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

Non-Compete fees paid to employees who were rendering service outside India would be considered as salary and hence not taxable in India.

Facts:

- Two employees viz., M.S. Kumar and Mr. Kevin Koenig were in employment of M/s SNSL a subsidiary company of the assessee and were employed as Chief Executive Officer and Chief Operating Officer respectively with effect from 1-4-2004.
- The aforesaid subsidiary company merged with the assessee on 1-4-2005. The assessee therefore offered employment to the aforesaid two persons on 31-3-2005, as they were in key strategic positions of the subsidiary company. Mr. Kumar and Mr. Kevin Koenig accepted the offers of employment with the assessee respectively on 31-3-2005 and 23-5-2005. The Non Compete Agreements were entered into on 2-5-2005 and payments under the agreements to the tune of $5,63,000/- (Rs.2,46,53,770/- each) were made to the employees on 31-5-2005. Thus, the payments were made to the aforesaid persons after they had become the employees of the assessee.
- Three contracts were executed between the two employees and the assessee viz., Employer Agreement, Non Disclosure Agreement and Employee Non Compete Agreement.

Assessee's contention:

- The assessee filed the C.A. Certificate with the remitter bank with the endorsement that no tax is required to be deducted at source since, remittance is towards consideration under the Non Compete Agreement and is covered by Article 16(1) of the DTAA between India and USA and hence not taxable in India.
- Alternatively, it is submitted that under the DTAA, the tax, if any, has to be levied in United States as per Article 23(2).

Revenue's contention:

- Revenue contended that place of execution of Non Compete Agreements is not specified. It was further held that under the agreement the employees have been **prohibited from taking employment with the competitors of the assessee based in India** and thus such prohibition will operate in India. Also, rights and obligations of the parties were to take effect in India. Hence, income under the Agreement arises in India under section 5(2) of the Act and the payments cannot be treated as arising from employment or treated as profits in lieu of salary within the meaning of Section 17(3) of the Act. Revenue further contended that non compete fees paid by the assessee is taxable under Article 23(3) of DTAA and the appellant has not been able to show that taxes have been paid voluntarily or otherwise to the United States Government.

[1] [2020] 117 taxmann.com 278 (Karnataka)

Ruling:

- The two employees were in employment as Chief Executive Officer and Chief Operating Officers of subsidiary company with effect from 1-4-2004, which subsequently merged with the assessee on 1-4-2005. It has further been held that Non Compete Agreements were entered on 2-5-2005 and payments were made on 31-5-2005 after the aforesaid employees had accepted the employment in the assessee on 31-3-2005 and 23-5-2005 respectively. Thus, they had received the amount in question being employees of the assessee**.**

- Since, **the employees were rendering services outside India** i.e., U.S. and payments were also made in U.S., Article 16 of DTAA applies and the same is taxable only in U.S.A. It was held that income in the hands of the employees is salary/profit in lieu of salary and it has to be treated as such and in view of Article 16 of DTAA, the same is taxable in U.S.

Our comments:

- While taxing any amount in India we need to first check definition of salary as prescribed in section 17 of the Act wherein it can be said that any amount paid by employer to it's employee whether at the time of joining or at termination and which is in relation to employment will be chargeable to tax as salary and as per section 9 any salary would be deemed to accrue or arise in India only if employment is exercised in India. Thus, salary paid to non-resident outside India for performing employment outside India shall not be taxable in India as per Income tax act.

- Further, the Article 16 of DTAA does not define what kind of income would be taxable as salary it just says any income in nature of salaries, wages and other similar remuneration, subject to taxability under other articles would be considered for taxation as **DEPENDENT PERSONAL SERVICES** under article 16**.**

Section	**Section 9, 16, 17 and Article 16 and 23**
DTAA/Country	**India- USA**
Court	**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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