SATURDAY INTERNATIONAL TAX GYAN !!!
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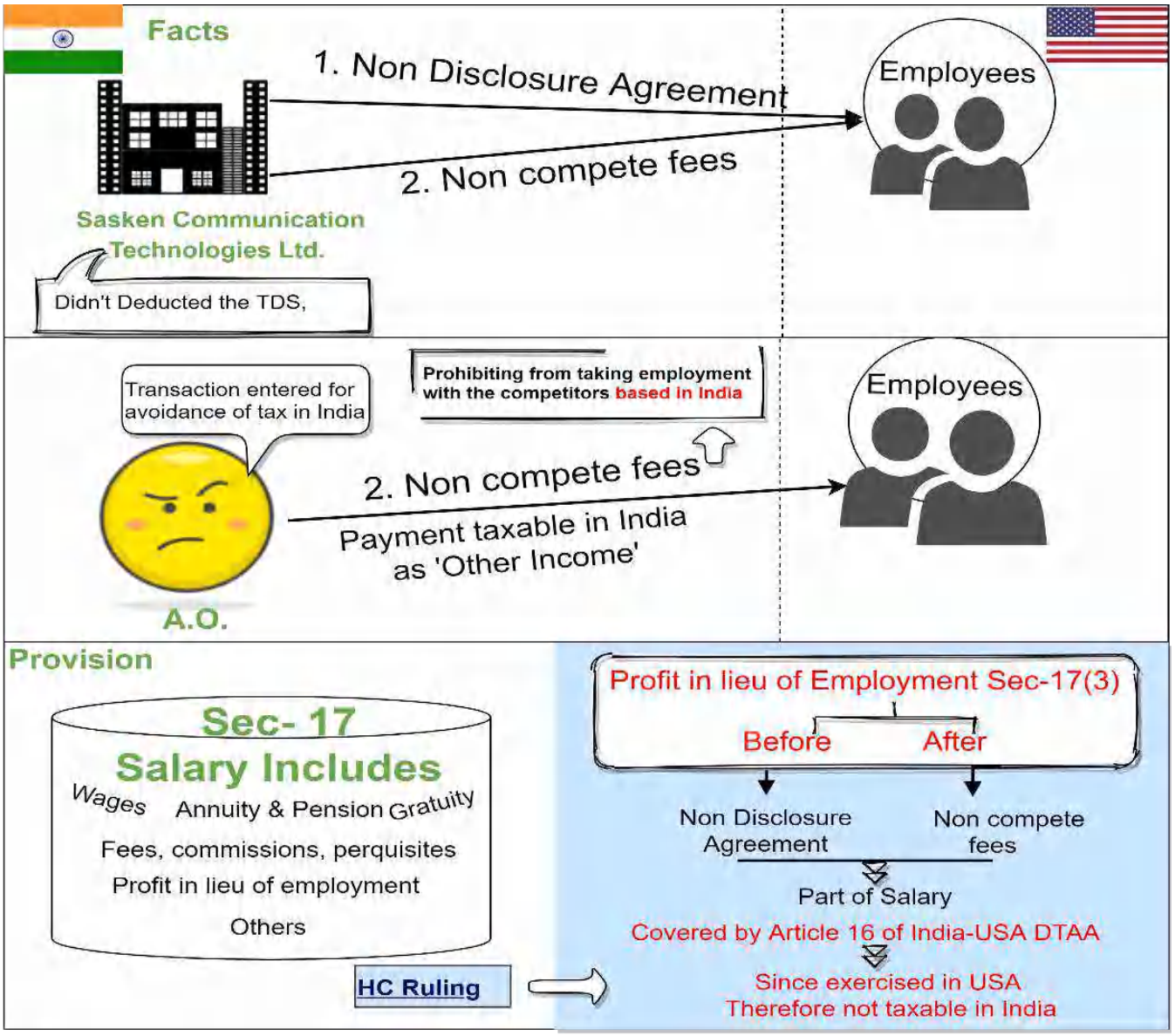
Director of Income Tax v. Sasken Communication Technologies Ltd.[1]

Agreement entered between employer employee during employment cannot be treated as business or other sources income



[1] 117 taxmann.com 278 (Karnataka)

Facts:

- The assessee company had merged its subsidiary company. Pursuant to the said merger, two of the key employees of the subsidiary company were offered employment by the assessee company by entering into three agreements- Employer Agreement, Non Disclosure Agreement and Employee Non Compete Agreement.

- The two employees were paid a huge amount for Non Disclosure agreement and Employee non compete agreement once they became the employee of assessee company.

- The Employee Non Compete Agreement was entered to stop the employees from joining any other competitor in India.

Assessee's contention:

- Assessee contended that the above payments were made to the employees after they were employees of the company and were in nature of salary and since the employees were employed in the USA the same was not taxable in India by virtue of Article 16(1) of India-USA DTAA.

Revenue's contention:

- The AO held that agreements and the payment made to the employees of the assessee were sham and solely created for the purposes of avoiding payment of tax in India.

- AO contended that the Non compete agreement entered by assessee company was restricting the employees from entering contract with any competitor company in India and hence same was liable to tax in India u/s 5(2) of the Income tax act.

- CIT(A), held that payments made under the Non-Compete Agreement could not be treated as income arising from employment or as 'profit in lieu of salary' u/s 17(3) of the Act and were thus taxable as other income in India under Article 23(3) of the DTAA i.e. taxable as other sources income.

Ruling:

- On scrutiny of both the agreements it could be found that both contracts were different and one would restrict employees during his employment and one would restrict him after the employment and the same would be covered under section 17(3) of I.T. act and both the agreements were entered to retain the employees who were at the highest position in the subsidiary company.

- Further, since such payment was specifically covered under Article 16 of India US DTAA same

cannot be brought under residuary article i.e. article 23 and since the services were rendered in the USA the income would be taxable in the USA by virtue of India US DTAA.

Our comments:

- Agreement entered between employer and employee which is going to have effect in India but if service is rendered in foreign country the same may not be taxable in India after considering the conditions in the relevant article of DTAA.
- Contract between employee and employer is of paramount importance to understand the taxability and should be taken due care while drafting. It should reflect the actual contract between the parties.

Section	**Sec- 201(1A), 5,17, Article 16 and 23**
DTAA/Country	**India - USA**
Court	**High Court of Karnataka**
Date of decision	**10.06.2020**

Note: Case law name in Red- in favour of the Revenue, Green- In favour of the Assessee, Orange = Partial.

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Thank you