shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force :"

From the aforesaid provisions of section 195(1), it may be seen that it does not apply to income chargeable under the head "*Salaries*". In this context, it may be stated that there appears to be a lacuna, because a number of situations may arise where income chargeable under the head "*Salaries*" may not be liable to tax in India. It may, further, be stated that the aforesaid exclusion of income under the head "*Salaries*" from section 195(1) has been made perhaps under the assumption that all the persons employed in India and drawing income under the head "*Salaries*" are resident in India. Such an assumption does not appear to be correct, because after the enactment of section 195 in the Income-Tax Act, 1961, there has been a sea change in the business operations and other multilateral transactions.

Besides, from the aforesaid provisions of section 195(1), it may appear that an employer making any payment to his employee under the head "*Salaries*" will be liable to deduct tax at source from the payment of salary to the employee under section 192 of the Act. Such a conclusion, however, does not appear to be rational, keeping in view the other provisions of the Act, as also the impact of Double Taxation Avoidance Agreement, in respect to such payment.

In this connection, it will be necessary to refer to the charging section 4 of the Act, which authorizes tax liability on an assessee under the Act and also TDS and advance-tax, in relation to

such tax liability under the Act. For the sake of ready reference, section 4 of the Act, is reproduced as follows :

"*4. Charge of income-tax.*

(1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income-tax) of, this Act in respect of the total income of the previous year of every person :

***Provided** that where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly.*

(2) In respect of income chargeable under sub-section (1), income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act."

From the aforesaid provisions of section 4, it may be seen that –

(i) As per section 4(1), income-tax shall be charged for any assessment year at the rates in force in respect of total income of the previous year of every person.
The expression "*total income*" as defined under section 2(45), means the total amount of income referred to in section 5, computed in the manner laid down in the Act.

Besides, as per the scope of total income under section 5, r.w.s.9 of the Act, vide aforesaid paragraph I(A), the salary, bonus and incentive received or receivable by an employee who is non-resident in India and who is rendering his services outside India, **will not form part of his total income under the provisions of the I.T.Act, 1961.**

Further, the total income chargeable under section 4(1) of the Act, will be Nil and accordingly, the tax payable thereon, will also be Nil.

(ii) As per section 4(2), in respect of income chargeable under section 4(1), income-tax shall be deducted at source or paid in advance, where it is so deductible or payable under any provisions of the Act.

As already stated that the income chargeable under section 4(1) of the Act, in the case of non-resident employee is Nil. Therefore, there will be no tax deductible at source in respect thereof, under section 4(2) of the Act.

From the provisions of section 4(2) of the Act, it is clearly established that no tax is required to be deducted at source, in respect of income which is not chargeable to tax under section 4(1) of the Act.

Otherwise also, it is obvious that TDS is one of the modes of recovery of income-tax and if the impugned income / payment is not chargeable to tax in India, then the question of TDS in respect thereof, cannot and does not arise.

Even as per a number of Circulars of the CBDT, no tax is required to be deducted at source, in respect of income which is exempt from income-tax. The relevant parts of the aforesaid Circulars are discussed as follows :

(i) *Circular No.022 / 68-IT(B) [F.No.12 / 23 / 68-IT(B)], dt.28.3.1968 – I.T.Act, 1961 – Section 194A read with section 197(1) / (2) – Income by way of interest other than "interest on securities" – Deduction of tax at source – Instruction regarding.*

As per paragraph (5) of the aforesaid Circular, no tax will be deducted under section 194A from any income from interest, which is wholly exempt from income-tax.

(ii) *Board's F.No.12 / 113 / 68-IT (ALL), dt.28.10.1968 – Deduction of tax from interest other than "Interest on securities" when the provisions of section 194A not applicable.*

It has been laid down in this Circular that no deduction of tax at source from interest is required to be made by the payers under section 194A, in case of an educational institution whose income is exempt from tax under section 10(22) of the Act.

(iii) *Circular No.735, dt.30.1.1996 – Clarification regarding payment of income by way of interest on securities and rent made to Regimental Funds or Non-public Fund established by Armed Forces of Union for welfare of past and present members of such forces or their dependants, whose income is exempt under section 10(23AA).*

Vide paragraph (2) of the aforesaid Circular, it has been laid down that since the income of these organizations is exempt under section 10(23AA) of the Income-Tax Act, 1961, it has

been decided that no tax may be deducted at source under sections 193 and 194-I from the income of such Funds.

(iv) *Circular No.741, dt.18.4.1996 – Whether in case of a provident fund, whose income is exempt under section 10(25)(ii), established under scheme under Employees' Provident Funds and Miscellaneous Provisions Act, 1952, income by way of interest on securities of Central and State Governments may be paid to such provident funds without deduction of income-tax at source.*

As per paragraph (2) of the aforesaid Circular, in case of provident fund whose income is exempt under section 10(25)(ii), no tax is to be deducted at source, in respect of interest on securities.

(v) *Circular No.745, dt.19.7.1996 – Payment of income by way of interest on securities to Ramakrishna Math and Ramakrishna Mission whose income is exempt under section 10(23C)(iv).*

As per paragraph (2) of the aforesaid Circular, it has been clearly laid down that as the income of the Ramakrishna Math and Ramakrishna Mission is exempt under section 10(23C)(iv) of the Act, the income by way of interest on securities of Central and State Governments may be paid to it, without deduction of tax at source.

(vi) *Circular No.3 of 2002, dt.28.6.2002 – Requirement of deduction of income-tax at source under sections 193, 194A and 194K of the Income-Tax Act – Payment to Ramakrishna Math and Ramakrishna Mission, whose income is exempt under section 10(23C)(iv) of the Income-Tax Act, 1961.*

Vide this Circular, it was decided that no tax should be deducted at source from the income of the Ramakrishna Math and Ramakrishna Mission, as the same was exempt under sections 10(23C) and 10(23D) of the Act.

(vii) *Circular No.4 of 2002, dt.16.7.2002 – Requirement of tax deduction at source in case of entities whose income is exempt under section 10 of the Income-Tax Act.*

The heading of the aforesaid Circular itself, is very relevant.

As per the aforesaid Circular, it has been decided that there will be no requirement of TDS in case of entities whose income is exempt under section 10 of the Act.

From the aforesaid Circulars of the CBDT also, it is clearly established that no tax is required to be deducted at source under the Act, in respect of any income which is exempt from tax.

In the light of the aforesaid reasons, even if payment of salary, etc, is being made to Mr.X by his employer located in India, such an employer will not be required to deduct tax at source there from.

III. Whether there would be any obligation on the Indian Company to deduct any tax at source from the payment, by way of salary, bonus and incentive to Mr.X.

We may now consider the issue whether any tax is required to be deducted at source by the Company, in case the payment of the aforesaid salary, bonus and incentive, is directly made to him from India and thereafter, received by him in Singapore.

In this context, it may be stated that vide the aforesaid paragraph I, it has been clearly established that the salary, bonus and incentive received or receivable by Mr.X, who is resident in Singapore and rendering his services from Singapore, will not be liable to tax in India, either under the provisions of the Income-Tax Act, 1961 or under the provisions of the DTAA between India and Singapore. Further, vide the aforesaid paragraph II, it has been clearly established that no tax is required to be deducted at source, in respect of any income or payment, which is exempt from tax in India.

The next issue for consideration will be whether, notwithstanding the aforesaid factual position, the employer of Mr.X located in India, will be liable to deduct tax at source under section 192 of the Act, in respect of the aforesaid salary, bonus and incentive, receivable by him in Singapore. Besides, as per the charging section 4 of the Act, no tax is required to be deducted at source under the relevant provisions of Chapter XVII, in respect of income / payment, which is not chargeable to tax in India. It implies that no tax is required to be deducted at source, in respect of the aforesaid salary, bonus and incentive, receivable by Mr.X, either under the provisions of section 192 or section 195 of the Act.

Further, as regards the provisions of section 195, no tax is required to be deducted at source there under, in respect of any income or sum which is not chargeable to tax in India.

As regards deduction of tax under section 192 of the Act, as already pointed out, no tax is required to be deducted at source under Chapter XVII, in respect of any income or payment which is not chargeable to tax in India. Obviously, section 192 also falls under Chapter XVII of the Act. Therefore, no tax will be required to be deducted at source from the salary, bonus and incentive, receivable by Mr.X in Singapore, even if payment of the same is made by the Indian Company, directly from India.

The aforesaid stand is also supported by a Circular of the CBDT and two legal precedents, which are discussed as follows :

1. **Circular No.586, dt.28.11.1990 – Clarification regarding liability to income-tax in India and deduction of tax at source of members of the crew for foreign going Indian ship.**

In the present context, Circular No.586, dt.28.11.1990, providing a clarification regarding liability to income-tax in India and deduction of tax at source of members of the crew for foreign going Indian ship, is very relevant. Paragraphs (3) and (4) of the aforesaid Circular are relevant in the present context and the same are reproduced as follows :

*"**3.** Thus, generally, Indian members of the crew of a foreign-going Indian ship would be non-resident in India if they are on board such ship outside the territorial waters of India for 182 days or more during any year. Accordingly, such seamen will be charged to tax in India only in respect of earnings received in India or the earnings for the period when they are working within the Indian waters on coastal ships, etc.*

4. Under section 192 of the Income-tax Act**, persons responsible for paying salary and other incomes chargeable under Income-tax Act under the head "Salaries" are required to deduct income-tax from such income at the time of payment. For this purpose, the amount of tax to be deducted is computed at the average rate of income-tax arrived at by applying the rates in force for the financial year in which the payment is made on the estimated income of the person to whom salary is paid. **Since, as explained above, in the case of members of crew of foreign-going Indian ships, who are not likely to be in India for a period or periods exceeding 182 days in a year, income which accrues or arises outside India and is also received outside India is not liable to tax in India, the shipping companies and other persons responsible for paying salary to such members of crew may take these factors into account while computing the amount to be deducted as tax and deduct only so much of tax as would be chargeable on the estimated income liable to tax

in India. *If the shipping person who was earlier considered as not likely to be resident in India and deduction of tax at source was made on that basis is now likely to be resident in India, the shipping company or the other person responsible for making the payment, may increase the deduction so as to adjust any deficiency arising out of an earlier short deduction or non-deduction during the same financial year."* [Emphasis added].

From the aforesaid Circular, it is clearly established that even under section 192 of the Act, tax deductible at source will be only in respect of the income chargeable to tax in India.

Therefore, if an individual is non-resident in India, rendering his services outside India, then no tax will be required to be deducted at source under section 192 of the Act, even if the employer of such an individual is located in India.

In view of the aforesaid reasons, the Company will not be required to deduct tax at source from the salary, bonus and incentive, receivable by Mr.X in Singapore, even if payment of the same is made by the Company directly to Mr.X in Singapore.

2. CIT Vs Coromandel Fertilizers Ltd [1991] 187 ITR 673 (AP)

In this case, the assessee company secured the services of one Mr. Larner with the approval of the Central Government as a foreign technician subject to the provisions contained in section 10(6)(viia) of the Act. The Central Government conveyed its approval to the contract of Mr. Larner's service in India, as required by section 10(6)(viia)(2) of the Act. Consequently, salary to the extent of Rs. 4,000 paid to Mr. Larner was wholly exempt from income- tax. Income-tax is, however, payable on the amount in excess of Rs. 4,000 paid to Mr. Larner but that liability to pay tax was that of the company in accordance with the contract of service approved by the Central Government.

It was the contention of the Revenue that in respect of the sum in excess of Rs.4000, which is not exempt, the assessee ought to have deducted tax at source under section 192 of the Act and the failure to so deduct tax at source and pay the same to the Central Government, attracted liability to pay interest under section 201(1A) of the Act.

The aforesaid claim of the ITO for levy of interest stood negatived by the orders of the Appellate Assistant Commissioner, as well as the Income-Tax Appellate Tribunal.

Thereafter, the IT Department referred the following question of law to the Andhra Pradesh High Court :

"Whether, on the facts and in the circumstances of the case, the Tribunal is justified in holding that the assessee is not liable to charging of interest under section 201(lA) of the IT Act, 1961, in respect of the assessment years 1972-73, 1973-74 and 1974-75 ?"

It was held by the High Court that it failed to see how the provisions of s. 192 of the Act come into operation at all in this case, when admittedly the sum paid to Mr. Larner was not chargeable as income from salary in his hands. It was not the Revenue's case that any part of the sum paid to Mr. Larner was liable to be assessed in his hands as income under the head "Salary" and, therefore, the obligation to deduct tax arose. There was no dispute about the fact that pursuant to the contract of service, Mr. Larner himself was not liable to pay tax on any part of the sum paid to him by the assessee-company. In that situation, the question of deducting any tax at source from out of the amount paid to Mr. Larner by the assessee did not arise. Unless there was an obligation on the part of the recipient, Mr. Larner, to pay tax under the head "*Salary*", the obligation to deduct tax under section 192 could not arise.

It was, thus, held that pursuant to the contract of service, the foreign technician was not liable to pay tax under the head "*Salaries*" on any part of the sum paid to him by the assessee. Therefore, there was no obligation on the assessee to deduct tax under section 192 of the Act.

In other words, even if a payment falls under the head "Salaries", but such a payment is not liable to tax in the hands of the payee, then the employer is not liable to deduct tax at source under section 192 of the Act.

The aforesaid judgement of the Andhra Pradesh High Court fully supports the aforesaid stand.

3. **CIT Vs Avtar Singh Wadhwan [2001] 247 ITR 260 (Bom)**

In this case, the assessee was working as a marine engineer in an Indian ship, owned by the Shipping Corporation of India. During the relevant FY, the ship did not touch India, except in about 8 days.

The Assessing Officer (AO) came to the conclusion that since the assessee was an employee of the Shipping Corporation of India, the income accrued to him in India. The Tribunal, however,

held that since the income was earned in foreign waters, it had accrued to the assessee outside India.

The aforesaid judgement of the Tribunal was challenged by the IT Department before the Bombay High Court. The following question was referred under section 256(1) of the Act before the High Court :

"Whether, on facts and in the circumstances of the case, the Tribunal was right in holding that the salary received by the assessee from Shipping Corporation of India—employer during the period of account relevant to the assessment year 1974-75 was not taxable in India."

In the aforesaid judgement, the Bombay High Court took into consideration the provisions of sections 5(1), 5(2) and 9(1)(ii) of the Act and thereafter, upheld the order of the Tribunal and answered the question in the affirmative, i.e. against the Department and in favour of the assessee.

In other words, it was laid down by the Bombay High Court in this case that notwithstanding the fact that the employer of the assessee, viz. Shipping Corporation of India was located in India, since the income was earned in foreign waters, it had accrued to the assessee outside India. Further, as the ship had touched India only for a period of around 8 days, the assessee was non-resident in India for the relevant AY. Therefore, the salary received by the assessee from Shipping Corporation of India was not taxable in India.

In the light of the aforesaid Circular of the CBDT and the legal precedents, it is clearly established that no tax would be required to be deducted at source under section 192 of the Act, by the Company, in respect of the salary, bonus and incentive, receivable by Mr.X, even if the aforesaid payment is made by the Company directly to Mr.X in Singapore.

IV. Whether the Company will be required to deduct tax at source, in respect of reimbursement of the aforesaid payment to its subsidiary company located in Singapore.

We may now consider the issue whether the Company is required to deduct tax at source in respect of reimbursement of the aforesaid payment to its subsidiary company, located in Singapore or any other group entity located outside India. In other words, the issue will be

whether tax is required to be deducted at source, in respect of reimbursement of expenses made to a non-resident entity.

In this connection, it will be relevant to state that tax is required to be deducted at source only in respect of income chargeable to tax in India. The relevant provisions of the Act, will clearly prove that tax is deductible at source only in respect of income. This view clearly emerges from the reading of the TDS provisions under the Act and also on the basis of relevant legal precedents. The same are discussed as follows :

1. **Section 4 – Charge of income-tax**

   Section 4 of the Act is the charging section and the power to deduct tax at source is derived from the provisions of section 4(2) of the Act.

   For the sake of ready reference, section 4 of the Act is reproduced as follows :

   "Charge of income-tax.

   4. *(1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions including provisions for the levy of additional income-tax of, this Act in respect of the total income of the previous year of every person :*

   Provided *that where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly.*

   (2) In respect of income chargeable under sub-section (1), income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act."

   From the aforesaid provisions of section 4(2), it is quite clear that income-tax is deductible at source in respect of income chargeable to tax under section 4(1) of the Act. In other words, it is quite clear that tax is deductible at source in respect of income, which is chargeable to tax under the Act.

2. **Section 195 – TDS in respect of payments to non-residents**

   In this context, section 195(1) is relevant. From the provisions of section 195(1), it is clear that any person responsible for paying to a non-resident any interest or any other sum chargeable to tax under the provisions of the Act, shall, at the time of credit of such **income** to the account of the payee, deduct income tax thereon at the rates in force.

Thus, it is quite clear that tax is required to be deducted at source from the element of income embedded in the total payment being made by the person responsible in respect thereof, to the non-resident entity.

3. **GE India Technology Centre P.Ltd Vs CIT [2010] 327 ITR 456 (SC): 44 DTR 201 (SC)**

It was held in this case that a person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not chargeable to tax under the IT Act. Section 195 also covers composite payments which have an element of income embedded or incorporated in them. Thus, where an amount is payable to a non-resident, the payer is under an obligation to deduct tax in respect of such composite payments. However, obligation to deduct tax is limited to the appropriate proportion of income which is chargeable under the Act.

From the aforesaid provisions of the Act and the legal precedents, it is clearly established that tax is deductible at source only in respect of income or any other sum, which comprises an element of income.

The next issue for consideration will be whether an element of income is embedded in the reimbursement of expenditure incurred by the payee, on behalf of the payer. Obviously, no element of income is embedded in the reimbursement of the aforesaid expenditure. Therefore, no tax will be required to be deducted, in respect of reimbursement of expenses incurred by the payee on behalf of the payer.

In support of the aforesaid stand, reliance is placed on the following legal precedents :

1. ***Mahindra and Mahindra Ltd Vs Dy.CIT [2009] 313 ITR (AT) 263 (Mum)(SB) : 22 DTR (Trib) 361 (Mum)(SB).***

It was, *inter alia*, held in this case that reimbursement of expenses cannot be considered to be in the nature of income and therefore, it is not income by way of fees for technical services.

It was further held that when a particular amount of expenditure is incurred and that sum is reimbursed as such, that cannot be considered as having any part of it in the nature of income. Any payment, in order to be brought within the scope of income by way of fees for technical services under section 9(1)(vii) should, be or have at least some element of

income in it. Such payment should involve some compensation for the rendering of any services which can be described as income in the hands of the recipient. In other words, the component of income must be present in the total amount of fees paid for technical services to constitute an item falling under section 9(1)(vii). Where the expenditure incurred is reimbursed as such without having any element of income in the hands of the recipient, it cannot assume the character of income deemed to accrue or arise in India and accordingly, there was no obligation to deduct tax at source therefrom under section 195 of the Act.

2. ***WNS Global Services (UK) Ltd Vs ADIT (IT) [2013] 88 DTR (Trib) 177 (Mum)***

It was, *inter alia,* held in this case that it was a case of reimbursement of leaseline charges by WNS India to the assessee, which did not include any mark up or profit and such reimbursement of actual expenditure, cannot be treated as income of the assessee chargeable to tax.

3. ***JDIT (IT) KRUPP UHDE GmbH [2010] 1 ITR (Trib) 614 (Mum) : [2009] 26 DTR 289 (Mum)***

It was, *inter alia*, held in this case that reimbursement of expenses did not involve an element of income and therefore, it could not be taxed under Article 12 of the DTAA between India and Germany.

4. ***Expeditors International (I) P.Ltd. Vs Addl.CIT [2010] 2 ITR (Trib) 153 (Del) : [2008] 13 DTR 435 (Del)***

It was, *inter alia*, held in this case that it was a case of reimbursement of common expenses incurred by the parent company for the benefit of all group concerns, including the assesse-company, which did not attract any deduction of tax at source and accordingly, disallowance could not be made by invoking the provisions of section 40(a)(iii), for non-deduction of tax from reimbursement.

5. ***Nathpa Jhakri Joint Venture Vs ACIT [2010] 5 ITR (Trib) 75 (Mum) : 41 DTR (Trib) 233***

It was held in this case that reimbursement of expenses was not income in the hands of the non-resident and therefore, not liable to TDS under section 195 of the Act.

It was further held that it is axiomatic that tax is charged on income and not on receipts. The reimbursement of expenses by the Indian assessee to the non-resident was not taxable in the hands of the non-resident. Only if the sum paid or credited is chargeable to tax in the hands of the payee, the assessee is liable to deduct tax at source. If the assessee payer did not move application under sub-section (2) of section 195 of the Act, it could not be held that the liability to deduct tax at source had automatically arisen. As the reimbursement of expenses was not taxable in the hands of the payee, the assessee was not liable to deduct tax at source.

6. ***Linklaters LLP Vs ITO (Int.Tax) [2011] 9 ITR (Trib) 217 (Mum): [2010] 42 DTR 233 (Mum)***

It was, *inter alia*, held in this case that no part of reimbursement of expenses could be treated as income.

From the aforesaid discussion, it is clearly established that –

(i) Tax is deductible at source only in respect of payment of income or other sum comprising an element of income, and

(ii) No element of income is embedded in the reimbursement of expenses to the payee, which was incurred on behalf of the payer.

Therefore, no tax is required to be deducted at source, in respect of reimbursement of expenses.

In the light of the aforesaid reasons, the Company will not be required to deduct any tax at source, in respect of reimbursement to a foreign entity, in regard to payment, by way of salary, bonus and incentive to Mr.X, by such an entity.

V. Conclusion

From the factual and legal position brought out in the preceding paragraphs (I) to (IV), it is clearly established that –

1. **The salary, bonus and incentive, receivable by Mr.X in Singapore, will not be liable to tax in India.**

2. **No tax is required to be deducted at source, in respect of income / payment which is not liable to tax in India.**
3. **There will be no obligation on the Indian Company to deduct tax at source from the payment, by way of salary, bonus and incentive to Mr.X.**

4. **The Company will not be required to deduct tax at source, in respect of reimbursement of the aforesaid payment to its subsidiary company, located in Singapore.**

In the light of the aforesaid conclusions, the queries raised by the client, were answered as follows :

(i) The salary, bonus and incentive, receivable by Mr.X, will not be liable to tax in India, even if the payment of the same is made by the Indian Company, directly to Mr.X, without routing the same through its subsidiary company in Singapore, or elsewhere.

(ii) The Company will not be required to deduct tax at source, in respect of reimbursement of the aforesaid expenses to its subsidiary company located in Singapore.

(iii) Mr.X will not be liable to pay tax in India, in the light of the facts already brought on record.

(iv) The reimbursement of the cost of salary, etc, by Indian Company to its overseas subsidiary will not lead to a conclusion that the aforesaid payment is made in India, notwithstanding the fact that Mr.X has an employment contract with the Company located in India.

(v) The source of payment of the salary, bonus and incentive receivable by Mr.X, will not be relevant in the present context.

Further the aforesaid payment will not be liable to tax in India and therefore, no tax will be required to be deducted at source, in respect thereof, by any entity, including the Company located in India.

S. K. TYAGI	**Office**	: (020) 26133012	Flat No.2, (First Floor)
M.Sc., LL.B., **Advocate**		: (020) 40024949	Gurudatta Avenue
Ex-Indian Revenue Service	**Residence**	: (020) 40044332	Popular Heights Road
Income-Tax Advisor	**E-mails**	: sktyagidt@airtelmail.in	Koregaon Park
Website: www.sktyagidt.com		: tyagi@sktyagidt.com	PUNE - 411 001