

BPO businesses are set-up upon commencement of training of employees

September 12, 2014

In brief

Recently, the Delhi High Court, in the case of **Omniglobe Information Tech India Private Limited** (the taxpayer), held that in the business process outsourcing (BPO) industry, training of employees was an important, essential and integral element of the business, and when the taxpayer had the infrastructure for employee training in place, the business could be treated as set-up. It was further held that the moment employees were recruited and enrolled, and the infrastructure to use their services was in place, the set-up of business was complete.

In detail

Facts

The taxpayer¹ was incorporated on March 19, 2004 as a subsidiary of M/s Omniglobe International, USA. The taxpayer was a BPO service provider to its parent company. The taxpayer had claimed deduction under section 10B of the Income-tax Act, 1961 (the Act) starting from April 1, 2004 on the premise that approval as a 100% export oriented unit under the STPI scheme had been obtained, and the operations had commenced from April 1, 2014. The taxpayer had entered into a service agreement with its parent company for rendering BPO services from June 1, 2004.

The taxpayer also entered into an agreement dated March 30, 2014 with M/s. Agilis

Information Technologies International Private (Agilis) for use of the leased premises of Agilis, personal computers, furniture and fixtures. The taxpayer would install its own internet link and pay for the proportionate water and electricity charges. The taxpayer had hired premises from June 15, 2004.

During the period between April 1, 2004 and May 31, 2004, the taxpayer incurred INR 5,902,448, of which a majority of the expenditure was attributed towards salary and wages, leased line charges, recruitment expenses, professional charges, transportation charges. The employees recruited were given training during this period.

The tax officer disallowed this expenditure of INR 5,902,448 treating it as capital in nature on the contention that the business of the taxpayer commenced only from June 1,

2004, i.e. the date on which the taxpayer entered into the service agreement with its parent company. The said agreement with Agilis was placed on record before the Commissioner of Income-tax (Appeals) (CIT(A)), who ruled in favour of the taxpayer.

Aggrieved by the CIT(A)'s decision, the revenue filed an appeal before the Income-tax Appellate Tribunal (Tribunal). The Tribunal did not look at the agreement between the taxpayer and Agilis, and ruled in favour of the revenue authorities.

Aggrieved by the Tribunal's decision, the taxpayer filed an appeal before the High Court.

Issue before the High Court

Whether the business of the taxpayer could be considered to have been set up on April 1, 2004 or June 1, 2004?

¹ Omniglobe Information Tech India Pvt Ltd v. CIT [TS-526-HC-2014(Delhi)]

High Court's ruling:

The High Court observed that there was a distinction between the "setting up of business" and "commencement of business"². A proviso to section 3 of the Act referred to and defined the term, "previous year" in relation to the newly set-up business or profession, and not with reference to the date of commencement. Section 28 of the Act postulated that profit and gains of the business or profession carried out at any time during the previous year should be taxed under the head "profits and gains of business or profession"³.

The mere fact that the business of the taxpayer had commenced its operations from June 1, 2004, i.e. the date from which the actual services were rendered, did not mean that the business of the taxpayer was not set up for the purposes of the Act. To determine whether the taxpayer's business was set up or not, the factual matrix of the case had to be analysed.

Considering the nature of business carried out by the taxpayer, training and imparting skills to employees recruited or testing their performance could not be said to be a pre-set-up expenditure. The moment employees were recruited and enrolled, and infrastructure to use their service was in place, the set-up was complete. It was indicative of the fact that business operations had been set-up. In the BPO industry, the training of employees was an important, essential and integral element of

the business activities, and when the taxpayer had the infrastructure for training in place, the business could be treated as set up⁴.

As a service industry, the first step was to recruit the right kind of employees, then to interact with them, train them, or check their performance. Unlike manufacturing activity, where the requisite plant and machinery had to be procured and installed before the business operations started, in the BPO industry, the process started with recruitment of employees. Training or introduction after recruitment would be akin to the trial production, or the first step, in production undertaken by a manufacturer of goods. However, it had to be seen whether the infrastructure to utilise their services was in place or not. Upon recruitment of employees, the fact that expenditure under the different heads, as noticed above, had been incurred, was indicative that the business was set up. Training was post-set-up, as the employees were recruited. The business of a service provider could not exist without training being given to the employees, both at the initial stage and after business had commenced. Training was done to ensure proper performance and to provide services of an acceptable quality, or to ensure zero or minimal errors. It was to ensure proper standards and optimum utilisation of human resources already employed.

In the present case, a substantial and large number of employees

were kept on the payroll after recruitment, the taxpayer paid for their provident fund, employees insurance charges, and maintenance charges, and distributed uniforms. The training continued even when the business was in operation. It was a part and parcel of business activities as a service provider.

In view of the above, the High Court answered the question of law in favour of the taxpayer and against the revenue.

The takeaway

The decision can serve as good guidance for determining the set-up date of an entity in the service industry. That said, the date of set up of a business is fact-specific and should be analysed on a case-by-case basis.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Tax & Regulatory Services – Direct Taxes

Shyamal Mukherjee, *Gurgaon*
+91-124 330 6536
shyamal.mukherjee@in.pwc.com

Ketan Dalal, *Mumbai*
+91-22 6689 1422
ketan.dalal@in.pwc.com

Rahul Garg, *Gurgaon*
+91-124 330 6515
rahul.garg@in.pwc.com

² Western Indian Vegetable Products Limited v. CIT [1954] 26 ITR 151 (Bombay)

³ CIT v. Samsung India Electronics Limited [2013] 356 ITR 354 (Delhi), CIT v. Arcane Developers Private Limited [2014] 221 Taxman 475 (Delhi), Century SPG and Mfg. Company Limited v. Commissioner of Wealth-tax [1978] 112 ITR 497 (Bombay)

⁴ Reference made to CIT v. E-Funds International India [2007] 162 Taxman 1 (Delhi), CIT v. Hughes Escorts Communication Limited [2009] 311 ITR 253 (Delhi), CIT v. Whirlpool of India Limited [2009] 318 ITR 347 (Delhi), CIT v. Saurashtra Cement and Chemical Industries Limited [1973] 91 ITR 170 (Gujarat), Prem Conductors Private Limited v. CIT [1977] 108 ITR 654 (Gujarat), CIT v. Sponge Iron India Limited [1993] 201 ITR 770 (Andhra Pradesh)

Our Offices

Ahmedabad

President Plaza
1st Floor Plot No 36
Opp Muktidham Derasar
Thaltej Cross Road, SG Highway
Ahmedabad, Gujarat 380054
+91-79 3091 7000

Bangalore

6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bangalore 560 008
Phone +91-80 4079 7000

Chennai

8th Floor
Prestige Palladium Bayan
129-140 Greams Road
Chennai 600 006
+91 44 4228 5000

Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th
Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034,
Andhra Pradesh
Phone +91-40 44246000

Kolkata

56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake
Kolkata - 700 091, West Bengal
+91-033 2357 9101/
4400 1111

Mumbai

PwC House
Plot No. 18A,
Guru Nanak Road(Station Road),
Bandra (West), Mumbai - 400 050
+91-22 6689 1000

Gurgaon

Building No. 10, Tower - C
17th & 18th Floor,
DLF Cyber City, Gurgaon
Haryana -122002
+91-124 330 6000

Pune

7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006+91-20
4100 4444

For more information

Contact us at
pwctr.knowledgemanagement@in.pwc.com

About PwC

PwC helps organisations and individuals create the value they're looking for. We're a network of firms in 157 countries with more than 184,000 people who are committed to delivering quality in Assurance, Tax and Advisory services.

PwC India refers to the network of PwC firms in India, having offices in: Ahmedabad, Bangalore, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, please visit www.pwc.in.

*PwC refers to PwC India and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details. Tell us what matters to you and find out more by visiting us at www.pwc.in



For private circulation only

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwCPL, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. Without prior permission of PwCPL, this publication may not be quoted in whole or in part or otherwise referred to in any documents.

© 2014 PricewaterhouseCoopers Private Limited. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers Private Limited (a limited liability company in India having Corporate Identity Number or CIN : U74140WB1983PTC036093), which is a member firm of PricewaterhouseCoopers International Limited (PwCIL), each member firm of which is a separate legal entity.