

Secondment: An Endless Battle with the Tax Authorities!

Secondment of employees, as an approach, has become a common practice followed by multinationals to utilize their skilled resources with an ambition of geographical expansion. Many Multinational Companies (“MNCs”) have spread their businesses worldwide and often share their talent pool across borders and jurisdictions to achieve various objectives. To give the initial push and help set up the operations, maintain requisite standards and provide technical and managerial assistance, MNCs generally depute their experienced or skilled employees to their group companies in other host countries (including India). These deputed employees are well versed with the operations and practices of the MNCs and help to perform certain assigned activities, provide technological assistance and skill-development opportunities to employees of group companies.

Customarily, the Seconded Employees (“**Secondees**”) work under the control and supervision of the host entity for a mutually agreed period as per the terms and conditions of the contract (*typically a Master Services Agreement or “MSA”*) but remain on the payroll of their employer viz., the overseas entity for the ease of compliance and migration procedures. The overseas entity remunerates the seconded employees, and the host entity reimburses for such remuneration on a cost-to-cost basis.

The modus operandi in relation to secondment is as under:

- Secondees are on the payroll of the overseas entity and continue to remain so;
- Secondees are deputed to a group entity (host entity) outside the jurisdiction of his / her original employer, in India for the purpose of rendering technical and managerial assistance;

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- Secondees work under the supervision and control of the Indian entity for such mutually agreed period as per the terms and conditions of the MSA;
 - For convenience and administrative purposes, the overseas entity pays the remuneration to such Secondees (*including the social security benefits in accordance with local employment rules and regulations*), which is offered to tax by such Secondees in India;
 - The overseas entity raises an invoice on the Indian subsidiary for the reimbursement of the salary costs of such Secondees on a **cost-to-cost basis i.e., without any mark-up**; and
 - Secondees return to the overseas jurisdiction once the term of secondment is over after satisfaction of the role and responsibility laid down by the Indian entity.

Section 195 of the Income Tax Act, 1961 (“**IT Act**”) governs the provisions of Deduction of Tax at Source (“**TDS**”) on payments made to non-residents, including foreign companies. This provision mandates that TDS needs to be deducted before making payments to non-residents if the payments made are in the nature of interest (subject to certain exceptions) or if any other sum is chargeable to tax in the hands of such non-residents.

There is no threshold limit to deduct TDS u/s 195. However, the payer must deduct tax only when the payment made to a non-resident is taxable in India. Therefore, no tax is to be deducted in case of exempt income or any other income that is not taxable as per the IT Act. When the payer believes that no amount or only a partial amount (*other than salary*) is taxable in the hands of the non-resident in India or that tax is to be withheld at a lower rate, then he may make an application to the Assessing Officer (**‘AO’**) for obtaining a lower or nil TDS certificate.

In this context, the litigation in case of Flipkart Internet Private Limited¹ (“**Flipkart**”) is noteworthy. In the facts of this case, M/s. Walmart Inc., Delaware, USA (“**Walmart**”) seconded certain senior level employees to Flipkart for provision of services and entered into a Global Assignment Arrangement (“**GAA**”) with the Secondees, which provided that the Secondees would work for the benefit of Flipkart. As a consideration, Flipkart had reimbursed the salaries of Secondees to Walmart on a **cost-to-cost basis**. With respect to this, Flipkart had filed an application under Section 195 of the IT Act before the AO, seeking a nil TDS certificate in respect of the reimbursements to be made to Walmart, which was rejected by the AO on the basis that there was no

¹ M/s Flipkart Internet Private Limited v. DCIT, Order dated June 24, 2022, in W.P. No. 3619/2021 (Karnataka High Court)

employer-employee relationship between Flipkart and the Secondedees and the payments to be made were in the nature of Fees for Included Services ('FIS'), both under the provisions of the IT Act as well as under the India-US tax treaty, and thus was liable to TDS under Section 195 of the IT Act.

Aggrieved with the order of AO, Flipkart moved a writ petition before the High Court of Karnataka. The Hon'ble High Court held that it was clear and undisputed that the Secondedees worked for the benefit of Flipkart, and it could be concluded that Flipkart was the 'real employer' since it issued the appointment letters to such Secondedees, who in turn, reported to Flipkart. The fact that Walmart had the power under the GAA to decide on the Secondedees' continuance after the secondment, should not make any difference as it related to a service condition post the period of secondment and did not alter the relationship between Flipkart and the Secondedees. It was further held that payment did not constitute FIS within the meaning of Article 12(4) of the India-US tax treaty as the 'make-available'² clause did not get triggered and that the provisions of the tax treaty overrule the IT Act to the extent they are more beneficial to the assessee. Therefore, it was concluded that there was a bonafide employer and employee relationship between Flipkart and the Secondedees and the reimbursement was in the nature of reimbursement of 'salary' contrary to FIS, and hence, Flipkart was not liable for TDS on such reimbursement to Walmart. Accordingly, the Hon'ble High Court quashed the order of the AO and directed the AO to issue a NIL TDS certificate under Section 195(2) of the IT Act to Flipkart.

The above ruling re-affirms the principle that TDS liability under section 195 of the IT Act would trigger only if payment were chargeable to tax in India (as laid down by the Apex Court in the case of **GE India Technology Centre Private Limited**).³

The Hon'ble High Court highlighted that Apex Court's ruling in the case of **Northern Operating Systems Pvt. Ltd.**,⁴ was delivered in the context of service tax and the only question for determination was whether the supply of manpower was covered under the taxable service and was to be treated as a service provided by foreign company to Indian company, whereas in the case of Flipkart, the legal requirement was whether to treat a service as FIS and whether the same is 'made available' to the Indian company.

² For avoidance of double taxation, certain tax treaties of India have the 'Make Available' clause that imposes a restrictive interpretation of what constitutes Fees for included pr technical services. Certain precedents are Raymond Ltd. v. DCIT (86 ITD 791; CIT v. De Beers India Minerals (P) Ltd. (TS-312-HC-2012 (Kar)); US Technology Resources Pvt. Ltd. v. CIT ((2018) 407 ITR 327)

³ GE India Technology Centre Private Limited v. CIT, (2010) 10 SCC 29 (Supreme Court)

⁴ C.C., C.E. & S.T.-Bangalore (Adjudication) etc. v. M/s. Northern Operating Systems Pvt. Ltd. (Civil Appeal Nos. 2289-2293/2021)

In addition, the Hon'ble High Court distinguished the judgement rendered by the Delhi High Court in the case of **Centrica India Offshore (P) Ltd.**⁵ and ruled that to be not relevant in the instant case as it was rendered in the context of different facts and based on the material available.

Recently, in another case of **Ernst & Young US LLP**⁶ (“**EY US**”), a similar issue arose before the Delhi bench of Income Tax Appellate Tribunal (“**Delhi ITAT**”). In this case, EY US seconded certain employees to the EY India member firms for provision of services and EY India member firms had reimbursed the salary costs of such Secondees to EY US. As per the deputation agreement, EY India member firms had also complied with the TDS obligations at the time of payment of salary to the Secondees. However, the AO made additions in the hands of EY US on account of such reimbursement, holding that the reimbursement of salary costs falls within the meaning of Fees for Technical Services (“**FTS**”).

Considering the facts of the case, the Delhi ITAT held that EY US is not liable to tax on reimbursement of salary costs of the Secondees as FTS and relied on the ruling of Karnataka High Court in the case of Flipkart. It further held that the same amount could not be subjected to tax twice – firstly in the hands of the Secondees working in India and secondly again in the hands of EY US. The Delhi ITAT also relied on a co-ordinate bench ruling in case of **Boeing India [P] Ltd.**⁷ which was affirmed by the Hon'ble High Court of Delhi.

COURSE AHEAD

- Secondment of employees, agreements for secondment and reimbursement, legal and economic employment have been a matter of discussion in various judicial forums.
- There is more than ever a need to carefully document in “substance” the nature of employment, secondment, rights, and duties of all parties to a secondment arrangement and therefore, applicability of TDS provisions will have to be determined on a case-to-case basis.
- The Secondees must be under operational control of the Indian entity in terms of their day-to-day work during the period of secondment.

⁵ Centrica India Offshore (P) Ltd. v. CIT, (2014) 227 Taxmann 368 (Delhi High Court)

⁶ Ernst & Young U.S. LLP v. ACIT [TS-335-ITAT-2023(DEL)]

⁷ Boeing India [P] Ltd. 121 Taxmann.com 276

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- The expertise and specialized knowledge of the Secondedees used for the economic benefit of the Indian entity shall constitute a quid pro quo under the secondment arrangement.
 - Reimbursement of salary costs of Secondedees, unless carefully structured, can result in serious tax implications, both for the Indian subsidiary and the overseas entity.
 - Separately implications under Goods and Service Tax Laws and Social Security Laws need to be considered.

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