

Litigation on RCM on Expat Salary: Northern Operating Systems Case under GST – High Courts and CBIC Intervene

By: Team Tax Connect

After the decision of The Hon'ble Supreme Court in Northern Operating System in the Service tax regime, across the Country taxpayers are calculating their exposure under GST. However, still issue which needs to be looked into is that if the payment is made to expatriate employees in terms of the separate employment contracts entered into with them by the Indian Company, whether RCM would be applicable.

In the case of Northern Operating system, the remuneration was being paid by the foreign company to its employees seconded to serve in India. The assessee in that case was required to reimburse the payments to its foreign affiliate. Therefore, it was a clear case where the foreign company was the employer and not the Indian company. The payments were made in the said case, not on account of separate contracts entered into between the Indian company and its employees.

On the said ground, after the Hon'ble Karnataka High Court and the Hon'ble Punjab and Haryana High Court, even the Hon'ble Delhi High Court has stayed the proceeding in the case of METAL ONE CORPORATION INDIA PVT LTD Vs UNION OF INDIA [2023-VIL-816-DEL]

On 13th December 2023, The CBIC has come out with an Instruction No. 05/2023-GST to further right-direct the litigations in this regard. We will understand the case as well as the Instruction in detail in this regard –

Crux of The Matter

1. Taxability of the cross charge.
2. Who should be reckoned as an employer of the seconded.
3. If the Indian company is treated as an employer, the payment would in effect be reimbursement and not chargeable to tax in the hands of the overseas entity.

4. In the event the overseas entity is treated as the employer, the arrangement would be treated as service by the overseas entity and taxed.

5. Whether the relationship between an employee and another, is one of master servant, or whether there is an underlying contract for service, by which the real employer, lends the services of his employee to another.

Issues Raised

1. Is deputation of secondee from Deputer (Foreign Employer) to Deputee (Indian Co) "Provision of general back office and operational support (Managerial & Technical Service) to such group companies."

1A. Can the service be termed as "*manpower recruitment or supply agency service*".

2. Is Control & Supervision over the secondee with the Deputer or with Deputee.

3. Would the fact that Salary of secondee is provided from Deputer & Termination right is with the Deputer – impact the case.

4. Would the deduction of TDS by the Deputee impact provision of service.

5. Was continuing of secondee on Deputer's payroll is for social security benefit only.

6. Secondee would report & be responsible to Deputee – would that mean employer/employee relationship between depute and employee.

7. Is the agreement (Letter of Understanding) between depute & employee a "contract of Service".

8. Is the remittance of salary a mere reimbursement based on actuals and the fact that there is no amount which is payable in respect of the activity in question and therefore there is no consideration involved, be considered in favour of the depute.

9. *Would the fact that depute is getting work from deputer be considered as 'Quid Pro Quo'.*

10. Did the deputer provide the "services of its employees" to the assessee for the performance of agreed tasks.

11. *Would the control of depute over the employee be considered as only for a temporary period, and only for operational purposes.*

12. *Did 'temporary control' over the manner of performance of duties of the employees seconded take away or diminish the fact that their real employer was none other than the overseas company.*

13. Can salaries be said to be consideration paid to group companies for provision of service – *Would Intercontinental Consultants and Technocrats Pvt. Ltd ((2018) 4 SCC 669, apply*

Principles laid down by The Apex Court

1. In *D.C. Dewan Mohideen Sahib and Sons v. Secretary, United Beedi Workers' Union* (1964 (7) SCR 646), the court analysed the sample agreement which disclosed the facts of the case before it, and, for the first time, held that the "control" test is not necessarily determinative to discern the real employer.

2. In *Silver Jubilee Tailoring House v. Chief Inspector of Shops & Establishments* (1974 (1) SCR 747) this court remarked how the test of control, or manner of performance of a task, by an employee by another is not conclusive to decide if an employer employee relationship subsists – It was applicable in earlier ages where it was a typical "labour supply".

3. No formula in the nature of a single test to tell a contract of service from a contract for service will serve any useful purpose.

4. All the factors referred to in the cases on the topic have to be analysed. Not all of these factors would be relevant in all these cases or have the same weight in all cases.

5. No magic formula can be propounded, which factors should be treated as determining ones.

6. Courts can only perform a balancing operation weighing up the factors which point in one direction and balancing them against those pointing in the opposite direction.

7. Cardinal principles of interpretation of documents, is that the nomenclature of any contract, or document, is not decisive of its nature.

7A. An overall reading of the document, and its effect, is to be seen by the courts. Thus, in *State of Orissa v. Titaghur Paper Mills Co. Ltd* (1985 Supp SCC 280) - [1985-VIL-01-SC](#) it was held.

8. Mere payment in the form of remittances is just one method of reckoning if there is consideration.

8A. The other way of looking at the arrangement is the economic benefit derived by the assessee, which also secures specific jobs or assignments, from the overseas group companies, which result in its revenues.

8C. *quid pro quo* for the secondment agreement, where the assessee has the benefit of experts for limited periods, is implicit in the overall scheme of things.

9. No question of revenue neutrality - 2 orders relied on by it (in *SRF* and *Coca Cola*) by this court, merely affirmed the rulings of the CESTAT, without any independent reasoning. Their precedential value is of a limited nature.

That a particular rate of tax- or no tax, is payable, or that if and when liability arises, the assessee, can through a certain existing arrangement, claim the whole or part of the duty as refund, is an irrelevant detail.

The incidence of taxation is entirely removed from whether, when and to what extent, Parliament chooses to recover the amount.

Supersession not acceptable -

10A. The revenue's argument that the assessee had indulged in wilful suppression, in this court's considered view, is insubstantial.

10B. The view of a previous three judge ruling, in *Cosmic Dye Chemical v. Collector of Central Excise* ((1995) 6 SCC 117) - [1994-VIL-19-SC-CE](#) in the context of Section 11A of the Central Excise Act, 1944 –

- There should be "intent" to evade duty.
- *misstatement or suppression are qualified by the word "wilful".*

- Words "contravention of any of the provisions of this Act or rules" are qualified by "with intent to evade payment of duty".
- Misstatement or suppression of fact must be wilful."

10C. This decision was followed in *Uniworth Textiles v. Commissioner of Central Excise* ((2013) 9 SCC 753) - [2013-VIL-09-SC-CU](#) where it was observed that "(t)he conclusion that mere non payment of duties is equivalent to collusion or willful misstatement or suppression of facts" is "untenable". This view was also followed in *Escorts v. Commissioner of Central Excise* ((2015) 9 SCC 109) - [2015-VIL-42-SC-CE](#), *Commissioner of Customs v. Magus Metals* ((2017) 16 SCC 491) and other judgments.

CBIC Instruction No. 05/2023-GST dated 13th December 2023 provides a ray of Hope to Ease issues –

1. It is noted that secondment as a practice is not restricted to Service Tax and issue of taxability on secondment shall arise in GST also.
2. However, The Hon'ble Supreme Court's emphasis was on a nuanced examination based on the unique characteristics of each specific arrangement, rather than relying on any singular test.
3. The decision of the Hon'ble Supreme Court in the NOS judgment should not be applied mechanically in all the cases.
4. Investigation in each case requires a careful consideration of its distinct factual matrix, including the terms of contract between overseas company and Indian entity, to determine taxability or its extent under GST and applicability of the principles laid down by the Hon'ble Supreme Court's judgment in NOS case.
5. Section 74(1) cannot be invoked merely on account of non-payment of GST, without specific element of fraud or wilful mis-statement or suppression of facts to evade tax.

Where the investigation indicates that there is material evidence of fraud or wilful mis-statement or suppression of fact to evade tax on the part of the taxpayer, provisions of section 74(1) of CGST Act may be invoked for issuance of show cause notice,.

6. Evidence for invoking Section 74(1) should also be made a part of the show cause notice.

Way Ahead for Taxpayers under GST & ST

1. This Order is not a doctrine for all such cases. The Apex Court says that 'there is no magic formula. The CBIC Instruction has also said accordingly.

2. Contracts are required to be scrutinized so as to clearly deal with the taxability aspect. HR must function in tandem with Finance/Taxation.

3. Contract 'of Service' shall be when –

- Salary is paid to the employee by the depute.
- All Social Security is by the Depute.
- Employment is terminated from the deputer and made with the depute.
- The employment may be for a specific period with a clause to re transfer to deputer.
- The Letter of Understanding should in fact be between the Deputer and Depute.
- There might be a service fee for the Lou as above on which GST shall be chargeable.

4. "Control & Supervision" are a thing of the past. Now its whether it is "contract of service" or "Contract for Service".

5. For the period of secondment there should ideally be no salary routing through deputer.

LET'S DISCUSS FURTHER!

OUR OFFICES:

MUMBAI

Unit No. 312, Omega Business Park, Near Kaamgar Hospital, Road No. 33, Wagle Industrial Estate, Thane West, Maharashtra- 400604

Contact Person: Priyanka Vishwakarma

Email: priyanka.vishwakarma@taxconnect.co.in

BENGALURU

951, 24th Main Road, J P Nagar, Bengaluru, Karnataka – 560078.

Contact Person: Anil Pal

Email: anil.pal@taxconnectdelhi.co.in

DELHI (NCR)

B-139, 2nd Floor, Transport Nagar, Noida-201301 (U.P)

Contact Person: Poonam Khemka

Email: poonam.khemka@taxconnect.co.in

KOLKATA

6, Netaji Subhas Road, 3rd Floor, Royal Exchange Building, Kolkata - 700001

Contact Person: Tithly Roy

Email: tithly.roy@taxconnect.co.in

KOLKATA

R No 119; 1st Floor; Diamond Arcade; 1/72, Cal Jessore Road, Kolkata – 700055

Contact Person: Uttam Kumar Singh

Email: uttam.singh@taxconnect.co.in

DUBAI

Azizi Feirouz, 803, 8th Floor, AL Furjan, Opposite Discovery Pavillion, Dubai, UAE

Contact Person: Rohit Sharma

Email: rohit.sharma@taxconnect.co.in

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