Supreme Court rules service tax to be applicable on inter-company reimbursement of salary and other expenses in relation to secondment of expat personnel in India

I. Context

This update relates to a ruling of Supreme Court of India (*CCE&ST vs. Northern Operating Systems Pvt. Ltd.)* relating to applicability of Service Tax on inter-company payment of salary and other expenses in relation to seconded expatriate employees in India.

The Respondent, *Northern Operating Systems Pvt. Ltd*., had entered into agreements with its overseas group entities for rendering back-office support and information technology support services. Pursuant thereof, an overseas group entity was required to second its employees to the Indian company. The seconded employees were required to act under the directions of Indian company. The seconded employee would receive salary, bonus, social benefits and out of pocket expenses from its overseas group entity.

The Respondent raised the following contentions:

a. Circular F. No. B1/6/2005-TRU dated 27 July 2005 clarified the scope of "Manpower Recruitment or Supply Agency" service to include staff who are not contractually employed by the recipient but work under the direction of the recipient. This view is further strengthened by Master Circular No. 96/7/2007-ST dated 23 August 2007.

b. Prior to 2012, '*manpower recruitment or supply agency*' services were specifically defined as a taxable service under the Finance Act, 1994. Thereafter, with the implementation of the negative list regime, the services provided by an employee to the employer in the course of employment had been kept explicitly excluded from the definition of 'service'.

c. In the present case, one agreement related to provision of back-office support services by Indian entity to foreign entity on cost plus markup basis. Through a second agreement, Indian entity requested its foreign entity for secondment of its managerial and technical personnel in India. Such personnel were required to devote all their time and efforts under the direction of the Indian entity. The process of dispersal of the salaries and allowances is solely for the sake of convenience and continual of the social security benefits in the home country of the seconded employee. Consequently, an employer-employee relationship existed between the Indian entity and the personnel.

II. Ruling by Hon'ble Supreme Court

The Apex court has ruled out there is no singular determinative test, which could be laid down to employer-employee relationship, the Supreme Court held that such examination must be based on a host of factors. Thus, adopting a 'substance over form' approach to identify the "real" employer, the SC undertook a detailed review of the agreements and concluded that an employer-employee relationship does not exist between the Indian entity and the personnel. Following reasons are highlighted:

i The terms of employment of the personnel, even during the secondment, are in accord with the policy of the overseas company;

ii It was observed that secondment is part of the global policy of the overseas employer loaning their services, on temporary basis. On the cessation of the secondment period, they have to be repatriated in accordance with a global policy.

iii The salary package, with allowances, etc., were all expressed in foreign currency. Also, the allowances included a separate hardship allowance of 20% of the basic salary for working in India. Additionally, a monthly housing allowance and an annual utility allowance was also assured.

III. Our Comments

The ruling of Supreme Court, though provided in relation to a factual backdrop, may have deep impact in relation to disputes on the issue pending before Tax authorities and Tribunal. The reasoning provided may also be applicable under the GST regime. The ruling effects a change in position earlier laid down by CESTAT in decisions of *Volkswagen India Pvt. Ltd.* and *Franco Indian Pharmaceutical Pvt. Ltd.*

For any clarification, please write to:

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