Supreme Court on Services of Seconded Employees

*By Ashutosh Mahajan**

1. In a recent judgement [Commissioner of Custom, Central Excise & Service-tax – Bangalore (Adjudication) etc. vs. M/s Northern Operating Systems Pvt. Ltd.] (Civil Appeal No. 2289-2293 of 2021), reported in 2022-TIOL-48-SC-ST-LB, on the given facts of the case, Hon'ble Supreme Court of India (SC) has held that the seconded employees are employees of the overseas group company and Indian entity is a service recipient for service (of manpower recruitment and supply services) by the overseas entity, in regard to these seconded employees, for the duration of their deputation and therefore, the Indian entity is liable to pay service tax.

2. While holding so, SC has given the following findings of facts and law:

   2.1 In terms of service agreement, overseas group company assigns certain tasks to the Indian entity, including back-office operations of a certain kind, in relation to its own activities or that of other group companies. For these services, Indian entity is compensated for costs plus a mark-up of 15%.

   2.2 In terms of secondment agreement, the parties agree that overseas employees are temporarily loaned to the Indian entity. During the period of secondment, Indian entity has control over the employees and is responsible for the work of seconded employees. Indian entity can require the seconded employees to return if not found suitable and likewise, such employees have the discretion to terminate this relationship. The overseas employer pays the seconded employees, which is reimbursed to the overseas group company by the Indian entity. The secondment is for a specific duration and employment with the Indian entity ceases at the end of this period.

   2.3 Letter of understanding issued by the overseas group company to the seconded employee specifies that the tenure with the Indian entity is an assignment and at the conclusion, repatriation will be in accordance with the Global Mobility Repatriation Policy. The salary terms (such as salary, hardship allowance, vehicle allowance, servant allowance, paid leave, housing allowance etc.) signify that the seconded employees are of a certain skill and possess the expertise which the Indian entity requires.

2.4 SC relied upon Director Income Tax v. M/s Morgan Stanley & Co. Inc. (2007) 7 SCC 1, to make home the point that as long as the seconded employees have a lien on their employment with the overseas group company, the said company retains control over the deputationist's terms and employment. Further, the test of control, or manner of performance of a task, by an employee is not conclusive to decide if an employer employee relationship subsists. [Silver Jubilee Tailoring House v. Chief Inspector of Shops & Establishments 1974 (1) SCR 747].

2.5 Relied upon State of Orissa v. Titaghur Paper Mills Co. Ltd. 1985 Supp SCC 280 to hold that one of the cardinal principles of interpretation of documents, is that the nomenclature of any contract of document, is not decisive of its nature. Therefore, the court must discern the true nature of relationship between the seconded employee and the assessee, and the nature of the services provided – in that context – by the overseas group company to the assessee, based on an overall reading of the materials presented by the parties. Test of substance over form needs to be applied, requiring a close look at the terms of the contract, or the agreements.

2.6 There is no single determinative test, but that what is applicable is *"a conglomerate of all applicable tests taken on the totality of the fact situation in a given case that would ultimately yield, particularly in a complex hybrid situation, whether the contract to be construed is a contract of service or a contract for service. Depending upon fact situation of each case, all the aforesaid factors would not necessarily be relevant, or, if relevant, be given the same weight."* [Sushilaben Indravadan Gandhi v. New India Assurance Co. Ltd. (2021) 7 SCC 151].

2.7 While the control (over performance of the seconded employees' work) and the right to ask them to return, if their functioning is not as is desired, is with the assessee, the fact remains that their overseas employer **in relation to its business** (a vital fact), deploys them to the assessee, on secondment. Secondly, the overseas employer – for whatever reason, pays them their salaries. Their terms of employment – even during the secondment – are in accordance with the policy of the overseas company, who is their employer. Upon the end of the period of secondment, they return to their original places, to await deployment or extension of secondment.

3. While holding so, one of the key findings of the SC that has also been considered a vital fact, is that the overseas employer deployed these employees on secondment to Indian entity **in relation to its business**. With due respect, those personnel were deputed to Indian entity for the purpose of Indian entity's business which may ultimately be providing services to the foreign entity/group companies under a cost-plus arrangement. This is a case of two independent legal entities, resident in two separate tax jurisdictions and operating on an arm's length principle. Once the requirement of personnel came from the Indian entity and those personnel, during their period of secondment, worked under control & supervision of the Indian entity, it cannot be said that these personnel were seconded to India for foreign entity's business. Use of such a wide term 'in relation to its business' without substantial discussion on how it will encompass the independent legal entity principle only adds to the woes of tax payers.

4. Once the Hon'ble Supreme Court has held that seconded employees are in fact employees of the foreign group company and the Indian entity is a service recipient, it becomes difficult for the foreign entity, in this case, to argue that it does not have a Permanent Establishment (PE) in India on account of its employees physically located in and providing services in India. In our view, this, however, remains an independent question, to be examined afresh in the light of detailed facts, and subject to Double Taxation Avoidance Agreement (DTAA) between India and the country of employer from where these employees have been seconded. Any other foreign company having similar facts would also be equally exposed to this question of PE which must be examined on an urgent basis.

5. This judgement also opens a pandora's box for all multinational companies having subsidiaries in India and having employees seconded to Indian entity from the overseas parent/group companies. The applicability of this judgement will vary based on facts of each case. Some of the critical facts that require immediate attention are: a) Whether Indian entity requires and asked for the services of these seconded employees, or they have been mandatorily pushed into Indian entity by the overseas parent? b) Who decides the remuneration of these seconded employees? Whether these employees work under the terms of employment of Indian entity or that of foreign entity? c) Who pays the remuneration to these seconded employees? d) Whether the seconded employees have a lien back on their employment with the parent during and after their secondment? e) What are the activities performed by these

seconded employees while working with Indian entity and can it be said that all activities are performed for the Indian entity's business? e) Even if all the activities have not been performed for the Indian entity's business, what are the nature of activities performed for the foreign parent/group company, and can it be said that those activities were performed in relation to the business of the foreign parent/group company?

Conclusion

While it is a Three Member Larger Bench judgement of Hon'ble Supreme Court of India and is the law of land today on specific facts of the case, we are sure that the subject of secondment of employees by a foreign group company to an Indian entity has not seen full discussion yet and is far from being settled. Given this judgement, all multinationals will have to closely look at their secondment policy and documentation around it. It further needs to be seen whether based on existing facts of their case, they will be able to distinguish themselves from this judgement, or will it require a change in their secondment policy & documentation? Whatever be the case, principle of substance over form must always be kept in mind. Secondment of employees has always been a sensitive subject and given the history of compliance & litigation around this subject, facts generally have not been so forthcoming nor have been delved deeper on an individual secondee to secondee basis. Instead, subject has been dealt with more based on agreements. It is our considered view that cause of justice would be served better if facts come out more clearly, in greater detail and with evidence, rather than all secondees being lumped together into a homogenous group.

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