Secondment of Expatriates - Taxation thereon

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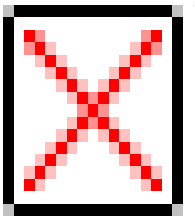

SECONDMENT
refers to an arrangement between two entities, to deploy the employee of one entity to another, on agreed terms and conditions. Generally, under secondment, an employee of an overseas entity is deployed to an Indian entity or vice versa. With economic liberalization and globalization of businesses, the secondment of expatriates has become a common practice amongst global business conglomerates.

Taxability of secondment of expatriates has always been under dispute, whether the same should be classified as supply of manpower services or under the employer-employee arrangement. In the past, different appellate forums have pronounced such arrangement to be covered under the employer-employee relationship and thus non-taxable service.

However, the Hon'ble Supreme Court in the case of Northern Operating Systems Private Limited [***NOS***] - **2022-TIOL-48-SC-ST-LB** passed a landmark ruling wherein it considered **secondment of expatriates as import of 'manpower supply service'** thereby requiring the Indian company to **pay tax on such transaction under RCM.**
This ruling was followed by the CESTAT in the case of Dell International Services Private Limited .

With these recent rulings, transaction of secondment has once again come under the scanner of tax authorities and notices are being issued demanding tax under reverse charge mechanism (RCM) considering secondment as supply of manpower service.

The queries to be answered here are-

1) Whether the above ruling of Northern Operating Systems has universal application?

2) Will all forms of secondment from overseas entity to Indian entity amount to import of services?

3) Can assessee avail ITC today, of the tax paid as RCM liability for the past period?

In order to answer these questions, it is pertinent to understand the basis on which the Hon'ble Supreme Court held secondment as 'manpower supply service' in case of NOS.

The Hon'ble Supreme Court has ruled out the existence of employer-employee relationship between seconded expatriates and Indian entity, by considering the overseas entity as employer of seconded expatriates and the said arrangement as supply of manpower services, on the below mentioned grounds:

- Expatriates continue to remain on the payroll of the overseas entity as they received salaries, bonus, social benefits, etc. from the overseas entity during the secondment period.

- Although expatriates are under the functional/operational control of the Indian entity, their terms of employment are in accordance with the global policies. **Direction and control test are not the sole criteria to determine employment**.

- The salary packages, allowances, etc. are expressed in overseas currency and **separate allowances were granted for working in India**, which further indicated that the seconded employees were employees of the overseas entity.

- Employees of overseas entity were deputed for a specific duration for providing services to the Indian entity which was in turn engaged in providing services to the overseas entity. Thus, **skilled personnel were deputed by the overseas entity to the Indian entity to enable the Indian entity to perform its tasks assigned by the overseas entity** .

- On completion of the secondment period, the expatriates would return to the overseas entity.

- Revenue neutrality is irrelevant.

- The **Supreme Court's own rulings in Volkswagen and Computer Sciences Corporation** were held to be of **no precedential value** since such rulings were mere affirmation of the CESTAT judgement, without any independent reasoning.

The DGGI has started issuing notices to companies, which indicates the government's intention to collect taxes on secondment of expatriates.

Thus, it is imperative for companies to review their existing agreements for secondment / deputation and ascertain whether it is possible to establish employer-employee relationship. It is important for companies to identify distinguishing factors in such agreements, from that as discussed in the NOS ruling.

For future secondment agreements, companies must carefully devise the terms and conditions considering the discussions made by the Supreme Court in the NOS ruling.

The liability under RCM must be paid mandatorily in cash, which can have an impact on the working capital of the assessee. The same may also be an additional cost to entities in case they are not eligible to claim such ITC (exempted outward supply) or claim partial ITC (NBFCs, Banking companies, etc.)

The present ruling though rendered for levy of indirect tax would also impact the transaction from a direct tax perspective, since same transaction cannot be treated differently under different laws.

1) Whether this ruling would have universal application?

The ruling is fact specific and may not have universal application. As discussed in the ruling, the terms & conditions of secondment agreement play an important role in determining the taxability under GST.

2) Would all forms of secondment from overseas entity amount to import of services?

Some of the factors that need to be analysed to determine if secondment shall classify as manpower services are:

- The nature of tasks performed by the seconded employee under direction of the Indian entity

- Nature of activity undertaken by the Indian entity to whom the expatriate is seconded

- Reimbursement of salary is obvious if the employee works on the tasks of the Indian entity and hence the same cannot be used as mere reason for classifying as manpower supply service

However, the facts and circumstances of each case needs to be analysed in detail to determine the nature of secondment and classification of service.

3) Can ITC be availed on RCM liability paid today for the past period?

ITC may be availed based on the self-invoice issued under RCM. However, such ITC may be restricted in case the tax is paid post issuance of notice, under provisions of Section 17(5)(i) of the CGST **Act, 2017**.

The Supreme Court did consider a ***"substance over form"***
approach for determining the employer-employee relationship in the NOS ruling. However, some of the factors considered while pronouncing the ruling are likely to have a far-reaching impact in evaluating similar arrangements both from an indirect tax as well as direct tax perspective.

Furthermore, the tax authorities are already issuing notices with respect to secondment. Thus, companies need to adopt a proactive approach, re-visit their past litigations, and review their secondment agreements to determine the further course of action.

[Pinal Shah, Associate & Sanika Ajgaonkar, Executive, NMAH & Co. also contributed towards the article. The views expressed are strictly personal.]