Secondment of expat employees: Complexities and challenges under GST

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This update covers:

1 The concept of secondment and how it is structured

Two years ago, the Supreme Court of India held secondment arrangements to be taxable under the Service Tax regime. This article examines the resultant uncertainties created in indirect taxation, especially Goods and Services Tax, and suggests possible strategies for dealing with ongoing litigations and structuring secondment arrangements. It also reviews the recent recommendations of the Goods and Services Tax Council impacting ongoing litigation on secondment issues.

Driven by globalisation, companies are expanding their operations internationally to seek new markets, partners, and growth opportunities. This expansion often requires movement of personnel across borders. As a strategic tool, companies enter secondment arrangements to optimally utilise their talent. India, with its rapidly growing economy and increasing role in global trade, is also seeing an uptick in secondment arrangements.

In a secondment arrangement, expatriates are deputed by the foreign parent company to an Indian subsidiary company. The foreign entity and the Indian entity enter into a secondment agreement that governs the terms of the secondment. Subsequently, a separate employment agreement is executed between the secondee and the Indian entity which typically specifies that the seconded employee will be in full-time employment with the Indian entity during the period of secondment. It outlines details such as the tenure of employment, place of work, salaries and other benefits of secondees, duties and responsibilities of secondees, termination of employment, resignation, dispute resolution, etc. The secondees must follow the rules, regulations, office timings, and code of conduct of the Indian entity and make themselves eligible for tax deduction at source and paying taxes in India. The period of secondment is normally fixed and is extendable on mutual agreement between secondees and the Indian Entity. For all practical purposes, the secondees work under the direction and control of the Indian entity. The salary of the secondees is directly disbursed by the Indian entity and the residual portion (mainly, the social security benefit) is paid by the foreign entity which is then reimbursed by the Indian entity.

Under the Service Tax regime, service provided by an employer to its employee was excluded from the definition of service[1] and therefore from the applicability of Service Tax as well. It was also well settled by orders of the Customs, Excise and Service Tax Appellate Tribunal that secondees work under the control and supervision of the Indian entity as an employee and the Indian entity did not pay any direct/indirect consideration to the foreign entity. Thus, the transaction would not qualify as a manpower supply service as no agency/client relationship could be established between the foreign entity and the Indian entity. So, such arrangements did not fall under the tax net till the Supreme Court pronounced its ruling in *CCE & ST v Northern Operating Systems Private Limited*[2] (NOS Ruling) on 19 May 2022.

[1] Under Section 65(B)(44) of the Finance Act, 1994
[2] 2022 (5) TMI 967-SUPREME COURT

2 Key aspects of the NOS Ruling

In the NOS Ruling, while analysing the nature of the secondment arrangement, the Supreme Court emphasised on the substance of the agreement over its form as being the decisive factor. It found that the Indian entity was providing back-office support services to the foreign entity. The arrangement was that the foreign entity secured global contracts that required skilled personnel for their performance. The Indian entity was performing the tasks in the contracts by using such trained and skilled manpower while the foreign entity seconded its employees to enable the Indian entity to provide this support.

The Court also considered the following factors:

a. While the Indian entity had '*operational and functional control*' over the employees, the foreign entity continued to be the economic employer as payrolls of the secondees continued there. The foreign entity determined the terms of employment of the secondees.

b. Salaries of the secondees were fixed in foreign currency and they were paid a separate '*hardship allowance*' for working in India. The Indian entity remitted the salaries to the foreign entity which in turn remitted the amounts to the respective employees.

c. The secondees possessed specialised skills and expertise. They were deputed for specific duration and specific tasks. They returned to the foreign entity on completion of the secondment period and the foreign entity could deploy them to some other secondment.

d. The foreign entity charged an additional markup from the Indian entity for the administrative cost incurred.

Based on these considerations, the Supreme Court concluded that the Indian entity received manpower supply services from the foreign entity and was liable to pay Service Tax under the Reverse Charge Mechanism. Importantly, the Court noted that its ruling was rendered on the specific facts and circumstances of this particular arrangement and may not form a precedent in all secondment cases.

3 Ripple effect of the NOS Ruling on the Goods and Services Tax regime

Due to similarity in provisions with Service Tax, the key question to determine taxability of employees' secondment under the Goods and Services Tax (GST) regime also is whether the foreign entity is supplying manpower services to the Indian entity (which is taxable) or is there an employer-employee relationship between the Indian entity and seconded employees (which is not taxable).[3]

The NOS Ruling, despite stating that its findings are unique to the specific terms of the secondment agreement between NOS and the foreign entity, immediately triggered investigations by various authorities including the Directorate General of GST Intelligence.

Taxpayers in secondment arrangements adopted either of the following three approaches in the face of such investigations:

[3] Section 7(1) of the Central Goods and Services Tax Act, 2017 defines supply to include all forms of supply made for a consideration by a person in the course or furtherance of business. Section 7(1)(c) provides that supply includes activities specified in Schedule I, made or agreed to be made without a consideration. Clause 2 of Schedule I deems activity of supply between related persons when made in the course or furtherance of business even without consideration as supply. Section 7(2) provides that transactions specified in Schedule III of the CGST Act shall be treated neither as supply of goods nor as supply of services. Clause 1 of Schedule III covers services provided by an employee to employer in the course or in relation to his employment. Sections 5(3) and 2(11) of the Integrated Goods and Services Tax Act, 2017 read with S.No.1 of the Notification No.10/2017 – Integrated tax (Rate) dated 28 June 2017, levies integrated goods and services tax on import of services, under reverse charge.

a. Paid the entire GST involved in such arrangements under protest and claimed Input Tax Credit (ITC) (which renders the situation revenue neutral), upon receipt of an inquiry letter or in anticipation of such letter;

b. In some cases, taxpayers decided to contest the tax demand on its merits without any payment; or

c. Paid GST with interest in terms of Section 73(5) of the CGST Act (voluntary GST payment) to avoid any anticipated proceedings.

Tax authorities responded by issuing show cause notices demanding GST along with interest and penalties. In some cases, show cause notices were also issued under Section 74 of the Central Goods and Services Tax Act, 2017 (CGST Act) alleging fraud, suppression of facts, etc., even though the issue was of interpretation of statutory provisions and not of intentional tax evasion. Adding to the complications, various show cause notices proposed rejection of ITC claims either under the pretext of Section 17(5)(i) (denial of ITC if tax is paid in accordance with Section 74) or for being time-barred in terms of Section 16(4) of the CGST Act.

4 Considerations - GST applicability

Given its fact-specific ruling, the Supreme Court had not considered issues like secondees being under full time employment or not, rights of Indian entity to accept or reject a particular secondee, the compliances being undertaken in India, concept of dual employment, etc. Therefore, it is crucial to distinguish the facts of one's case from the NOS Ruling for existing secondment arrangements. At the same time, for all future transactions, it is essential to structure secondment agreements in a manner that employer-employee relationship is clearly identifiable from the scope of the agreement. Some of these distinguishing factors are:

a. Who is the economic employer apart from the Indian entity having operational and functional control?

b. Period of secondment - whether it is for a limited task or period or is it an ongoing task.

c. Manner of remitting salary - whether it is done directly to secondees by the Indian entity or through the foreign entity.

d. Repatriation policies and the possibility of resumption of duties with foreign entity after the period of secondment in India has ended.

These factors will be instrumental in determining whether there exists an employer-employee relationship not attracting GST, or whether there is a manpower supply service attracting GST.

5 Relief on the horizon: Indirect tax regulator and GST Council address issues surrounding secondment arrangement

The one-size-fits-all approach adopted by tax authorities over the past two years has set the stage for litigation before the courts – with multiple writ petitions filed before various courts challenging the show cause notices and orders issued by the tax authorities. In most cases, the courts ordered a stay on these notices and orders pending final determination. Even under the Service Tax regime, the dispute has not been put to rest yet as the Supreme Court has admitted another matter[4] which is pending a final decision. Till then, the uncertainty created by the NOS Ruling is set to continue. However, the following actions of the Indirect Tax regulator and the GST Council (Council) are likely to bring some relief to taxpayers.

[4] *Commissioner of GST and CE Chennai v Komatsu India Private Limited*, 2022-VIL-97-SC-ST

a. *Instruction issued by the Central Board of Indirect Taxes*

In view of the multiple investigations undertaken by the tax authorities by mechanically applying the NOS Ruling without analysing the terms of the secondment agreement, the Central Board of Indirect Taxes (**CBIC**) proactively issued an instruction on 13 December 2023.[5] This instruction clarified that each case must be individually assessed to determine taxability. Moreover, for invoking Section 74 of the CGST Act for imposing 100% penalty, the allegations must be supported by evidence of fraud, willful suppression of facts, etc. However, the letter and spirit of this instruction are yet to be properly implemented by the tax authorities.

b. *Recommendations of the Goods and Services Tax Council*

The GST Council (**Council**) conducted its 53rd meeting on 22 June 2024 and made certain recommendations in this regard.

i. The Council has recommended a conditional waiver of interest or penalty or both on tax demands raised under Section 73 (unpaid/erroneously paid tax and wrong availing/utilising of ITC) for FY 2017-18 to FY 2019-20. This would help taxpayers facing demand notices on secondment arrangements. However, this relief is conditional upon payment of full tax by 31 March 2025. This proposal will be implemented by adding a new Section 128A to the CGST Act.

ii. The Council recommended issuing a clarification that the import of services by a related person (where the recipient can claim full ITC) must be valued as per Rule 28 of the Central Goods and Services Tax Rules, 2017 (**CGST Rules**). The Council also recommended that where a foreign entity provides services to its related Indian entity, the value declared by the Indian entity be deemed as the open market value. If no invoice is issued by an Indian entity that is eligible to claim full ITC, the value of the service supplied to it by the related foreign entity can be deemed NIL under Rule 28. Since the parties to a secondment arrangement are related, taxpayers can contest the GST demand by applying Rule 28 to value the secondment services as NIL. Consequently, the GST payable will also be NIL. In many instances, taxpayers have paid GST only on the foreign component of the amount disbursed to secondees. In such cases, if the tax authorities are disputing the valuation, taxpayers can contend that the value declared by the Indian entity would be deemed to be the open market value. The CBIC has issued a circular on 26 June 2024[6] to give effect to this recommendation.

iii. The Council recommended issuing a clarification that the time limit for availing ITC under Section 16(4) of the CGST Act is the financial year in which the invoice was raised by the recipient. Therefore, wherever show cause notices are proposing to deny the ITC claim on a secondment arrangement for being time-barred (as tax for FY 2017-18 to FY 202-23 was paid only in the year 2022 or 2023 and ITC was claimed in the same year as the tax payment), this clarification will be favorable for the taxpayers. The CBIC has issued a circular on 26 June 2024[7] to give effect to this recommendation.

While the fine print of one of these recommendations is yet to be finalised in the form of an amendment to the GST Act, the Council's recommendations and the consequent circulars issued by the CBIC seem to have resolved multi-faceted tax issues arising in secondment arrangements. It remains to be seen how these recommendations and circulars will be implemented by the tax authorities.

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5 Instruction No. 05/2023-GST
6 Circular No. 210/4/2024-GST
7 Circular No. 211/5/2024-GST