L&S UPDATE
An e-update to clients from Lakshmikumaran & Sridharan

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TAX

Implications of the General Motors Overseas Corporation case

The recent decision of the Mumbai Income Tax Appellate Tribunal (**"ITAT"**) in the *General Motors Overseas Corporation* case has laid new ground in the law relating to secondments. In this update, we shall discuss the facts of the case, arguments raised before the ITAT and the implications of the decision.

FACTS

General Motors Overseas Corporation (**"GMOC/the Appellant"**), a USA-based corporation, is engaged in the business of providing management and consulting services to its group entities worldwide. It entered into a Management Provision Agreement (**"MPA"**), dated December 26, 1995, with General Motors India Limited (**"GMIL"**), which is engaged in the business of manufacture, assembly, marketing and sale of motor vehicles and other products in India. GMIL also entered into a separate 'technical information and assistance agreement' with Adam Opel AG.

1. Under the MPA, GMOC assigned two personnel to GMIL whose costs were cross-charged to GMIL without any mark-up:
   (i) President and Managing Director (**"MD"**): Responsible for overall management and direction of operations.
   (ii) Vice President, Manufacturing (**"VP"**): Responsible for overall management of GMIL facilities to manufacture, produce and assemble products as per the standards.

2. GMOC filed an application before the Advance Ruling Authority (**"AAR"**) to assess its tax liability with respect to the cross charges from GMIL. The AAR held that with the available information, cross charges do not constitute fee for technical services (**"FTS"**). However, the concerned authorities may verify it considering detailed facts. The AAR further held that GMOC constitutes a Permanent Establishment (**"PE"**) in India.

3. GMOC filed its tax returns in India disclosing the cross charges as business income. During the assessment proceedings, the Assessing Officer (**"AO"**) asked GMOC to provide a service agreement related to the cross charge. However, GMOC did not submit the agreement. In the absence of information, the AO subjected the entire cross charge amount to tax on a gross basis. Further, the AO held that the income of the PE is to be computed as per Article 7(3) of the India – USA Tax Treaty, read with Section 44D of the Income Tax Act, 1961 (**"the Act"**) i.e. the computation of income from FTS is subject to domestic tax laws (Section 44D). Further that, Section 44D of the Act bars allowability of any expenses to a foreign company while computing the income from FTS.

4. In an appeal before the Commissioner of Income Tax (Appeals) (**"CIT(A)"**), GMOC did not get the desired relief. CIT(A) held that the services of MD do not qualify as FTS as the "make available" condition isn't being satisfied and hence, the cross charges towards his salary / expenses remain taxable as business income. With respect to VP, the CIT(A) held that he is an

experienced technical personnel and his services qualify the "make available" criterion and hence, cross charge for his services will be FTS / Fees for Included Services (**"FIS"**).

With the above backdrop, an appeal was filed before the ITAT.

Summary of Arguments: GMOC

1. The AAR has already given a binding ruling that the services of two deputies does not qualify as FTS. Therefore, the income tax authorities and ITAT are precluded from taking contrary view.

2. Revenue authorities have been examining the activities of GMOC for many years and there is no change in facts. Therefore, principal of consistency should be followed.

3. No technology has been made available to GMIL. Also, "managerial" services are not covered under the scope of FIS in Article 12 of the India-US DTAA, as it covers only technical and consultancy services.

4. With respect to its contentions that the income of the PE is to be taxed on net basis, it relied on Delhi ITAT in the case of *Rolls Royce*[1]. Further, relying on the Mumbai ITAT in the case of *Morgan Stanley*[2] it contended that the cost-to-cost cross charges leave no margins or profits to be taxed in India.

Summary of Arguments: Revenue

1. GMOC didn't submit service agreements before the AAR. The AAR in its ruling has kept it open for the concerned tax authorities to examine the factual position and take appropriate action in proceedings before them.

1. [2010] 42 SOT 264 (Delhi ITAT)
2. [2018] 68 ITR(T) 275 (Mumbai ITAT)

2. The decision of AAR is not binding on the ITAT. ITAT, being the final fact-finding authority, is required to adjudicate the dispute before it. AAR's decision relied on by GMOC is distinguishable on facts and law and not applicable to the facts of the present case.

3. As per Article 7(3) of the India-US DTAA, the domestic tax law must be adhered for providing deduction for expenses in computing the income. If the domestic tax laws do not allow for the deduction for expenses, then the same will not be allowed to calculate the net profit.

Decision of the ITAT:

BINDING NATURE OF THE RULING OF AAR:

- The AAR has left it open for the authorities to examine the services rendered and decide whether it was FIS or not. Also, the AAR hasn't ruled on the manner of computing profits or allowability / deduction of expenses incurred to earn such profits. Therefore, the ruling of the AAR is not an absolute and unqualified ruling. It is neither binding on revenue nor on the ITAT.

ON FIS / FTS:

- The VP, Manufacturing was with GMOC before being sent to GMIPL. The experience of an expert lies in the mind of an expert and if an expert having knowledge and expertise is transferred from one tax jurisdiction to another tax jurisdiction, then it cannot be said that only the employees were *per se* transferred and not the technology. In other words, technology is made available by one entity situated in one tax jurisdiction to another entity situated in another tax jurisdiction, through the transfer on deputation of its experienced / expert technical employees. Therefore, the assignment of VP, Manufacturing to GMIL is considered as making available the technology.

ON CONSISTENCY:

- The above issue was never dealt in any of the previous years. When there is no decision by the revenue for the earlier years, the issue of consistency does not arise.

APPLICABILITY OF ARTICLE 7(3) READ WITH SECTION 44D:

- From the reading of Article 7(3) of the India US DTAA and Section 44D of the Act, it is abundantly clear that with respect to royalty and FIS / FTS income of a foreign company under an agreement entered before April 1, 2003, no deduction of expenses under Sections 28 to 44C of the Act is available. Once the deduction is prohibited under domestic tax laws, then the income is to be taxed on gross basis. Further, application of gross basis of taxation under Section 44D is not violative of Section 90 (which states that a

treaty is to override the domestic tax laws, to the extent it is beneficial), because the tax treaty itself provides for allowability of expenses in accordance with and subject to limitation of the domestic tax laws. Therefore, FIS is to be taxed on gross basis without allowing any deduction for expenses.

- The ITAT distinguished the *Rolls Royce* case on the facts.

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L&S COMMENTS

- Over the years, secondment arrangements have received detailed scrutiny by the Revenue Authorities and decisions on both sides are available from the Courts in India. Considering the facts of each case, the courts have taken different views on the nature of income being FTS / FIS, business income or mere reimbursement of expenses, existence of PE, etc.

- The decision of the Mumbai ITAT in case of *GMOC* adds a new dimension to the prevalent controversy by:
    a. Holding that the employee's skill-set is to be seen for determination of FTS / FIS as against the actual job responsibilities and work carried out, and
    b. Finding that the royalty / FTS income of the foreign company having PE in India is taxable on gross basis in terms of Section 44D if the agreement is entered into prior to April 1, 2003.

- Although this contention of taxing royalty / FTS income connected to PE on gross basis has also been upheld in certain other decisions also (*DIT* v. *Rio-Tinto Technical Services TY Ltd.*[3] *and DDIT (IT)* v. *Pipeline Engineering Gmbh*[4]), but this is new to secondment cases.

- The Mumbai ITAT's decision can have far-reaching ramifications in secondment matters and therefore it is important to see how this ruling is followed in other cases by the ITAT as well as lower tax authorities. It will also be interesting to see whether this ruling gets challenged before the Bombay High Court and how the higher court considers the issues.

3. (2012) 340 ITR 507 (Delhi HC).
4. (2009) 28 SOT 121 [Mumbai ITAT].

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