NALSAR

Secondment Arrangements

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Contents

Section

1

Background

Article 15 - Dependent Personal Services (DPS)

1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.
2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:
   a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and
   b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and
   c) the remuneration is not borne by a permanent establishment which the employer has in the other State.

10(6) in the case of an individual who is not a citizen of India,

(vi) the remuneration received by him as an employee of a foreign enterprise for services rendered by him during his stay in India, provided the following conditions are fulfilled -

(a) the foreign enterprise is not engaged in any trade or business in India;

(b) his stay in India does not exceed in the aggregate a period of ninety days in such previous year; and

(c) such remuneration is not liable to be deducted from the income of the employer chargeable under this Act;

Short stay exemption

Concept of ‘Economic Employer’ vs. ‘Legal Employer’

- Refer Para 8.12 to 8.15 of OECD commentary to Article 15 - DPS
- Some Illustrative tests:
  - ✓ Who has the authority to instruct the individuals regarding the manner in which work has to be performed
  - ✓ Who has the right to impose disciplinary sanctions related to the work
  - ✓ Who determines the work schedule
  - ✓ Who puts the tools and materials necessary for the work at the disposal of the employee
  - ✓ Remuneration of the Individual is directly charged by the formal employer to the enterprise to which services are provided
  - ✓ Which enterprise bears the responsibility or risk for the results produced by the individual’s work.

Section

2

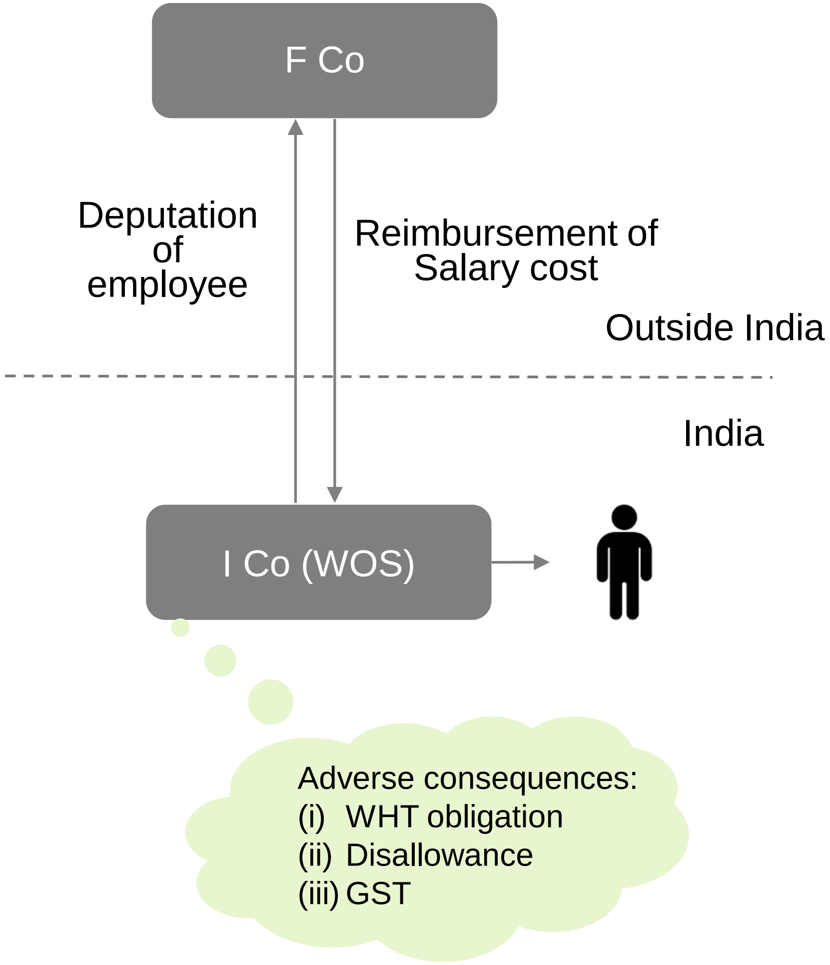
Concept of ‘Secondment’

Concept of Secondment

Tax implications depend upon the terms of secondment arrangement:

- The Indian tax authorities have time and again sought to tax the reimbursements made to F Co by an associate entity in India (I Co) on the grounds that a secondment arrangement is essentially an arrangement for the provision of FTS by F Co to I Co effected through the seconded employees.
- In certain scenarios, the Indian tax authorities contend that the services provided by the secondees to I Co create a PE of the F Co in India.

#	Particulars	Whether taxable as FTS
1	I Co to qualify as an <u>economic employer</u> of employee. Salary cost re-charged at actuals by F Co. to I Co.	No. Also refer conditions laid down by the Judicial precedents
2	I Co to qualify as an economic employer of employee. Salary cost re-charged <u>at mark-up</u> by F Co. to I Co.	FTS
3	F Co. deputed employee for providing <u>services to I Co</u>. Cost re-charged by F Co <u>at actuals or at mark-up</u>.	FTS

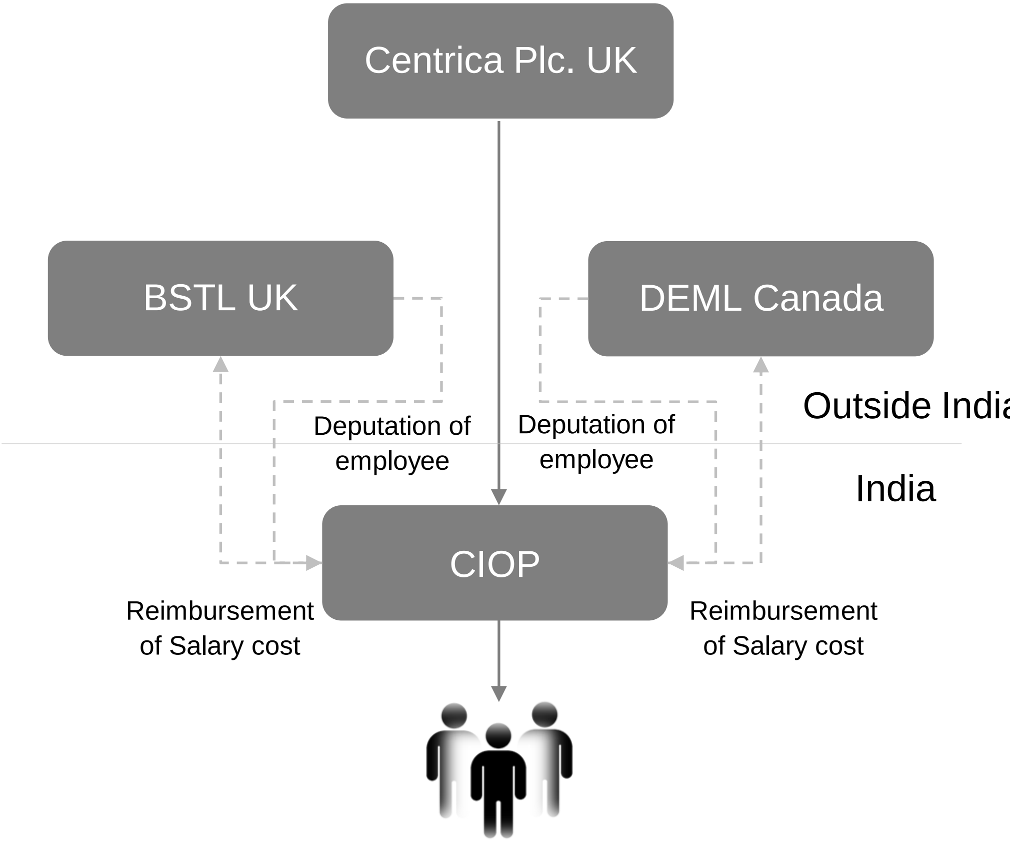


Secondment vs. FTS

Centrica India Offshore Pvt. Ltd. (2014) 44 taxmann.com 300 (Delhi), SLP rejected (2014) 51 taxmann.com 386 (SC)

Facts of the case:

- 'BSTL' and 'DEML' were in the business of supplying gas and electricity to consumers across the UK and Canada. These entities outsourced their back-office support functions (viz., debt collections/consumers' billings/monthly jobs etc.) to third party vendors in India.
- To ensure that the Indian vendors comply with quality guidelines, CIOP was established in India to act as service provider to those overseas entities.
- To seek support during initial year of its operation, assessee sought some employees on 'secondment' and entered into an agreement with the overseas entities in which the latter seconded some employees for fixed tenure.
- The employees so seconded worked under CIOP's direct control and supervision.
- Assessee claimed the payments made to AE as reimbursement and that there is no service PE since assessee is economic employer



Secondment vs. FTS

Centrica India Offshore Pvt. Ltd. (2014) 44 taxmann.com 300 (Delhi), SLP rejected (2014) 51 taxmann.com 386 (SC)

Ruling of the Delhi HC:

- Payments were held to be FTS
  - The expression expressly ‘technical service’ includes the provision of the services of personnel. The nature of the services - cast as 'business support services' by assessee - as also clearly within the hold 'technical or consultancy’.
  - In terms of India-Canada DTAA, the make-available test would be satisfied. The secondees are not only providing services to assessee, but rather tiding assessee through the initial period, and ensuring that going forward, the skill set of assessee's other employees is built and these services may be continued by them without assistance.
- Observations in relation to the existence of PE:
  - Seconded employees retained their entitlement to participate in the overseas entities' retirement and social security plans and other benefits in terms of its applicable policies
  - Whilst CIOP was given the right to terminate the secondment, (in its agreement with the overseas entities) the services of the secondee vis-à-vis the overseas entities - the original and subsisting employment relationship - could not be terminated. Rather, that employment relationship remained independent, and beyond the control of COIP.
  - Obligation to pay the salary rested with the overseas entities and the right of the employee to claim it is only against the overseas entities.
  - The seconded employees in the present case, oversee quality control of the work of such vendors. This work cannot be characterized as mere stewardship.
  - The seconded employees are to be integrated into assessee, for the agreed period and are subject to its supervision and control. The overseas entities were not responsible for any errors or omissions of such seconded employees or for their work. These limited and sparse factors cannot displace the larger and established context of employment abroad.

Secondment vs. FTS

- SLP rejected by the Apex Court in Limine (i.e., at the threshold)
- Is the concept of ‘Legal employer’ vs. ‘Economic employer’ still relevant?
- Judicial adjudications post Centrica ruling ?

✓ When an SLP in Limine is dismissed without a speaking order, it does not constitute a declaration of law or a judgment on the merits of the case. The Court simply declines to grant leave to appeal.

✓ Thus, dismissal or rejection of SLP does not signify that the SC has approved the judgment of the Delhi HC. Therefore, the decision of Delhi HC in the case of Centrica may not be held as final on the issue of “Secondment”.

Section

3

Jurisprudence post ‘Centrica’

Secondment vs. FTS

Morgan Stanley International Incorporated vs. DDIT (2015) (53 taxmann.com 457) (Mumbai Tribunal)

Ruling of the Mumbai Tribunal:

- Para 6 of Article 12 makes it amply clear that taxability of 'royalty' and 'fees for included services' shall not apply, if the resident of the contracting state (USA) carries on the business in other contracting states (India) in which FIS arises through PE situated therein, then in such case the provisions of Article 7 i.e., "Business Profits“ shall apply. In other words, if there is a PE, then Royalty or FIS cannot be taxed under Article 12, albeit only under Article 7 of the DTAA.
- If the taxability of such payment has to be examined and determined on the basis of computation of business profit under Article 7, then the salary paid by the assessee would amount to cost to the assessee, which is to be allowed as deduction while computing the business profit of the PE in India.
- In our opinion, if logical conclusion of the decision of the Hon'ble Supreme Court in the case of *Morgan Stanley & Co* and the decision of *Hon'ble Delhi High Court in the case of Centrica India Offshore (P.) Ltd* is to be arrived at, then the seconded employees will constitute Service PE of the assessee in India and in that case any payment received on account of rendering of service of such employees will have to be governed under Article 7 as per unequivocal terms of para 6 of Article 12. Thus, the ratio laid down in the decision of Hon'ble Delhi High Court, will not help the case of the revenue in any manner because under the concept of PE, FIS cannot be taxed under Article 12, but only as a business profit under Article 7.
- It is very interesting to note that, similar provision is also embodied in the India-Canada DTAA in para 6 of Article 12, but this issue was neither raised or brought to the notice before the Hon'ble Delhi High Court nor it was contested by either parties. There is inherent contradiction in this concept, as in most of the treaties, exclusionary clause like Article 12(6) has been embodied, which makes the issue of taxability of FTS of FIS in such cases as non applicable and have to be viewed from the angle of Article 7.

Section 3

Jurisprudence post 'Northern Operating Systems'

Secondment vs. FTS

Northern Operating Systems, [2022] 138 taxmann.com 359 (19 May 2022)

Ruling of the SC:

- Where employees were seconded to assessee by group overseas entity, assessee was service recipient for manpower recruitment and supply services, and assessee would be liable to pay service tax.
- The SC observed the following:
  - Employees were under control of assessee, and worked under its direction
  - Overseas employer paid them their salaries and their terms of employment even during secondment were according to policy of overseas company
  - Employees would return to their overseas employer upon cessation of term of secondment and may be sent elsewhere on secondment
  - In case it was dissatisfied, assessee could only ask for return of the employee to her or his original position with the foreign employer.

Secondment vs. FTS

Petitioner made contribution to PF as an 'employer of seconded employees' and that the said employees are working in India on 'Employment VISA' wherein, the petitioner is declared to be an 'employer'.

Flipkart Internet (P.) Ltd. vs. DCIT [2022] 139 taxmann.com 595 (Karnataka) (24 June 2022)

Ruling of the Karnataka HC:

- What would be of significance is the relationship between the petitioner and the seconded employees during the period of secondment that has been lost sight of while passing the impugned order. Arter the period of secondment or its termination, the fact that 'Walmart Inc.' has the power to decide on the employees' continuance with 'Walmart Inc.' would not make any difference, as it would relate to a service condition post the period of secondment.
- Further, the mere payment by 'Walmart Inc.' to the seconded employees would not alter the relationship, as the petitioner only seeks to make payment to 'Walmart Inc.' of its payment to the seconded employee which is stated to be by way of reimbursement.
- It is not a case where the petitioner is merely acting as a back office for providing support service to the overseas entity, whereby the overseas entity could be treated as an employer. The petitioner issues the appointment letter, the employee reports to the petitioner, the petitioner has the power to terminate the services of the employee. For the purpose of a limited finding under section 195 on the basis of the available material, it could be concluded that the petitioner is the employer.
- The Apex Court in the particular facts of the case (Northern Operating Systems) had held that the Overseas Co., had a pool of highly skilled employees and having regard to their expertise were seconded to the assessee and upon cessation of the term of secondment would return to their overseas employees.
- It needs to be noted that the judgment rendered was in the context of service tax and the only question for determination was as to whether supply of manpower was covered under the taxable service and was to be treated as a service provided by a F Co to an I Co. But in the present case, the legal requirement requires a finding to be recorded to treat a service as 'FIS' which is "make available" to the I Co.

Secondment vs. FTS

Flipkart Internet (P.) Ltd. vs. DCIT [2022] 139 taxmann.com 595 (Karnataka) (24 June 2022)

Ruling of the Karnataka HC:

- Any conclusion on an interpretation of secondment as contained in the MSA to determine who the employer is would have no conclusive bearing on whether the payment made is for 'FIS' in light of the further requirement of "make available“.
- The agreement between assessee and 'W', if subjected to scrutiny as regards the aspect of secondment does not reveal the satisfaction of the requirement of 'make available' which is a sine qua non for being a 'FIS’. As the agreement does not support 'make available', further enquiry beyond that may not be called for, considering the nature and scope of proceedings.

Impact on PF for International Workers

- As per the Northern Operating System ruling, employees of the foreign entity working with an Indian company will not be considered to be employees of the Indian Company.

- A question arises whether it would unfasten the liability on the Indian company to contribute to PF of the International Workers.? Courts are yet to test this in the context of PF on International Workers

- Note: The Hon'ble Karnataka High Court in the month of April 2024, in the case of Stone Hill Education Foundation v. Union of India and Others, struck down Para 83 of the Employees Provident Fund Scheme, 1995 as unconstitutional and arbitrary as the provisions are violative of Article 14 of the Indian Constitution. The Hon'ble High Court held that International Workers drawing higher salaries cannot be forced to contribute towards PF on their entire salary without any wage ceiling while a wage ceiling of fifteen thousand as has been prescribed for domestic workers.

Thank You

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