


Tax Insights**21 May 2022****Supreme Court holds secondment of employees by an overseas group entity to an Indian entity as service by applying principle of 'substance over form'****In brief**

In a recent appeal,¹ the Supreme Court has held that the secondment of employees by an overseas group company (OGC) to an Indian company is liable to service tax based on a detailed analysis of the agreements and applying the principle of 'substance over form'.

In detail**Facts and issue**

- The taxpayer entered into agreements with its group companies located outside India to provide general back office and operational support to such group companies. To provide the aforementioned services and assist in the business, the group entities provided certain technical personnel to the taxpayer.
- The group companies select the employees who are seconded to the taxpayer under an agreement for a temporary period.
- During the term of secondment, the taxpayer has control over the seconded employees and is responsible for their work. The employees continue to be on the payroll of the group companies for the purpose of continuation of social security, retirement and health benefits. However, for all practical purposes, the taxpayer is the employer.
- The OGC pays remuneration to the seconded employees and claims reimbursement from the taxpayer. The letter of understanding issued to the seconded employee specifies that the tenure with the taxpayer is an assignment, and repatriation would be in accordance with the global mobility repatriation policy.
- The seconded employees file income-tax returns and contribute to the provident fund in India. Moreover, the taxpayer issues prescribed forms to the seconded employees as provided under the Income-tax Act, 1961.
- Revenue authorities sought to recover service tax on the amounts paid to the OGC for providing 'manpower'

¹ Civil Appeal No. 2289-2293 of 2021

recruitment and supply agency services' to the taxpayer. The issue before the Supreme Court was whether the OGC, with whom the taxpayer had entered into secondment agreements, provides manpower services to the taxpayer.

Supreme Court's decision

The Supreme Court holds that, regarding employees seconded to the taxpayer for the duration of secondment, the taxpayer was the recipient of manpower recruitment and supply services from the OGC. However, the Supreme Court also holds that invocation of the extended period of limitation is not tenable. This is based on the following observations.

Nature of service provided by the OGC

- The crux of the issue is the taxability of the cross-charge, which is primarily based on who should be reckoned as an employer of the secondee, the Indian company or the overseas entity. In this regard, the Supreme Court refers to the principles established by the court.
- The court has relied on the principle of 'substance over form' and held that the 'cardinal principles of interpretation of documents, is that the nomenclature of any contract, or document, is not decisive of its nature'.
- The overall effect of the agreements clearly points to the fact that the OGC has a pool of highly skilled employees who are entitled to a salary structure as well as social security benefits. Considering their expertise and specialisation, these employees are seconded (deputed) to the group entities for use of their skills. Upon cessation of the term of secondment, they return to their overseas employer, or are deployed on some other secondment.
- For all appearances, the seconded employee is under the control of the taxpayer and works under its direction during the period of secondment. Nevertheless, the fact remains that they are on the payroll of the overseas employer. This is a legal requirement since they are entitled to social security benefits in the court of their origin.
- The secondment is a part of the global policy of the overseas employer and, on cessation of the secondment period, the employees have to be repatriated in accordance with the global repatriation policy of the overseas employer.
- The employment, even during the secondment, is in accordance with the policy of the OGC, who is their employer. The salary package with allowances is expressed in foreign currency, which are substantial and could have been only by resorting to a standardised policy of the overseas employer.

Consideration and *quid pro quo* is implicit

- The taxpayer argued that it is not required to pay any consideration to the OGC. The court observes that one method of reckoning if there is consideration, is payment in the form of remittances or amounts for the secondment. The other way of looking at the arrangement is the economic benefit derived by the taxpayer, who also secures specific jobs or assignments, from the OGCs, thus resulting in its revenue. The *quid pro quo* for the secondment agreement, where the taxpayer has the benefit of experts for limited periods, is held to be implicit in the overall scheme of things.

Revenue neutrality

- Regarding the argument on revenue neutrality, the court observes that it is called upon to adjudicate about the nature of the transaction and whether the incidence of service tax arises by virtue of the provision of secondment services. Whether a particular rate of tax or no tax is payable, whether the whole or part of the duty is claimed as refund etc., is held as irrelevant.

Precedential value of earlier rulings

- The earlier orders relied upon in the context of revenue neutrality or secondment. They are held as having limited or no precedential value since they were without any independent reasoning.

Invocation extended period of limitation

- Considering the previous orders of the Customs, Excise and Service Tax Appellate Tribunal on this issue, it was held that the taxpayer's view about its liability is neither untenable nor malafide. The Revenue's contention about the existence of wilful suppression of facts or deliberate misstatement is turned down.

The takeaways

This is a landmark and crucial decision wherein employee secondments by OGCs are held to be manpower supply service. The Supreme Court has examined the agreements in detail and applied the principle of 'substance over form' to determine the relationship between the parties and nature of the services provided. The observations on consideration and *quid pro quo* are also interesting to note. This decision would have far-reaching implications, and companies need to evaluate its impact on similar secondment arrangements under not only the service tax regime but also under the GST regime.

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