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Levy of service tax on the salary paid to the seconded employees – split verdict by CESTAT

22 December 2023

Summary

The Customs, Excise and Service Tax Appellate Tribunal (CESTAT) Chennai bench has delivered a split ruling on the issue of whether salary and other allowances paid directly in Indian currency by the appellant to secondees will be liable to service tax. The issue dealt in the present case was limited to the question of valuation and not the taxability of the transaction. The judicial member has held that the allowances paid directly by the appellant to secondees cannot be included in the taxable value whereas the technical member has held that such payments can be included in the taxable value. The CESTAT has referred the case to the third member on resolution of the issue raised.

Facts of the case

- An audit was conducted on the M/s. Nissan Motors India Private Limited ('the appellant') wherein, the department noted that the appellant has entered a secondment agreement with its group company located outside India, M/s. Nissan Motor Company Ltd, Japan to employ expatriates in India.
- Furthermore, the appellant has also entered a separate agreement with the seconded foreign employees.
- The department relied on the Circular F.No.137/35/2011-ST dated 13 July 2011 wherein it was clarified that where one organisation sends its employees to another organisation for a consideration, service tax under the category of manpower supply services will be applicable. Therefore, the department contended that the activity of supplying employees to appellant unit will fall under manpower services.
- The department noted that the part of the salary was paid to the deputed employees directly by the appellant company in Indian rupees and part by the associated company outside India. Thereafter, the appellant company had reimbursed the part amount to the foreign company and noted that the appellant did not include the salary portion paid in Indian rupee to discharge its service tax liability.
- Therefore, the department invoked extended period of limitation alleging that the appellant has suppressed facts of payment of part of the salary in INR to the deputed employees. Thus, it reduced the taxable value with an intent to evade payment of service tax. Later, the demand was confirmed.
- Therefore, aggrieved by the same, the appellant filed the present appeal before the Tribunal.

Appellant's contentions:

- The appellant contended that the service tax is applicable only on those costs that are charged by the service provider.
- The show cause notice (SCN) relied upon the Rule 5 of the Service Tax (Determination of Value) Rules, 2006 (STDR) and Section 67 the Finance Act, 1994 (FA); however, the Rule 5(1) of STDR has been ruled out by the Supreme Court (SC) in the case of Intercontinental Consultants and Technocrats Private Limited.
- Furthermore, the appellant relied on the decision of CESTAT in the case of M/s. Neyveli Lignite Corporation Limited wherein it was held that service tax was

not payable on salaries paid directly to employees.

- The CBEC, vide Circular No 199/11/2023-GST dated 17 July 2023, clarified that GST is not applicable on the salary component in respect of internally generated services.
- Furthermore, in the case of M/s Boeing India Defence Private Limited it was held by CESTAT that perquisites paid to seconded employees are outside the ambit of Section 67.
- The appellant submitted that neither any payment has been made to Nissan, Japan nor was any debit made in the books of the appellant to Nissan, Japan being an associate enterprise. Therefore, the point of taxation does not arise in the present case.
- The demand made on the entire salary portion including the TDS is not sustainable.
- The appellant also submitted that Nissan, Japan qualifies as an intermediary under Service Tax laws, and therefore, the location of the service provider (Nissan, Japan) will be applicable to demand service tax.

Issue before the Tribunal:

The Tribunal needs to ascertain whether the salary, bonus, allowances, and expenses paid by the appellant directly to the secondees in India, is also to be included in the taxable value for payment of service tax under manpower recruitment services under reverse charge mechanism (RCM).

CESTAT Chennai observations and judgement [Service Tax Appeal No.41909 to 41911 OF 2017 dated 11 December 2023]

Arguments of the Judicial Member (Ms. Sulekha Beevi C.S.)

- **Difference in facts vis-à-vis NOS judgement:** The member differentiates the present case from the ruling of Northern Operating System (NOS) judgement, wherein the seconded employees were entirely remunerated through the payroll of the foreign company. However, in the present case the appellant reimburses to Nissan, Japan only part of the salary which is borne by Nissan Japan.
- **Analysis of the term 'gross amount charged':** Furthermore, the member analysed the term 'gross amount charged' and 'consideration' and noted that the appellant has rightly paid tax only on the amount, which has been reimbursed to or charged by the foreign entity because costs that are incurred but not charged does not form part of the consideration; and relied on the decision in the case of M/s. Boeing India Defence Private Limited wherein it was held that only the gross amount charged must be considered.
- **Earlier jurisprudence:** The member drew reliance from the decision in the case of M/s. Neyveli Lignite Corporation wherein it was held that if the salary is paid directly and later not reimbursed by the assessee then that amount would not be leviable under service tax. Similar stance was taken in the case of M/s. Boeing India Defence Pvt Ltd. Contrary to the above, in the case of M/s Renault Nissan Automotive India Pvt Ltd. it was held relying on the decision of NOS judgement that tax will be levied on the part of salary paid directly to employee and not charged on the foreign company. However, the member held that the above ruling is not applicable because the above ruling was not considered.

- **Amount to be included in taxable value:** Furthermore, relying on the decision of the apex court in the case of M/s Bhayana Builders wherein it was held that only such amounts, which are charged on the service provider, need to be included in the taxable value for the purpose of discharging service tax liability.
- **Extended period not invokable:** The member held that the extended period cannot be invoked, because the issue involved was purely interpretational in nature.

Arguments of the Technical Member (M. Ajit Kumar)

- **Analysis of the term 'consideration':** The member analysed the term 'consideration' under the Indian Contract Act, 1872 and applied the same to the context of the Finance Act and noted that the amount that is payable to the overseas supplier of manpower service, either if paid directly or indirectly to the secondee at the behest of the supplier, i.e., by both the overseas supplier (reimbursable) plus the appellant, it will represent the gross consideration for the service provided or to be provided. This view is substantiated by the SC decision in the case of M/s. Bhayana Builders Private Limited.
- **Terms of agreement:** As per the secondment agreement, it is clear that the appellant has accepted the group company's promise for services of skilled employees on payment of the gross amount that the group company charges as per certain conditions. Therefore, fulfilment of the agreement's conditions and payment or debit of the books of accounts to pay the secondees their full salary, bonus and allowances as per the gross amount 'charged' by the group company will attract service tax. The member held that the cases referred by the appellant on the issue of whether reimbursable charges are to be included in the value on which tax are of limited precedential value.
- **Payments to form part of assessable value:** The member also held that as per the provisions of RCM all the payments made by the receiver of service, who is deemed to be the provider of service, towards the salary and advances of the secondee (both in Indian and foreign currency) will form a part of the assessable value on which duty has to be levied.
- **Employer-employee relationship:** Furthermore, the member analysed the concept of employer and employee relationship in the present factual background and opined that the appellant has operational or functional control over the secondee, similar to a service recipient of manpower, and also as it is clearly mentioned in the agreement that the secondee will continue to be the employee of Nissan, Japan. Therefore, it was concluded that no employer-employee relationship exists. Moreover, the company and it's subsidiary will not be considered as joint employer.
- **Not an intermediary:** The member held that there is nothing on record to show that the group company is an 'intermediary' employed to perform any act for another.
- **Demand amount incorrect:** The member held that there is no provision under law which specifies to include TDS in the value for purposes of calculating service tax. Therefore, the amount of demand is not correctly calculated. The member held that invocation of the extended period and

imposition of penalty in the present case is not justified.

- **Payments in Indian rupee to be included in assessable value:** The member has held that payments made directly in Indian rupee can be included in the taxable value.

Given the difference of opinion between the two members, the matter has been referred for resolution by the third member.

Our comments

The leviability of GST on salary paid to seconded employees has been extensively deliberated post the decision of the Supreme Court (SC) in the case of Northern Operating System. However, in many cases stay has been granted where the GST department issued notices demanding GST on payment of the salary/reimbursements related to seconded overseas employees.

Even, the Board has recently issued an instruction clarifying that the decision of the SC in M/s. Northern Operating Systems Private Limited [CA No. 2289-2293/2021] (NOS) cannot be extended to each and every secondment transaction mechanically. The taxability of the transaction will be determined only after evaluating different factual matrices, specifically the terms of the contract between the overseas company and the group company. The CBIC has further underlined that an extended period of limitation can only be invoked by establishing fraud, wilful misstatement, or suppression of facts to evade tax and not solely on non-payment of tax.

Earlier, the Board vide Circular No. 199/11/2023-GST dated 17 July 2023, clarified that the cost of salary of employees of the Head Office, involved in providing services to Branch Office is not mandatorily required to be included while computing the taxable value of the supply of such services.

While the matter has been referred to the third member, it is relevant to note that similar matters are pending before the SC in the case of M/s Komatsu India Pvt. Ltd, and M/s. Nortel Networks India Pvt. Ltd.

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