Employees' Secondment & Cost Reimbursement - Intertwining Web of Tax Jurisprudence

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Globalization and liberalization in our country has resulted in the rapid growth of the economy and increased cross-border flow of capital, technology and human resources.

Human capital management is the currency to meet business goals. It has become a common practice for businesses and companies to relocate or assign workforce employed by one entity to another entity located in a multiple geographical location for various reasons such as to share knowledge, experience, technical skills or to set-up and oversee business functions, processes etc.

Such cross-border management of human capital is known by different terms, of which ‘secondment’ is one such term used in tax parlance. Secondment refers to an arrangement between two companies to deploy an employee of an organisation to another on agreed terms and conditions. An employee is temporarily relocated by the home employer (country of origin) to the host employer (country of destination) to a different role or a department, often for a specific purpose or task but mostly under the supervision & control of the host employer. The financial benefit of secondment to both the entities are that the home employer exposes their employees to global markets and work environments without additional costs, at the same time, the host employer benefits from the skill set of the assignee without incurring long-term employment costs.

Sometimes terms Secondment & Deputation are used interchangeably however generally deputation involves shorter tenure where supervision & control continues to remain with home employer (*which also carries Permanent establishment especially Service PE risks*) whereas in Secondment the transfer is more permanent or longer in nature where supervision & control is with host employer.

A typical secondment arrangement is tabulated below:

Particulars	Specifics of secondment
Type of arrangement	Temporary transfer from one organization to another.
Nature of contract	Contract of Service
Requirement	Basis requirement of host employer
Control and supervision	Exercised by host employer

Risk and reward of work	Borne by host employer
Remuneration	Remitted by home employer in overseas bank account of the assignee but borne by the host

Such movement can be an inbound transfer wherein an employee of one entity located in a foreign country is assigned to work in India or outbound transfer wherein an employee of an Indian entity is assigned to work in an entity located in a foreign country.

Assignees are in essence employees working in a country away from their country of legal residence. Generally, the home employer initially remits the salary of the assignees in their overseas bank account and the Indian (host) employer subsequently reimburses the cost to the home employer.

Such an arrangement may be implemented for convenience and uninterrupted availability of social security benefits to the assignees. India exercises its right to tax the salary income earned by the assignees by virtue of source based taxation, at the same time the assignee may also be taxed in the home country. Additionally the Indian tax authorities have also looked to tax such salary cost reimbursements between 2 employers. Indian legal precedents have added to the ambiguity by giving contrary decisions and creating more confusion than delivering clarity. This has led to multiple points of taxation on a single transaction from different perspectives and creating protracted litigation.

In this article we will briefly touch upon the taxation of salary paid to inbound assignees coming to India and analyse taxation intricacies of reimbursement of salary cost between the home and host employer, relying on diverse judicial rulings which have significantly impacted such arrangements from Indian Income-tax perspective.

Taxability of such payment is analysed from two perspectives:

1. Taxability of salary income received by the assignee;
2. Taxability of reimbursement of salary by the host employer to home employer.

1. Taxability of Salary income received by the assignees:

For the period of secondment, the assignee is expected to work in India under the control and supervision of the Indian host employer. The scope of taxability of income of assignee will depend on his residential status as per laws of home country and host country.

Residential Status of an individual in India is determined based on the physical presence in India and covered under section 6 of the Income-tax Act, 1961 (“the Act”). Since the assignees are citizens of foreign country, it is also important to determine the Residential Status under the Double Tax Avoidance Agreement (DTAA) with that country. In case, if assignee is resident of both home country and host country then ‘Tie Breaker Rule' as mentioned in the Treaty has to be applied to determine his residential status.

The taxability of any income received is covered under Section 5 – Scope of total income of the Act which is tabulated below

Nature of Income	Taxability in case of		
	Resident (ROR)	Not Ordinarily Resident (RNOR)	Non-resident (NR)
Income received or deemed to be received in India	Yes	Yes	Yes
Income accruing or deemed to accrue in India	Yes	Yes	Yes
Income received or deemed to be received outside India	Yes	No	No
Income accruing or deemed to accrue outside	Yes	No	No

India

From the plain reading of section 5 of the Act, it can be inferred that if an assignee renders services in India, the income is said to accrue or arise in India and consequently the same is taxable in India.

Hence, the income earned by an assignee working in India would be arising from the employee-employer relationship, irrespective whether he/she is on the payroll of the foreign entity or the Indian entity, and **therefore the same would be subject to tax in India as 'Income from Salary'** . Salary will be salary as defined under the Act and would also include components such as allowances, perquisites, contribution to Provident Fund, etc. Income from salary would be computed as per provisions of the Act and the assignee would be eligible for claiming standard deduction and other deductions available under the Act.

The host employer would be required to comply with withholding tax obligations and remit the salary net of taxes to the assignees in India.

The salary income which is liable to tax in India may also be liable to tax under the taxation laws of home country as well. This scenario leads to double taxation of same income and in order to avoid such double taxation, DTAAs generally contain specific provisions to provide relief and the assignee will be able to claim credit of taxes paid in source country while filing his tax return in country of residence where there global income is offered to tax.

2. Taxability of reimbursement of salary by host employer to home employer (the controversy)

The dispute arises on the matter of taxability of the reimbursement of the salary by the Indian host employer to the home employer. The Indian entities have usually taken a stand that the payment to the overseas company as reimbursement of salary costs is not liable to tax in India as there is absence of income element in the transaction. However the tax department has been alleging that the payment is for services rendered by the overseas entity through its employee and hence, taxable as 'Fees for Technical Services' (FTS).

To further augment their argument of taxability, in some cases, the Indian tax authorities have contended that the services provided by the assignees to the Indian entity creates a permanent establishment (PE) of the overseas entity in India and taxable as business income in India. This contention is based on the premise that services rendered by the assignees in India constitute a **contract for service** rather than a **contract of service** with the Indian entity.

There have been various judicial precedents in support of both the stand taken by the Indian entities as well as in favour of tax department.

The Delhi High Court's judgement in case of **Centrica India Offshore Pvt Ltd** [TS-237-HC-2014(DEL)] has been a landmark ruling often relied on by the tax authorities to bring such reimbursements under purview of tax. The Court had upheld the ruling of Authority for Advance Rulings (AAR) which stated that secondment of employees give rise to PE as the employees "make available" technical knowledge to the Host employer. Therefore the payments made by host employer to the overseas entity qualify as FTS under the Act as well as the DTAA provisions and hence is taxable in India.

The ruling by AAR and Delhi High Court delved into various aspects of the secondment agreement which can be summarised as under:

a) The test of 'Real Employer' – Although Centrica India had direct control, supervision and direction over the assignees, the employee's **right to seek their compensation was from overseas entity only** (being cost reimbursement) and **right to terminate the employee also vested with the overseas entity** as per the agreement (legal ownership v economic ownership). Hence irrespective of nomenclature used in the agreement, there was no purported relationship between employees and Centrica India and the overseas employer remained the real employer of the assignees.

b) The test of PE – The seconded employees were specifically chosen since they had knowledge and

experience of various processes and practices employed by the company. They were **transferred to train and familiarize the staff** employed by Centrica India with those processes and practices, **thereby imparting their technical knowledge and expertise** to the local employees for future consumption. This gave rise to Service PE in India as long as the employees continued to have lien on their jobs with the overseas entities.

c) The test of Reimbursement vs. Payment for Services (FTS) - The nature of activity and substance of the transaction is determinative of whether it constitutes a contract of service or contract for service. **Mere absence of mark-up cannot cloak the nature of transaction** and in this case the seconded employees were imparting their technical expertise and know-how thereby transferring and making available their technical ability. Hence business support services provided by the deputed employees would clearly fall under the definition of technical services as per some of the tax treaties between India and other countries (Notably - Article 12 of the India-Canada DTAA and of included services as per Article 13 of the India-UK DTAA.)

The Delhi High Court has placed **more importance on the legal relationship between the foreign entity and the assignees than the economic relationship** between the assignees and the Indian entity. Here, the terms of agreement had a huge impact on the decision of the Court as various factors depicted that the even though the Indian entity had operational and functional control over the assignees, the overseas entity remained the real employer. **Hence the secondment was ruled as contract for services**.

The Mumbai bench of ITAT also, in case of **General Motors Overseas Corporation v. ACIT [TS-134-ITAT-2020(Mum)]** held that reimbursement of costs with respect to services provided by a foreign entity to an Indian entity, via the deputation of experienced employees with technical expertise, fall within the definition of Fees for Included Services (FIS)

"As stated above, the vice president manufacturing was knowing the technology and was having the experience to implement the standards of the taxpayer in India and by sending the said vice president in India , in fact the technology was made available in India by the taxpayer.

....

***In the garb of sending the technical experts in India, it cannot be permitted to say** by the taxpayer that they were merely employees and **the cost is reimbursed by the Indian counterpart to the taxpayer** for the services rendered by such employee. In fact as noted herein above, **the technology was transferred through the expert experienced technocrat by the taxpayer to Indian counterpart** and therefore, in our view, the lower authorities were right in arriving at the conclusion that the taxpayer was liable for fees for included services."*

Au Contraire, the Indian entities have taken a position that compensation of costs pertaining to assignees are pure reimbursements hence not liable to withhold tax while making such payments.

There are various rulings of Courts/Tribunals wherein they have held that the assignees in substance are employees of the Indian entity and the payments made by the Indian entity to the foreign entity have been characterised as a mere reimbursement, and accordingly, no further tax implications arise on the payment thereof.

The Bombay High Court in **DIT (International Taxation) v. M/s Marks and Spencer Reliance India Pvt Ltd** [TS-5522-HC-2017(BOMBAY)-O] affirmed the findings of ITAT, Mumbai and held that TDS cannot be charged on payment of salary under a secondment agreement as payments made under a such agreement were reimbursements of expense, not fees for technical services. The ITAT determined that the assistance provided by the assignees to Indian entity did not include making available any technical knowledge or skills and, therefore, the payments could not be considered FTS under the treaty.

In case of **DCIT v. DLF Projects Ltd** [TS-689-ITAT-2018(DEL)] the non-resident entity had only supplied employees on secondment basis and were not responsible for those employees in any way. Also the reimbursements by DLF were done with a mark-up on actual costs as the invoices specified a clear distinction between actual costs and margin and the assesse had withheld tax on mark-up portion. Hence

the Delhi bench of ITAT held that tax was not required to be deducted on entire reimbursement and ruled in favour of the assesse.

It also observed that non-resident entity had deposited the tax on the salary paid by it for the services rendered by its employees in India on secondment and hence there was no loss to the revenue on that account. **While distinguishing** between the present case and Centrica Offshore (supra), the tribunal noted that the **assignees were not taking forward the business of the foreign company in India and were effectively working under the control and supervision of the Indian company** and hence it cannot be said to be rendering services on behalf the foreign entity.

Also recently, the Bangalore bench of ITAT in case of **Google LLC v. JCIT** [TS-73-ITAT-2023(Bang)] held that reimbursement by Google India Pvt. Ltd. (GIPL) towards cost of assignees reimbursed to the Google LLC is not taxable as Fees for Included Service (FIS) under Article 12 of India-USA DTAA. The ITAT observed that the **seconded employees were solely working under the control and supervision of GIPL and not on behalf of the Taxpayer** and Taxpayer's **role was merely to facilitate payment of salary on behalf of GIPL** which was subsequently reimbursed on cost to cost basis without any element of profit. GIPL had deducted tax at source under Section 192 against salary and other allowances paid to the seconded employees and that GIPL had made social security contributions as per Indian regulations. Similar view was taken by Delhi ITAT in **Serco India Pvt. Ltd Vs DCIT** [TS-363-ITAT-2023(DEL)],

Adding fuel to the fire: Supreme Court decision in case of Commissioner of Central Excise and Service Tax v M/s Northern Operating Systems Pvt Ltd [TS-216-SC-2022-ST]

In a last year's landmark judgement the Hon'ble Supreme Court negated the existence of an employer-employee relationship between the parties and classified the secondment arrangement to be a contract for supply of service and liable to service tax. In a nutshell, the Supreme Court relied on substance over form principle and analysed various sections of the agreement and it was of the view that the secondment of group of highly skilled employees **was 'import of manpower recruitment and supply services'**.

- The overseas entity seconded these employees in relation to its own business
- Salary was paid by overseas entity which was reimbursed by Indian entity
- Control on terms of employment, termination and legal ownership is with overseas entity

This ruling will strengthen the stance of revenue authorities on such transactions with similar arrangements as above deeming it as **contract for services** and will be used to bring such payments under the ambit of FTS by stating that services are made available to the Host employer (Indian employer).

The decision by the Hon'ble Supreme Court is relating to Service tax law, Apex Courts decisions are treated as the law of the land. If a transaction is characterized as payment for service under one statute, could it be distinguished and held to be reimbursement under the Income-tax Act??

Northern Operating System decision appear to be have delivered based on the certain peculiar/specific facts hence it can't or shouldn't be generalise which can be seen from **some Income-tax decisions who have distinguished the above Apex court judgment…..**

In Flipkart decision [Flipkart Internet (P.) Ltd. Vs. DCIT [TS-503-HC-2022(KAR)] the Karnataka High Court held that reimbursement of the salary of seconded employees by an Indian entity to an overseas entity was not FTS as the services did not satisfy the 'make available' condition in the DTAA.

It distinguished the above Supreme Court decision stating the same was in the context of service tax law to determine whether it was a service and whether such service payment will attract income-tax in India will depend on the Act and DTAA provisions. Similar findings have been made in the case of BOEING India (P.) Ltd [TS-404-ITAT-2020(DEL)] and M/s. Google LLC vs. JCIT (OSD) (IT)/DCIT (IT) IT(IT)A No. 167/Bang/2021) [TS-73-ITAT-2023(Bang)]

Key takeaways for the taxpayers:

There are judgements that have been in favour of the taxpayer as well as the revenue authorities. Although each of these rulings have been decided on case to case basis, on perusal of these judgements certain factors have specifically been analysed and have played an important role in the outcome of the judicial authority :

- **Substance over form for effective employment** – The courts/tribunals have examined who is the real employer of the assignees. Such distinction is important as if the assignees are concluded to be employees of Indian entity then the payments as treated as pure reimbursements which works in favour of Indian entities.
- **Terms and conditions of the agreement** – Mere nomenclature is not enough anymore and the language of the agreement and overall reading of the terms help in further establishing the nature of relationship between the Indian company and the assignees. The lien on employment of the overseas employer and the restricted control that the Indian employer has over the assignee is a deliberation before finalising a secondment agreement
- **Nature of services provided by the assignees** – One needs to evaluate the purpose for which the assignees are deputed. If it can be deduced that deputation of employees is to impart technical knowledge and expertise which assists in furtherance/establishing of business then payments made can be covered under FTS/FIS.

The courts and tribunals do not give primacy to any single determinative factor when analyzing whether an arrangement is a **contract of service or a contract for service**. Instead, multiple factors are considered based on the totality of the facts and circumstances of the case and all factors may not be given same weightage while deciding on the matter.

The Indian taxpayer is ambivalent when it comes to interpretation of tax issues. He is fully aware of the vagaries of this enigmatic situation. **However, he has to remain vigilant and updated**.

Tax issues relating to reimbursement of costs are still debated at various levels. This topic will continue to be a point of litigation. Therefore, parties need to give careful consideration to above discussed points while entering into such arrangements.

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