L&S UPDATE
An e-update to clients from Lakshmikumaran & Sridharan

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INDIRECT TAX

Service tax payable on RCM basis on secondment of employees from foreign group companies under ‘Manpower Supply’

UPDATE NO. 22 OF 2022

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A three Judge Bench of the Hon'ble Supreme Court has held that the service tax is payable on the payments (salaries and allowances) towards secondment of employees. The Hon'ble Supreme Court noted that although operational or functional control over the seconded employees was exercised by the assessee, the seconded employees continue to remain as employees of the foreign group companies.

FACTS

- The issue for determination arose out of demand notices issued to the assessee company (**'assessee'**) in India. The assessee entered into agreements with its various group companies located in the United States of America, United Kingdom, Dublin, Singapore etc. and provided general back office and operational support to such group companies.

- As per the understanding with group companies, when required the assessee requested the group companies for managerial and technical personnel to assist in its business and accordingly the employees were selected by the foreign group company and transferred to assessee in India.

- The seconded employees would receive their salary, bonus, social benefits and other expenses from the group company and there after the assessee would reimburse the same to the group company.

- Demand of service tax under Reverse Charge Mechanism (**'RCM'**) was raised under 'Manpower Recruitment or Supply Agency Service' for payments made to foreign group companies w.r.t. seconded personnel. Period in dispute pertained to October 2006 to March 2014.

ORDER OF ADJUDICATING AUTHORITY AND CESTAT

The Adjudicating Authority confirmed the demand of service tax for the period October 2006 to March 2012 on the ground that the idea behind secondment arrangement was that the secondee will remain employed by the original employer during the secondment, and will, following the termination of the secondment return to the seconder as a consequence of which the secondee does not become integrated into the host's organization in India. For the period post April 2012, the demand was dropped holding that employer-employee relationship exists between the assessee and seconded employee.

Appeals were made to the CESTAT. The CESTAT allowed the assessee appeals and dismissed the Revenue Appeals holding that agreement between the assessee and group company does not relate to 'supply of manpower' and that the assessee and seconded employees were related as employer-employe.

SUPREME COURT JUDGMENT

On appeal by the Revenue, the Hon'ble Supreme Court affirmed the findings of the Adjudicating Authority that employer-employee relationship did not exist between the assessee and seconded employees. It was observed that although seconded employee was under visible control and works under the direction of the assessee in India, seconded employee continued to be in the payroll of the group company. If the assessee was not satisfied with the seconded employee, the secondee returned to the group company. Additionally, after successful completion of secondment, the seconded employee returned to the group company. Further, even the secondment was as per the policy of the group company.

Under the contractual arrangement, the group company in relation to its business deployed them to the assessee. The consideration in the transaction was that the assessee benefited from the skilled employees, assigned them with specific jobs or assignments and thereby benefited from increase in revenue. The *quid pro quo* in secondment of employees was implicit in the scheme of things.

Implications :

The judgment of the Supreme Court is important for its industry wide ramifications. The scope of Manpower Supply Service has been expanded. The supply of seconded employees was considered to be in relation to the business of the overseas group company. The Supreme Court also observed that even if the control and power to remove from work rests with the assessee in India, the fact that seconded employees continue to enjoy a right of lien on the employment in the group company and therefore, cannot be considered as employee of assessee. Additionally, the present judgment introduces a new test of consideration. The reimbursements in the present case were also treated as *quid pro quo* for the overall benefit to the assessee arising out of the transaction.

[*Commissioner* v. *Northern Operating Systems Pvt. Ltd.* – Judgement dated 19 May 2022 in CA 2289-2293/2021, Supreme Court]

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