Tax Hotline

January 21, 2004

RETENTION ALLOWANCE PAID TO EXPATRIATES EXEMPT FROM INDIAN TAXES

In a recent judgment delivered by the Bangalore Income Tax Appellate Tribunal ("**ITAT**"), it was held that retention money paid by former employers of expatriate employees of Indian entities would not be taxable in India in the hands of these expatriates.

The judgment was in the case of an Indo Japanese joint venture, Indo-Nissin Foods ("**JV**"). The Japanese collaborator, Nissin Foods ("**Nissin**"), had deputed certain employees to the JV. The expatriates became employees of the JV and received salaries and other allowances from the JV, which were duly offered for taxes in India. However, these expatriates also received some amounts from Nissin in the form of retention pay, the purpose of which was to keep a lien on the services of these employees deputed to India.

Under the Indian Income tax Act, 1961 ("**ITA**"), any income which falls under the head "salaries" is taxable in India, provided it is earned in India. The retention amounts payable are for retaining the services of the employees outside India by their former employers and not for the services rendered in India. Accordingly, such amounts would not be taxable in India, unless the expatriate is an ordinarily tax resident in India, in which case his worldwide income would be taxable in India.

However, the Indian income tax authorities, in the case of the JV attempted to tax this retention pay, and the ITAT while deciding this case ruled in favour of the JV, observing that the retention pay was linked to employment in Japan and not for services rendered in India, and hence could not be taxable in India. The ITAT has upheld the decision of the Gujarat High Court in the case of CIT v S G Pgnatale [1980] 124 ITR 391 (Guj) where it was held that 'retention allowance' paid by the former employer cannot be considered as 'earned in India' for 'services rendered in India' and hence cannot be taxable in India.

Source: *The Economic Times, January 20, 2004.*

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