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SUPREME COURT CONFIRMS SERVICE TAX ON SECONDMENTS TO INDIAN ENTITY FROM OVERSEAS GROUP ENTITIES, MAY LEAD TO DISPUTES UNDER GST

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Introduction

While this is a judgment[1] under the pre-GST service tax laws, the legal provisions analyzed in this judgment are similar to corresponding provisions under GST and to that extent, this judgment has the potential to re-open the pandoras box of service tax/GST issues on secondment/deputation of manpower, whether from outside India to India or within India.

Facts of the case

The respondent, i.e., Northern Operating Systems Pvt. Ltd. (Assessee), had contracted with its overseas group entities for rendering back-office support and information technology support services. Under the contract, the overseas entity was required to second its employees (Seconded Employees) to the Assessee as per the Assessee's requests. The Seconded Employees were required to act under the directions and control of the Assessee. However, the salary, bonus/incentives, social security and welfare benefits of the Seconded Employees were paid to them by the overseas group entity. Such expenses were subsequently reimbursed by the Assessee to its overseas entity.

The liability to pay service tax on such reimbursements by the Assessee was in question before the Supreme Court (SC).

Provisions under consideration of the SC

Prior to 2012, '*manpower recruitment or supply agency*' services were specifically defined as a taxable service under the Finance Act, 1994.[2] Thereafter, with the implementation of the negative list regime from 01.07.2012, the definition of 'service' was expanded to encompass any activity carried out by one person for another (other than specified exclusions).

However, services provided by an employee to an employer were excluded from the definition of service under Section 65B (44) (b) of the Finance Act, 1994. This exclusion of services of an employee to employer from the tax net continues even under the GST regime, as per Entry 1 of Schedule III of the Central Goods and Services Tax Act, 2017.

The framework of analysis adopted by the SC to ascertain amenability to service tax of the aforementioned reimbursements was to identify the "real" employer of the Seconded Employees. If Assessee were to qualify as the "real" employer, there would be no liability of service tax on the Assessee. However, if the overseas group entity was

[1] CCE v. Northern Operating Systems - Civil Appeal No. 2289 of 2021; Judgment dated 19.05.2022
[2] Section 65 (68) of the Finance Act, 1994.

held to be the "real" employer of the Seconded Employees, it would be tantamount to provision of services by the overseas group entity to the Assessee.

Judgment

Observing that no singular determinative test, could be laid down to conclude vis a vis employer-employee relationship, the SC held that such examination must be based on a multitude of factors. Thus, adopting a "substance over form" approach to identify the "real" employer, the SC undertook a detailed review of – (1) master services agreements between the Assessee and the overseas entities; (2) secondment agreements; and (3) letters of understanding issued to the Seconded Employees by Assesee.

On the basis of this analysis, the SC concluded that the overseas group entities were the "real" employers of the Seconded Employees, in light of the following factors :-

- ***Lien on employment of Seconded Employees vested with the overseas entity*** – The SC noted that, the Seconded Employees continued to be on the foreign entity's payroll. Further, all salary payments and social security benefits were paid by the foreign entity. While the operational and functional control was exercised by the Assessee over the seconded employees only for the secondment period, such control was necessary to ensure performance of the duties entrusted to them. However, it was merely facial. Thus, the arrangement was a "contract for service" and not a "contract of service".

- ***Specialised nature of services*** – The Court took cognizance of the "vital fact" that the nature of business of the overseas group entities was to secure contracts which required highly trained and skilled personnel. Thus, the Seconded Employees possessing the specific skill sets were being deployed to the Assessee which is also evident from the nature of the perks and salary paid. Thus, it was observed that the Seconded Employees were seconded to the Assessee for the use of their specific skills.

- ***Repatriation back to overseas entity*** - The letter of understanding between the Assessee and the Seconded Employees nowhere stated that the Seconded Employees would be treated as employees of the Assessee after the period of secondment. Further, the Assessee could not terminate the employment of Seconded Employees on cessation of the secondment period; the Seconded Employees had to be repatriated to their overseas employer and could be sent elsewhere on secondment. Thus, the Assessee was not empowered to terminate the employment of the Seconded Employees or even amend their terms of employment in an adverse manner.

- **Salary/allowances in foreign currency** - The fact that salary package, allowances, etc., were all expressed in foreign currency and separate allowances were granted for working in India further buttressed that the Seconded Employees were the employees of the overseas entity.

Accordingly, it was held that the Assessee was the service recipient of manpower recruitment and supply services provided by the overseas entity, vis a vis the employees it seconded to the Assessee, for the duration of their deputation or secondment.

Thankfully for the Assessee, it was held that the extended period of limitation under service tax would not apply.

Aligning with the position adopted for direct taxes?

It appears that this judgment is effectively aligning the position of the Supreme Court on taxability of seconded employees under indirect taxes with that under the Income Tax Act, 1961 for fee for technical services.

For instance, in the *Centrica case*[3], the Delhi High Court (subsequently affirmed by the Supreme Court) had laid emphasis on the fact that while the control and supervision on seconded employees was exercised by the Indian entity, the right of lien on employment with the overseas entity remained for the seconded employees as the seconded employees were getting retirement and social security benefits from the overseas entity. Further, importantly, the court noted that even if the secondment could be terminated by the Indian entity, the employee still had a lien on the employment with the foreign entity.

Our Comments

The subject decision is significant as it upsets the previous jurisprudence on the issue of taxability of reimbursements for seconded employees. Various indirect tax Tribunal judgments in the past had held that services rendered by seconded employees are not in the nature of manpower supply services. Practically speaking, indirect tax authorities had almost given up the fight vis a vis secondment/deputation of manpower; but this judgment may reinvigorate them and lead to greater scrutiny of all secondment arrangements during upcoming GST audits.

However, it is well settled in law that a judgment is an authority only vis a vis the facts of that case and cannot be treated as a precedent for all other matters, irrespective of the difference in facts.[4] Thus, the potentially disruptive impact of the present decision may arguably be said to be confined to its facts where – (1) the purpose of secondment of the employees was for the performance of specialised functions for the Indian entity as recorded in the contractual documents; and (2) the Indian entity did not have the right to terminate/adversely impact the employment/terms of employment of the Seconded Employees.

As such, in suitable cases, the subject judgment may be distinguishable if underlying contractual documents are worded differently as compared to the features discussed above.

It is pertinent to note that even under income tax law, the impact of factual distinctions has been appreciated - judgments have emerged where seconded employees have been treated as employees of the Indian entity and not the foreign entity. For example, where the lien on employment, during the secondment, was transferred to the Indian entity and the foreign entity was discharged of all its obligations, the Indian entity was held to be the real employer of seconded employee.[5] Similarly, where the right to terminate employment of the seconded employee was conferred on both the Indian entity and the overseas entity, it was held that the Indian entity would also be the legal and not just the economic employer of the seconded employee.[6] As such, rich guidance may be drawn from the jurisprudence under the Income Tax Act, for structuring contractual documents for secondment/deputation in the coming days in light of this SC judgment.

The Way Forward

This judgment necessitates the following points of review and analysis for deputation/secondment arrangements between offshore group entities and their Indian counterparts (and also between group companies in India):-

- Developing necessary documentation identifying the purpose of secondment keeping in mind this judgment;

- Reviewing inter-company services agreement, staff secondment agreements, assignment/recommendation letters between seconded employees and the group entities to identify necessary amendments/ additional documentation in light of this judgment

[3] Centrica India Offshore (P.) Ltd. V. CIT [2014] 44 taxmann.com 300 (Delhi) *as affirmed by the Supreme Court in Centrica India Offshore (P.) Ltd. v. Commissioner of Income-tax-I, New Delhi [2014] 51 taxmann.com 386 (SC)*;
Also see:- Intel Corporation v. DDIT TS-6722-ITAT-2016(BANGALORE); Panasonic Corporation v. DCIT TS-8950-ITAT-2018(Chennai);
[4] Fuerst Day Lawson Ltd. v. Jindal Exports Ltd. - (2001) 6 SCC 356; Bhaskar Laxman Jadhav v. Karamveer Kakasaheb Wagh Education Society - (2013) 11 SCC 531
[5] DDIT V. Yum Restaurants [2020] 117 taxmann.com 759 (Delhi - Trib.);
[6] Temasek Holdings Advisors v. DCIT (2013) 27 ITR 0125

Separately, it is also important to be mindful of whether the secondment can result in a taxable presence (i.e. permanent establishment) of the foreign entity in India adding to the complexity and tax claims by the tax authorities.

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