

Termination of Employment during Secondment

Introduction

It would be correct to state that the world cannot ignore India, which has come to the center-stage as an investment destination and global companies want to be a part of its vibrant economy. As a result, many multinationals have established entities and, often, send their employees on secondments for a limited period to either oversee the operations, or train the local teams so that there is a uniformity of approach, or provide technical assistance, or provide opportunities to employees to develop skills etc. As secondment has become increasingly common, it has given rise to a multitude of related questions emanating from employment matters, including, among others the right to terminate the employment of a seconded employee.

This e-newsline shall discuss the relevant jurisprudence to determine the actual employer of the seconded employee and with who does the right to terminate the employment of the seconded employee rest during the period of secondment.

1.0 Secondment arrangement – why the need for an agreement?

Secondment is an arrangement between companies whereby an employee of one company is transferred to another company, be it a group or a customer etc, to perform certain assigned activities for a specific period of time. It is a common practice for foreign companies to depute their employees to their Indian counterparts in connection with a project or for rendering certain services or for safeguarding their interest in India. The general idea behind such a secondment arrangement is that the seconded employee will remain employed with the original employer during the secondment and will, following the completion of the secondment term, “return” to the original employer. However, there is a risk that the seconded employee may, due to the nature of the work, be considered an employee of the secondee company, despite the parties’ intentions. In such a scenario, the question of determining “who is the actual employer of the seconded employee” becomes important, particularly for the secondee company as the law imposes a number of liabilities on the employer and grants several rights to the employee.

In India, there is no specific statute that governs secondments or employment of a white-collar employee and the relationship is rooted in a contract. Companies, therefore, prefer to execute a contractual arrangement with detailed terms and conditions of secondment to address critical issues like, roles and responsibilities of secondee employee, remuneration, termination, consequences of termination etc. However, it has generally been observed that group companies do not execute such agreements and this practice sometimes leads to untoward situations that may be related to taxation, termination or determination of the actual employer having control over the seconded employee.

2.0 The actual employer – jurisprudence

How does one determine who the actual employer of a seconded employee is? Is there a litmus test for this? In the absence of a specific statute, to answer this question it is necessary to examine the jurisprudence created by the Indian courts.

In Centric India Offshore Pvt. Ltd (**“Applicant”**),¹ the Authority for Advance Ruling (**“AAR”**), while deciding a question on whether reimbursement of salary cost of a seconded employee by an Indian subsidiary is liable to tax deduction at source under Section 195 of the Income Tax Act, 1961, had to decide on the question of “who is the employer” in a secondment.

To understand the reasoning behind the AAR’s observation, it is important to discuss the facts of the case. The Applicant was incorporated as a subsidiary of Centrica Plc, UK (**“Parent Company”**). The Parent Company along with its overseas group entities, namely British Gas Trading Ltd. (a company incorporated as per the laws of the UK) and Director Energy Marketing Limited (a company incorporated as per the laws of Canada) entered into a service agreement with the Applicant for provision of certain services. Simultaneously, under a secondment agreement between the Applicant and its overseas group entities, the employees of the overseas entities were seconded to work under the control and supervision of the Applicant to fulfill the role envisaged in the service agreement. Under the secondment agreement, the Applicant was required to reimburse the entire salary cost of the seconded employees plus 15% to the overseas entities. The overseas entity seconded individuals to perform duties at the Applicant’s location for a specific period and to report to the Applicant as per the terms of the secondment agreement.

During the period of secondment, the overseas entities were not responsible for the results of the work performed by the seconded employees. Further, as per the secondment agreement, the Applicant had the right to terminate the secondment of the seconded employee. Though the seconded employee remained on the payroll of the overseas entities, the Applicant ultimately reimbursed them the cost of remuneration, reimbursements and participation in overseas retirement and social security plans. This reimbursement was viewed by the revenue department as payments made by the Applicant to the overseas entities in the nature of “fees for technical services” and “fees for included services” under the double taxation agreement with the UK and Canada, respectively and hence taxable in India. Further, the department’s position was that the services rendered were managerial services and thus a contract for service. To this, the Applicant contended that it was the “economic employer” of the seconded employees and the salary was being paid by the overseas entities out of convenience. Accordingly, the Applicant argued that the reimbursement of the salary to the overseas entities was not taxable in India and thus they should not be required to withhold the tax on such payments.

¹ TS-163-AAR-2012

The AAR observed that the seconded employees remain the employees of the original employer and are paid salaries, allowances, employment benefits and other perquisites by them. As per the secondment agreement, the right of the seconded employees to seek their salary and other emoluments stems from the original employer and not the Applicant. Further, the Applicant only had the right to terminate the secondment, whereas the right to terminate the employment remained with the employer, even though the control and supervision of the employees was with the Applicant for the duration of the secondment.

The AAR dismissed the Applicant's arguments that the payment to the overseas group entities could not be considered as income as it is a case of diversion of income by overriding title. The AAR also held that the employees continue to be employees of the overseas group entities and that the employees are rendering services for their employer in India by working for a specified period for a subsidiary.

In another case, Abbey Business Services (India) Pvt. Ltd, with similar facts as those of Centric India Offshore Pvt. Ltd, the Commissioner of Income (Appeals) ("**CIT Appeals**") took a different view and held that the secondee company is the employer.² The difference in facts of the two cases was that Abbey's secondment agreement contained two clauses, described below, which led to the CIT Appeals to declare the Indian entity as the employer.

- (i) Reimbursement was calculated on the basis of the time utilized and was bereft of profits, and
- (ii) Number and qualifications of the employees was determined by the secondee company.

Based on the above rulings, in order to establish "who is the employer" there should be clarity on the following critical issues and should be determined while executing the secondment agreement:

- (a) Who bears the responsibility or risk for the results produced by the employee's work during secondment?
- (b) Who has the authority to instruct and supervise the work of the seconded employee?
- (c) Where the work is performed and under whose control and responsibility is such work performed?
- (d) Does the remuneration reimbursed to the original employer? If yes, does it include profits?
- (e) Who determines the number and qualifications of the employees that are to be seconded and where to be seconded?
- (f) Is the secondment agreement a "contract for service" or a "contract of service"?

² Abbey Business Services (India) (P.) Ltd. v. Deputy Commissioner of Income-tax (AIT-2012-223-ITAT)

As observed in both the cases discussed above, the court concluded that even if the company to whom the services are provided by the seconded employee is deemed to be the employer; such company only has the right to terminate the secondment³ and not the employment of the seconded employee. This right still rests with the company sending the employee on secondment.

While the question in the foregoing judgments was related to tax, the observations of the AAR and the CIT Appeal can have a far reaching effect on secondment arrangements. For instance, if it is determined that the employer is the seconded company, which is an Indian company, other employment benefits such as payment of gratuity under the Payment of Gratuity Act, 1972⁴ may get triggered as well.

Conclusion

In summation, a secondment cannot be considered as a permanent transfer of employment. Needless to say, caution is necessary in drafting the secondment agreement as otherwise an unintentional obligation for the Indian secondee company may be created under law. Regardless of who the employer is, the jurisprudence in India confirms that the right to termination of employment remains with the company sending the employees on secondment. The secondee company has a limited right of terminating the secondment. However, this must be specifically captured in the secondment agreement otherwise there may be a risk that the secondment can be treated as a permanent transfer.

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³ Abbey Business Services (India) (P.) Ltd. v. Deputy Commissioner of Income-tax (AIT-2012-223-ITAT)

⁴ This is a monetary reward which is given by an employer to an employee who has continuously served with the employer for a period of five (5) years or more