



CIRCULAR/INCOME-TAX ACT

Section 9 of the Income-tax Act, 1961 - Income deemed to accrue or arise in India - Taxation of Business Process Outsourcing Units in India

CIRCULAR NO. 1/2004, DATED 2-1-2004

A non-resident or a foreign company is treated as having a permanent establishment or business connection in India under article 5 of the Double Taxation Avoidance Agreements or under section 9 of the Income-tax Act, 1961, if the said non-resident or foreign company carries on business in India through a branch, sales office etc., or through an agent (other than an independent agent) who habitually exercises an authority to conclude contracts, or regularly delivers goods or merchandise, or habitually secures orders in India, on behalf of the non-resident principal. In such a case, the profits of the non-resident or foreign company attributable to the business activities carried out in India becomes taxable under the Income-tax Act, 1961.

2. During the last decade or so India has seen a steady growth of outsourcing of business processes by non-residents or foreign companies to IT-enabled entities in India. Such entities are either branches or associated concerns of the foreign enterprise or an independent Indian enterprise. Their activities range from mere procurement of orders for sale of goods or provision of services and answering sales related queries, to the provision itself of services like software maintenance service, debt collection service, software development service, credit card/mobile telephone related service etc. In some cases the entire or major portion of the revenue generating activities of the non-resident enterprise is performed by the BPO (Business Process Outsourcing) unit in India. The extent to which global profits of a non-resident enterprise is to be attributed to the activities of the BPO unit in India in these various circumstances, has been under consideration in the Board.

3. The manner and extent of such attribution of profits will evidently depend on the facts of each case and the nature of services rendered by the BPO unit, and the same has to be determined in accordance with the provisions of the treaty applicable and the domestic law. The Board is, however, of the view that in a case where a non-resident, carrying on manufacture and sale of goods or merchandise or provision of services outside India, outsources some of its incidental activities viz. conclusion of contracts and procurement of orders (which enable the core activities to be carried on abroad) to an IT-enabled entity in India, which constitutes a permanent establishment of the non-resident principal, then the insignificant profit which is difficult to determine and attributable to the conclusion of such contracts or procurement of such orders can be considered to be embedded in the income of the permanent establishment taxable in India, if the price charged in respect of the above services by the permanent establishment is an arm's length/fair market price. In such a situation, therefore, no income shall separately accrue or arise or be deemed to accrue or arise to the non-resident principal in India.

4. An example of such services by an IT-enabled entity in India could be a case where a foreign company manufacturing computers abroad and also selling such computers to customers abroad, engages or sets up a call centre in India to procure orders from or conclude contracts with customers abroad and also to answer sales related queries on telephone. In such a case, no income shall accrue or arise or be deemed to accrue or arise to the non-resident in India, apart from the income of the call centre. Similarly, where a foreign insurance company insuring risks in countries other than India appoints or sets up a call centre in India to attend to calls from customers outside India regarding acquisition of new insurance policy or revision of existing policy, to disseminate relevant information and accept insurance proposals from the customers, while actual policy issuance as well as collection of premium is done outside India by the foreign insurance company, no profits of the non-resident shall be taxable in India, apart from the income of the call centre if the charges paid to the call centre for its services are at arm's length/fair market price. Another example of such services could be the case of a foreign credit card company issuing credit cards to customers living in countries other than India, which appoints or sets up a call centre in India to attend to calls from customers outside India seeking to acquire a new credit card, disseminate relevant information and accept the request for issue of a credit card from the customer, while the actual card issuance, the delivery of the card and collection of charges are being done outside India by the foreign credit card company, and the charges paid to the Indian call centre for its services are at arm's length/fair market price.

5. On the other hand, where a non-resident or a foreign company outsources the whole or part of its core revenue generating business activities to an IT-enabled entity in India, such as the services of a travel agent, software developer, software maintenance, investment consultant, debt collection service, etc., and the IT-enabled entity in India renders the services either directly to the customers abroad or through the non-resident principal, a considerable portion of the profits derived by the non-resident or the foreign company from its customers abroad would certainly be attributable to the activities performed by the IT-enabled entity in India. If such entity constitutes a permanent establishment of the non-resident or foreign company in India, such attributed profits would be taxable under the Income-tax Act, 1961 in accordance with the provisions of the relevant tax treaty.