Q & A

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One of our senior management official has refused to accept the increment offered by the Company and is demanding a higher increment. The company is unable to provide the increment demanded by her. Please let us know whether this amounts to insubordination, and if, the company can take disciplinary action against her. If not, what are the options before the Company?

The compensation payable to an employee is generally a matter of agreement between the employer and the employee, and more so, in the case of a senior executive. The executive in question is entitled to negotiate or demand an increase in her compensation. However, it is the prerogative of your company to accept such a demand or refuse to grant the increment demanded by the executive. Nevertheless, refusal by the executive to accept the increment offered by your company may not constitute an act of insubordination. Disciplinary action merely on the ground that the executive has refused to accept the increment offered by your company is, in my view, not sustainable.

However, in the present circumstance, as the executive and your company are at disagreement in so far as the compensation offered to the executive is concerned, the company may consider communicating to the executive that if the increased compensation is not accepted by the executive, it would be deemed that the executive is not desirous of continuing in the employment of the company. You may request the executive to communicate in writing that the compensation offered by the company is acceptable with a specified time frame, failing which it would be deemed that the executive is unwilling to continue in the employment, and the company may exercise its right to severe the relationship by following the process enshrined under the contract of employment.

We are a factory engaged in manufacture of textiles registered under the Factories Act. On account of cost reduction, we wish to terminate certain workers. Would such termination be considered as a retrenchment or a lay-off?

Please note that the ID Act defines lay-off to mean the failure, refusal or inability of an employer to give employment to a workman, whose name is borne on the muster-rolls of his industrial establishment, and who has not been retrenched. Such failure, refusal or inability of the employer to give employment to workmen should be on account of shortage of coal, power or raw materials or the accumulation of stocks or the break-down of machinery or natural calamity or for any other connected reason. A workman whose name is borne on the muster-rolls of the industrial establishment and who presents himself for work at the establishment at the time appointed for the purpose during normal working hours on any day and is not given employment by the employer within two hours of his so presenting himself is deemed to have been laid off for that day within the meaning of the ID Act.

Lay-off signifies a temporary inability of the employer to give employment to the workmen on account of shortage of coal, power or raw materials or because of accumulation of stocks or breakdown of machinery. Further, lay-off may or may not lead to cessation of relationship of employment. Thus, termination of employment of certain workmen by your establishment on account of cost efficiency, in my view, would not be considered lay-off of such workmen. However, such termination would fall within the purview of retrenchment. Please note that the term 'retrenchment' has been defined under the ID Act to mean termination by the employer of the service of a workman for any reasons whatsoever otherwise, than as a punishment inflicted by way of disciplinary action.

We are a financial services firm based in Bangalore and are intending to introduce a VRS policy for executives to reduce our manpower strength. Please let us know how to draft a VRS policy. What are the various legal aspects to be kept in mind?

Please note that Voluntary Retirement Schemes (VRS) were initially used as a tool by the Government and/or Public Sector Undertakings (PSUs) to reduce their work force. PSUs were suffering huge losses due to over staffing and VRS provided a way out for such PSUs to reduce their work force by way of voluntary resignations. The private sector has also started using VRS over the last two decades or so. Although certain guidelines have been laid down by the Government for PSU's, there is no specific law that governs VRS in so far as the private sector is concerned. Companies / firms are free to formulate their own VRS policies. There is no prescribed format for drafting the VRS policy of a firm. The purpose of the VRS is to make it attractive for employees in general, or a class of employees to tender their resignations. You need to make an offer to the employees such that some of the employees come forward and accept the offer by tendering their resignation. You need to however ensure that the acceptance of the offer made by your firm by employee(s) is voluntary. HC

Employment Sans Legal Presence In India

- BY **K.V.SINGH**

Employers who do not have any presence in India, and, are based in countries which do not have any double taxation avoidance agreement (DTAA) with India are often confronted with queries as regards their tax liability, in case they employ someone in India, without establishing an Indian subsidiary or opening a branch or a liaison office. In such cases, the employee is generally required to work from home, or from a business centre, and, often travels to the jurisdiction where the employing foreign company is based, on account of his work. In other words, if a foreign company based in a jurisdiction which does not have a DTAA with India decides to employ a person in India without opening an office, or establishing a presence in India, will the employment of an Indian by such foreign company trigger any Permanent Establishment (PE) exposure in India for such foreign company? Further, will the foreign company be obligated to deduct tax at source from the salary paid to such employee? Furthermore, will the Indian employee be liable to pay taxes in India if he often travels in connection with his work to the jurisdiction where the employing foreign company is based?

Since there is no DTAA between India and the foreign jurisdiction where the employing foreign company is based, taxability in India of any income arising in India, whether for the foreign company or its Indian employee will have to be determined with reference to the provisions of the Indian Income Tax Act alone. It may be clarified that the concept of PE is not applicable in such cases as there is no DTAA between India and the jurisdiction where the employing foreign company is based. In this regard, it may be noted that in terms of section 5 of the Income Tax Act, in the case of a foreign company, any income which is received by it in India; or which 'accrues or arises' in India; or which is 'deemed to accrue or arise' to it in India during a year, will be taxable in India. In a case where a foreign company does not have a legal presence in India and no income is being received by such foreign company in India, any income from business or contracts executed outside India cannot be held to accrue or arise to such foreign company in India. While income received in India or income which 'accrues or arises' in India need no further explanation, in so far as income 'deemed to accrue or arise in India' is concerned, reference may be made to section 9 of the Income Tax Act, which provides that:

"9. The following incomes shall be deemed to accrue or arise in India:

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India."

In terms of Explanation 1 (a) below the above provision, if only a part of the business activities of a non-resident entity are carried out in India, then only such part of its income as can be reasonably attributed to such activities in India will be deemed to accrue or arise in India. The issue will have to be determined with reference to the existence of 'business connection' on account of presence of the employee or availability of fixed place of business in India to him.

Therefore, the key question is whether the presence of an employee of the foreign employing company in India will result in creation of a 'business connection' in India? Business connection is understood to imply the existence of an ongoing relationship between the income earning activity of the foreign company, and some activity in India, which contributes directly or indirectly to those income earning activities. Presence of the Employee of the foreign company in India, or maintaining an office or place of business for him in whatever arrangement, will be regarded as giving rise to a business connection in India. However, if the foreign company is not engaged in income earning activities in India per-se, it can be argued that though there is a business connection in India, there is no income accruing or arising from such a business connection.

In so far as the tax liability of the employee is concerned, it may be noted that the salary and perquisites payable by the employing foreign company to the employee for services rendered in India will be liable to tax in India. In case the employee stays in India for 182 days or more in any fiscal year (April to March), or spends 60 or more days in India in a year, and 365 or more days in preceding four years, then he will be treated as a tax resident of India for that year. Both conditions apply alternatively, i.e. if any of the two is satisfied in a given year, then the employee will be treated as a tax resident of India in that year. In such a case, his global income from all sources i.e. salary, rent, interest, dividends etc. would be liable to tax in India.

Since the employing foreign company has a 'business connection in India' due to the presence of the Employee in India or access to a fixed place of business in India, it will be liable to withhold tax from the salary payable to the employee for services rendered in India. This will be so even in case when in a particular year, the residential status of the employee is of non-resident in India. The withholding tax is to be deducted at the time of payment or credit of salary to the employee's account, whichever is earlier, and, has to be deposited in government account within seven days of the end of the month in which it was deducted. In cases where the employee spends only a part of a month in India, withholding has to be made from the salary of that month, based on the number of days spent by him in India in that month. It will also have to file quarterly and annual returns of withholding tax electronically, and issue a certificate of deduction to the employee. For this purpose, it will also need to obtain a Tax deduction Account Number (TAN). HC