

The title is framed by two thick black L-shaped brackets. One is on the left side, starting from the top and extending down, then turning right. The other is on the right side, starting from the top and extending down, then turning left.

REIMBURSEMENTS – INTERNATIONAL TAXATION, INCOME TAX AND TRANSFER PRICING

CA NarendraKumar J Jain, Advocate
01.09.2021

Reimbursement - Meaning

Black's Law Dictionary

- i) Repayment; ii) Indemnification

P. Ramanathan Aiyar Law Lexicon

- In ordinary parlance reimbursement means re- payment of what has been spent. To reimburse is to repay what is expended. (Deepak Fertilizer and Petroleum Chemicals Corpn. Ltd. v. Union of India, (1996) 381 DRJ 209).
- The word 'reimbursement' means and implies restoration of an equivalent amount for something paid or expended. It presupposes previous payment. (Tata Iron and Steel co. Ltd v Union of India, (2001) 2 SCC 41, para 16)
- The act of paying back somebody for his or her out-of-pocket expenses.

Reimbursement - Prerequisites

- The actual liability to pay should be of the person who reimburses the money to the original payer.
- The liability ought to have been clearly determined. It should not be an approximate or varying amount.
- The liability ought to have crystallized. In other words, payments which were never required to be done, but were done just to avoid a potential problem may not qualify as reimbursement.
- The payment should be first be made by somebody else whose liability it never was and the repayment should then follow to that person to square off the account.
- There should be clearly three parties existing.

Reimbursement - Types

- Reimbursement of third party expenses not having connection with any service rendered by the reimbursee party;
- Reimbursement of out of pocket expenses (“OPE”) in addition to fees for services;
- Payment under cost-sharing/cost-contribution arrangements;
- Payment made towards services rendered at cost; and
- Reimbursement of salary cost in secondment arrangements.

Reimbursement - Issues

International taxation

- When reimbursements paid to NR, whether liable for TDS.
- Section 195 provides for TDS on 'sum chargeable to tax'. The issue for consideration is whether any income arises to NR in the context of reimbursement.
- Non-deduction of TDS may result in disallowance u/s 40(a)(i).

Transfer Pricing

- Reimbursement paid as well as received are subject matter of scrutiny under TP.
- Further, whether cost itself is correct can be scrutinised – Del HC in Cushman & Wakefield.
- In case of reimbursement paid, the issue is whether the same is at cost. If markup is charged by the AE, it needs to be tested as to whether markup is required and if so, whether it is at arm's length.

Reimbursement - Issues

Transfer Pricing

- In case of reimbursement received, the issue is whether markup should have been charged. If yes, what is arm's length mark up. Calculation of operating cost also is a relevant issue.
- In case of CCA, whether the arrangement is at ALP - Section 92(2)

Income tax

- TDS on reimbursement and the cost sharing and disallowance u/s 40(a)(ia).
- In case of presumptive taxation, whether reimbursement should be included to compute presumptive profit. For example, section 44AD, uses the terms "total turnover or gross receipts".

Reimbursement of Third Party Expenses

- Reimbursement of third party expenses not having any connection with a service rendered by the Payee;
- It is common for multinational groups to procure common service, at a global level from the international services providers (software, lease lines, etc). The billing happens at a global level, which is then recouped from the respective companies on a cost-to-cost basis.

International Taxation

- Whether TDS applicable on such payments.
- Whether it needs to be seen if the income is 'chargeable to tax' in India in hands of 'service provider' ("Look through concept")?
- Look through concept applied in:
 - *C.U. Inspections (I) (P) Ltd. v. DCIT [2013] 34 taxmann.com 75 (Mumbai ITAT)*
 - *Ershissanye Construction Group India P. Ltd v. DCIT (2017) (84 taxmann.com 108) (Kolkata-Trib)*
 - *DCIT v. UPS Jetair Express P. Ltd, (2015) (56 taxmann.com 387) (Mumbai – Trib).*

Reimbursement of Third Party Expenses

International Taxation

- Held as Reimbursement in: DIT v.WNS Global Services (UK) Ltd (2013) (32 taxmann.com 54) (Bombay HC)
- If Look through – which treaty to apply, rate of TDS and whose TRC to take.

Income Tax:

- DCIT v. Kodak India P Ltd (2015) (56 taxmann.com 113) (Mumbai – ITAT) – payment to handling agents for payment towards transportation, crane hire etc. Composite invoice. Both did not deduct TDS. TDS on total amount.
- CIT v. Gujarat Narmada Valley Fertilizers Co. Ltd. (361 ITR 192) (Gujarat HC) – As long as agent has discharged TDS, it is sufficient.

Transfer Pricing:

- To demonstrate if services are used for India and whether benefit received in India.
- Basis of allocation – whether reasonable.
- Impact of reimbursement received on **PLI Computation**– Bangalore ITAT in Lineage.

Reimbursement of OPE

- Reimbursement of out of pocket expenses (“OPE”) is generally paid in addition to fees for services.

International Taxation

- It needs to evaluate whether reimbursement of such amounts is taxable as ‘income’ in the hands of NR.
- Assessable as FTS - Cochin Refineries Ltd. v. CIT [1996] 222 ITR 354 (Kerala HC), Ashok Leyland 120 ITD 14 and Nippon India TS-171-ITAT-2019(CHNY).
- Siemens (310 ITR 320 Bom HC) – cannot be regarded as income.

Income Tax

- Under section 194J, 194C etc – whether TDS to deduct on OPE.

Reimbursement of OPE

Transfer Pricing

- If OPE paid – documentation to support the expense.
- In case of services rendered, OPE may be recovered in addition to service fee. The tax department has been taking a view that such OPE should be considered for PLI computation and markup should be charged on the same.
- Favourable Decisions:
- Cheil Communication I I taxmann.com 205 - Assessee incurred various media expenses. Reimbursement received. Excluded from cost and revenue. The TPO included in both. The Tribunal upheld the action of the assessee.
- LG soft 35 taxmann.com 202 - OPE is not part of operating cost
- PCIT vs. CPA Global Services Pvt. Ltd. 394 ITR 473 (Del) - Determination of operating costs - Reimbursement of costs received from AEs. The HC upheld the finding that reimbursement of cost of infrastructure was without a mark up and allowed the claim of assessee to exclude cost of infrastructure.
- Contrary View: If not pure reimbursement of cost, mark up required - Kirby Building TS-386-ITAT-2014(HYD)-TP, Television 18 TS-223-ITAT-2013(DEL) and Seagram Manufacturing Pvt. Ltd TS-157-ITAT-2016(DEL)-TP

Reimbursement towards CCA / Cost Sharing

- Payment under cost-sharing/cost-contribution arrangements.
- OECD - *A CCA is a framework agreed among the enterprises to share the costs and risks of developing, producing, obtaining assets, services, or rights, and to determine the nature and extent of the interests of each participant in the results of the activity of developing, producing, or obtaining those assets, services or rights.*

International Taxation

- Recoupment of IT Costs - SC in **A.P. Moller Maersk AS 392 ITR 186** - held that once the character of a payment is found to be in the nature of reimbursement of expenses, it cannot be characterized as 'income' chargeable to tax.
- Recoupment of R&D expenses from Indian Group Company - CIT v. Dunlop Rubber Co. Ltd. [1983] 142 ITR 493 (Cal HC) and ABB Ltd, in re [2010] 322 ITR 564 (AAR).
- Contra view: CGI Information Systems and Management Consultants P Ltd 48 Taxmann.com 264 (Kar HC)

Reimbursement towards CCA / Cost Sharing

Transfer Pricing

- Section 92(2) lays down the framework for ALP determination.
- Patni Computers 135 ITD 398 (Pune ITAT) - Consulting fee paid to McKinsey. The TPO was of the view that 30% of the fee should be shared by NR AE. The ITAT held that there is no agreement and no evidence that AE was benefited from the consulting.
- LG Electronics 35 taxmann.com 344 - Payment towards Cricket World Cup sponsorship. Shared between Korea and India in the ratio of 60:40. The TPO changed the allocation on the basis of global profits. Indian share reduced to 5.40%. The ITAT held that out of cricket playing nations, India sales is at 41.33%. Therefore, addition to be deleted.

Reimbursement – Services rendered at Cost

- At times, services are rendered by group companies and recovery is made on a cost-to-cost basis. No mark-up is charged.

International Taxation:

- Whether one can claim that foreign party has rendered services at cost and therefore provisions of section 195 are not attracted.
- Danfoss Industries (P) Ltd [2004] 268 ITR 1 (AAR)
- Timken India Ltd [2005] 273 ITR 67 (AAR)
- Cotecna Inspection India (P) Ltd v ACIT (2015) 56 taxmann.com 220 (Mumbai – Trib.) – rendering of services at cost does not effect the character of payment.
- Whether Instruction 2 of 2014 can be relied.

Reimbursement – Services rendered at Cost

Transfer Pricing:

- If services are received at cost, section 92(3) would protect the assessee.
- If services are rendered at cost, in Indian context, high probability of TP adjustment has no independent party would render services at cost unless there are other commercial considerations or benefits.
- In such cases, bundled approach may have to be adopted.

Reimbursement - Secondment

- The main issue is who is the real Employer – Indian company or foreign company.
- Factors suggested by OECD in Commentary to Article 15 on Income from employment:
 - Who has the authority to instruct the individual regarding the manner in which the work has to be performed;
 - Who controls and has responsibility for the place at which the work is performed;
 - The remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided.
 - Who puts the tools and materials necessary for the work at the individual's disposal;
 - Who has the right to select the individual who will perform the work and to terminate the contractual arrangements entered into with that individual for that purpose;
 - Who has the right to impose disciplinary sanctions related to the work of that individual;
 - Who determines the holidays and work schedule of that individual.

Reimbursement - Secondment

- Multiple conflicting decisions

In favour of Revenue

- Centrica India offshore P Ltd v. CIT (2014) 364 ITR 336 (DELHI HC). SLP dismissed by SC
- Verizon Data Services India P Ltd. v AAR (2012) 346 ITR 489 (Mad HC),

In favour of Assessee

- DIT v. Marks & Spencer Reliance India (TS-178-HC-2017) (BOM HC).
- Abbey Business Services (India) P Ltd. v. DCIT (2012) (53 SOT 401/23 taxmann.com 346) (Bangalore), confirmed by Kar HC in 122 taxmann.com 174.

Documentation

- Agreement between Parties clearly setting out the terms of reimbursement.
- Debit notes for reimbursements.
- Back-to-back third party invoices matching with debit notes.
- In case of cost allocation – back-up of cost incurred, allocation key and actual allocation. Wherever possible, there should be Audit Certificate supporting the allocation.
- For secondment arrangements – i) Agreement for cost recharge; ii) Assignment letter between the foreign company and the seconded individual; iii) Employment letter between the Indian company and the seconded individual; iv) Debit notes raised by the foreign company on the Indian company; and v) Supporting for payments made to the employee.

Disallowance u/s 40(a)(ia)

Reimbursements to C&F Agents

- DCIT vs. Dhanya Seeds (P) Ltd. (42 taxmann.com 277 – Bang) – Assessee was not liable to deduct tax at source under section 194C while making reimbursement of expenses to C&F agents who had incurred expenses on behalf of assessee and claims were made on actual basis.
- Gujarat High Court in the case of PCIT vs. Consumer Marketing (India) (P) Ltd. (64 taxmann.com 16) – No TDS liability on reimbursement of expenses incurred by C&F agent if separate bill was raised by him.
- ACIT v. Swastik Pipes Ltd (Delhi ITAT) – TDS under section 194C is not applicable on reimbursement of inland haulage charges to C&F agents.
- ACIT v P. P. Overseas 2011-TIOL-440-ITAT-MUM – Payment to C&F agent towards reimbursement of statutory liability is not liable for TDS.

Disallowance u/s 40(a)(ia)

Cost Sharing

- Utility Powertech Ltd v ACIT 2010-TIOL-545-ITAT-MUM – Assessee made payment towards office upkeep etc and was at cost. Held that reimbursement at cost and therefore disallowance u/s 40(a)(ia) not to be made.
- Mahyco Monsanto Biotech (India) Ltd [TS-858-ITAT-2012(Mum)] – No disallowance u/s 40(a)(ia) in respect of expenses reimbursed by assessee to group concerns
- CIT vs. ITD Cem India JV 405 ITR 533 (Bom) – The Assessee made reimbursement of administrative expenses to joint venture partner. The genuineness of transaction established on verification. The HC held that disallowance rightly deleted by Tribunal.

Disallowance u/s 40(a)(ia)

Salary Reimbursement

- CIT v OCB Engineers (2013) 32 taxmann.com 271 (Bombay) -The HC held that there was no liability to deduce TDS on Salary reimbursement paid to sister concerns. Accordingly, no disallowance u/s 40(a)(ia) to be made.
- DCIT v. Mahanagar Gas Ltd [2016] 69 taxmann.com 321 (Mumbai – Trib.): Reimbursement of salary of seconded employees to AE couldn't be treated as 'FTS' to attract TDS under section 194]

Lease Rent

- PCIT v. Sanghi Infrastructure Ltd. [2018] 96 taxmann.com 370 (Gujarat) – Assessee reimbursed lease rent charges paid by 'S' to lessor on behalf of assessee and 'S' had deducted TDS on same, therefore no disallowance could be made for non-deduction of TDS in hands of assessee

THANK YOU