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BUSINESS PROCESS OUTSOURCING UNITS IN INDIA – TAX CONCERNS

Indian income-tax authorities have recently served notices on some BPO units engaged in telemarketing services asking them to furnish particulars of their foreign principals. The issue has to be analyzed carefully because many global majors in the credit card, insurance, travel and financial services sector use BPO units or call centers based in India to solicit business from customers across the globe. It appears that, the income-tax authorities are trying to establish that foreign companies, which have outsourced their jobs to India, have a permanent establishment in India.

The BPO units have replied to the notices stating, among other things, that their confidentiality obligations with their principals do not permit them to furnish the required particulars. They have also added that, as the products sold through the telemarketing activities do not come to India, the foreign principals are not subject to taxation in India in any way. In relation to "associated enterprises," section 92D(3) of India's Income-tax Act, 1961 (the "IT Act") provides that an assessing officer or a Commissioner (Appeals) may, in the course of any proceeding under the IT Act, require any person who has entered into an international transaction, to furnish any information or document in respect thereof, and that such information will have to be provided within a period of 30 days from the date of receipt of a notice issued in this regard. Therefore, it is unlikely that the BPO units that are wholly owned by or are dependent on tools supplied by one foreign company will succeed in preventing disclosure of particulars of their foreign principals. Moreover, outsourcing agreements normally contain provisions permitting disclosure of information if so required by a government entity. Thus, recourse to breach of contractual confidentiality obligations will not hold much water in the long run.

A better approach may be for BPO units to prove that the rendition of telemarketing services resulting in income being earned by their foreign principals is not income accruing or arising in India.

In this regard, section 9(1)(i) of the IT Act provides that all income accruing or arising, directly or indirectly, through or from any **"business connection"** in India is income which is deemed to accrue or arise in India. The term **"business connection"** is defined under Explanation 2 to section 9(1) of the IT Act to

include any business activity conducted on behalf of a non-resident through a person, who:

a) has the authority to conclude contracts on behalf of the non-resident;

b) habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or

c) habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident.

This provision does not apply if a person's activities are limited to the purchase of goods or merchandise for the non-resident. Further, if such person is an agent of an independent status (both legally and economically) and acts in the ordinary course of his business, it will not constitute a business connection. However, the person shall not be deemed to be of independent status if he works wholly for the non-resident, or other non-residents who are either controlled by the principal non-resident or have controlling interest in the principal non-resident or are subject to same common control as the principal non-resident.

Explanation 3 to section 9(1) of the IT Act clarifies that where a business is carried on in India through a person referred to in the aforesaid clauses (a), (b) or (c) of Explanation 2, only so much of the income as is attributable to the operations carried on in India shall be deemed to accrue or arise in India.

The focus of the income-tax authorities seems to be on sub-clause (c) of Explanation 2 to section 9(1) of the IT Act under which a BPO unit that habitually secures orders mainly or wholly for a non-resident company will result in the non-resident company having a business connection in India. What is the meaning of securing orders? Can it be argued that pure telemarketing services under which a BPO unit calls customers in foreign countries to introduce a new product, and does nothing more, cannot be regarded as securing an order. Typically, if a call center only makes telephone calls and passes on details of interested new customers to its client for further action, including actual sale or execution of a contract, there can be no question of the client's income accruing in India. However, if not only the call is made by the BPO unit, but the actual processing of the order is also done by it, then there is a greater likelihood of the client being regarded as having a business connection in India.

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In this regard, India's Central Board of Direct Taxes has set up the Emerging Issues Task Force for resolution of issues relating to taxation of non-resident Indians. The BPO industry has informed the Emerging Issues Task Force about the adverse impact on the sector, due to the uncertainty created by the introduction of the foregoing new explanations to section 9(1) of the IT Act. It is anticipated that to alleviate the maladies, the Ministry of Finance will issue a notification exempting multinational companies, which operate BPO units in India through subsidiaries, from payment of tax arising out of a business connection. However, this will be subject to maintenance of arm's-length pricing in transactions between the multinationals and their Indian subsidiaries.

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