

Service Tax leviable on secondment arrangements

C.C.E. & ST v. Northern Operating Systems Pvt. Ltd.¹

The Hon'ble Supreme Court in a recent judgment has fastened Service tax liability on the salary reimbursements made by an Indian company ('assessee') to its overseas group company for employees seconded by the latter. Relying on the principle of 'Substance over Form', the Court held that the seconded personnel did not qualify as employees of the assessee and rather it was a case of contract of service. Hence, the payments made for employee salaries etc. were amenable to Service tax under reverse charge mechanism ('RCM').

Facts of the case:

- The assessee, in the instant case, was registered under the Service Tax Law.
- The overseas group company ('foreign party') had assigned specified tasks to the assessee, including back-office operations of a certain kind. Towards such activities, the assessee was paid a mark-up of 15% of the overall expenditure it incurred such as employee salaries, consultancy charges, communication expenses etc.

- For performing the agreed tasks, the foreign party loaned some of its employees to the assessee, on secondment basis.
- During the secondment period, the assessee had complete operational control and was responsible for the work of the seconded employees. Moreover, the seconded employees carried out functions for the business operations of the assessee and were accountable for their performance to the assessee.
- The seconded employees were paid remuneration by the foreign party, which was, in-turn, reimbursed to the foreign party by the assessee. The employees also remained on rolls of the foreign party.
- Pertinent that the assessee duly deducted TDS under Section 192 of the Income Tax Act, 1961 (which pertains to 'salary income') on such employee remuneration. The assessee reported these payments under the expense head of "Salaries & Allowances" in their financial statements. Moreover, the seconded employees too filed their income tax returns and contributed to the provident fund as per the relevant Indian laws.
- Service tax proceedings were initiated against the assessee for payments made to foreign party in

¹ 2022-VIL-31-SC-ST



relation to such foreign employees' salaries etc. for both pre-negative as well as post-negative list regime.

- CESTAT Bangalore, on examination of agreements, facts and documentation on record held that the instant arrangement was not of supply of manpower. In-fact, employer–employee relationship existed between the assessee and the seconded individuals and thus, no 'service' element was present for Service Tax levy.
- Aggrieved by the decision of the CESTAT, Bangalore the Revenue preferred an appeal before the Supreme Court.

Judgment of the Supreme Court:

Relying upon its earlier judgments passed in the Income Tax regime², the Apex Court set aside the decision of the CESTAT and held that the assessee was liable to discharge Service tax under RCM on the manpower supply services received from the foreign party.

Some important observations made by the Hon'ble Supreme Court are as follows:

- One of the cardinal principles of interpretation of documents, is that the nomenclature of any contract, or document, is not decisive of its nature. The 'essence' of the contract takes precedence over its form. Thus, true nature of the relationship between the seconded employees and the assessee has to be discerned.
- In the instant case, the assessee had only functional or operational control over the seconded employees, who were responsible for performing tasks for the assessee's activities or business, for a short duration of time.
- Since the employees carried out activities on assessee's behalf, it was only natural to expect the foreign party to seek reimbursement of the employees' salaries, since the employees were not

engaged in any activity for the foreign party during the secondment period.

- The seconded employees always remain on the payroll of the foreign party. Secondment arrangement is a part of global policy of the foreign party of loaning its services on a temporary basis. Further, on cessation of the secondment period, the seconded employees were repatriated back to the foreign party, to merge with the 'employee pool' they were originally a part of.
- By accepting the seconded employees, the assessee gets economic benefit of securing new jobs or assessment against which it makes payment of salary cost of seconded employees. Hence, there exists a quid-pro-quo under the secondment arrangements.
- Emphasis must be placed on the overall essence of the secondment arrangement. The Court further relied on the principle of 'Substance over Form' for interpreting the contractual arrangements entered between the parties.
- Past rulings passed in the cases of **Volkswagen India (Pvt.) Ltd. and Computer Sciences Corporation India Pvt. Ltd.**³ under the Service Tax regime hold no precedential value.
- Revenue neutrality shall not come to aid the assessee and shall be no ground for not making tax payment.

Dhruva Comments

It is a common business practice among multi-national corporations ('MNCs') to depute its manpower to subsidiary companies for particular projects and for a specific period of time.

In these arrangements, the remunerations are generally paid by the home ('parent') company directly to the seconded employee, which in turn, is reimbursed by the subsidiary to the parent company.

² CIT v. Eli Lilly & Co. Pvt. Ltd., (2009) 15 SCC 1; DIT v. Morgan Stanley & Co. Inc. (2007) 7 SCC 1

³ Commissioner v. Volkswagen India (Pvt.) Ltd., 2013-VIL-29-CESTAT-MUM-ST; Computer Sciences Corporation India Pvt. Ltd. v. CST Service Tax, Noida, 2014-VIL-554-CESTAT-DEL-ST



Taxability of these employee reimbursements made by the subsidiary company has always been a matter of dispute even under the *erstwhile* Service Tax regime.

Noteworthy that post 2012, there have been several judgments⁴ wherein Tribunal has consistently held that an employer-employee relationship exists between the Indian entity and the seconded employees and thus, the reimbursements made by the latter for salaries paid to seconded employees shall fall outside the purview of Service tax.

Interestingly, the above position stands, more or less, affirmed by CBIC itself vide its Draft Circular⁵ which states that where staff is employed by one or more employers who normally share the cost of such employment, the services provided by such employee will be covered by the exclusion provided in the definition of service.

The judgment has, effectively, jolted the industry and opened a pandora's box on a position which was, hitherto, considered settled under the Service tax regime and shall have a lasting impact under the GST regime also.

Previously, backed by the relevant Income Tax provisions (which provided for withholding of tax under the head 'Salaries'), businesses did not offer such reimbursements to levy of Service Tax, by arguing that the same qualified as consideration paid under an 'Employer-Employee relationship'.

The judgment will have to be applied carefully, especially considering the fact pattern of each case and with an eye on the Income Tax implications it creates, so as to ensure consistency in the stand across the taxation laws.

⁴ Franco Indian Pharmaceutical Pvt. Ltd., 2016-VIL-280-CESTAT-MUM-ST; Target Corporation India Pvt. Ltd., 2021-VIL-18-CESTAT-BLR-ST

⁵ F. No. 354/127/2012 – TRU





ADDRESSES

Mumbai

1101, One World Centre, 11th floor,
Tower 2B, 841, Senapati Bapat Marg,
Elphinstone Road (West), Mumbai 400013
Tel: +91 22 6108 1000 / 1900

Ahmedabad

B3, 3rd Floor, Safal Profitaire,
Near Auda Garden,
Prahladnagar, Corporate Road,
Ahmedabad 380015
Tel: +91-79-6134 3434

Bengaluru

Prestige Terraces, 2nd Floor
Union Street, Infantry Road,
Bengaluru 560001
Tel: +91-80-4660 2500

Delhi / NCR

101 & 102, 1st Floor, Tower 4B
DLF Corporate Park
M G Road, Gurgaon
Haryana 122002
Tel: +91-124-668 7000

Pune

305, Pride Gateway, Near D-Mart, Baner,
Pune 411045
Tel: +91-20-6730 1000

Kolkata

4th Floor, Unit No 403, Camac Square,
24 Camac Street, Kolkata
West Bengal 700016
Tel: +91-33-66371000

Singapore

Dhruva Advisors (Singapore) Pte. Ltd.
20 Collyer Quay, #11-05
Singapore 049319
Tel: +65 9105 3645

Dubai

WTS Dhruva Consultants
Emaar Square Building 4, 2nd Floor,
Office 207, Downtown,
Dubai, UAE
Tel: + 971 56 900 5849

KEY CONTACTS

Dinesh Kanabar

Chief Executive Officer
dinesh.kanabar@dhruvaadvisors.com

Niraj Bagri

niraj.bagri@dhruvaadvisors.com

Ranjeet Mahtani

ranjeet.mahtani@dhruvaadvisors.com

Dhruva Advisors has been consistently recognised as the **“India Tax Firm of the Year”** at the ITR Asia Tax Awards in 2017, 2018, 2019, 2020 and 2021.

Dhruva Advisors has also been recognised as the **“India Disputes and Litigation Firm of the Year”** at the ITR Asia Tax Awards 2018 and 2020.

WTS Dhruva Consultants has been recognised as the **“Best Newcomer Firm of the Year”** at the ITR European Tax Awards 2020.

Dhruva Advisors has been recognised as the **“Best Newcomer Firm of the Year”** at the ITR Asia Tax Awards 2016.

Dhruva Advisors has been consistently recognised as a Tier 1 firm in **India’s ‘General Corporate Tax’** and **‘Indirect Tax’** ranking tables as a part of ITR’s World Tax guide. The firm is also listed as a **Tier 1 firm** for India’s **‘Transfer Pricing’** ranking table in ITR’s World Transfer Pricing guide.

Disclaimer:

The information contained herein is in summary form and is therefore intended for general guidance only. This publication is not intended to address the circumstances of any particular individual or entity. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation. This publication is not a substitute for detailed research and professional opinions. Before acting on any matters contained herein, reference should be made to subject matter experts, and professional judgment needs to be exercised. Dhruva Advisors LLP cannot accept any responsibility for loss occasioned to any person acting or refraining from acting as a result of any material contained in this publication

