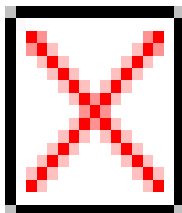


Impact of Northern Operating judgment - what lies in store

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Background

THE Apex Court in the case of C.C., C.E. & S.T. Bangalore v. Northern Operating Systems (P.) Ltd. ¹, ("**Northern Operating**"), while construing a contract for secondment, upheld the demand for service tax on the supply of manpower by a foreign company to its Indian affiliate. This judgement of Supreme Court has been the talk of the town for global business involved in the practice of secondment of employees as it undisputedly has the potential to re-open the pandoras box of Service tax or GST issues on secondment of employees.

It is pertinent to note that post this judgement of Supreme Court, Directorate General of GST Intelligence (DGGI) has issued notices contending the taxability of secondment, classifying it as manpower supply.

This article intends to analyse the Supreme Court's judgement in Northern Operating case with the aim to distinguish the Northern Operating Judgement on facts. The analyses would further provide a way forward to the businesses involved in practice of secondment.

Introduction

Secondment is an agreement between two businesses to send a worker from one to the other under pre-determined terms and circumstances. An employee from a foreign company might be transferred to an Indian company, or vice versa, in a normal secondment situation. Through secondments, multinational corporations frequently share their talent pool across borders and countries. This helps the group to comprehend cultural variations and allows the affiliates to benefit from the parent or group company's experience. Additionally, it offers a chance to improve the bonds between the members of the group.

Under GST, Section 7 of CGST Act read with Entry 1 of Schedule III of the CGST Act, provides that services provided by an employee to the employer in the course of or in relation to his employment is treated neither as supply of goods or supply of services. The issue that arises for consideration is whether the expatriates have an employment relationship with the Indian affiliate. If it is determined that the expatriates have an employment relationship with the Querist, the same will be covered under Entry 1 of Schedule III and no GST is payable on the same. Same was the view of Hon'ble CESTAT (Customs, Excise & Service Tax Appellate Tribunal) that there exists no supply of manpower if a seconded employee and the host establish an employer-employee relationship during the secondment.

On the contrary, Supreme Court in Northern Operating Case observed that the secondee would continue to be employed by the original employer, i.e., the foreign company. The Court, further, noticed that the terms of employment were in accord with the policy of the foreign company. The Supreme Court observed that while determining whether a contract is a contract of service, there is no one single determinative factor or test. Every case has to be examined in the context of its facts. Each case is to be determined as per the agreement in that case to determine if any services are being provided by the overseas entity to the Indian entity.

Analysis

In the Northern Operating Case, there was a master service agreement between the Indian entity and the overseas entity whereby the Indian entity was to provide general back office and operational support to the overseas entity. Further, the whole of the salary to the seconded employees was paid by the overseas company which was later reimbursed by the Indian entity to the overseas entity. Lastly, one of

determinative factors in Northern Operating Case was the retention of the payroll by the foreign company. Hence, this part is distinguishable, if it is established that expatriates during their tenure of secondment work solely for the Indian entity and are not related to the overseas entity. This can be further established if the Indian entity enter into employment agreements with each expatriate and bear all the costs and expenses in relation to the employment agreements.

It is pertinent that the Indian entity becomes the employer of the expatriates for their tenure as seconded employee. In furtherance to this, the expatriates must function solely under the control, direction, and supervision of the Indian entity and the overseas entity is not concerned with the deliverables of the seconded employees. The agreement needs to be drafted in such a way where the salary is offered and decided by the Indian entity as per Indian entities policies. This would make the Indian Entity, the recipient, and the service provider will be the expatriate and not the overseas entity, hence the supply of service will be between the Indian entity and expatriates, on which GST is not attracted.

Reliance in this regard should be placed on the decision of Hon'ble Karnataka High Court in Flipkart Internet Private Ltd. v. DCIT (International Taxation) ²

, wherein, while adjudicating on the eligibility of Income Tax on Secondment Agreements, Court held that the mere payment by the overseas entity to the seconded employees would not alter the relationship between the Indian entity and the seconded employees as the Indian entity pays the overseas entity for the payments made to the seconded employees by way of reimbursement.

Further, Hon'ble CESTAT in Franco Indian Pharmaceutical (P.) Ltd. v. Commissioner of Service-Tax, Mumbai ³

, held that deputation of employees and acceptance thereto by an employee amount to 'joint employment' of the employee with many employers; hence, such a deputation of employees would not amount to a service. It was further held that in the absence of a mark-up on reimbursement, the payments received against debit notes by one employer-company upon the other employer-companies, will not amount to any consideration for service, but will merely represent a reimbursement.

Will Northern Operating Have Retrospective Effect?

As per Section 13(1) of the CGST Act, the liability to pay tax on services shall arise at the time of supply. The time of supply of services in cases where tax is payable under Reverse Charge Mechanism, is to be determined as per Section 13(3) of CGST Act. It is pertinent to note that Section 13(3) does not contemplate the date of a judgement as the time of supply. The Supreme Court, in P.V. George v. State of Kerala ⁴, observed that law declared by a court will have a retrospective effect, if not otherwise stated to be so specifically. In Northern Operating, it was nowhere stated by the Supreme Court that the ruling was to apply prospectively. Therefore, the judgement in Northern Operating will apply retrospectively.

Further, a judgement of the Supreme Court only declares the law and does not legislate the law. Therefore, it cannot be said that the liability to pay tax arises on the day when the judgement in Northern Operating was delivered.

Conclusion

The judgement of Northern Operating Case unsettles the settled position of law on the issue of taxability of reimbursements in case of secondment of employees. However, it can be safely concluded that this judgement can be distinguished based on differences in facts. The effect of Northern Operating judgement is only restricted wherein the Indian entity was not 'real' employer of seconded employees with the right to terminate and control the terms of employment. Secondly, the judgement is restricted wherein the purpose of secondment as laid down in the contract was for the performance of specialized functions.

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¹C.C., C.E. & S.T. Bangalore v. Northern Operating Systems (P.) Ltd., [2022-TIOL-48-SC-ST-LB](#)

² Flipkart Internet Private Ltd. v. DCIT (International Taxation), [2022-TII-14-HC-KAR-INTL](#)

³ Franco Indian Pharmaceutical (P.) Ltd. v. Commissioner of Service-Tax, Mumbai, - [2016-TIOL-2371-CESTAT-MUM](#).

⁴P.V. George v. State of Kerala, (2007) 3 SCC 557

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