



## Secondment Agreements & Indirect Taxes

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Recently, the doctrine of “**substance over form**” has found its application in the realm of indirect taxation even in the absence of fraud or overwhelmingly compelling circumstances.

### **Northern Operating Systems’ Judgement<sup>1</sup>**

In the context of secondment agreements, the Supreme Court held that “*the nomenclature of any contract, of document, is not decisive of its nature*”. Reflecting on the changing global realities and on the international practices of hiring of labour, the Court underscored the need for “*requiring a close look at the terms of the contract, or the agreements.*”

In a typical secondment arrangement, an overseas entity second or loans an employee to its Indian entity, which then takes on the responsibility of salary and of compliances with local laws. In certain cases, the overseas entity makes payments directly to the seconded employee for the sake of continuity of her social security status in country of her base location. Such costs are subsequently reimbursements by the Indian entity. The seconded employee works under the control and supervision of the Indian entity, provides all her services to the Indian entity and on expiry of the arrangement, she is either repatriated or seconded to another entity.

Until now, under the service tax regime, the reimbursements made by the Indian entity were not generally regarded by the tax tribunals to be consideration for service. This position was guided by the belief that (a) the salary was being paid by

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<sup>1</sup> *Commr. of Customs, Central Excise and Service Tax v. Northern Operating Systems (P) Ltd.*, 2022 SCC OnLine SC 658



the Indian entity; and (b) all compliances with local tax laws and labour laws were also carried out by the Indian entity.

But in the specific facts of the *Northern Operating Systems* case, the Court rejected the form of the secondment agreement and confirmed the demand of service tax on the transaction. The Court performed an overall reading of materials presented by the parties to discern the true nature of the relationship between the seconded employees and the Indian assessee, and the nature of the service provided in that context, by the overseas entity to its Indian entity.

### **Implications and the way ahead**

The decision is likely to have vast implications, even under the current GST regime, for multinational companies using secondment arrangements.

An inquiry based on this doctrine introduces several factors for determining the liabilities under such arrangement agreements. The assesses will have to re-work their defense in all pending litigations. For future transactions, the companies will have to relook the manner in which they structure their global workforce. It should be possible to distinguish one's case from the factual setting of *Northern Operating Systems*. As it is, the decision *Northern Operating Systems* is premised deeply on its peculiar factual matrix.

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