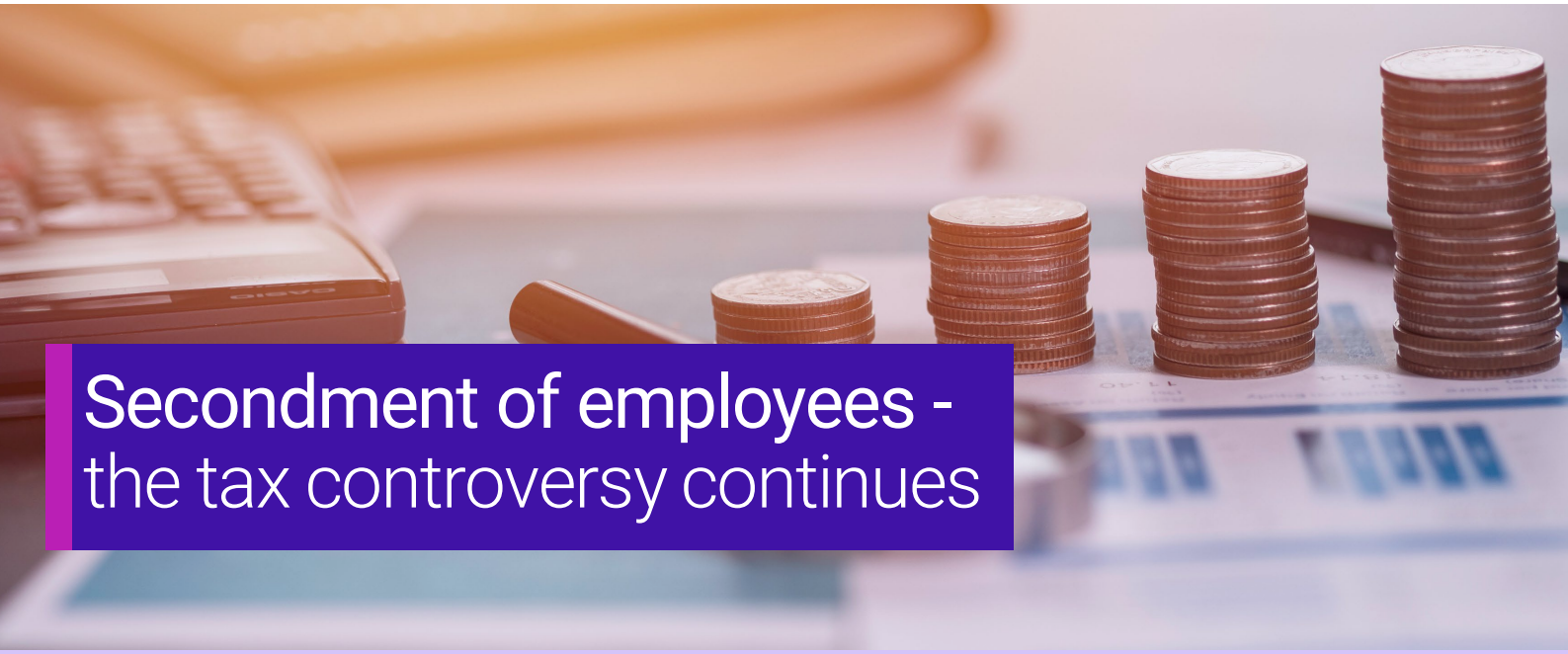


Secondment of employees - the tax controversy continues

The taxability of salary reimbursement for seconded employees has been debatable with various contrary judicial precedents. The recent Supreme Court decision regarding the applicability of service tax/GST provisions on reimbursements of salary of seconded employees has aggravated the dispute further.

In a secondment arrangement, an employee of an overseas company is deputed for a specified period to an Indian company to work for the Indian company. Such arrangements are generally between group companies that want to leverage personnel talent available elsewhere to set up, expand, and grow Indian businesses.

For the period of secondment, the employee is expected to work for the Indian host company under the supervision and control of the Indian host company. Here, the salary earned by the employee is taxed in India and the Indian host employer remits the withholding tax on such salary as well.

Usually, the overseas company initially remits the salary of the seconded employee and the Indian host company subsequently reimburses the cost to the overseas company. Such an arrangement may be implemented for administrative convenience and uninterrupted availability of social security benefits to employees in an overseas country.

The dispute concerns the taxability of the reimbursement of the salary by the Indian host company to its overseas entity, and the moot issue resulting in the taxability dispute is who is the employer of the seconded employee.

The assesses considered the payment to the overseas company as reimbursement of salary costs not liable to tax in India in the absence of any income element. Whereas the tax department has been alleging that the payment is for services rendered by the overseas entity through its employee and hence, taxable as 'Fees for Technical Services' (FTS). Multiple contrary rulings of various courts have reviewed the employment and secondment agreements and concluded on the taxability or otherwise. The principle emerging out of the decisions is that the underlying facts in each case had to be analyzed in detail to determine who the employer was - whether it was the Indian entity or the overseas entity. Here, due regard has to be given to the substance of the transaction.

The most relied upon decision by the tax department is the Delhi High Court decision in the case of Centrica India Offshore (P.) Ltd[1], which held that the reimbursement made by an Indian entity to the overseas entities in Canada and UK was taxable in India as FTS/Fees for Included Services (FIS). The Supreme Court has subsequently affirmed this decision. In this case, the High Court reviewed the secondment arrangement and the relevant agreements and observed as follows:

- For the period of secondment, the employees were subject to the supervision and control of the Indian entity and the overseas entities were not responsible for any errors or omissions of the employees; The Indian entity was responsible for the work performed by the seconded employees and reaped the benefit of the output as well.
- However, these employees retained their entitlement to participate in the overseas entity's retirement and social security plans. As per the secondment agreement, the Indian entity could only terminate the secondment arrangement and not the employment with overseas entity. The employees continued to exercise lien on the employment with the overseas employer.
- Given the above observations, the High Court concluded that the payment by the Indian entity to the overseas entity was not reimbursed and was taxable in India as FTS/FIS.

In spite of the above decision, there were rulings by various courts contrary to the ruling of the Delhi HC in Centrica, distinguishing the facts in each case. Then last year, in the context of Service Tax law, the Supreme Court[2] ruled that reimbursement of the salary of the seconded employees would be liable to service tax as it was 'manpower recruitment and supply service.' The Apex Court interpreted the concept of a secondment agreement taking note of the contemporary business practice and held that the traditional control test to determine who the employer is not the sole test to be applied. The facts noted by the Supreme Court were as follows:

- The overseas entity seconded its employees to its Indian entity. During the period of secondment, these employees worked under the control and supervision of the Indian entity. While the Indian entity controlled and supervised the employees' work during the secondment period, the fact remained that the overseas entity seconded these employees in relation to its own business.

1. Centrica India Offshore (P.) Ltd vs CIT [2014] 364 ITR 336 (Delhi)
2. C.C.,C.E. & S.T. Bangalore v. Northern Operating Systems (P.) Ltd. [2022] 138 taxmann.com 359 (SC)

- The overseas entity paid them a salary and other emoluments for administrative convenience, which were subsequently recovered from the Indian entity.
- The employees continued to remain on the payroll of the overseas entity for the continuity of their social security/retirement benefits. The terms of their employment, including salary, continued to remain in accordance with the policy of the overseas company. Upon the end of the period of secondment, they return to their original places.
- The Court observed that in case the Indian entity was not satisfied with the performance of the deputed employee, the Indian entity could only terminate the secondment arrangement. In such a case, the employee would return to the US company and await deployment to a new project or a different secondment.

Given these observations, it has been concluded that the assessee was a service recipient of the overseas group company concerned, which can be said to have provided manpower supply service exigible to service tax.

The aforesaid decision has re-emphasized that every secondment arrangement's facts and substance need to be evaluated in detail to determine the secondee's real employer and the transaction's nature. If, based on the facts, the real employer continues to be the overseas entity, the seconded employees are rendering services for the overseas entity. While the decision is in the context of Service tax law, it has been pronounced by the Supreme Court and hence, is the law of the land. If a payment is characterized as payment for service under one statutory law, could it be distinguished and held to be reimbursement in Income tax law?

There have been a few decisions on the taxability of salary reimbursements of seconded employees post the above-referred Supreme Court decision.

In the case of Flipkart Internet (P.) Ltd.[3], the Karnataka High Court held that reimbursement of the salary of seconded employees by an Indian entity to an overseas entity was not FIS as the services did not satisfy the 'make available' condition in the tax treaty. Here, the secondment arrangement was studied in detail and held that the overseas entity continued to remain the employer of seconded employees and hence, the reimbursement was, in fact, a service payment. While the payment was characterized as a service payment, the assessee could still avail of the beneficial provisions of the tax treaty regarding 'make available.'

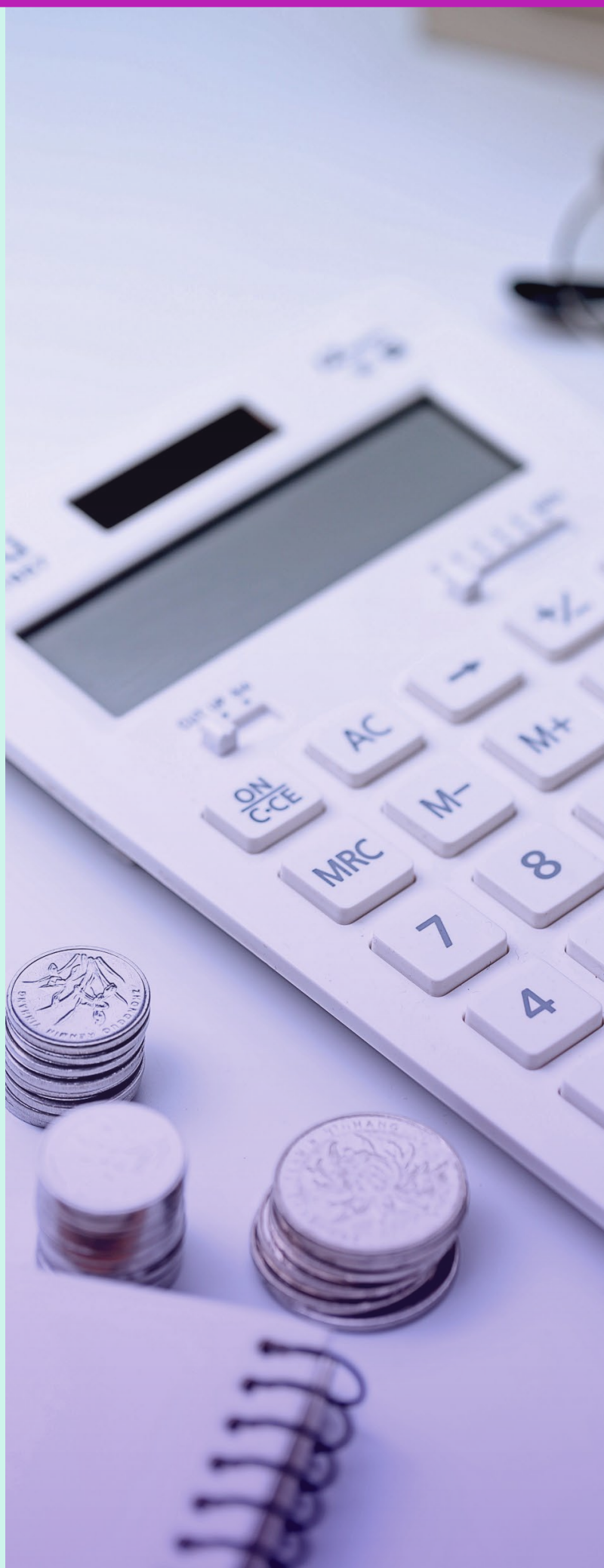
While pronouncing its decision, it made an interesting observation regarding the Supreme Court decision in the case of Nothern Operating Systems (supra). It held that the Supreme decision was in the context of service tax law to determine whether it was a service. Whether such service payment would attract income tax in India would depend on the provisions of the Income-tax Act and the relevant tax treaties.

Similar findings have been made in the case of BOEING India (P.) Ltd[4]. and M/s. Google LLC vs. JCIT (OSD) (IT)/DCIT (IT)[5].

3. Flipkart Internet (P.) Ltd. Vs. DCIT [2022] 139 taxmann.com 595 (Karnataka)
4. [2020] 121 taxmann.com 276 (Delhi - Trib.)
5. IT(IT)A No. 167/Bang/2021

Concluding the discussion, the following points need to be kept in mind while entering into a secondment arrangement:

- Facts in every transaction need to be analyzed independently having regards to the substance of the transaction.
- The underlying documentation is the key to determining the arrangement's substance and taxability of the payment for reimbursement of the salary.
- The lien on employment in an overseas entity and the limited rights that the Indian entity could exercise in respect of the seconded person's employment are significant considerations to conclude on the employment arrangement.
- Even if the payment is held for a service, the taxability of the same would be determined considering the Income-tax Act provisions and the relevant tax treaty. In other words, the beneficial provisions of the tax treaty relating to the 'make available' clause should be applied.
- And most importantly, the moot question is to determine who the employer of the deputed person is - the Indian host company or the overseas entity.



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