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GMS Flash Alert

2022-108 | June 2, 2022

India - Indian Company Liable for Service Tax on Seconded Employees

The Supreme Court of India has held that, in certain situations, service tax is payable on the secondment of employees to India from overseas companies where the Indian company has had the benefit of expert services for the period of the secondment.[1] Therefore, the Indian company receiving human resources can be liable to pay service tax on the salaries of seconded employees reimbursed to the overseas company.

WHY THIS MATTERS

This decision is significant for companies sending their employees on secondment to Indian entities. Companies should be cognizant of the applicability of service tax with respect to recharge of costs between the two entities regarding secondment arrangements.

Following the new holding from the highest court of India, companies will have to review their existing secondment arrangements to determine their potential exposure to service tax.

Facts of the Case

The details of the judgment are as follows:

- The taxpayer, an Indian registered company (referred to in the judgment as "Assessee"), entered into an agreement with its group company located outside of India which includes agreement for the secondment of personnel to assist in its business in India. The employees are selected by the group company and transferred to Assessee. As per the terms of the agreement with the seconded employees:
  - they shall act in accordance with instructions and directions of Assessee;
  - they shall continue to be on payroll of group company but shall be employees of Assessee;
  - they would receive salary and other expenses from the group company.

- Assessee reimburses group company for all these expenses with no mark-up.
- In addition to the above, Assessee pays for certain other services received from the group company on which it has discharged service tax.
- Revenue issued “show cause” notice and thereafter confirmed the demand on the contention that Assessee has failed to discharge service tax under the category of "manpower recruitment or supply agency service" holding that the group company is a service provider and Assessee is the service recipient.
- Revenue filed an appeal before the Supreme Court against the order of CESTAT, which held that the overseas group company that had contracted with Assessee is not in the business of supply of manpower and that Assessee was not a service recipient.

Revenue’s Contentions

- Through the combined reading of the agreements/documents on record, the arrangement between Assessee and the overseas group company is of a *contract for service* (i.e., a contract between the parties was essential for the supply of services by the concerned overseas company to Assessee).
- Tasks performed by seconded employees were to aid Assessee's work which was undertaken by it through the service agreement with the overseas group company.
- The mere fact that the temporary control by Assessee over the manner of performance of duties of the employees that were seconded did not take away or diminish the fact that the real employer was the overseas group company.
- The control if any, which was with Assessee was for a limited duration. It was not enabled to impose sanctions such as cuts in salary, etc.

Assessee’s Contentions

- Employee-employer relationship is outside the scope of service.
- Service becomes a taxable service only if it is provided by a manpower recruitment or supply agency. The category of supply of manpower covers those cases where the manpower so supplied comes under the direction and control of the recipient without contractual employment.
- The overseas group company is not in the business of supplying manpower.
- Salaries cannot be said to be consideration paid to the group company for the provision of service.

Supreme Court’s Decision

The Supreme Court set aside the order of CESTAT and upheld the contentions of the Revenue. Below is the gist of the prominent inferences pronounced by the Court:

- Agreements entered into by Assessee with the overseas group company clearly point to the fact that the overseas group company has a pool of highly-skilled employees who are entitled to a certain salary structure as well as social security benefits. Upon the cessation of the term of secondment, seconded employees return to their overseas employer, or are deployed on some other secondment.
- While control over their performance and the right to ask the seconded employees to return is with Assessee, the fact remains that their overseas employer in relation to its business deploys them to Assessee on secondment.

- The overseas group company pays the salary. Terms of employment is as per the policy of the overseas group company.
- The quid pro quo for the secondment agreement, where Assessee has the benefit of experts for limited periods, is implicit in the overall scheme of things.

KPMG NOTE

This is a very important judgment in terms of the levy of service tax on secondments of employees to India given that until now several judgments held that the tax is not payable. The general view of the industry over the years has been that since "control" over the seconded employees is with the Indian entity, no tax is payable as there is an employee-employer relationship. Following this judgment, organisations will have to review their existing arrangements and secondment contracts.

This judgment will not just impact past service tax cases, but could also impact the position in terms of the GST regime. Further, there could be corporate tax and transfer pricing implications in this judgment.

For more information on the holding, see "Assessee Liable to Pay Service Tax on Secondment of Employee from Overseas Group Companies" *in Tax Flash News* (25 May 2022), a publication of the KPMG International member firm in India.

FOOTNOTE:

1 Case Name: C.C., C.E. & S.T. - Bangalore (Adjudication) Etc. v. M/s. Northern Operating Systems Pvt. Ltd. [2022-VIL-31-SC-ST]. See: https://main.sci.gov.in/supremecourt/2021/14156/14156_2021_2_1501_36077_Judgement_19-May-2022.pdf .

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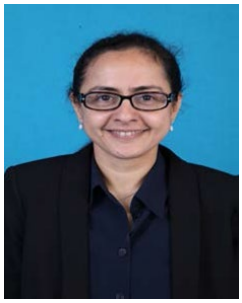
Contact us

For additional information or assistance, please contact your local GMS or People Services professional or the following professional with the KPMG International member firm in India:



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