

Tax Hotline

August 18, 2003

TASKFORCE TO EXAMINE TAX ISSUES APPLICABLE TO BPO INDUSTRY

The idea behind Business Process Outsourcing ("BPO") is moving a job or function to less expensive yet proficient locations. The magnitude of the resulting cost savings is just too compelling to ignore. In order to cut cost in this depressed market, business entities in various sectors, including banking, financial services, telemarketing, insurance, HR, to name a few, outsource their back office operations to cost effective countries. India, Philippines, Malaysia, are a few countries, which have earned a name as cost effective and efficient destinations.

Considering the increase in the BPO activities in India, the government of India is all set to examine whether the non-resident company that has outsourced business processes to a call centre in India should be subject to tax in India. This issue has become relevant on account of the amendment made to the definition of the term Business Connection ("BC") by the Finance Act, 2003 ("FA-2003").

The term BC is analogous to the concept of Permanent Establishment ("PE") under tax treaties, although it wasn't specifically defined thus far under the Indian Income Tax Act, 1961 ("ITA"). As per section 9 of the ITA, a non-resident having a BC in India is taxed only in respect of income attributable to the operations of the BC. The FA-2003 added an explanation to section 9 of the ITA laying out the situations under which an Indian agent would constitute a BC of such non-resident entity in India. The amendment aims at bringing within the ITA the concept of agency BC, along the lines of agency PE under the tax treaties.

Thus, as per the amendment, an Indian agent dependent on his non-resident principal will constitute a BC in India if he exercises an authority to conclude contracts on behalf of the non-resident; he habitually maintains in India stock of goods from which he makes regular delivery on behalf of the non-resident; or it habitually secures orders mainly for the non-resident and its related parties. Further, an Indian agent will be deemed to be a dependent agent if he carries out work mainly for the non-resident or its related entities.

The issues being examined by the Indian government are whether a BPO outfit concluding contracts on behalf of its foreign clients would constitute an agency BC as envisaged under the amended section 9 of the ITA and thus, whether the foreign client of the Indian BPO company who concludes a contract through the call centre is liable to tax in India.

The task force set up by the government to advise it on the emerging issues in non-resident taxation is expected to examine this issue. For this, the taskforce may also look into the practices followed in other BPO hubs like Philippines and Malaysia for taxation of foreign clients of domestic BPO centres.

Clarity on the subject is considered vital for further growth of the BPO industry. If the government decides to tax the foreign clients of Indian BPO outfits, they would factor in this as additional cost and that would alter the competitiveness of the Indian call centre industry vis-a-vis its counterparts abroad.

Source: The Economic Times, August 18, 2003

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