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ACC Quick Overview: Engaging Workforce in India — Key Considerations for Foreign Entities

Employment and Labor

Law Department Management

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Key highlights:

- Engagement of India-based personnel by foreign entities in an employer-employee relationship without a formal business presence in India may expose the entities to various foreign exchange and taxation associated risks.
- In-house counsel need to understand the options available for engaging an India-based workforce, the implications in terms of Indian employment laws, and the do's and don’ts that entities should consider following in such situations.

The COVID-19 pandemic has greatly impacted the employment landscape across the world. Entities have been familiarized with various practices, including remote working arrangements. Many employers have seen it as an opportunity to grow their workforce and global presence. While the practice of engaging workforce from foreign jurisdictions existed before the pandemic, now, more than ever, entities are actively seeking to build a globalized workforce.

A globalized workforce enables entities to engage personnel from a diverse pool of talent without being confined to physical locations. Several entities also see this as a cost-effective approach, by engaging personnel on a remote working basis without having a local entity or any formal business presence in the concerned jurisdiction.

Given the easy availability of skilled and qualified personnel, India is a preferred choice in such arrangements. However, that approach also brings a host of challenges from the perspective of Indian taxation and foreign exchange laws. Accordingly, foreign entities should be mindful of considerations associated with such arrangements.

Applicability of Indian employment and labor laws

The applicability of Indian employment and labor laws is often one of the most significant concerns for foreign entities looking to hire India-based personnel. Such laws in India have territorial application limited to India, or part thereof, and are designed in such a manner that they can secure the interests of the workforce in the country. For this reason, several of these laws entail registration, return filing, and local facility inspection, where the employer's presence in India is required. In other words, two important conditions are required to be satisfied for the application of labor laws in India: (a) there is an "establishment" in India, and (b) such establishment is the employer of the concerned individual(s).

Therefore, these labor laws do not apply to an entity based outside of India, such as a foreign company or other corporate body, if the entity does not have any establishment, office, subsidiary or joint venture in India. Consequently, the risk of a foreign entity with no actual business process in India being exposed to claims of deemed employment by India-based personnel is *prima facie* negligible.

Key foreign exchange considerations

As per the Indian foreign exchange regulatory regime, a foreign entity is allowed to have a formal business presence or place of business in India once it has set up (a) an incorporated subsidiary or joint venture entity, or (b) a branch office, project office, or liaison office, in India. Incorporation of any of these structures entails its own procedural compliance and limitations regarding the manner and extent of its permissible operations.

In the absence of such a place of business in India, engagement of Indian personnel residing in India as employees by a foreign entity, is likely to be subjected to scrutiny under the Indian foreign exchange control regulations.

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That said, it is not practical or even feasible from a cost perspective for a foreign entity to establish a physical presence in India for a limited number of personnel, when it is only in the process of exploring its business prospects in the country. This calls for the need to explore alternative arrangements (as described below) that may be better suited for foreign entities to mitigate associated risks while promoting their business interests in the country.

Key taxation considerations

Under the Indian tax laws (read with any applicable tax treaty between India and other jurisdiction), the presence of employees of a foreign entity in India could be considered a taxable presence, i.e., “permanent establishment” (PE) of such foreign entity in India, depending *inter alia* on the duration of such presence and the nature of activities undertaken in India.

For instance, India’s tax treaties with the United States and the United Kingdom, respectively, provide that where a non-resident has a fixed place in India at its disposal, through which its business is wholly or partly carried on, such fixed place shall be considered as its PE (fixed place PE), subject to certain exceptions (such as for preparatory and auxiliary activities). Additionally, the tax treaties also provide that an agency PE or a service PE may be created on satisfaction of certain conditions.

A service PE is created when a non-resident provides services (including managerial services, but excluding services for which the fees are taxable as royalty or fees for technical services under the treaty) through its employees or personnel in India, and such activities continue in India for such duration as is specified in the applicable tax treaty. An agency PE is created when any person other than an “agent of independent status” is acting on behalf of a non-resident in India and has the authority to negotiate and conclude contracts or secure orders on behalf of the non-resident.

Possible alternative arrangements

To mitigate the risks with respect to foreign exchange and taxation laws, foreign entities operating with no local entity in India may enter alternative arrangements and engage Indian personnel either (a) as independent consultants (on a principal-to-principal basis), or (b) through a third-party manpower services agency (MSA) wherein a foreign entity may enter into a services agreement with a MSA in India, which employs the concerned Indian personnel.

While both types of arrangement may not eliminate the challenges discussed above, the level of risk would be mitigated. Such risks may be further alleviated by following certain safeguards as described below.

Do's and don’ts while undertaking alternative arrangements

Foreign entities may consider the following points to mitigate risk and limit potential liabilities under individual consultancy arrangements or arrangements involving engagement of personnel who are on the payroll of a third party in India.

- **Nature of the arrangement**: Either arrangement must clarify that it is entered on a principal-to-principal basis. It helps to demonstrate that India-based consultants or third-party manpower are not engaged on an exclusive basis and that the payment to consultants or third-party manpower services providers is made by the service recipient entity on an arm’s length basis.

- **Clear and robust agreement**: The agreement executed between the foreign entity and the consultants or manpower services providers should include robust terms clarifying the independent relationship between the parties. It should also ensure that the nomenclature used in the agreement accurately reflects the relationship. For instance, in the case of a consultancy arrangement, reference should be made to payment of a “consultancy fee” to

the Indian personnel (as opposed, for example, to referring to payment of a fixed monthly salary) upon receipt of an invoice for the performance of services.

- **Engagement practices**: The foreign entity should ensure that sufficient distinction is always maintained between the treatment of employees on the one hand and consultants or third-party manpower on the other. The foreign entity should not exercise direct control or supervision over the day-to-day activities of the consultants or third-party manpower. The consultants should be able to operate and render services in their own way (including using their own resources, infrastructure, and/or assets). As for third-party manpower, any instructions to them on expected deliverables should be routed through their employer. The consultants or third-party manpower should also be advised to refrain from indicating any direct association with the foreign entity on public or social media platforms.

- **Benefits offered to consultants or third-party manpower**: No benefits and welfare schemes typically associated with an employer-employee relationship (such as discounts on medical treatment) should be extended to consultants or third-party manpower.

- **Limited authority**: The consultants' or third-party manpower's role should not extend to negotiations, execution of contracts, or securing contracts or business on behalf of the foreign entity.

- **MSA's obligations and monitoring thereof**: The MSA should be responsible for compliance with all applicable labor laws with respect to the personnel on its payroll, including but not limited to all laws relating to the deposit of due social security contributions, timely payment of wages, health and safety provisions, and other statutory compliance. As the recipient of the services, the foreign entity should monitor the MSA's compliance with applicable laws and should contractually require the MSA to periodically submit proof of compliance.

What's on the horizon

As much as India is a preferred destination for talent acquisition, it presents numerous challenges when it comes to engagement of India-based personnel by foreign entities. The points above highlight the importance of proper manpower planning and assessment of key foreign exchange and taxation considerations as the factors to determine the manner of local operation. Evaluating these aspects may be imperative not only when a foreign entity first contemplates hiring India-based personnel, but also when foreign nationals working with foreign entities in an overseas location consider moving to India for specific durations to work remotely.

???????Anshul Prakash

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Anshul Prakash is a partner at Khaitan & Co and leads the employment, labor, and benefits practice group of the firm. Anshul and the practice group under his leadership have won several awards and recognitions over the years being ranked Tier-1 across league tables.

Prakash exclusively advises several prominent domestic and international clients on full suite of contentious and noncontentious employment law and related matters concerning workforce management, social security, industrial relations and trade union strategy, transition due to business transfers, workplace harassment and

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Prakash also leads the firm's thought leadership initiative on advocacy and knowledge sharing in employment and labor law space, and actively shares insights on evolving jurisprudence in the employment and labor law space in several industry publications through numerous articles over the years, print media, and public speaking events organized by industry bodies. Some recent notable literary contributions include contribution to the India chapter of the *International Comparative Legal Guide* to: *Employment & Labour Law* (2020, 2021, and 2022) published by Global Legal Group, Chambers Global Practice Guides Employment 2022 (Asia Pacific), and contribution to the report on Future of Work as part of collaboration between International Bar Association and International Labour Organisation (2018-2019).

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Deeksha Malik is a senior associate in the employment, labor, and benefits practice group and focuses on a range of matters from employment terms and employee benefits to wage restructuring and workforce redundancy. In particular, she works extensively in the area of disciplinary issues, prevention of sexual harassment, and diversity and inclusion. She has also been active on the impact assessment exercises conducted by the practice group in relation to upcoming labor codes. Her major contribution to the practice group also comes in the form of her advocacy, knowledge-sharing and pro bono endeavors. She frequently makes representations to the central and the state governments on labor reforms, including the implementation framework under the labor codes. On the knowledge-sharing front, she has over 40 articles to her credit (co-authored with other colleagues in the practice group) published by Wolters Kluwer, International Bar Association, BW People, Chambers and Partners, People Matters, Human Capital, etc.

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