TAXMANN®
Tax & Corporate Laws of INDIA

[2022] 139 taxmann.com 600 (Article)

Date of Publishing: June 30, 2022

Secondment Quandary- the story continues

SACHIN VASUDEVA

SCV & Co. LLP

MRIDHU MALHOTRA

SCV & Co. LLP

With the advent of globalisation, movement of employees across different countries has garnered a lot of prominence and has become a common practice. Normally employees of one group entity are seconded to another group entity in a foreign country, either for any specific assignment or to provide technical support or expertise in specific areas of operations or to oversee the functioning of the associate entity, while ensuring maintenance of quality standards, considering the Group's brand and policies.

Typically, if not always, seconded employees, remain on the payroll of the foreign entity. The limited purpose of the same is to ensure continuity of their social security regime in the home country. Practically, unless this is assured by the employer, employee mobility gets significantly hampered. The foreign company usually pays such social security contributions along with some portion of the employee's salary, in the home country and recovers the same from the group company to which the employee has been seconded, without charging any mark-up.

Secondment has been a vexed issue in India for years now. The bone of contention is that the tax authorities allege, that under the secondment arrangement, the foreign company provides services to its group company in India through the seconded employees. Consequently, it is argued that such an arrangement creates either a Permanent Establishment (PE) of the foreign company in India or that the reimbursement to the foreign company by the Indian group company, of social security contributions including salary paid in the home country qualifies as 'Fee for Technical Services' (FTS) and is hence taxable in India.

Courts have delved into the matter and the key principles emerging are that, each case needs to be factually analysed and substance over form needs to be taken into consideration in deciding whether the secondment arrangement is a ***contract for service*** or ***contract of service.***

Under this arrangement, the seconded employees are transferred to the payroll of the Indian company and work for the business of Indian company under its direction, supervision, and control. Employee's entire salary and related cost (including social security contributions etc paid in the home country), is borne by the Indian company. The Indian company takes responsibility of the work done by the seconded employee during the period of secondment in India and usually retains the right to terminate the secondment.

It is pertinent to note that following the principle of substance over form, various courts[1] have held that while the foreign company may be the employer on paper, however in substance the Indian company is the real employer of such seconded employees. Given the same, since the foreign company merely seconds its employees to India, this cannot be construed as providing services to the Indian company through its employees. Therefore, the seconded employees also cannot be said to be providing services to the Indian company on behalf of the foreign company.

However, certain courts[2] have rejected the argument that the Indian company is the real employer of the seconded employees. Emphasis has been laid on the fact that the seconded employees, even during secondment are entitled to the social security benefits of the foreign employer and remain on the payroll of the foreign company. Another

factor repeatedly pointed out and relied upon by the courts has been that, after the end of the secondment period, the employees return to their jobs with the foreign company. Employees are said to retain a lien over their employment with the foreign company and hence it has been held that the foreign company remains the employer of the seconded employees, even during the period of secondment to India.

The moot point in a secondment arrangement remains as to who qualifies as the real employer (foreign company v Indian Company) of the seconded employee, during the period of secondment in India. Based on the same the income tax implications need to be evaluated.

Even from an indirect tax standpoint, the applicability of indirect taxes under the erstwhile Service Tax and under the Goods and Service Tax (GST) regime on secondment arrangements has also been a matter of litigation. The issue that arises is whether deputation of expatriates by a foreign company to Indian company under secondment arrangement qualifies as 'Manpower Recruitment or Supply Agency Service'. Given the same, applicability of service tax/GST under reverse charge mechanism on 'Manpower Recruitment or Supply Agency Service' is a matter of dispute.

Under the service tax/ GST regime, no taxes are liable to be paid where there is an employer employee relationship.

In a secondment situation, applicability of service tax/GST is dependent on whether the Indian company qualifies as the employer of the seconded employee. Where an employer employee relationship is established between the India company and the seconded employee, service tax/ GST would not be applicable.

While there have been rulings to this conclusion, however recently the **Hon'ble Supreme Court in the case of M/s Northern Operation Systems Pvt. Ltd. (Assessee)** has held that service tax would be applicable on the secondment arrangement.

In the aforesaid case the assessee had entered into an agreement with its overseas group company for payment of salary and other perquisites in respect of employees seconded from such overseas company. The seconded employees operated under the control, direction and supervision of the assessee. Further, the assessee withheld tax on the salary paid to such employees as per the requirements of the Income

Tax Act, 1961. The salary payment to such employees was disbursed by the overseas group company. Subsequently, the salary cost was reimbursed to the overseas group company by the assessee. The tax authorities issued demand order for discharge of service tax under the reverse charge mechanism considering reimbursement of salary by Indian Company / assessee to Group Company, as import of manpower supply services.

The Hon'ble Supreme Court has held that during the period of secondment the assessee was the service recipient of 'manpower recruitment and supply services' by the overseas Group Company in respect to the employees seconded in India. As a result, the assessee was liable to discharge service tax liability for the relevant periods.

The Hon'ble Court based on the particular facts of this case made the following key observations:

- While in appearance the seconded employees for the duration of secondment would be under the control of assessee and work under its directions, however they remain to be on the payroll of the overseas employer
- The reality was that secondment was part of the global policy of the overseas employer, loaning their services on a temporary basis.
- On cessation of the secondment period the employees would be repatriated in accordance with the global repatriation policy of the overseas company.
- The letter of understanding between the assessee and the seconded employee did not state that the latter would be treated as the former's employees after the seconded period. In fact, they would revert to their overseas employer and may in fact, be sent elsewhere on secondment.
- The salary packages, including allowances, perks etc were expressed in foreign currency and being substantial amounts appeared to be in accordance with the standardized policy of overseas employer.
- Based on all the agreements, it was clear that the overseas company had a pool of highly skilled employees, who were entitled to a certain salary structure as well as social security

benefits. These employees, having regard to their expertise and specialization, were seconded the assessee for the use of their skills. Upon the cessation of the term of secondment, they would return to their overseas employer, or be deployed on some other secondment.

The Supreme Court observed that while the control (over performance of the seconded employees' work) and the right to ask them to return, if their functioning was not as desired, was with the assessee, the overseas employer remained their employer in relation to its business and deployed them to the assessee, on secondment. Further, the overseas employer for whatever reason, paid them their salaries. The terms of employment, even during the secondment, were in accordance with the policy of the overseas company, who was their employer. Further upon the end of the period of secondment, they would return to their original places, to await deployment or extension of secondment.

Basing its opinion on the above observations, the Hon'ble Supreme Court held that the assessee was the service recipient of 'manpower recruitment and supply services' by the overseas Group Company in respect of employees seconded and hence liable to discharge service tax under reverse charge mechanism.

In the instant case while the Hon'ble Supreme Court has adjudicated on the specific facts of the case, however, the Hon'ble Court has re-iterated the principle that in the absence of employer employee relationship the service tax liability would get triggered under reverse charge mechanism.

From a tax perspective, be it income tax or service tax/ GST, the implications for a secondment arrangement boil down to the pertinent question- *Who is the employer of the seconded employees?*

In-effect the Hon'ble Supreme Court has also re-iterated the same. It is worthwhile to note that the Hon'ble Supreme Court's judgement is based on specific facts of the case. Therefore, the possibility to distinguish the same on facts is available.

Although the judgement has been passed in context of the service tax regime, however the same may have a ripple effect on income tax matters. While the tax authorities may attempt to apply this ruling in income tax matters, it may be possible for the assessee to distinguish

its case based on its specific facts and support non-withholding of taxes on reimbursement made by the Indian company of salary paid by the foreign company.

It is interesting to note that in a recent judgement pronounced by the Hon'ble Karnataka High Court in case of ***Flipkart Internet (P.) Ltd.*** **v.** ***DCIT (International Taxation)*** **[Writ Petition No. 3619 of 2021, dated 24-6-2022],** theHon'ble Court has held that the reimbursement of salary for seconded employees to the foreign company, was subject to 'NIL' withholding tax.

In the said case the tax authorities placed reliance on the Hon'ble Supreme Court's judgement in the case of **Northern Operation Systems Pvt. Ltd (supra)** and held that the payment by Flipkart to the Foreign company for salaries of seconded employees paid by the foreign company in the home country for administrative convenience, was taxable as FTS both under the Act and the relevant tax treaty. However the Hon'ble High Court distinguished the same by holding that the recent ruling in **Northern Operating Systems**, is in the context of service tax and the only question for determination was whether supply of manpower was covered under the taxable service and was to be treated as a service provided by foreign company to Indian company, whereas in the instant case, the legal requirement is whether to treat a service as FIS, which is 'made available' to the Indian Company.

Hon'ble Karnataka High Court's judgment may therefore be relied upon by the assessees in support of the argument that, the Hon'ble Supreme Court's judgement has limited pertinence in context of income tax implications under a secondment arrangement.

In any case, the Indian company must be able to answer the question '*Whether it is the real employer of the seconded employee?*' in affirmative, supported by robust documentation to that effect, to aid its case before the tax authorities.

■■

1. *Burt Hill Design (P.) Ltd.* v. *Dy. DIT (International Taxation)* [2017] 79 taxmann.com 459/164 ITD 697 (Ahd. - Trib.), *Goldman Sachs Services (P.) Ltd.* v. *ACIT* [2022] 138 taxmann.com 263 (Bang. - Trib.), *Toyota Boshoku Automotive India (P.) Ltd.* v. *Dy. CIT* [2022] 138 taxmann.com 166 (Bang. - Trib.), *DIT* v. *HCL Infosystems Ltd.* [2005] 144 Taxman 492/274 ITR 261 (Delhi), *Dy. DIT* v. *Yum! Restaurants (Asia) Pte. Ltd.* [2020] 117 taxmann.com 759 (Delhi - Trib.).
2. *Centrica India Offshore (P.) Ltd.* v. *CIT* [2014] 44 taxmann.com 300/224 Taxman 122/364 ITR 336 (Delhi), *Nippon Paint (India) (P.) Ltd.* v. *Asstt. CIT* [2017] 79 taxmann.com 8 (Chennai - Trib.)