Supreme Court Ruling Sets the Foundation for GST on Secondment of Employees

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Japanese Multinational companies often share their talent pool across borders and jurisdictions by secondment of Japanese nationals. This enables the group to understand cultural differences and for the affiliates to take advantage of the experience of the parent or group company. It also creates an opportunity to strengthen the relationship within the group.

A secondment is an arrangement, where an employee has a relationship both with the seconding and host Company. As an example, a Japanese multinational, may provide an employee on secondment to an Indian subsidiary / group company. During the period of secondment, the employee's status with the Overseas Group company is dormant, as if the employee is on long leave, and that with the Indian Company ('Host Company') is active. The employee remains on the payrolls of the Group company in Japan and receives its salary in Japan. The Indian Company or host reimburses the whole or part of the salary of the employee to the Group Company in Japan. The seconded employee operates and works under the control and supervision of the host company. On completion of secondment, the employee reverts to the Group Company.

The Service Tax authorities have in the past contended that host company receives 'manpower services', for which the host company pays a consideration, in the form of reimbursement of salary to the overseas Group company. The CESTAT (Customs, Excise & Service Tax Appellate Tribunal) has ruled, that in a secondment, an employer- employee relationship comes into existence between the seconded employee and the host, and hence there is no supply of manpower.

The Supreme Court of India in a recent ruling, in the case of Commissioner *of Customs, Central Excise & Service Tax-Bangalore (Adjudication) Vs. M/s Northern Operating Systems Pvt. Ltd*. has made a departure from this settled legal position and held that service tax is applicable, on secondment of employees by an Overseas Company to an Indian Company, where the salary is disbursed by the Overseas Company and the same is later reimbursed by the Indian Company on actuals.

The Supreme Court Decision in The Northern Operating Case

In the Northern Operating case, the Indian host Company was providing Backoffice Support Services, to the Overseas Group Company and seconded employees were working in connection with these Backoffice Support Services.

The Court held that 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 critical fact was that overseas group companies' business was to secure contracts, which can be performed by its highly trained and skilled personnel. Accordingly, the Overseas Group Company would enter into contracts with host companies, for providing such services, by seconding its employees.

The Court noted that the overseas employer, deploys the employees to the host company on secondment, in relation to its own business. Further, the overseas employer, pays them their salaries. Their terms of employment – even during the secondment – are in accord 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.

Considering the above arrangement, the Supreme Court held that *quid pro quo* is implicit, as both the parties are deriving economic benefit from the arrangement. The Overseas Company gets the benefit of quality work from the Indian Company and the Indian Company is able to get business due to presence of expert seconded employees. In this context, the Court held that secondment of employees is a taxable service of 'manpower supply'.

Our view on Implications under the GST regime

This decision is significant as it upsets the previous jurisprudence on the issue of taxability of reimbursements for seconded employees. The Supreme Court has treated secondment as a manpower supply, only where the seconded employees are involved in the provision of a service by the host Indian company to the overseas company. While this ruling may not apply to all cases of secondment, it will open such transactions for scrutiny, having regard to the overall arrangement between the parties, especially as the authorities are likely to apply this ruling to current transactions under GST.

Japanese Companies will need to revisit the clauses of their inter-company services agreements, secondment agreements, and letters issued to seconded employees, especially in cases where the Indian host Company is providing a service to the Overseas Company, and seconded employees are working in relation to such service. Companies will also need to maintain necessary documentation for identifying the purpose of secondment keeping in mind this judgment.