

Secondment Arrangements – PE Exposure

This Article summarises a recent ruling of the Authority for Advance Rulings (AAR) in the case of *Centrica India Offshore Pvt. Ltd.* (Assessee) on the issue of taxability of payments made to overseas group companies under a secondment arrangement. The AAR held that the personnel seconded to the Assessee, a group company in India, did not become its employees in the absence of an obligation undertaken by the Assessee to pay employment costs of such personnel. This was held despite the fact that the Assessee exercised control and supervision, and was also responsible for the work of the personnel. Further, presence of such personnel in India, rendering managerial services to the Assessee on behalf of the overseas entities, created a service permanent establishment (Service PE) of the overseas entities under the India-UK Double Taxation Avoidance Agreement (UK DTAA) and India-Canada Double Taxation Avoidance Agreement (Canada DTAA). Accordingly, the payments made by the Assessee to the overseas group entities towards the services of the personnel were taxable in India.

Background

The Assessee, a company incorporated in India, is a wholly owned subsidiary of a foreign company incorporated in the UK (UK Parent). The UK Parent has two other subsidiaries in the UK and Canada (collectively referred to as 'FCos'), which are engaged in the business of supplying gas and electricity across the UK. FCos have outsourced their back-office support functions (such as consumers' billings/debt collections/monthly job reporting) to third-party service providers in India (Vendors). In order to ensure that the Vendors in India work according to the quality guidelines, the Assessee was incorporated in India. A Service Agreement was entered into between the Assessee and FCos, under which the Assessee was required to act as a local interface between FCos and the Vendors in India. For this, the Assessee was compensated on a cost-plus basis. Since the Assessee was newly incorporated, it needed the knowledge of processes and practices of FCos to successfully fulfill its role under the Service Agreement. In this regard and on the same day as Service Agreement, the Assessee and FCos entered into a Secondment Agreement, under which the Assessee requested FCos to provide staff (Assignees) with knowledge and experience of various processes and practices employed by FCos.

The Secondment Agreement included the following terms:

- Assignees to perform duties at the location of the Assessee for a specified period and report to the Assessee.
- The Assessee to designate a position to each Assignee, authorise them to perform specified duties/work and integrate them into its organisation.
- Assignees are subject to the Assessee's supervision and control, and bound by the instructions and directions of the Assessee.
- All rules, regulations, policies and other practices established by the Assessee for its employees to apply to Assignees.
- FCos would not be responsible for the work or errors/omissions by the Assignees. The Assessee

(Contributed by the Committee on International Taxation of the ICAI. Comments can be sent to citax@icai.org)

to take all risks/benefits in respect of work of Assignees.

- The Assessee would bear the monthly costs of employment of Assignees, which included Assignees' basic salary, the cost of participation in FCos retirement/social security plans, other compensation and benefits as applicable (employment costs).
- Employment costs to be paid by FCos to the Assignees in their respective countries and FCos would recover actual costs from the Assessee on a monthly basis.
- Either FCos or the Assessee could terminate the Secondment Agreement by giving a written notice to the other party. Additionally, the Assessee had the right to terminate the secondment of an Assignee for non-compliance of work place rules/regulations and policies of the Assessee. However, it had no right to terminate the employment of the respective Assignees with the FCos.

In order to ensure that employment costs were received uninterrupted by Assignees, FCos paid such costs directly into the overseas bank account of the Assignees and, subsequently, recovered the amount from the Assessee on an actual basis.

The Assessee sought a ruling from the AAR on whether employment costs paid by the Assessee under the terms of the Secondment Agreement were in the nature of taxable income in the hands of FCos and, consequently, subject to tax withholding under the Indian Tax Laws (ITL).

Contentions of the Assessee

The contentions of the Assessee are summarised as under:

- The Service Agreement was a contract of service and not a contract for service.
- The Assessee was the economic employer of the Assignees, since they worked under the supervision, control, directions, and instructions and as per the schedule/scope of work specified by the Assessee. Further, FCos were not responsible for any work or

The Ruling of the AAR on the Secondment Arrangement in the case of *Centrica India Offshore Pvt. Ltd.* said that the Assessee was incorporated to provide service to FCos under the Service Agreement and to guide the Assessee for this purpose, Assignees were seconded by FCos. The Secondment Agreement was specifically based on the fact of the Assessee's requirement to understand the processes/policies of FCos to enable it to render services to its customers. ☺

omission in the work performed by the Assignees. The entire risk was borne by the Assessee.

- Amounts paid by the Assessee to FCos were reimbursements of employment costs of the Assignees and there was no income element in it. The initial payments were made by FCos only for the convenience of payment in the respective country (UK/Canada) of each Assignee.
- Being the economic employer of Assignees, withholding obligation was only in relation to payment of employment costs to Assignees, which was duly fulfilled.
- It would be a case of diversion of income by overriding the title and the payments made by the Assessee would not become income of FCos.
- Reliance was placed on the Supreme Court (SC) ruling in the case of *Morgan Stanley* to support that the presence of Assignees in India would not create a Service PE in India for FCos, as there is no rendition of services through secondment of employees.

Contentions of the Tax Authority

The contentions of the revenue authorities are summarised as under:

- FCos were the employers of Assignees, and the arrangement was a contract of service.
- Services rendered by Assignees were managerial services, and remuneration paid to FCos for seconding such Assignees were in the nature of fees for technical services (FTS) under the ITL, and UK DTAA and fees for included services (FIS) under Canada DTAA. Reliance was placed on the ruling of the AAR in the case of *Verizon Data Services* [2].
- Presence of Assignees in India would result in Service PE of FCos in India under the UK DTAA and Canada DTAA.

Ruling of the AAR

Secondment Arrangement

- The Assessee was incorporated to provide service to FCos under the Service Agreement and to guide the Assessee for this purpose, Assignees were seconded by FCos. The Secondment Agreement was specifically based on the fact of the Assessee's requirement to understand the processes/policies of FCos to enable it to render services to its customers.
- Assignees continue to be the employees of FCos based on following facts and terms of the Secondment Agreement:
 - Employment costs of Assignees are paid by FCos. Assignees have a right to seek such remuneration from FCos, and they have no recourse to the Assessee for the purpose.

- o Obligation to pay employment costs to Assignees rests with FCos. The Secondment Agreement merely ensured that FCos can recover employment costs from the Assessee, and there is nothing to suggest that the obligation to pay such employment costs is undertaken by the Assessee. The Appointment letters given by the Assessee to Assignees are also silent on this aspect. This reaffirms that the Assessee has no economic control over the Assignees.
- o Right to dismissal of Assignees remains with FCos. The Assessee can merely terminate the secondment, but not their employment with FCos.
- Reliance was placed on the commentary by Klaus Vogel to support that merely because the employee performs services for an enterprise or because the enterprise gives instructions regarding his/her work would not qualify the enterprise as an employer. There may exist two work relationships and in such cases, the one responsible for the remuneration would be determined as the employer.
- In the present case, the work done by Assignees while of secondment with the Assessee is not unconnected with the activities of FCos; on the other hand, it is a part of FCos activities. Hence, even if two work relationships are postulated, FCos would be the employers who are responsible to pay employment costs of the Assignees.
- The obligation to pay salary to an employee is different from an obligation undertaken to compensate their employer by tendering an equal amount. In the absence of the Assessee's obligation to pay employment costs, its contentions cannot be accepted. The fact that the amounts are recorded as reimbursement of Cost in the books of accounts would not be decisive factors.
- Payments made to FCos by the Assessee cannot also be held to be a case of diversion of income by overriding title in the absence of the Assessee's Obligation to pay employment costs to the Assignees.

Nature of Income and Taxability

- Assignees were rendering managerial services, and there was no material on record to indicate that they were performing technical functions or consultancy functions. Under the UK DTAA and Canada DTAA, the meaning of FTS/FIS does not include managerial services within its scope. The AAR ruling in the case of Verizon Data Services may not be relied on, since the issue was remanded by the High Court of Madras for re-consideration.

S econdment of personnel by a foreign company to its Indian affiliate is a common practice among multinational groups. The tax consequences of such arrangements have been a subject matter of dispute with the Indian Tax Authorities. While many decisions in the past have accepted that there should be no withholding on payments made to the foreign company towards such reimbursement payments, this ruling appears to have taken a different view. In an earlier occasion too, the AAR had given an unfavorable decision based on peculiar facts of the case as interpreted by the AAR. Determination of who is the employer of seconded employees is a vexed issue, and various courts have considered different factors to ascertain the same. The present ruling seems to take an unfavorable view based primarily on the fact that legal obligation of paying remuneration is a decisive test. ”

- The SC, in the case of Morgan Stanley, had only stated that if the employees continue to be on the payroll of the non-resident and have a lien on their jobs in the non-resident multinational, a service PE can emerge if services are rendered in India for specified periods.
- Since it has been found that Assignees continue to be the employees of FCos, and they are rendering services in India on behalf of FCos. This will result in creation of a service PE of FCos in India under the UK DTAA as well as Canada DTAA.

Comments

Secondment of personnel by a foreign company to its Indian affiliate is a common practice among multinational groups. The tax consequences of such arrangements have been a subject matter of dispute with the Indian Tax Authorities. While many decisions in the past have accepted that there should be no withholding on payments made to the foreign company towards such reimbursement payments, this ruling appears to have taken a different view. In an earlier occasion too, the AAR had given an unfavorable decision based on peculiar facts of the case as interpreted by the AAR. Determination of who is the employer of seconded employees is a vexed issue, and various courts have considered different factors to ascertain the same. The present ruling seems to take an unfavorable view based primarily on the fact that legal obligation of paying remuneration is a decisive test. ■