Secondment of Employees - *Recent Controversy*

The secondment of personnel by a foreign company to its Indian affiliate is a common practice among multinational groups. The structure and the intent behind entering such secondment arrangements can have considerable impact on the consequential tax implications. Such arrangements have been under the constant scrutiny of the Revenue Authorities in the recent past. In absence of any specific provision in the Indian Tax laws, the advance rulings and court decisions pronounced seems to be divided on the issue, in spite of the existence of similar set of facts. In this article, the author attempts to discuss the key tax implications arising on the secondment of employees of foreign companies to India in light of the recent decision of the Delhi High Court in the case of Centrica India Offshore Pvt. Ltd[1].

Introduction

The secondment of personnel by a foreign company to its Indian affiliate is a common practice among multinational groups. With a robust growth in business opportunities in India, the frequency at which multinational companies have been seconding employees to their Indian affiliates has increased manifold.

The mobility of employees has become an integral part in today's global scenario. Mostly, the employment gets concluded in its local domicile to bag commercial advantages. However, the practice in vogue by multinational parent companies to second their employees to Indian subsidiary companies cannot be disregarded.

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Typical secondment arrangements

Secondment arrangements involve relocation of employees to India, who may occupy key managerial positions in the Indian company. While these seconded employees are generally detached from responsibilities in their home country, they may continue to remain on the payroll of their foreign employer for availing social security benefits back home.

In such a scenario, the Indian subsidiary becomes the real or the economic employer (the secondees work under its control and supervision), the risks and benefits arising out of the secondment arrangement accrues to the Indian company and the foreign company is not responsible for the work and performance of the seconded employees. The

[1] *Centrica India Offshore Pvt. Ltd. vs. CIT [W.P.(C) No 6807/2012] order dated 25-04-14*

secondees may receive a major part of their salaries in the home countries and such salary paid by the overseas entity is generally cross charged to the Indian subsidiary.

Accordingly, as a matter of industry practice, salaries of such seconded employees are initially paid by foreign employer, which is reimbursed by the Indian company (generally without any mark up). The taxability of such receipts in the hands of the foreign employer has been a subject matter of debate in the past.

The concept of an economic employer *vis-a-vis* the legal employer gains importance while determining the taxability of the cross charge. In situations where supervision, guidance and control over the secondees rest with the Indian company and the foreign company assumes no responsibility for the work of the secondee, the Indian company ought to be considered as an employer. The payment of cross charge in such a situation should partake the form of reimbursements and is not chargeable in the hands of the foreign company. On the other hand, where the secondees retain *lien* over their employment abroad and the work is done by the secondee in furtherance of the existing business relationship, the Revenue Authorities consider the foreign company as the employer of such secondees. In such a situation, they allege that the foreign company is taxable in India in the form of 'Service PE' and in some cases, they have also alleged that such services involve the character of fees for technical services (FTS) taxable in India. It may be worthwhile to note that the tax consequences are contingent upon who is held to be the employer.

Recent Delhi High Court ruling on Centrica – A cause of concern for secondment arrangements

The structure and the intent behind entering such secondment arrangements can have considerable impact on the consequential tax implications. Such arrangements have been under constant scrutiny of the Revenue Authorities in the recent past. In absence of any specific provision in the Indian Tax laws, the advance rulings and court decisions pronounced seems to be divided on the issue, in spite of the existence of similar set of facts.

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In this article, the author attempts to discuss the key tax implications arising on secondment of employees of foreign companies to India in light of the recent decision of the Delhi High Court in the case of Centrica India Offshore Pvt. Ltd.(*supra*).

a) Key facts of the case

Centrica Plc. (hereinafter referred to as "Centrica UK"), a company incorporated in the United Kingdom had subsidiaries in Canada and the UK (hereinafter referred to as "the overseas entities") besides Centrica India Offshore Pvt. Ltd. (hereinafter referred to as "Centrica India"). The overseas entities are in the business of supplying gas and electricity to consumers across UK and Canada. The overseas entities outsourced their back office support functions *viz.* debt collections, consumer billing, monthly jobs to third party vendors in India. Centrica India entered into a service agreement (secondment agreement) with the overseas entities, thereby acting as an interface between the overseas entities and the Indian vendors. According to the terms of the agreement, Centrica India charged cost plus a mark-up of 15% from the overseas entities.

Centrica India requested the overseas entities to provide staff with appropriate expertise and knowledge about the process and practices implemented at Centrica UK with an intent to seek support during the initial years of set up. Centrica India subsequently entered into individual agreement with the seconded employees (Secondees).

Some of the key features of the secondment agreement were:

- Seconded employees would work directly under the supervision and direction of Centrica India.
- All applicable rules, regulations, policies and other practices established by Centrica India shall apply to the Secondees.
- Centrica India shall bear all the risks in respect of work performed by the Secondees and reap benefit from their output.

As a matter of industry practice, salaries of such seconded employees are initially paid by foreign employer, which is reimbursed by the Indian company (generally without any mark-up). The taxability of such receipts in the hands of foreign employer has been a subject matter of debate in the past.

- Overseas entities shall not bear any risk in terms of performance of the Secondees.
- Secondees continued to participate in the retirement and social security benefits in their home countries.

Salary reimbursement to overseas entities was on cost to cost basis. Centrica India offered to tax the salary paid to seconded employees in India after suitable deduction of taxes. Service Income received by Centrica India in terms of the service agreement was offered to tax under the Income Tax Act, 1961 (hereinafter referred to as the "Act").

Centrica India sought advance ruling in respect of taxability of reimbursement of cost to overseas entities and applicability of withholding tax provision in terms of Section 195 of the Act.

b) Centrica India's Contentions

- Centrica India is the real and economic employer, even though the legal employers were the overseas entities.
- Overseas entities were not providing any service to Centrica India and as such reimbursements made to them were not taxable as income in India.
- Payment to seconded employees by overseas entities was reimbursed by Centrica India on cost basis.
- Reimbursement to the overseas entities cannot be considered as income under doctrine of 'diversion of income by overriding title.'
- Reimbursement to overseas entities was not taxable in India, as taxes were already paid in India in respect of seconded employees.

c) Revenue's Contentions

- On review of the secondment agreement, it was clear that the seconded employees had to possess the technical expertise to make available their experience and skill in managing and applying the processes and practices.
- Reliance was also placed on the decision of Bharti Cellular[2] to hold that the deputed or seconded employees were rendering managerial services in the nature of 'fees for technical services' in terms of Section 9(1)(vii) of the Act
- The services in the nature of making available technical knowledge and expertise to Indian operations would certainly fall within the purview of Article 13 of the India-UK tax treaty and Article 12 of the India-Canada tax treaty respectively.
- Centrica India was not the real employer as it had right to terminate the secondment agreement only and not the right to terminate contract of those employees.

d) Ruling by Authority for Advance Ruling (AAR)

- AAR held that reimbursement of salary to overseas entities is in the nature of income accrued to the overseas entities.
- Services rendered are managerial in nature but cannot be held to be fees for technical services.
- Overseas entities constitute as Service PE.

e) High Court Ruling

i. Fees for Technical Services

- In the present case, the overseas entities have, through the seconded employees, undoubtedly provided 'technical' services to Centrica India, since the expression FTS/FIS expressly includes the provision of the services of personnel. The seconded employees, who work for Centrica India are deputed by the overseas entities and the work conducted by them was through the overseas entities.

Where the secondees retain lien over their employment abroad and the work is done by the secondee in furtherance of the existing business relationship, the Revenue Authorities consider the foreign company as the employer of such secondees.

[2] *CIT vs. Bharti Cellular Ltd., [2008] 319 ITR 139 (Delhi)*

- The term "technical" services does not limit itself only to technological services, but rather, extends to knowhow, techniques and technical knowledge. Indeed, the term 'technical' has not been defined in the DTAA, and must be accorded its broader dictionary meaning, unless limited by the parties to the instrument.
- The Court also held that mere rendition of service in itself is not an "included service" which can trigger tax liability. It is also to be seen whether the enterprise "makes available" the skill behind that service to the other party. In the instant case, the secondees imparted their technical expertise and know-how onto the other regular employees of Centrica India thereby transferring their technical ability or 'make available' their know-how for future consumption.

ii. Existence of Service PE

- Though the control and supervision powers were vested with Centrica India and all risks in relation to the work were borne by them, there was no purported relationship between Centrica India and the seconded employees.
- Neither was any entitlement or obligation clearly spelt out whereby Centrica India had to bear the salary cost of these employees nor could the secondees sue Centrica India for default in payment of their salary.
- Whilst Centrica India could terminate the secondment agreement, no powers were vested with it to terminate the original and subsisting employment relationship. The employment relationship with overseas entities remained independent.
- Even though Centrica India may have operational control over these persons in terms of the daily work, and may be responsible (in terms of the agreement) for their failures, these limited and sparse factors cannot displace the larger and established context of employment abroad.
- The Delhi High Court in light of these facts and placing reliance in the case of Morgan Stanley and OECD commentary on Article 15 held that Service PE exists so long as the secondees continued to have lien on their jobs with the overseas entities.

Given the diverse jurisprudence and the uncertainty on taxability of payments made pursuant to secondment contracts continue to create a dilemma in minds of Indian entities as well as multinational corporations deputing their employees in India.

The Delhi High Court ruling in case of Centrica (supra) shall have far reaching tax implications and to ensure that a secondment agreement does not trigger a potential permanent establishment exposure, it is vital to document "substance" and the terms of employment, together with the rights and obligations of the employees, as comprehensively as possible.

iii. Payment not in the Nature of Reimbursements

- The fact that the nomenclature used in the secondment agreement for payments made to the overseas entities as 'reimbursements' cannot be a determinative factor and change the nature of services.
- Absence of mark-up over and above the cost of maintaining secondees cannot negate the nature of transaction.
- In cases where services are provided between related parties, the demand of only as much money as has been spent in providing the service would not remove the tax liability altogether. This is clearly an incorrect reasoning that conflates liability to tax with subsequent deductions that may be claimed.

iv. Diversion of Income by overriding title

- The argument of Centrica India that the money paid to the overseas entity is overridden by the obligation to pay the secondees, and thus, is not income was untenable.
- The payments were not in the nature of reimbursement, but rather, payment for services rendered.
- The obligation of the overseas entities to pay the secondees arises under a

separate agreement, based on independent conditions, in relation to Centrica India's obligation to pay the overseas entities.

- The reimbursements to the overseas entities may or may not be applied for discharging its obligation to the seconded employees.

OECD concept of Economic employer not applied

In reaching its conclusion, the Delhi High Court has not applied the commentaries of the OECD Model Convention dealing with the concept of 'economic employer' in favour of the taxpayer. In a number of cases, like *Tekmark Global Solutions LLC*[3] and *IDS Software Solutions*[4], having somewhat similar underlying facts, the different Benches of the Tribunal has applied the concept of 'economic employer'. In these cases, it has been held that where seconded employees work under the control and supervision of the Indian entity with no control exercised by the overseas entity over the seconded employees, the Indian entity shall be considered as the economic employer of seconded employees.

In this regard, it may be useful to go through following factors considered as relevant by the OECD Commentary for determining, who is the economic employer of an employee:

- Who has the authority to instruct the individual regarding the manner in which the work has to be performed;
- Who controls and has responsibility for the place at which the work is performed;
- Remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided;
- Who puts the tools and materials necessary for the work at the individual's disposal;
- Who determines the number and qualifications of the individuals performing the work;
- Who has the right to select the individual who will perform the work and to terminate the contractual arrangements entered into with that individual for that purpose;
- Who has the right to impose disciplinary sanctions related to the work of that individual; and
- Who determines the holidays and work schedule of that individual?

Going forward, multinationals should critically review and assess the impact of the ruling on their existing/proposed secondment arrangements to strike a balance between commercial expediency and tax implications.

Concluding Remarks

In today's competitive business environment, sharing the expertise of trained resources has assumed significance resulting in a global resource pool. Given the diverse jurisprudence and the uncertainty on taxability of payments made pursuant to secondment contracts continue to create a dilemma in minds of Indian entities as well as multinational corporations deputing their employees in India. Actual role and responsibilities of the secondees coupled with the underlying documentation assumes significant importance in determining tax implications.

The Delhi High Court ruling in case of Centrica (*supra*) shall have far reaching tax implications and to ensure that a secondment agreement does not trigger a potential permanent establishment exposure, it is vital to document 'substance' and the terms of employment, together with the rights and obligations of the employees, as comprehensively as possible. In order to mitigate the risks associated with such secondment arrangements w.r.t. the concept of legal versus economic employment, the relationship between the secondees and the economic employer shall have to be strengthened and properly documented. It also appears that the termination clauses of the secondment agreement have received greater attention from the Courts. Accordingly, it would specifically require certain degree of validation on the part of corporates to serve twin objectives–firstly, demonstrating the transfer of economic employment to the Indian company and secondly, exercise of control over employee by the Indian company during the secondment period.

Going forward, multinationals should critically review and assess the impact of the ruling on their existing/proposed secondment arrangements to strike a balance between commercial expediency and tax implications. However, to put at rest the stir created by such rulings, concrete clarification from the Legislature or the final word from the Apex Court in the near future is the need of the hour. ■

[3] *DDIT vs. Tekmark Global Solutions LLC [2010] 131 TTJ 173 (Mum)*
[4] *IDS Software Solutions (India) (P.)Ltd. vs. ITO [2009] 122 TTJ 410 (Bang)*