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Business Process Outsourcing
- Legal & Tax Issues

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Nishith Desai Associates (NDA) is a research based international law firm with offices in Mumbai, Bangalore, Silicon Valley and Singapore.
The firm specializes in strategic legal, regulatory and tax advice coupled with industry expertise in an integrated manner. We focus on several niche areas in which we provide significant value and are invariably involved in select highly complex, innovative transactions which require “critical surgery”.

Core practice areas of the firm include International Tax, Fund Formation, PE & VC Investments, Mergers & Acquisitions (M&A), Corporate & Securities Law, International Employment Law, Intellectual Property Law and Cross-border Dispute Resolution. Our specialized industry niches include financial services, IT and telecom, pharma and life sciences, media and entertainment, real estate and infrastructure.

Among the several firsts to the Firm’s credit are the pioneering work done in the area of international tax specialization, advice for setting up the first India focused private equity fund, the first ever American Depository Receipt issuance by an Indian company, and the world’s largest private equity investment in microfinance. The firm is associated with marquee repeat Fortune 500 clientele, of which over 60 per cent are US corporations.

In the Financial Times - RSG Consulting survey of Indian law firms in early 2009, the firm was ranked highest for *‘Quality’*. The firm is part of the Asian Legal Business Watchlist as one of the ‘Top 10 firms to watch in 2009’ in Asia- Pacific. The Tax Directors Handbook, 2009 has also lauded the Firm for its constant and innovative out-of-the-box ideas

The firm is differentiated by the quality of its team that comprises lawyers and professionals, with multiple qualifications in business management, chartered accountancy, medical surgery, engineering and company secretaryship. The firm also has the distinction of being the first Indian law firm to be licensed to practice Indian law by the State Bar of California and the Attorney General of Singapore.

Nishith Desai, founder of Nishith Desai Associates, has been ranked No. 28 in a global Top 50 "Gold List" by Tax Business, a UK- based international tax journal following a global survey of tax professionals who had influenced tax policies. The firm is listed in Practical Law Company’s (PLC) Which Lawyer? Yearbook 2009 as the leading Indian firm in Taxation and IT & Ecommerce and is among the recommended firms for Capital Markets, Corporate Real Estate, M&A, IP, Outsourcing, Private Equity, Venture Capital & Telecom.

Other past recognitions include being named the Indian Law Firm of the Year 2000 and Asian Law Firm of the Year (Pro Bono) 2001 by the International Financial Law Review, a Euromoney publication. In an Asia survey by International Tax Review (September 2003), the Firm was voted as a top-ranking law firm and recognized for its cross-border structuring work. Our research oriented approach has also led to our members being recognized and felicitated for thought leadership at the International Bar Association.

Nishith Desai Associates believes strongly in constant knowledge expansion and has developed dynamic Knowledge Management (‘KM’) and Continuing Education (‘CE’) programmes, conducted in-house and for select invitees. KM and CE programmes cover key events and global and national trends as they unfold, examine case studies, debate and analyse emerging legal, regulatory and tax issues.

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Contents

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APPROACH AND METHODOLOGY

The hype continues to surround business process outsourcing (“**BPO**”) and the ability and opportunity for India to exploit this market. However, many questions are left unanswered by the popular media. In our study, we aim to offer greater clarity on the broadly-defined BPO industry and India’s position and value proposition in this sector.

This report of the study:

- Examines the reasons, strategies, and procedures in outsourcing business processes;
- Examines the concept and rationale for offshore outsourcing of business processes;
- Highlights the competitive advantage India offers compared to other potential offshore outsourcing destinations;
- Proposes the various structures for outsourcing to India and analyzes the legal and tax issues associated with each structure;
- Briefly discusses the legal issues that a client should consider when entering into agreements with BPO service providers;
- Examines the recent developments in the BPO industry.

We have relied on reports published by various organizations such as CIO Insight, Dun & Bradstreet, Gartner, Inc., the National Association of Software and Services Companies (**NASSCOM**), Gartner.

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EXECUTIVE SUMMARY

- Companies outsource their non-core functions such as human resource management, finance and accounting, customer relationship management, etc. to third parties so that they can focus on their core activities and reduce costs. Traditionally, companies in developed countries outsourced their services to companies in their own countries. When companies realized the considerable difference in the cost structure between developing countries and developed countries, they began to outsource to countries such as India, the Philippines, and China, to name a few. Among the countries providing offshore outsourcing, India has an extremely advantageous position due to its low cost structure and large pool of skilled manpower.

- If a foreign company decides to outsource operations to India, it can enter into an agreement with an Indian company or it can establish a wholly-owned subsidiary / joint venture in India. If a foreign company establishes a company in India, it is necessary to structure the investment in a tax efficient manner and consider issues such as repatriation of profits, transfer pricing, permanent establishment, and the modes of exit.

- Once a customer identifies a service provider, it is necessary to enter into a detailed agreement with it to ensure that the commercial understanding of the parties is well documented. It is extremely important to examine issues relating to the intellectual property, privacy, and termination provisions of the agreement. If the service provider is in a foreign jurisdiction, it is also necessary to consider issues relating to the enforcement of foreign awards and judgments.

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I. INTRODUCTION

Business process outsourcing is "*the act of transferring some of an organization's recurring internal activities and decision rights to outside providers, as set forth in a contract*."[1] Gartner Dataquest defines the BPO as "delegation of one or more IT intensive business processes to an external provider that, in turn, owns, administers and manages the selected process(es) based upon defined and measurable performance metrics." Thus, BPO involves relinquishing responsibilities and authority related to the design, development, implementation, and operations of an outsourced business process - including operational decision-making, hiring people, building facilities, acquiring and maintaining equipment, and upgrading technologies - associated with the process.

1. Historic, Economic, and Philosophical Background of BPO

The ancient trade routes to China and India existed to provide access to produce and products that could not be farmed or manufactured in other countries. This is the earliest example of value-addition in the form of services (such as banking, brokering, and transportation) on a global scale. These trade-related services in themselves did not create any new products, but they made it easier for the consumers to obtain the products they wanted. In return, the consumers paid for these services, and thus began the outsourcing of services. The activities that were possible for people to do by themselves were still delegated to others, because others could do them better and at a lower cost.

As Adam Smith stated, "*it is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.*"[2] Such self-interest leads to a division of labor, which ignites innovation and wealth creation for individuals and nations. Given this historical, economic, and philosophical background, nations have tried to focus on what they can do best.

With the development of efficient transportation, logistics systems, and hubs on a global scale, routine manufacturing activities were outsourced to east Asian countries such as Japan, South Korea, Taiwan, and more recently, China, Malaysia, Indonesia, and Thailand. Now, with the worldwide prevalence of information technology and voice/data communications infrastructure, it has become possible to outsource routine service activities to countries that can perform those tasks in a much more cost-effective manner while maintaining quality standards.

The first wave of information technology brought efficiencies within the organization and reduced the internal cost of transactions. This encouraged organizations to increase in size by performing inefficient external activities within the organization. However, the advent of the Internet has changed the dynamics. The rapid penetration of the Internet, along with the ubiquity of telecommunications infrastructure, is reducing external transaction costs. The competitive advantage does not come from having a large organizational size; it comes from being small, agile niche players with a low cost structure.

When a firm faces an economic downturn and uncertainty, it becomes even more difficult for it to carry out less efficient processes internally. The globalization of economies has increased competitive

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[1] Maurice F. Greaver II (1999),"*Strategic Outsourcing: A Structure Approach to Outsourcing Decisions and Initiatives,*" American Management Association, New York. p.3.

[2] Adam Smith, "*The Wealth of Nations*"(2000)(based on the edition published in 1784), The Modern Library Classics. 2000. p. xviii.

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pressure, reduced product development cycles, reduced product life cycles, improved service quality, and increased efficiency of the allocation of available resources. By outsourcing to other businesses, organizations will be able to adapt to this changing business environment and focus on their specialized activities that provide competitive advantages.

2. Benefits of Outsourcing

Organizations decide to outsource business processes for various reasons. These reasons can be divided into the following categories:

Benefits of Outsourcing
- **Improve Competitiveness**
- **Increase Control**
- **Reduce Costs**

- Improve Competitiveness
  - Focus on core competencies
  - Increase flexibility to adapt to the changing environment
  - Improve customer satisfaction
  - Access relevant skills and expertise
  - Improve credibility and image through association
  - Quickly ramp up business operations and product/services offerings
  - Serve larger markets
- Increase Control
  - Bring operational efficiency
  - Improve process performance
  - Monitor organizational activities
  - Transform or restructure organization
  - Reduce responsibility and liability
  - Better risk management
- Reduce Costs
  - Access higher-level human resources at lower cost
  - Obtain advanced technologies without significant upfront costs
  - Acquire innovative concepts and products
  - Capitalize on low cost structure of the provider
  - Release capital and reduce financial costs
  - Reduce operational costs

3. Classification of Outsourced Services

Outsourcing can take place at the following levels:

- Individual
- Process
- Functional

Individual: Individual level outsourcing involves outsourcing specific activities and associated positions to contract employees. It is usually done to gain special managerial or technical skills for short or medium duration projects.

Process: Process level outsourcing involves outsourcing a specific business process such as payroll, customer call centers, and recruitment to an external provider who specializes in those activities.

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Functional: Functional level outsourcing involves outsourcing whole functions such as accounting, production, or sales to an external organization. In this paper, we refer to BPO as outsourcing at all three levels, although the primary focus of BPO is on the process level.

In recent years, organizations increasingly have been trying to outsource non-core processes for various reasons, as discussed earlier. Outsourcing initially started with the outsourcing of some primary processes, but now involves outsourcing of an equal portion of secondary activities. The major activities currently outsourced are:

- Payroll
- Recruitment
- Employee training and development
- Retirement plan administration
- Information systems development
- Information technology infrastructure
- Customer call centers
- Travel reservations
- Technical support centers
- Billing
- Claims processing
- Inbound and outbound logistics
- Warehousing and inventory management
- Document processing
- Accounts payable/receivable
- Auditing
- Tax document preparation
- Facilities maintenance
- Medical transcription
- Contract research
- Legal documentation and information processing

Even in government services, outsourcing is becoming common. The most famous example of this trend is the move taken by New York City in outsourcing its parking ticket processes. Every day, city parking enforcement officers issue thousands of parking violation tickets. Those tickets are hand-written, given the cost-effectiveness and convenience of paper. A copy of the ticket is stuck on the violating vehicle and another copy is sent to the enforcement department for record keeping and the collection of fines. Given the poor quality of handwriting, automatic conversion of the ticket to computer text by an optical scanner is not possible. Employing special employees to manually convert all tickets is becoming cost prohibitive. The city now outsources this work to BPO providers in Ghana. The city uses high-speed scanners to take optical images of the tickets and securely sends those graphics files through the Internet to the BPO provider's server. Given the low cost structure of Ghana, the provider employs people who manually input ticket information into an information system, which transfers the information back to the systems of the city's enforcement department. According to recent reports, Infosys Technologies Ltd has been selected by the income-tax (I-T) department in India to set up a business process outsourcing unit to carry out its routine work and give tax officials more time to focus on nabbing tax evaders. The I-T department will provide space and Infosys will manage

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the hardware, logistics to move scanned tax returns to a central processing unit and software for data mining[3]

Offshore sites like India have recently witnessed a growth from BPO to KPO (knowledge process outsourcing). Knowledge Process Outsourcing involves outsourcing for high-end knowledge work which includes research and work on intellectual property, equity and finance, analytics, market research and data management, etc. According to a report by GlobalSourcingNow, the Global Knowledge Process Outsourcing industry is expected to reach USD 17 billion by 2010, of which USD 12 billion would be outsourced to India. In addition, the Indian KPO sector is also expected to employ more than 250,000 KPO professionals by 2010, compared with the current figure of 25,000 employees. A report by Evalueserve predicts that India will capture more than 70 percent of the KPO outsourcing sector by 2010. [4]

4. Expected Growth of BPO

The BPO segment's future is promising. In the recent past, though the IT sector as a whole experienced a slowdown, the BPO industry continued to be on an upswing.
Several research agencies have given positive predictions for the expected growth in the BPO space. A NASSCOM analysis has predicted that though the global technology related spending would reduce in 2009 due to economic downturn, it is expected to pick up in 2010 and the global market size of BPO will grow to about $181 billion by 2012 [5]
Though the future seems promising, the industry is not short on hindrances and bottlenecks. There are several actual and psychological barriers to BPO growth. Several successful experiences and case studies are required to overcome these barriers. The barriers to the growth include:

- Security of customer and product information
- Protection of intellectual property
- Viability of providers
- Quality of service
- Environmental and labor practices of BPO providers
- Reliability of technological infrastructure
- Laws prohibiting or restricting offshore outsourcing
- Pricing pressures couples with contract renegotiation due to economic uncertainty.

Several companies are still actively involved in outsourcing their business processes due to the cost advantage and by doing so, they can provide their customers with a higher quality of service. For example, a study done by Wipro Limited on Total Cost of Management reveals that if mid-sized organizations or large departments employing about 5,000 employees outsource their IT infrastructure management, the cost benefit obtained will be in the range of $9.7 Million - $18.4 Million annually. The report estimates that over a period of five years the savings may fall within the range of 35.8% to 50.7% of the total IT Infrastructure management cost. [6]

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[3] http://www.livemint.com/2009/01/30001700/Infosys-to-set-up-BPO-unit-for.html, visited on July 02, 2009

[4] http://www.outsource2india.com/why_india/articles/KPO.asp, visited on July 02, 2009

[5] Indian IT-BPO Industry 2009: NASSCOM Analysis.

[6] http://techlibrary.wallstreetandtech.com/data/detail?id=1024577556_352&type=RES&x=1457934715, visited on July 02, 2009.

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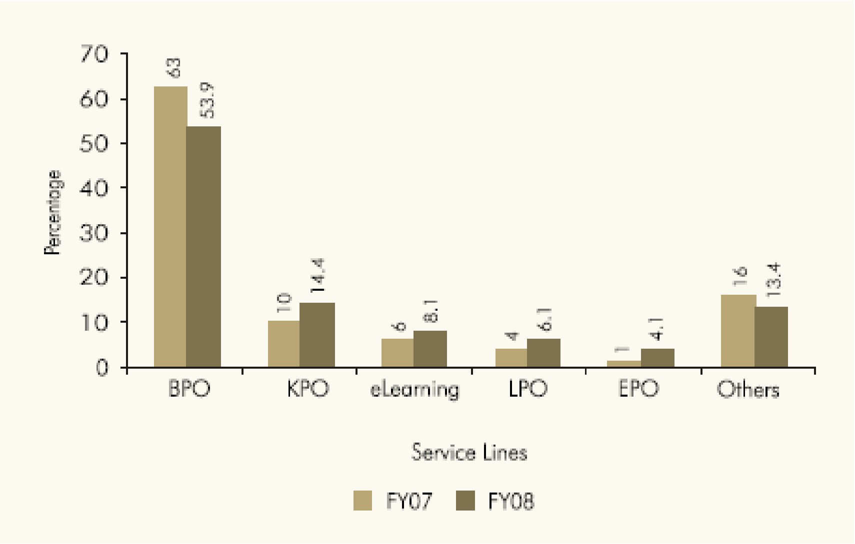
II. OFFSHORE OUTSOURCING IN A GLOBALIZED ECONOMY

Traditionally, companies have outsourced IT services and business processes to companies in their own countries. However, the development and growing maturity of the Indian market has reflected in widening of the service portfolio and greater penetration across verticals and geographic markets served. NASSCOM in association with Everest India conducted a study on the Indian BPO industry which showed that while customer interaction and support and finance and accounting have been the dominant horizontal market segments, other service segments like knowledge services are increasingly becoming important and continue to drive market maturity[7]. This report states that the domestic Business Process Outsourcing market provides an additional US$ 15-20 billion opportunity for the sector by 2012 . Out of the U.S. $35-37 billion offshore BPO market in 2008, India remained the leading offshore destination with 35% market share[8].

Dun and Bradstreet conducted a study of India's ITES and BPO companies in 2008 which shows that in comparison to 2007, conventional BPO services lost their share by almost 10%, whereas emerging service lines such as KPO, LPO and eLearning have increased their share considerably.



Source: Dunn And Bradstreet Report on India's Top ITeS and BPO Companies 2008

In the initial stages of development of the BPO industry, companies in developed countries were reluctant to outsource to companies in foreign jurisdictions. This reluctance was largely due to the lack of awareness of the political and economic stability of the specific foreign countries and concerns about the enforceability of legal obligations against the foreign companies. However, as companies

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7 http://www.nasscom.in/Nasscom/templates/NormalPage.aspx?id=53591, visited on July 02, 2009

8 http://www.enterpriser.in/India/Trends/India_Philippines_Account_for_50_of_BPO_Market/551-98416-452.html, visited on July 02, 2009.

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became more familiar with the economic, political, and legal systems of other countries, they became more inclined to outsource to those countries. The economics of offshore outsourcing provide a compelling reason for companies to outsource their business processes to the companies in developing countries, where labor costs are lower.

It is also pertinent to note that offshore outsourcing leads to adverse consequences, including the loss of jobs in the country that outsources services to a foreign country. Since the boom in the BPO industry which started in early 2000, there has been an onslaught of anti-outsourcing protests and legislative movements in client countries. In the U.S., while anti out-sourcing efforts have declined from their peak of a few years ago, the legislative action continues both at the state and the federal level to implement restrictions against offshore outsourcing. As of April 2007, legislation aimed at keeping jobs in the U.S. is pending in various states, including California, New York and Arizona[9]. Most of the pending anti-outsourcing legislation relates to preferential treatment through tax breaks and incentives to the U.S. firms that create jobs in their respective states or across the U.S. Although Indian BPO companies have expressed concerns towards these type of legislative activities, the fact remains that the basic economics of outsourcing have not changed and continuing pressure to reduce costs will prompt companies to continue to outsource. The reality is that, as yet, no legislation in the U.S. has been passed that serves as an absolute barrier to outsourcing or offshoring IT and business processes.

1. Strategies for Offshore Outsourcing

Despite these compelling economic reasons, companies may still be reluctant to outsource all of their operations to a foreign country due to concerns about security, delivery, and enforceability of agreements, among other concerns. Such risks can be minimized by:

- Setting up captive centers in the offshore jurisdictions, as this would address their concerns of non-delivery of services and enforceability of agreements.
- Outsourcing their low-end services to a foreign company, and then outsourcing higher-end work as they become more comfortable with the services they receive.
- Entering into a Build-Operate-Transfer (BOT) model.
- Combination of the above options.

As a special risk strategy, a company can outsource its processes to:

- several companies in the same offshore jurisdiction; or,
- companies in different jurisdictions.

Thus, if one service provider were unable to comply with its commitments due to political, legal, or economic reasons, the outsourcer would not be adversely affected, as other service providers in the same or different jurisdictions can ramp up their operations to service the needs of the outsourcer.

According to NASSCOM, the benefit derived by U.S.-based banking and financial services companies by outsourcing to Indian software vendors or by setting up captive BPO units over the past four years amounts to $8 billion[10]. Further, a study by ValueNotes, a research firm shows, revenues from the

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[9] National Policy For American Policy Brief; April 2007

[10] http://www.nasscom.in/Nasscom/templates/NormalPage.aspx?id=1397, visited on July 02, 2009

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Indian patent services offshoring industry are estimated at USD 46 million for 2007. It is expected to reach USD 206M by end 2012[11].

- In March 2008, Tata Consultancy Services (TCS), a leading IT services, business solutions and outsourcing company signed a multi-million Euro agreement with Nokia Siemens Networks, one of the world's foremost global enablers of communications services to transfer product engineering and research and development services from Nokia Siemens Networks to TCS[12]
- In June 2008, WNS Acquired Aviva Global Services, the UK-based insurance giant's captive BPO in India and Sri Lanka, for $230 million. The buyout will bring over 6,500 employees of Aviva Global Services spread across Bangalore, Pune, Noida, Chennai and Colombo under the WNS fold. [13]
- In February 2009, MphasiS, an EDS company, is reported to have won a clutch of contracts worth $52 million from US companies in the areas of systems integration and infrastructure technology outsourcing[14].
- In June 2009, Microsoft awarded a 3 year, $10-million BPO deal with Infosys for providing back-end support[15].
- The monetary worth of the offshore outsourcing can be gauged from deals such as the Tata Consultancy Services' contract with GE being valued at about $100 million, while a deal between HCL Technologies and British Telecom is estimated to be worth $160 million.

2. Countries for Offshore Outsourcing

India, the Philippines, China, Mexico, Egypt, Ireland, Poland, Australia, Hong Kong, Russia and New Zealand are some of the leading countries for offshore outsourcing. While evaluating the countries to which services can be outsourced, the following parameters should be considered:

- Availability of skilled manpower
- Cost of salaries and infrastructure
- Availability of land, telecommunication equipment, bandwidth, and other infrastructure
- Government support and assistance
- Legal environment
- Maturity of the markets / companies

3. Advantage India

India offers a strong value proposition among all IT-enabled services hubs for the following reasons:

- Skilled Manpower: India's abundant skilled manpower is drawing corporate hubs to back end their operations in India. The country's English speaking manpower rates high in qualifications, capabilities, quality of work, and work ethic. This places India ahead of competitors such as Singapore, Hong Kong, China, the Philippines, Mexico, Ireland, Australia, and Holland, among

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[11] http://www.researchandmarkets.com/product/f6c144/offshoring_patent_services_to_india, visited on June 02, 2009

[12] http://www.nokiasiemensnetworks.com/global/Press/Press+releases/archive_2008a.htm?languagecode=en, visited on June 022009

[13] http://www.bpoindia.org/vc/m-n-a.shtml, visited on June 02, 2009

[14] http://www.bpowatchindia.com/bpo_news/mphasis_eds/february-23-2009/.html, visited on June 02, 2009

[15] http://www.bpowatchindia.com/bpo_news/msn/infosysmicrosoft/june-18-2009/msn_infy_bpo_bags_deal_from_microsoft.html, visited on June 02, 2009

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others. With a young demographic profile, where over 3.5 million graduates and post graduates added annually to the talent base, no other country offers a similar mix and scale of human resources [16]

Knowledge Professionals Employed in the Indian IT-BPO Industry

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
IT Exports & Services Exports	296,000	390,000	513,000	690,000	860,000	946,809
BPO Exports	216,000	316,000	415,000	553,000	700,000	789,806
Domestic Market	318,000	352,000	365,000	378,000	450,000	500,000
Total	**830,000**	**1,058,000**	**1,293,000**	**1,621,000**	**2,010,000**	**2,236,614**

Source: NASSCOM

- Competitive Salary Levels: Salary levels in India are lower than most salary levels in other countries that have become centers for offshore outsourcing. Since cost cutting is one of the primary reasons for outsourcing, the cost advantage offered by India makes it the most attractive destination for outsourcing. A Dun and Bradstreet Report reveals that India has the second lowest ITES/BPO salary base of about US$7500 – 8500 just a little above China's base of US$ 7000 - 8000

- Training Centers and Institutions: India has several educational institutions that provide educated and skilled manpower. There are also several institutes that train people specifically for jobs in the BPO space.

- Geographic Location: India's unique geographic position enables it to offer a 24x7 service and quicker turnaround by leveraging the time zone differences.

- Government Initiatives: The central and state governments have been actively supporting the outsourcing industry and are implementing favorable policies. Many state governments, such as those of Andhra Pradesh, Gujarat, Karnataka, Kerala and Maharashtra have adopted BPO policies to make their states more attractive for foreign investment. The various initiatives taken by these states include amending the labor laws - to permit women to work at night, offer flexible timings, and to allow for the self-certification of compliance with certain labor laws. These states are also attracting BPO companies by offering rebates on registration and the transfer of property, and a waiver of the conversion fee for land. Various other states are in the process of adopting similar BPO policies. Thus, we see tremendous political will amongst the governments to actively promote the BPO market. Among other benefits, it is expected special package incentives would be given for setting up IT and telecom hardware manufacturing units in tier 2 and 3 cities [17].

[16] NASSCOM Strategic Review 2009.

[17] http://www.blonnet.com/2009/03/13/stories/2009031350511700.htm, visited on June 02, 2009

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- Tax Incentives: BPO services were categorized as Information Technology Enabled Services (**ITES**), and several special tax incentives were granted to ITES companies . Such tax benefits have been discussed in detail below.

- Industry Associations and Institutions: There are several associations, such as NASSOM, CII, and the Federation of Indian Chambers of Commerce and Industry (**FICCI**), which actively represent the interests of the ITES players. These associations have been instrumental in bringing about changes in regulations and policies to develop the ITES market.

- Security Framework in the Industry: There have been various initiatives in the industry to address global concerns regarding security in the Indian BPO industry. The National Skills Registry (NSR) is a centralized database of employees of the IT services and BPO companies, was launched as a step to ensure that there is a verified database (with independent background checks) of the human resources within the Industry. As of July 2007, the registrations for the NSR reached the 125,000 mark. The Data Security Council of India was launched in April 2007 as a self regulatory body to popularize, monitor and enforce privacy and data protection standards for India's ITeS-BPO industry[18].

- Quality and Process Certification: There is increasing awareness in India about the importance and need of adherence and compliance to standards such as ISO 270001, EU Directives, HIPPA and various other data protection regulations which would ensure the establishment of a proper risk management environment. A Dun and Bradstreet Study on certain profiled companies reveals that almost 90% of such profiled companies have some kind of quality certification in the form of ISO and/or BS 7799 and around 29% have some kind of process and/or compliance certificate including Six Sigma, COPC and HIPPA.

- Telecommunications and Infrastructure: One area in which, traditionally other countries have had an advantage over India is infrastructure, specifically property and transportation systems (see graphs above). The availability of telecommunications facilities and the cost of these services have traditionally been areas in which India has not performed well. High rates for property, stamp duty, and the restriction of foreign investment in property in India have been additional hurdles faced by foreign investors.

  However, it should be noted that the quality of India's infrastructure has been improving. Most cities and fist and second tier towns are connected and interlinked to each other. Major investments have gone into the development of highways, both on the side of the central and state Governments. Clearly, the Indian Government has understood the importance of infrastructure to industries such as IT and created a conducive environment for its development and expansion. The liberalization of the telecommunications sector has resulted in several competing players, which has led to a decrease in the cost of telecommunication services. The government has permitted private companies to set up international gateways and has also allowed for Internet telephony. The proactive attitude of the Indian government to facilitate the growth of the ITES/ BPO industry can be gauged by the recent policy changes that have been implemented. The government has permitted international call centers to have foreign-end connectivity through managed services from international long distance players. Further, the

[18] http://www.nasscom.in/Nasscom/templates/NormalPage.aspx?id=51971, visited on June 02, 2009.

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Department of Telecommunications has allowed foreign-end connectivity in international call centers through the use of technologies such as ATM/MPLS/Frame Relay-based managed international networks, in addition to the connectivity through point-to-point international privately leased circuits (IPLCs). The effects of the liberalization of the telecom sector in India can be gauzed from the fact that the inflow of foreign direct investment into India's telecom sector during Jan 1991 to August 2008 was about Rs 233,344 million [19]. Spectrum is one of the major bottlenecks for mobile operators who face network problems, poor voice quality and call dropping. With the growth in the number of mobile users, spectrum is falling short of requirements. One of the major reforms which is expected in the telecom sector in India is clarity regarding regulatory and licensing norms for spectrum allocation. Companies have been establishing their presence in satellite townships in which the land prices are lower and some governments have relaxed certain stamp duties for ITES companies. The government is actively improving the transportation systems in India by building new highways and undertaking other infrastructure development projects. States have set up telecommunications / BPO parks, thereby enabling companies to have access to telecommunications, bandwidth, power, and other infrastructure required for smoother operations.

- Reputation of Indian Software Companies: Indian companies have gained a formidable reputation in the software services industry. The listing of Indian software companies in the U.S. such as Infosys, Silverline, and Wipro, has improved the visibility and acceptance of Indian companies by U.S. corporations. BPO companies are leveraging this acceptance to gain greater visibility in the BPO space. A NASSCOM Analysis states that export revenues from the high-value added services such as engineering, and R&D, offshore product development and made in India software products grew at 15% and clocked US$ 7.3 billion in 2008 – 09[20].

- Maturity of Indian BPO Companies: Many Indian BPO companies not only have set up large-scale operations in India but also have made investments abroad or acquired foreign companies in the BPO space. The Indian BPO industry has made global footprint in over 400 delivery centres across 52 countries.[21] For example in August 2008, HCL Tech BPO acquired Control Point Solutions, a privately-held voice, data & wireless telecom expense management service provider in a deal worth US$ 20.8 million. Under the deal, HCL will acquire four delivery centers in US with over 200 professionals.[22] In August 2007, Wipro Technologies acquired Infocrossing Inc, a US-based provider of IT infrastructure management, enterprise application and business process outsourcing services in a deal that would give Wipro five data centers in the U.S. and approximately 900 employees, as well as access to Infocrossing's U.S customer.[23]

- Emerging Domestic BPO Market: As the economy becomes more globally integrated, Indian business houses are witnessing fierce competition from global players, thus requiring Indian companies to deliver world class levels of products and services. The domestic segment of the

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[19] http://www.dot.gov.in/osp/Brochure/Brochure.htm, visited on June 02, 2009

[20] Indian IT-BPO Industry 2009- NASSCOM Analysis

[21] http://www.bpowatchindia.com/bpo_news/nasscom_bpo/february-04-2009/nasscom_revises_bpo-it_estimates.html, visited on June 10, 2009.

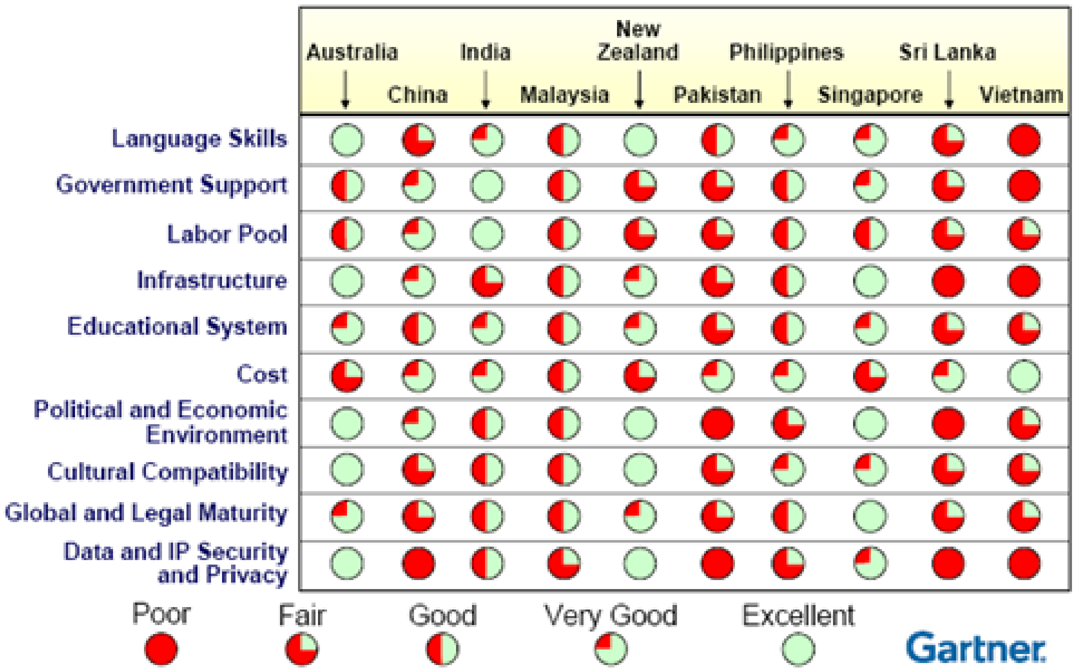
[22] http://www.financialexpress.com/news/HCL-Tech-buys-US-firm-Control-Point-for-20-mn/353115/, visited on June 10, 2009

[23] http://www.offshoringtimes.com/Pages/2007/BPO_news1696.html, visited on June 10, 2009

ITeS/BPO industry is beginning to increase its pie in this sector as domestic telecom, banking and financial companies are increasingly outsourcing their service activities such as customer care, tele sales, billing, IT support, data management, infrastructure management etc. In FY08, the domestic ITeS/BPO market grew to USD 1.6 bn from USD 1.1 bn in the previous year, reporting a growth of 45%.[24]

- Employment opportunities associated with the boom in the BPO industry are also on the rise. As on March 31, 2008, Genpact had a staff strength of over 34, 300 employees.[25] With over more than thirty six (36) ventres around the world, IBM Daksh employs more than 20,000 people. According to the Planning Commission of India, the Indian IT & ITeS-BPO sector would generate another 2.5 mn direct employment opportunities.

All of these factors combined provide unique advantages for outsourcing to India and have increased the comfort levels of foreign companies choosing India for their offshore outsourcing. A recent report by Gartner indicates that among the following countries, India offers one of the most favorable jurisdiction for offshore outsourcing.[26]



[24] http://www.dnb.co.in/itesbpo2008/ITeSBPO.asp, visited on April 16, 2009

[25] http://www.rediff.com/money/2008/jul/21sd2.htm, visited on April 20, 2009

[26] http://www.itbusinessedge.com/cm/blogs/all/gartners-take-on-best-offshore-destinations/?cs=10477, visited on June 02, 2009

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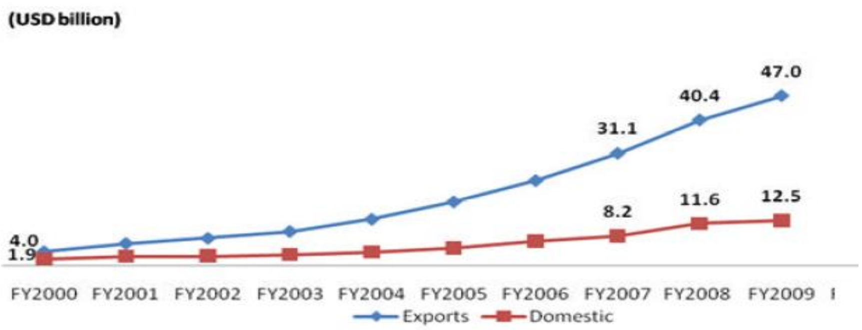
Expected Growth Rate in India

The IT-BPO industry has been increasingly contributing to India's total software and services revenues.



Source: Indian IT –BPO Industry 2009: NASSCOM Analysis

The following chart shows the estimates of revenue generation in the BPO industry:

Revenue \ Year	2003-04	2004-05	2005-06	2006-07	2007-08
Domestic BPO	0.3	0.6	0.9	1.1	1.6
Overall BPO Revenue	3.4	5.2	7.2	9.5	12.5
Figures in $ billion				**Source:** NASSCOM	

The following chart shows the industry wise revenue break-up of the Indian IT-BPO Industry:

USD Billion	FY 2007	FY 2008	FY 2009 (E)
IT Services	**23.3**	**31.0**	**35.2**
- Exports	17.8	23.1	26.9
- Domestic	5.5	7.9	8.3
BPO	**9.5**	**12.5**	**14.8**
- Exports	8.1	10.9	12.8
- Domestic	1.1	1.6	1.9
Engineering Services and R&D, Software Products	**6.5**	**8.6**	**9.5**
- Exports	4.9	6.4	7.3
- Domestic	1.6	2.2	2.3
Total Software and Services Revenues	**39.3**	**52.0**	**59.6**
Of which, exports are	31.1	40.4	47.0
Hardware	**8.5**	**12.0**	**12.1**
- Exports	0.5	0.5	0.3

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- Domestic	8.0	11.5	11.8
Total IT Industry (including hardware)	**47.8**	**64.0**	**71.7**

Figures may not add up due to rounding off.

Source: NASSCOM

4. BPO Companies in India

Indian BPO companies can be categorized by the services they provide and their ownership patterns.

Services Being Offered by Companies

The services that Indian BPO companies provide can broadly be classified into:

a. Customer Interaction, Including Call Centers: These centers provide information and support to customers around the clock. Such support is offered in a variety of ways, including marketing, selling, information dispensing, and the provision of advice.

b. Back Office Processing: These services include accounting, revenue accounting, data entry, data conversion, and HR services.

c. Transcription Services: Medical transcriptions involve the transcribing of medical records from an audio format (or that were dictated by doctors or other healthcare professionals) into either hard copies or electronic format. Doctors overseas record their findings into a Dictaphone or any other such device and the sound tracks are transferred through datacom links to ITES companies specializing in this area. Medical transcriptionists listen to the recordings of the doctors, transcribe them, and send them back electronically.

d. Digital Content Development: Digital content development caters to the needs of website management, and the production and delivery of multimedia over new media, including CDs, DVDs, and Internet TVs, in addition to existing segments such as movie production and gaming. Korea, Japan, the Philippines, and China have an 80% share of the global market, while India has only 0.1% of the segment. Thus, this is an area in which there is tremendous growth potential for Indian companies.

e. Geographic Information Services (**GIS**): GIS is the digitization of maps and remotely sensed satellite data. Such digitization is used for GPS navigation systems of modern cars and websites that provide detailed directions.

f. Contact Research Services (**CRS**): Global pharmaceutical firms have long outsourced functions such as manufacturing, packaging, clinical trials and sales force mobilization. Increasingly R&D activities are now also being outsourced and offshored.

g. Legal Process Outsourcing: Providers of legal process outsourcing provide a whole gamut of non-core legal services ranging from simple document review, legal research to technical patent applications.

Service Sector	Key Players
Customer interaction, including call centers	Wipro BPO Solutions, IBM Daksh, WNS Global , Dell, Transworks, Convergys, Trac Mail, First Source (formerly ICICI OneSource)
Back office processing	American Express, eServe International, Genpact (formerly GE Capital), HSBC, Wipro BPO Solutions
Transcription services	C-bay, Heartland, Max Healthscribe Ltd, , Sirius BPO Services Private Limited
Digital content development	Pentamedia, Crest Communications, Datamatics Technologies
Geographic information services	Infotech Enterprises
Contract Research Services	Nicholas Piramal
Legal Process Outsourcing	Pangea 3

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A NASSCOM Report lists out the profile of the top Indian BPO companies:[27]

Company	Parent/ History	Services Offered	# Employed
Genpact	Started as India-based business process operations for GE Capital. In 2005, with equity investments from General Atlantic and Oak Hill Capital Partners, it became an independent company and was rebranded Genpact.	Finance and accounting, collections and customer service, insurance, supply chain and procurement, analytics, enterprise application and IT infrastructure.	34,300
WNS Global Services	Warburg Pincus is the majority shareholder in WNS Global Services.	Travel, insurance, financial services, healthcare, professional services, manufacturing, distribution and retail	9000
IBM Daksh	Formed when IBM Corporation acquired Daksh e-Services in April 2004	Customer relationship management, finance & administration and back-office processes	20,000
Aditya Birla Minacs Worldwide	Formed when Minacs, Canada's leading BPO company, and TransWorks, the BPO arm of Aditya Birla Group, joined hands to become a leading global business process outsourcing player.	Automotive, banking, financial services, insurance, telecommunications and technology	12,000
Wipro BPO Solutions	Formed when Wipro Technologies acquired Spectramind in 2002.	Banking and capital markets, insurance, travel and hospitality, hi-tech manufacturing, telecom and healthcare sectors	19,000
First Source	Formerly ICICI Onesource	Customer care, Billing and collections, business research and analytics.	17,000
Infosys BPO Limited	Set up in 2002 as the business process outsourcing subsidiary of Infosys Technologies.	Finance and accounting.	16,295
HCL BPO	Started as a division of HCL Technologies Limited in 2001.	Retail, banking and financial services, insurance, hi-tech & manufacturing, and media, publishing and entertainment	13,200
EXL Service Holdings	In November 2002, Oak Hill Capital Partners L.P. and FTVentures along with	Insurance, Banking and financial services, healthcare and media	8,200

27 http://www.indiamarks.com/guide/Top-10-BPO's-in-India---A-Nasscom-Report/1059, visited on June 02, 2009.

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	members of the senior management team bought EXL from Conseco.		

Shareholding Pattern of Companies

With the realization of the tremendous scope of the BPO market, several players have set up BPO operations. The BPO companies in India can broadly be classified as:

- Wholly-Owned Subsidiaries of Multinational Corporations (MNCs): Several MNCs such as Dell, Morgan Stanley, HSBC, and Hewlett Packard have established wholly-owned subsidiaries that are captive call centers. Standard Chartered Bank's BPO subsidiary Scope International, is one of the largest captive units owned by an MNC bank in the country. It has more than 5,000 people and constitutes about 8% of Standard Chartered Group's global workforce. [28] New Jersey-based Cognizant Technologies has the majority of its billable employees in India since most of the company's software development centers and employees are located in India.

- Venture Capital-Backed Startups and Private Equity Investments: There are several startups that concentrate on the BPO market and have built niches for themselves. These companies have been funded by venture capitalists in the early stages.

Company	Investor
247Customer.com	Banyan Ventures
Brigade	General Atlantic Partners, Compaq & Mohr DaviDow Ventures, ICICI Venture
First Ring Inc.	WestBridge, Hero Group
Progeon	Citigroup
World Network Services Pvt. Ltd. (WNS)	British Airways and Warburg Pincus

The BPO industry continues to be attractive for Venture capitalists (VCs) companies. IT & ITES companies continue to corner the majority share of VC investments - accounting for about 70% in terms of number of investments. Within IT & ITES, vertically focused BPO companies have emerged as the favorite sector in 2007, followed by Internet-based Services. With 14 deals worth about $87 million, the Information Technology and IT-Enabled Services industry retained its status as the overwhelming favourite among VC investors during Q1 '08," according to a report by research firm Venture Intelligence Service. [29]

- Software Companies: Several well-established software companies are also making a foray into the ITES space, as there is steadier business with higher margins. Nearly 90% of contracts are renewed, while the reasons for non-renewal of the other contracts may be a change in client strategy or management changes. A presence in the BPO space also provides tremendous opportunities for cross-selling and to strengthen long-term relationships with clients.

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[28] http://www.scopeinternational.com/weatscope/faqs.aspx?id=9, visited on June 02, 2009

[29] http://world.rediff.com/news/article/www/money/2008/may/13it.htm, visited on April 20, 2009.

Wipro's acquisition of Spectramind is a good example of a software company's entry into the BPO space. Infosys has entered the BPO space with Progeon, a wholly-owned subsidiary, with Citigroup as a strategic investor. Similarly, HCL Technologies has E-serve as a wholly-owned subsidiary.

- Large Indian Business Houses: Since 2004, captive units have grown at around 30% year-on-year, approximately the same growth recorded by the Indian offshore services market. Indian Rayon, an Aditya Birla Group company, has entered into the BPO industry by acquiring TransWorks, a leading Indian ITES/BPO company, for approximately $13 million[30] Hindustan Lever Ltd. (HLL) has set up a new wholly-owned subsidiary called "Indigo" for undertaking BPO operations.
  In June 2009, Aegis, the business process outsourcing arm of Essar group, set up an independent subsidiary called Aegis Tech, to mark its foray into backend infrastructure management.

- Domestic BPO Business: Indian companies have not adequately explored the domestic BPO business. Several banks and domestic insurance companies are outsourcing their business processes to BPO companies in India. If the domestic business were adequately tapped, BPO companies would be able to reduce the "idle time" for their infrastructure. In other words, if an Indian BPO company were providing services only to a U.S. client, it would be active only during the night (Indian time) and would be idle during the day. If it has domestic clients, it would be able to utilize its resources and infrastructure during daytime hours as well. As the domestic market matures, it will provide additional business opportunities for domestic BPO companies. However, this seems to be changing as Indian companies seem to be availing services of domestic BPO companies for their backend operations.
  In June, 2009, Firstsource Solutions (Indian BPO Company) and Idea Cellular signed a five-year outsourcing contract valued at $ 30 million for customer management interaction services in India[31].

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[30] http://finance.indiainfo.com/news/2003/06/21/21bpo.html, visited on June 02, 2009.
[31] http://www.bpowatchindia.com/bpo_news/firstsourcedeal/june-25-2009/firstsource_signs_deal_with_idea.html, visited on June 12, 2009

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III. BPO OPERATIONS IN INDIA

Once a foreign company decides to use India for its outsourcing services, it is necessary to determine:

1. The appropriate structure for operating in India
2. The procedure for setting up and operating a BPO company in India
3. The exit options available for the foreign company

1. Structuring of Operations in India

A foreign company can use India for its outsourcing needs by:

Entering into an Agreement with an Indian BPO Service Provider

India has emerged as one of the most widely accepted offshore outsourcing centers. Indian companies provide a wide spectrum of services such as customer interaction (including call centers), back office operations (including revenue accounting, data entry, data conversion, finance and accounting services), human resource services, medical transcription services, data digitization, etc. Some of the major back office and support services outsourcing deals awarded to Indian companies in recent times are as follows:

a. In February 2009, HCL Technologies Ltd and Ketara entered into an alliance whereby HCL will deliver full-scope procurement outsourcing across industry verticals of Ketera.[32]

b. In February 2009, Kale Consultants Ltd, a solutions provider to airline, logistics and travel industry entered into a multi-year outsourcing contract with Wataniya Airways, Kuwait's new luxury airline. As part of the deal, Kale will deliver complete outsourced revenue accounting and passenger audit services from its delivery centre. [33]

c. In what is perceived as a trend setting move, in 2008 the world's premier hotel company, Chicago-based Global Hyatt Corporation, has outsourced part of its financial and accounting transaction services to India's Genpact. [34]

Equity Participation in an Indian BPO Company

Foreign companies can set up wholly-owned subsidiaries or joint ventures in India to provide outsourcing services. While considering investing in BPO companies in India, it is necessary to examine the exchange control and structuring issues.

a. Foreign Direct Investment (**FDI**) in BPO companies

According to the exchange control regime in India, 100% FDI has been allowed in the software industry or ITES space on an automatic basis (i.e., there is no need to obtain the prior approval of any regulatory authority). Since the activities of BPO companies can be categorized as "IT enabled services," 100% FDI is permitted in these companies under the automatic route.

According to the guidelines issued by the Department of Telecommunications (**DoT**), 100% FDI is permitted in call centers subject to certain restrictions.

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32 http://www.ciol.com/SMB/News-Reports/HCL-BPO-Ketera-offer-Source-to-Pay-services/11209115905/0/, visited on June 10, 2009

33 http://www.bpotimes.com/efytimes/catpagebpo.asp?buz=17, visited on April 21, 2009

34 http://economictimes.indiatimes.com/Big_BPO_deals_during_meltdown_bring_cheer_to_India/articleshow/3843239.cms, visited on June 10, 2009

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b. Investing in India: The Mauritius Route

As mentioned above, a foreign company can establish a wholly-owned subsidiary or enter into a joint venture with an Indian party. In either case, the foreign company can route its investment into India through a tax efficient jurisdiction such as Mauritius, to avail itself of the benefits of the India - Mauritius Double Taxation Avoidance Agreement (**India – Mauritius DTAA**). According to the provisions of the India – Mauritius DTAA, capital gains realized by a Mauritius resident company from the sale of shares in an Indian company should be subject to tax only in Mauritius and not in India, provided that the Mauritius company does not have a permanent establishment in India. Further, according to the domestic tax laws of Mauritius, capital gains are not taxable on such a sale. Hence, the interposing of a Mauritius holding company could be useful to eliminate capital gains tax, thereby making the Indian investment attractive. The need to implement a Mauritius entity should be ascertained on the basis of the business objectives. It should be noted that Mauritius is the largest single foreign investor in India.

Some doubts about the availability of benefits under the India – Mauritius DTAA were raised on account of a Delhi High Court ruling, which quashed a Circular[35] passed by the Central Board of Direct Taxes (**CBDT**) on the India – Mauritius DTAA. The Circular, *interalia*, stated that the "Certificate of Residence" (commonly referred to as a tax residency certificate) issued by the Mauritius tax authorities would constitute sufficient evidence as to residence and beneficial ownership in Mauritius for entitlement to the benefits of the India – Mauritius DTAA. The Circular had merely reiterated the provisions of the Treaty, which states that where a Mauritius '"person" is found liable for tax in India, the determination of the person's residency shall be made in accordance with the domestic laws of Mauritius. However in September 2002, the Government of India and the CBDT, being respondents in the proceedings before the Delhi High Court, jointly filed a Special Leave Petition (**SLP**) before the apex court, challenging the Order. Global Business Institute Ltd. (**GBI**), a not-for-profit company incorporated under the laws of Mauritius, also filed an independent SLP. The Supreme Court t in a landmark judgment ook up both SLPs together for hearing, and pronounced its judgment in October, 2003 quashing the Delhi HC order and upholding the validity of Circular 789. [36] Thus, foreign investors investing into India through a Mauritius intermediate holding company are entitled to claim benefits under the India – Mauritius DTAA.

Indian BPO companies are also provided special tax incentives, which are discussed in detail below. Until April, 2003 these tax benefits were lost if the beneficial ownership of the company changed by more than 49%. However, the Finance Act, 2003 removed this restriction and therefore a change in ownership of the Indian company would not have any adverse tax implications on the tax holiday. The use of a Mauritius entity may also allow for future restructuring / expansion in a tax optimum manner.

[35] Circular No. 789 dated April 13, 2000.

[36] *Union of India v. Azadi Bachao Andolan*, [2003] 263 ITR 706 (SC)

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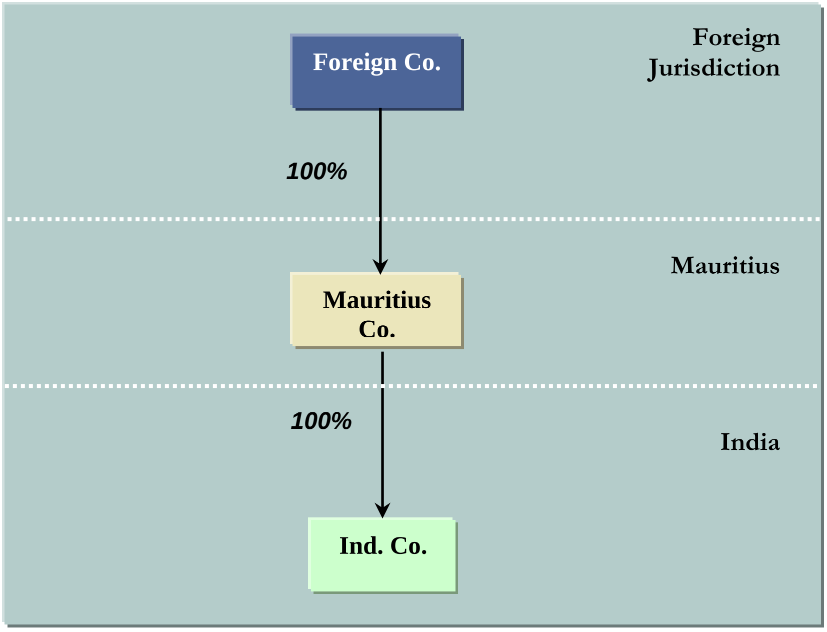
c. Wholly-Owned Subsidiaries

Several foreign companies, such as General Electric, Dell, and Cognizant Technologies, established wholly-owned subsidiaries in India, which are captive BPO service providers. A typical foreign company can use the following structure to set up a wholly owned subsidiary in India.



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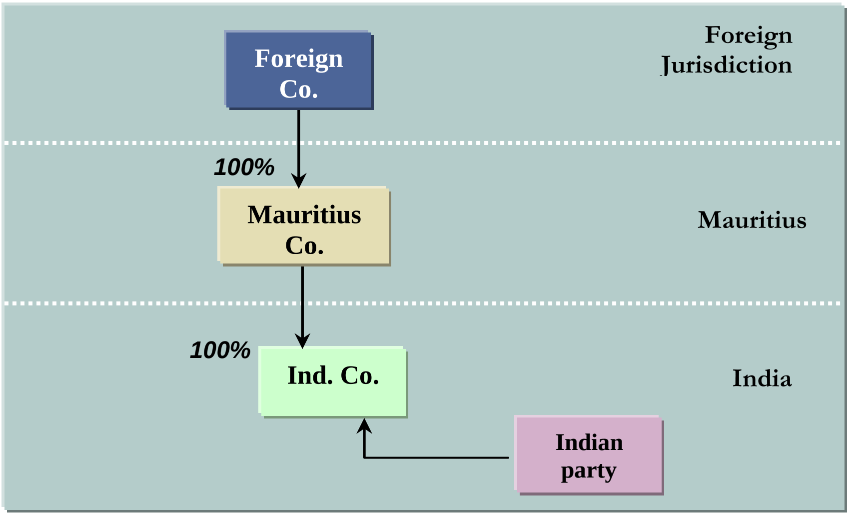
d. Joint Ventures

The foreign company can also enter into a joint venture with an Indian party. The parties achieve economies of scale and each contributes complementary competencies for share in profits. The joint venture company can provide services to the foreign company and also to third parties. Indian parties can use the joint venture route to receive foreign investment and technological know-how from established players in foreign jurisdictions. A typical structure is depicted below:



While considering the percentage ownership that a party wishes to have in a company, it is necessary to understand the mechanism of exercising control over an Indian company. Control can be exercised at the board and at the shareholder level.

There are two types of shareholders' resolutions under Indian law:

- Ordinary Resolutions: These resolutions require the approval of a majority (51%) of the shareholders. Such resolutions are required for, among other reasons, increasing the share capital, declaring dividends, appointing auditors, and increasing or reducing the number of directors.

- Special Resolutions: These resolutions require a 75% majority. Such resolutions are required to change the name of a company, altering the Articles of Association, offer further shares to any other people, and to wind up the company's affairs.

Thus, a shareholder would require at least 75% of the company's shares to be able to control its operations, unless the Articles of Association specified otherwise. Conversely, a shareholder who holds 26% of the shares of a company has statutory veto rights, which would entitle him / her to have negative control over the company. It is possible for the minority shareholder to protect his / her interests by having shares with differential voting rights or with a negative veto right over certain matters, where a decision cannot be taken without the minority shareholders' consent. Thus, it is important to carefully negotiate the shareholders' agreement and incorporate adequate control mechanisms.

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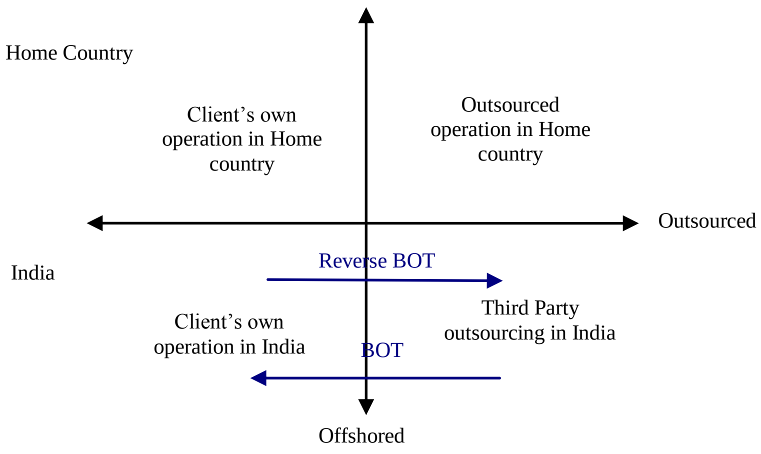
e. BOT AND REVERSE BOT



Build-Operate-Transfer (BOT)

Build Phase:

- Offshore firm builds facility to standards and specifications of Buyer and provides administrative, professional and other support staff.

Operations Phase:

- Offshore firm continues to provide administrative, professional and other support staff.
- Offshore firm has operational responsibility and liability to meet and comply with Service Level Agreements
- Customer is charged for services provided by Offshore firm
- Both Parties agree on division of responsibilities and appointment of executives.

Transfer Phase:

- Customer has option to take over entire operation and bring it in-house at any time.
- Both parties have option to extend 'operational' arrangement on mutually agreed terms.
- In the event of transfer, Customer pays to Offshore firm, a pre-defined price (linked to performance goals) and gets ownership of the physical assets and employees of the venture.

BOT Advantage

Customer is able to realise benefits of offshoring quickly with limited execution risk while minimizing upfront costs and long-term financial risks. Customer also retains flexibility of acquiring the facility.

The BOT model is adopted when functions which are core to the client are being offshored e.g. software development, for the purpose of taking low cost advantage. In the initial phases when the outsourcing entity does not have the resources including management resources for creating and managing captive offshore entity, third parties having resources and experience in the field are hired to built the facilities and

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create dedicated resources for the client. As the outsourcing entity gains sufficient knowledge and experience to manage and control offshore captive entity such third party facilities are later converted into a captive entity.

Reverse BOT

This occurs when the outsourced entity is created as a captive entity and thereafter the client divests its stake from the entity in favour of a third party. Reverse BOT is observed in cases where the vendor entity is created for servicing or undertaking non-core activities. When BPO industry was in the nascent stage and experienced third party vendors were not available, captive BPOs were created to take the benefit of lower cost and skilled labour in the offshore country. As the time progressed the outsourcing entities transferred the BPO rendering non-core services to third parties.

2. Sources of Income for Foreign Companies

The foreign company can receive income from an Indian company in the form of dividends, interest, royalties, or service fees.

Dividends

The foreign company can repatriate the profits of the Indian company in the form of dividends. Such dividends are usually declared from the profits of the Indian company. The Finance Act, 2002, had reintroduced the classical system of taxation (i.e., taxing dividends in the hands of shareholders). The Finance Act, 2003 restored the position to pre 2002 with some modifications. Dividends are now tax-exempt in the hands of all shareholders (irrespective of their residential status). However, the dividend distributing company has to pay a dividend distribution tax of.16.995 %.[37]

Other Sources

Currently, India does not have any thin capitalization rules in force. Accordingly, a foreign company has the flexibility to capitalize the Indian subsidiary either by equity or debt. However, the IT Act confers the power on the revenue authorities to disallow payments made to related parties that they consider "unreasonable" and are not on an arm's length basis. The Indian company can receive up to $ 500 million per annum 38under the automatic route (i.e. no prior approval of any regulatory authority would be required), subject to end use and certain other conditions. However, it should be noted that there are certain restrictions on the amount of interest that can be paid on such loans.

The foreign company can license its trademark, software, and other intellectual property and receive royalties for such use. The foreign company may also provide training and other services to the Indian company and receive fees for such services.

The Indian company would be required to withhold tax at source at the rate of 10.56%39 on the gross amount for payments attributable as royalty or fees for technical services. Moreover, these payments will be a tax-deductible expense for the Indian company only in the event the applicable tax has been

[37] The rate is inclusive of 10% surcharge and 3% higher and secondary education cess.

[38] RBI Circular No. 60, dated January 31, 2004

[39] The rate is inclusive of 2.5% surcharge which is applicable in the event the net income exceeds INR 10 million and 3% higher and secondary education cess.

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withheld before making the payments to the foreign company. However, withholding tax rates could be reduced depending on the DTAA between India and the foreign company's country of residence.

3. Tax Issues

A BPO operation that is run from India will have tax implications in India. These implications need to be carefully considered when deciding between setting up operations in India or outsourcing to a third party.

INCOME TAX RATES IN INDIA	
Category	**2008-09**
Individuals (Resident and Non-Resident) - maximum rate	33.99[40]%
Indian Companies	33.99[41]%
Foreign Companies	42.23[42]%

Under the Indian Income Tax Act, 1961 ("**IT Act**"), all Indian source income is subject to tax in India. The income tax rate changes every year. The table on the left shows the present rates of income tax for the financial year 2008-09.

If the foreign customer sets up a subsidiary in India, the Indian subsidiary would be subject to a 33.99% tax on its net income. If the foreign customer company were to operate out of a branch office in India, the branch would be regarded as a permanent establishment of the foreign company in India and hence be taxed at 42.23% on its net income.

Tax Benefits

Units set up by companies in Free Trade Zones (**FTZs**), Electronic Hardware Technology Parks (**EHTPs**), Software Technology Parks (**STPs**) or Special Economic Zone (**SEZ**) are entitled to certain tax benefits under section 10A, 10AA and section 10B of the IT Act. These exemptions are on profits generated from exporting articles, things, or computer software. The term "*computer software*" has been defined to include IT enabled services such as data processing, data entry and conversion, data analysis and control, and data management call center operations[43]. The entire export profits of a company, excepting an SEZ, that is set up in an STP, FTZ, or EHTP are exempt from tax until March 31, 2011[44].

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[40] The rate is inclusive of 10% surcharge which is applicable in the event the net income exceeds INR 1 million and 3% higher and secondary education cess.

[41] The rate is inclusive of 10% surcharge which is applicable in the event the net income exceeds INR 10 million and 3% higher and secondary education cess.

[42] The rate is inclusive of 2.5% surcharge which is applicable in the event the net income exceeds INR 10 million and 3% higher and secondary education cess.

[43] The definition of "computer software" has been broadened and includes IT enabled services like data processing, data entry and conversion, data analysis and control, data management, call center operation, *etc*. *vide* notification no. 11521/F.No. 142/49/2000-TPL dated 26 September 2000 issued by the CBDT, India.

[44] http://indiabudget.nic.in/, visited on July 08, 2009

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Further, the Special Economic Zones Act, 2005 has been brought into effect along with the Special Economic Zones Rules, 2006. As per this Act, SEZ units which begin to manufacture or produce articles or things or provide any services, on or after 01-04-2005 are eligible for a 15 year tax benefit in relation to export profits, in the following manner :-

(i) 100% income tax exemption on export income for SEZ units under Section 10AA of the IT Act for first 5 years;

(ii) 50% for next 5 years thereafter; and

(iii) 50% of the ploughed back export profit for next 5 years.

The SEZ units are also exempted from capital gains arising on transfer of capital assets in case of shifting of industrial undertaking from urban area to any Special Economic Zone.

In case of an amalgamation / demerger, the amalgamated / resulting company to which the unit enjoying the tax holiday is transferred, will enjoy the tax holiday for the balance period to which the amalgamating/transferor company would have been entitled. However, the amalgamating/transferor company will not be entitled to claim the tax holiday for the fiscal year in which such reorganization takes place.

Transfer Pricing

The parties to a BPO agreement may also be required to comply with transfer pricing regulations, which took effect in India on April 1, 2001.[45] The regulations state that the income arising from an international transaction entered into by associated enterprises should be computed based on an arm's length price.

It would be pertinent to note that the definition of the term "*associated enterprises*" under the Income Tax Act is broad. For example, if one enterprise holds shares either directly or indirectly, holds at least 26% of the voting power of the other enterprise, or advances a loan to the other enterprise equal to at least 51% of the book value of the total assets of that other enterprise, the parties may be regarded as associated enterprises and would be required to comply with transfer pricing regulations.

It is to be noted that the tax holidays described above would not be available in respect of income resulting from transfer pricing adjustment.

Permanent Establishment (PE)

As stated earlier, a company may carry out operations in India through a branch office, a subsidiary company or through a joint venture. However, while selecting the form of entity through which business operations may be carried out in India, one should consider the possibility of the Indian entity being regarded as the PE of the foreign company. If the foreign company were to operate out of a branch or an office or have a place of management in India it would be regarded as a PE. If the foreign company is held to have a PE in India, the profits of the foreign company, attributable to such PE would be taxed in India.

A subsidiary *per se* will not be regarded as a PE. Though the mere existence of a subsidiary by itself will not constitute a PE, it would be pertinent to note in this regard, the rulings passed by the Indian courts.

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[45] Sections 92 to 92F of the ITA.

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In a ruling[46] given by the Authority for Advance Rulings, India ("AAR"), the AAR has held that a subsidiary may be regarded as a PE, if it does not have significant independent activities of its own. In another ruling[47] the AAR has held that if the agent does not have the authority to conclude contract, then he cannot constitute a PE. However, on the other hand if the parent executes mass contracts made on standard forms without being scrutinized by it, then the agent may constitute a PE.

A number of significant PE related issues in the BPO industry were examined by the Supreme Court in the case of DIT v. Morgan Stanley[48], where it was held that deputation of employees by the foreign parent company to its wholly owned Indian subsidiary could give rise to a service PE in India. However, it was clearly affirmed that as long as the PE is compensated at arm's length, no further income may be attributable to such PE.

It may be observed that the determination of a PE is very subjective and it is critical to structure operations carefully to avoid exposure to PE. In the event that foreign company is held to have a PE in India, the profits of the foreign company to the extent attributable to the operations of Indian PE will be subject to tax in India. In this regard, the Ministry of Finance ("Ministry") vide Circular No. 5/2004 dated September 28, 2004 ("Circular")[49] has clarified that the non-resident entity outsourcing operations to India would be liable to tax in India only if the BPO unit constitutes its PE as per the provisions of Article 5 of the DTAA between India and the country of residence of the foreign company. It clarifies that the profits of the non-resident entity would be taxed in India only to the extent the amount is attributable to the PE in India. For this purpose, the amount attributable to tax in India would be the amount determined as per arm's length principle. The meaning of arm's length price for this purpose would be the same as defined in Section 92F(ii) of the Income Tax Act i.e. the price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions. While computing the profits of the PE, the expenses incurred in connection with the activity of the PE in India would be allowed as deduction in accordance with the accepted principles of accountancy and the provisions of the Income Tax Act.

<u>Indirect tax Implications</u>

VAT

Value Added Tax ("**VAT**") has replaced the erstwhile Sales tax regime that was prevalent in India. In India, the sales tax is imposed at a dual level at a Central level on the inter-state sale of goods and under the State level on the intra state sale of goods. While the Central Sales Tax is not a creditable tax, the local State level taxes are in the nature of VAT. The laws relating to value added tax maintain that the individual entities in the supply chain are required to pay taxes only with regard to the value additions done by them respectively. Further, there is a movement towards introducing a single level goods and service tax in India.

Service Tax

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[46] [1997] 223 ITR 416 – AAR P.No. 8 of 1995.

[47] TVM Limited Vs. CIT (Delhi) – [1996] 237 ITR 230 (AAR).

[48] 292 ITR 416 (SC).

[49] An earlier circular No.1/2004 had created difference between core and non-core activities for determining the attribution of income to an Indian BPO of a non-resident. This earlier circular has however been withdrawn by this new circular.

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Services provided by the BPO units are subject to service tax in India. Service tax is currently levied at the rate of 10.3% on the service provider, who normally passes it on to the customer or client. Services, which are paid for in foreign exchange, are currently exempt from service tax, provided the customer or client who consumes the services is situated outside India. Further, there is also the availability of credits on the service tax paid on the input service which can be used to offset the service tax liability of the BPO units. Further, where the services of the BPO unit are exported, the service tax paid on input services are available as a refund.

4. Labor laws

There are various statutes that may become applicable to an Indian company in terms of its employees. Listed below is an overview of some of the important labour law legislations. This is only an illustrative list and does not cover all applicable labour law statues.

Statutes	Summary
State-specific shops and establishments act ("**SEA**")	The SEA largely apply to shops and establishments located in the respective Indian States and deals with various aspects in relation to opening and closing hours, daily and weekly hours, overtime, leave and holidays, termination of employment, etc.
Payment of Wages Act, 1936 ("**POWA**")	The POWA was enacted primarily to regulate the payment of wages to employees. POWA applies to persons employed in a factory, railway and certain prescribed industrial establishments
Minimum Wages Act, 1948 ("**MW Act**")	The MW Act provides for the fixing of minimum rate of wages depending on the level of skill, location, type of industry, etc.
Payment of Bonus Act, 1965 ("**POBA**")	POBA seeks to provide payment of bonus to persons employed in establishments on the basis of profits, production or productivity. POBA is applicable to factories and to establishments employing at least 20 employees.
Employment Exchanges (Compulsory Notification of Vacancies) Act, 1959 ("**EECNV Act**")	The EECNV Act requires the employers to notify to employment exchanges of any employment vacancies. The EECNV Act applies to all public establishments and to all private establishments which has 25 or more employees on its roll.
Contract Labour (Regulation and Abolition) Act, 1970 ("**CLRA Act**")	The CLRA Act seeks to regulate the employment of contract labourers. The CLRA Act applies to establishment in which a minimum of 20 workmen are employed as contract labour.
Apprentices Act, 1961 ("**AA**")	The AA provides for the training of apprentices in order to provide them with relevant practical experience.

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Maternity Benefit Act, 1961 ("**MB Act**")	MB Act provides for maternity benefit (in terms of paid leave days) and certain other benefits. The MB Act is applicable to factories, mines, oilfields, plantations, shops or other establishments in which at least ten employees are employed.
Equal Remuneration Act, 1976 ("**ER Act**")	The ER Act ensures payment of equal remuneration to men and women workers and prevents discrimination on the grounds of sex in relation to recruitment, promotions, training or transfer.
Child Labour (Prohibition and Regulation) Act, 1986 ("**CLPR Act**")	The CLPR Act prohibits the engagement of children below the age of 14 years in certain employments and regulates the conditions of work of children.
Employees' Provident Funds and Miscellaneous Provisions Act, 1952 ("**EPF Act**")	The EPF Act is one of the most important social security legislations in the country. Under the EPF Act, the employer and the eligible employees are both required to contribute a certain percentage of salary to the Provident Fund Commissioner for depositing to the respective accounts of the employees. The EPF Act is applicable to establishments where a minimum of 20 employees are employed.
Employees' State Insurance Act, 1948 ("**ESI Act**")	The ESI Act seeks to provide certain benefits to employees in case of sickness, maternity and employment injury. As per the ESI Act, the employer and the eligible employees are both required to contribute a certain percentage of the salary in the form of insurance premium to the Employees' State Insurance Corporation. The ESI Act applies to all factories and establishments where 10 or more persons are employed.
Payment of Gratuity Act, 1972 ("**POGA**")	The POGA mandates the employer to pay gratuity to the employees upon the termination of employment. The POGA applies to factories, mines, oilfields, plantations, ports, and railway companies, and to shops or establishments where at least 10 employees are employed**.**
Workmen's Compensation Act, 1923 ("**WCA**")	WCA governs the payment of compensation for injury, accident or any disability suffered by the employees in the course of their employment.
Trade Unions Act, 1926 ("**TU Act**")	The TU Act seeks to provide for the registration of trade unions and in certain respects to define the law relating to trade unions.

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Industrial Disputes Act, 1947 (“**IDA**”)	The IDA regulates employment related disputes. The IDA also contains provisions in relation to establishment of labour courts / tribunals, change in service conditions, lay off, retrenchment (termination), strikes, lock-outs and closure of establishment. The IDA applies to industrial establishments or undertakings in which any industry is carried on.

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5. Setting Up Operations in India

The following issues have to be addressed while setting up operations in India:

- Incorporating a company
- Registering with the Software Technology Parks of India (**STPI**)
- Approval by the DoT for call center

Incorporating a Company

There are two main types of companies in India, public and private companies. It is advisable to set up Indian operations in the form of a private company rather than a public company because the former has more flexibility and is easier to operate than compared a public company. It normally takes 30-40 days to incorporate a company in India.

Registering with the STPI

As discussed above, certain tax benefits are available to 100% EOUs registered with the STPI. The STPI grants approval to establish a unit and specifies the amount of capital goods that can be imported, the minimum export performance, and the net foreign exchange earnings as a percentage of exports (**NFEP**). The units in the STPI are also granted certain indirect tax benefits, such as an exemption from payment of custom duties. The premises from where the units operate, along with the capital goods imported, need to be customs bonded. If a unit does not achieve the NFEP or export performance, the unit may be required to refund the tax benefits it has received under the STPI scheme. In addition, certain interest and penalty may be levied.

Approval by the DoT

An approval has to be received from the DoT for setting up a call center in India. The DoT Guidelines on call centers classify them within the ambit of "Other Service Providers."

6. Exit Options

The shareholders of the Indian BPO company can exit the company in the following ways:

- Transfer of shares of the BPO company
- Other routes

Transfer of Shares of the BPO Company

The shareholder of the BPO company can transfer its shares to a third party. Under Indian exchange control laws, the transfer of shares from a resident to a non-resident required the prior approval of the Foreign Investment Promotion Board (**FIPB**) and the Reserve Bank of India (**RBI**). This prior approval is no longer required. However, the price at which the shares are transferred is subject to a specified minimum price condition. This minimum price is based on the net asset value (**NAV**) of a private company and the price on a stock exchange for a listed company.

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The transfer of shares from a non-resident to a resident is subject to a maximum price cap. The RBI ensures that the price of the transfer is not above a maximum level, which is based on the NAV of a private company and the price on a stock exchange for a listed company.

It should be noted that one of the conditions imposed by the DoT while granting approval for setting up a call center is that there should not be any change in the Indian or foreign promoters / partners (or their equity participation) without the prior approval of the "competent authority."

The above-mentioned transfer of shares may also have certain tax implications, the most important of which is Capital gains. Under the provisions of the IT Act, gains realized on the sale/transfer of shares of the Indian company by the foreign company would result in capital gains tax in India.[50] Long-term capital gains[51] realized on the sale of shares of Indian companies not listed on a recognized stock exchange in India will be taxed at the rate of 20.91% (with a cost inflation indexation benefit). There will be no long term capital gains tax in the case of shares of companies listed on a recognized stock exchange in India in case where the transaction takes place on the stock exchange and both the buyer and seller have paid a Securities Transaction Tax ("**STT**") at the rate of 0.075% each[52] Short-term capital gains[53] realized on sale of unlisted shares in the hands of a non-resident company are taxed at the rate of 41.82%. The short-term capital gains on sale of shares listed on a stock exchange and traded on the stock exchange will be taxed at 10.46%. It may also be noted that in cases in which the parties to the transaction are related, the Indian transfer pricing provisions would also be implicated. However, it may be possible to reduce the capital gains tax to zero, if the investments are routed through Mauritius and the operations are structured so as to avoid PE classification in India.

Other Exit Routes

The shareholders of the BPO company can exit via an IPO. However, if the shareholders are treated as "*promoters*" of the company, there are certain lock-in requirements on the shares held by such promoters. The shareholders can also exit from the BPO company through a merger of the BPO company with another company or after a winding up of the Indian company.

[50] S. 45 of the ITA.

[51] Gains realized on the transfer of shares held for more than 12 months are deemed long-term capital gains.

[52] The STT was introduced by Finance Act, 2004. Finance Bill 2005 proposes to raise the STT in this case to 0.1 % to be paid both by the buyer and the seller. This STT is to be increased in both the years by an education cess of 2%

[53] Gains realized on the transfer of shares in a company held for a period of 12 months or less are called short-term capital gains.

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IV. BPO AGREEMENTS

1. Types of BPO Agreements

Depending upon the relationship between the parties and the nature of transaction, the BPO agreements could be:

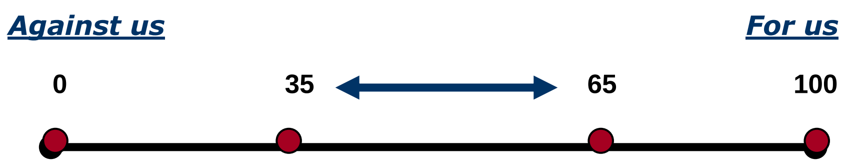
- Third Party Agreements for BPO, where the customer and the vendor are not related parties;
- Captive Agreements for BPO, where the customer and the vendor are related parties, the vendor typically being the subsidiary of the customer;
- Build-Operate-Transfer (BOT) Agreements, where the vendor builds and develops the BPO operation for the customer and at a future date transfers it to the customer.

2. Negotiating BPO Agreements

The foundation of any outsourcing relationship is laid out in a BPO contract. Therefore, it should be negotiated carefully - keeping in mind business, operational and legal risks - to ensure the long-term success of the BPO arrangement.

A Separate Negotiation Team: The BPO vendor and the customer should set up a negotiation team, consisting of representatives that deal with all aspects of the contract, such as operations, management, finance, and legal issues. The negotiation team should document all discussions pertaining to the transaction, to ensure that no stone is left unturned and that the team is on common ground with respect to the general approach towards the negotiation.

Approach: The approach towards negotiations should always be a balanced one. On a negotiation scale from "0-100" (where '0' represents an adverse term in the agreement, while "100" represents a favorable term), the goal should be to ensure that the entire negotiation process falls in the "35 to 65" band. A balanced approach will lead to a better understanding of the other party's interests and will result in successfully clinching the deal, ultimately creating a harmonious long-term relationship.



Negotiation Process: The following figure represents a typical negotiation process. It is prudent to begin any negotiation with the term sheet, which is the condensed version of the agreement. It records the initial understanding of the parties on certain basic issues. This approach helps parties compartmentalize issues and concepts to sort out macro level terms (including business terms), and to assess their capabilities and expectations. The term sheet could be binding or non-binding, should have at least binding confidentiality and no-shop clauses, and a termination clause and the effects of termination. Detailed agreements should be signed within a specific period. Pending negotiation of final contract if the service provider is likely to commence work, it would be prudent to at least have a term sheet in place setting forth the commercial understanding of the parties.

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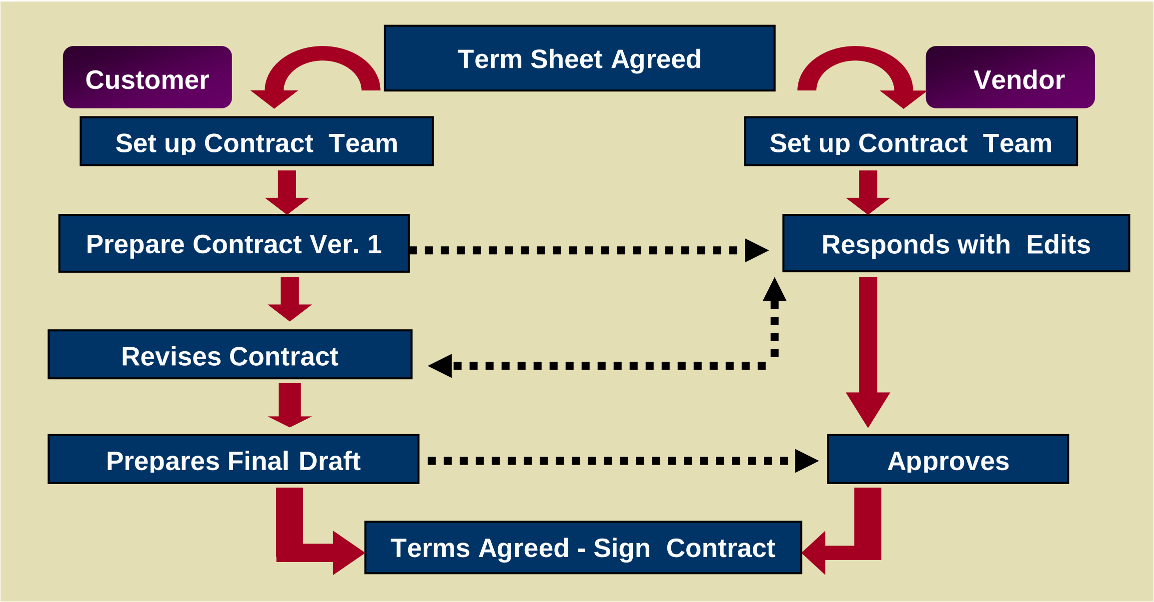
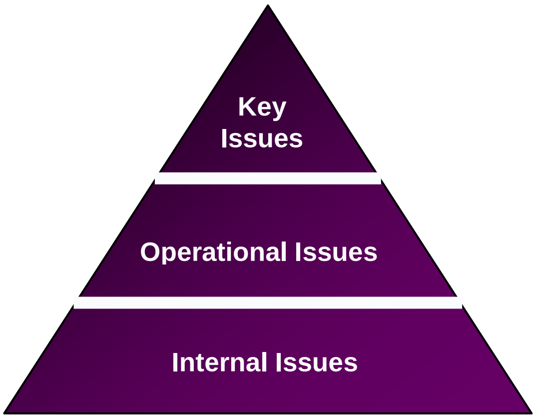
Contract Negotiation Process



Issue Management: The team should keep segregate the issues as "Key Issues," "Operational Issues," and "Internal Issues" so that each type is tackled at the appropriate levels in the organization.



Further, each issue should be categorized under:

- Non-negotiables
- Give-aways
- Don't-cares

This approach helps the party assess its bargaining power and also assists the party in setting up an effective negotiation strategy. Such categorization should be done on the impact vs. probability theory, as depicted below:

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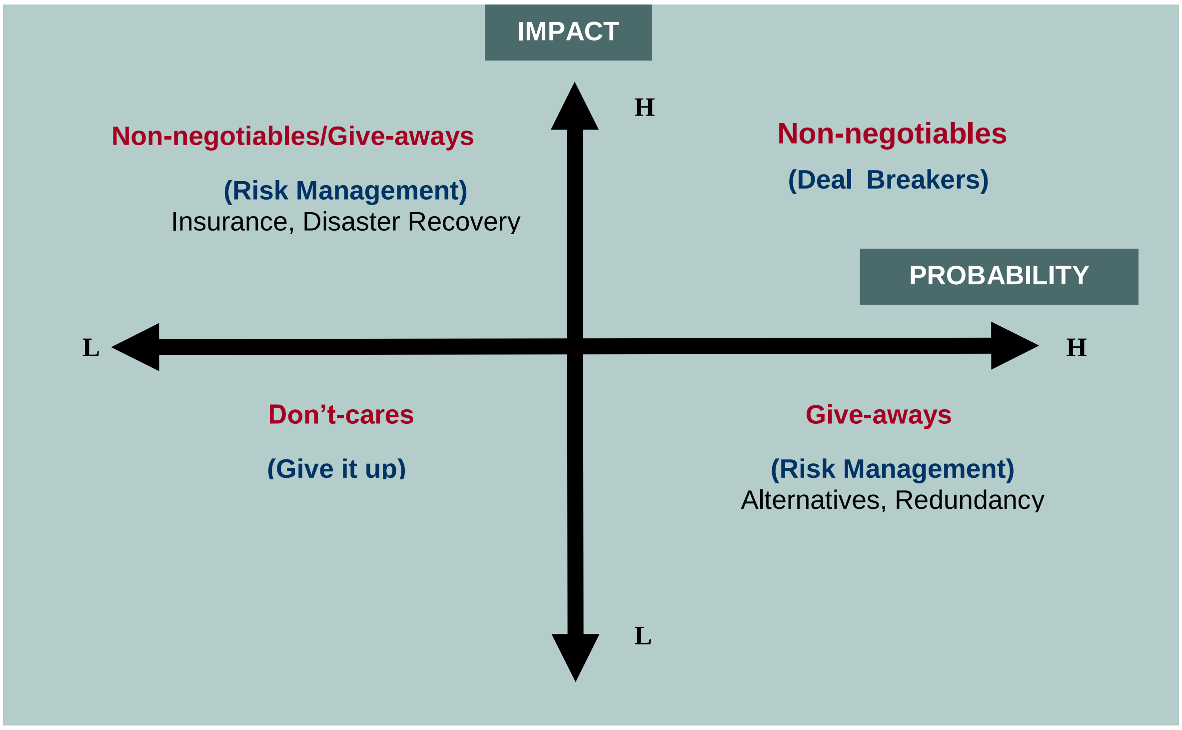
Impact vs. Probability Theory



3. The BPO Team

Outsourcing can often be a very complex project. Many factors can inhibit or significantly delay an outsourcing project. These factors include lack of awareness of the outsourcing process, loss of control over the project, loss of core competencies, resistance to change, disgruntled employees, difficulties in reversing the project once it has started, and various other failure points.

It is necessary to form a team that would handle the entire outsourcing project. This team should consist of people who are currently working on the service that is sought to be outsourced and those individuals having management and technical skills - whether employed by the company or not - such as:

- Consultants: They can help develop strategies for the project, help manage the project team, improve team work, reduce project cycle times, deal with human resources issues, change management, etc.
- Lawyers: They can help in negotiations, setting terms, drafting agreements, etc.
- Accountants: They can help analyze the cost effectiveness of a project, revise current accounting and auditing practices, etc.
- Tax Strategists: They can help identify tax implications and develop new tax strategies as the fixed costs turn into variable costs as a result of outsourcing.
- Technology Experts: They can help develop the required information technology infrastructure and systems to effectively manage and monitor outsourced activities.
- Benchmarking Specialists: They can help in comparing the costs and benefits associated with the project with those achieved by other organizations in the same industry and other industries.

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4. Service Agreements

Once a company (**customer**) completes the process of selecting a service provider, it is extremely critical to enter into a detailed agreement. Since a BPO contract forms the core of a successful outsourcing relationship, it should be drafted meticulously and must capture the unique business strategies and concerns, as well as the commercial understanding of the parties.

The agreement must document the nature of the outsourcing transaction, the type of business processes that are being outsourced, the scope of services to be rendered, responsibilities of the parties, performance specifications, accountability and measurement standards, a pricing structure for the services, a schedule of deliverables, and other conditions concerning employment, confidentiality, termination, dispute resolution mechanisms, and governing law. The main agreement may also contain schedules or exhibits that specify some of the terms and conditions in detail.

Incomplete documentation of the supplier's obligations can result in customer dissatisfaction. Inaccurate categorization of the service volumes and charges can result in disputes over payment as subsequent changes translate into additional costs for the customer or extra expenses for the service provider.

The following are some of the key issues that have to be addressed in the agreement.

Scope of Services

In relation to the scope of service following aspects should be captured in the agreement:

- details of the services to be rendered and the resources to be used for providing the services.
- How the parties should deal with the widening of the scope of services e.g. ramping up provisions with adequate notice to the vendor, applicable fees for additional services.

While the documentation of the scope of services and other related details may not appear to require the same rigor as is customarily applied to the more obvious "legal" provisions in the terms and conditions, the exhibits set out numerous important obligations. Complete and accurate content in the exhibits is integral to the successful operation of the relationship between the customer and the supplier. Placing sufficient focus on the exhibits early and consistently throughout the transaction cycle will allow the parties time to negotiate and document appropriate terms and ensure the consistency of the exhibits with the terms and conditions of the agreement.

Service Levels

One of the most important reasons for outsourcing is to capitalize on the expertise and higher quality of services offered by the service provider. Thus, some of the most important areas that an agreement should address are issues relating to service levels, such as specifying the deliverables, performances to be measured, and methods for measuring service levels. The parameters for service measurements would depend on the services that are being outsourced. Thus, if customer relations are being outsourced, then the parameters could be the response time and the number of queries responded to in a given time frame.

Following provisions may be covered in the agreement :

- That the vendor should provide the customer periodic reports on the performance of the services.
- What information will appear on the reports, such as exception reports for missed service levels and trend reports for key service levels.

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- supplier to conduct a root-cause analysis of service level failures and report the results to the customer.
- The customer should also have the chance to personally audit the vendor's performance on a regular basis.

Service Fees

The fees could be a lump sum amount or could depend on various factors such as the number of e-mails / phone calls responded to, the number of marketing calls made, and the number of hours spent on providing the services. Agreements may also link the consideration payable to the performance. Sometimes, the customer may receive a "service level credit,"[54] if the vendor fails to meet the desired service level. At other times, the vendor may also receive bonuses if the service level is exceptionally good or beyond the customer's expectations.[55] If the parties feel that they stand to gain if they perform their services well, the incentive to work proficiently will be apparent.

While determining the fees payable to the service provider, especially in case of captive outsourcing, the transfer pricing issues discussed earlier in this paper should be borne in mind.

Managing the Service Provider

Even if a company outsources its business process, it would like to maintain some degree of control over the service provider. E.g. To ensure stability and consistency in the management of the project, the customer should have the right of prior approval of the appointment, removal and replacement of the senior members of the service team. This is because, the senior members would have gained a comprehensive understanding of the client's needs and any replacement would require some time to achieve the same degree of familiarity. Further, it is very important to effectively manage the team, as the team personnel would have access to confidential information.

For better coordination between the customer and the vendor, each should appoint one contact person and all the communications between the parties should always be routed through such point people.

The customer may impose training requirements on the agents working on the transaction, seek reports on performance levels, and require the service provider to have the latest technology and infrastructure. The customer may also prohibit the service provider from subcontracting / assigning its services to a third party without the client's consent.

The customer imposes the above restrictions in order to maintain some control over the operations that are outsourced. While such measures provide a degree of comfort to the customer, the amount of control exercised should not become an administrative burden or amount to "managing" the service provider.

Intellectual Property (IP)

In any outsourcing agreement, there could be several IP issues involved, such as the licensing or assignment of copyrights, trademarks, and patents, etc. The issues concerning IP would largely depend on whether the IP is licensed by the service provider or the customer, or developed by the service provider.

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[54] A service level credit is a credit that the vendor grants to the customer after a service level failure.

[55] Greg Short, "*Don't Skip on the Details: Structuring and Documenting the Real Content of Outsourcing Agreements,*" Outsourcing Journal, April 2002.

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a. IP Owned / Licensed by the Service Provider: If the service provider claims that it owns, or has the right to use software which is required to provide the services, the customer should examine the license agreement or seek a representation and warranty stating that there is a valid right to use such software for the required purposes. If the service provider does not adhere to the terms and conditions of the license, the license could be terminated. This could have an adverse effect on the services being offered to the customer. Thus, the customer would normally impose an obligation on the service provider to do all that is necessary to maintain the license's validity.

If the service provider claims ownership of particular software, the customer would require a representation and warranty that the software does not violate the intellectual property of any third party. If the software violates any third party's rights, the service provider would be under an obligation to use similar non-infringing software that is non-infringing or to obtain a license from the software's owner, without any cost to the customer. The customer would also seek an indemnification against any suit that may be brought against it due to the infringing software.

The service provider may also own other types of IP, such as patented inventions that it uses to perform the services under a BPO agreement. In such a case, the service provider should be obliged to ensure that it continues to own the IP during the term of the agreement.

b. IP Owned / Licensed by the Customer: The customer may provide the vendor with operations manuals, systems documentation, and even computer hardware and software in order to perform the outsourced services. The service provider may have a license to use such software, or the customer may receive such a license and provide a sub-license to the service provider. The service provider may also grant a license to the customer to use the service provider's trademark. In the case of licensed trademarks, the agreement must stipulate how and for what activities the trademarks may be used. The service provider must ensure control over the right to use the trademark because it may suffer a loss of goodwill due to the acts of the customer.

In addition, while providing services to the customer, the service provider would have access to confidential information, trade secrets, and other intellectual property of the customer. Such information would continue to remain the intellectual property of the customer. Sometimes a customer may need to license certain patented inventions that it uses for its business processes, to the service provider. In such a case, the contract should regulate the manner in which the service provider uses the patented invention.

If the software is owned or licensed by the customer, a limited license is granted to the service provider to enable it to provide the services. The customer should ensure that the service provider does not use the software for any other purpose or customer, or sub-license it to any third party. The service provider should seek an indemnification from the customer against any suit that may be brought against the service provider due to the infringing software.

c. Developed IP: Intellectual property may be developed by the service provider while providing services to the customer. The agreement should clearly state the ownership of such intellectual property. Such intellectual property would normally vest with the customer and an obligation is imposed on the service provider to assign such IP to the customer. The agreement would have to specify that the customer is not under any obligation to make any additional payments for the assignment of such intellectual property. Alternatively, the parties

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could be co-owners of the intellectual property and they could share the revenues received by licensing such IP to a third party. The agreements of the service provider with its employee, consultants and sub-contractors should also be examined to ensure that the IP to be created by them has been appropriately assigned to the Service Provider.

Privacy and Data Protection

While providing services, the service provider would have access to personal and confidential data of the customer's clients. The customer would usually be under a contractual and a legal obligation to protect the privacy of its clients. The importance that governments attach to privacy issues can be gauged by the global developments with respect to privacy regulation.

a. Privacy Laws in the U.S: The U.S. historically favored self-regulation for privacy protection, and until recently, there were few privacy laws to consider in outsourcing transactions. However, due to increasing pressure from consumer protection groups, there is a variety of legislation that addresses privacy issues and data protection.

To address some of these concerns, the U.S. Congress enacted the Gramm-Leach-Bliley Act, which governs personal financial information; the Health Insurance Portability and Accountability Act (HIPAA), which covers health and medical information; and the Children's Online Privacy Protection Act (COPPA), which governs information collected online from children under the age of 13.

b. EU Directive on Data Protection: Outside of the U.S., privacy regulation is developing at a rapid pace. Multinational companies, or companies that simply receive data from other countries, may be subject to local privacy regulations. The European Union (EU) has been a leader in enacting and enforcing privacy regulation. For example, the EU's Directive on Data Protection[56] provides several rules that companies in the EU have to comply with while collecting and using personal information. In addition, it establishes a general rule that data should only be transferred to a non-EU country if it will be adequately protected there.[57]

c. Indian Laws on Data Protection and Privacy: Currently, the Indian legal regime does not have specific legislation for privacy and data protection. However, Indian courts have interpreted the right to privacy as an unarticulated fundamental right against an action by the state. The Information Technology Act, 2000 is India's mother legislation regulating the use of computers, computer systems and computer networks as also data and information in the electronic formats. . Certain amendments have been proposed in the Information Technology Act in 2008, which aim to plug the loopholes in the Act and check aberrant employee behavior in the BPO industry by including restrictive provisions addressing privacy issues and protection of confidentiality.[58]

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[56] EU Directive on Data Protection: http://www.privacy.org/pi/intl_orgs/ec/final_EU_Data_Protection.html, visited on June 6, 2002.

[57] The Directive, however, does not define the meaning of "adequate." Nevertheless, it provides that adequacy determinations will be made on a case-by-case basis, taking into account all the circumstances surrounding a data transfer operation.

[58] http://www.naavi.org/ita_2008/index.htm, visited on June 01, 2009

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It is necessary for an Indian company to be aware of the legislation in its customer's country, as it could have an impact on the service provider. It may be difficult for Indian companies to keep abreast of the latest legislation in foreign jurisdictions that would have an impact on the services that the Indian company provides to a foreign company. Hence, an obligation may be imposed on the customer to update the service provider on the foreign laws and the amendments to which the service provider must adhere. If the service provider does not comply with these laws, an indemnity obligation may be imposed on it.

Companies should take various steps to ensure that they minimize the risks of unauthorized access to sensitive personal information. Understanding the impact of privacy laws on one's business is the first step. Businesses should appoint a privacy team that will lead them through the assessment, planning, communication, and eventual compliance steps. For example, an appropriate team might include representatives from the following areas: HR, legal, marketing, communications, technology, finance, and corporate strategy. Corporations such as IBM, Microsoft, and AT&T have appointed "Chief Privacy Officers" and privacy teams to lead the effort in helping those businesses meet privacy compliance requirements.

Other Issues

a. Avoid Vagueness: The agreement should have clear definitions of the terms used in the agreement. Each aspect should be detailed and terms and conditions should not be left to be decided in the future. For example, parties often leave certain aspects to be "mutually decided" in the future. In the event the relationship between the parties sours, such mutual agreement is difficult to reach. Issues that are likely to have a long-term impact should not be left open.

b. Non-compete Provisions: The customer would typically insist upon a non-compete clause. The parties would have to negotiate a fair and enforceable noncompete clause. The vendor may in return insist upon an exclusivity clause.

c. Non-solicitation: The customer may often seek to employ high-skilled employees of the vendor and therefore, the vendor should include a non-solicitation clause.

d. Tax Matters: The BOT transaction has to be structured in a manner such that even after the transfer of operations the tax benefits are retained, and for that purpose relevant clauses have to be added in the agreement.

e. Transfer Pricing and Permanent Establishment Issues: The captive contracts and BOT agreements have to take into account transfer pricing and permanent establishment issues, and the relevant clauses must be inserted in the agreement.

f. HR issues: In the case of BOT Agreements, HR issues should be tackled carefully, as the vendor's employees are required to be transferred to the customer at a later date. Therefore, the employee contracts of the vendor have to be carefully drafted.

g. Limitation of Liability: The vendor should negotiate a limitation of liability provision in the contract, whereby the vendor's liability could be limited only to the extent of the fees being paid by the customer or to the extent that the loss or damage is on account of a default on the vendor's part.

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h. Liquidated damages: The customer could also negotiate a liquidated damages clause whereby the vendor is liable to pay to the customer monies in the form of damages, in the event there is a deficiency / delay in providing services and such deficiency / delay is attributable to a default by the Vendor.

i. Technology and Infrastructure: The customer should also ensure that the vendor has the latest technology and infrastructure in order for the services to be rendered in the most efficient manner.

j. Prohibition or Limitation on Vendor to Subcontract / Assign the Contract Services: In order to ensure control over the manner in which the services are provided, restrictions could be implemented prohibiting the vendor from subcontracting or assigning its services to a third party without the customer's consent.

k. Disaster Recovery: Detailed provisions on disaster recovery have become part of the BPO contracts specifying periodic back up, remote site for storage of the back-up, the standard of infrastructure to be maintained for the disaster recovery site.

l. Insurance: The vendor would require the client to maintain certain specified insurance cover. Often the vendor would have obtained Employer's Liability Insurance, Worker's Compensation Insurance, Comprehensive General Liability Insurance etc., in which case the client should examine the policies and if necessary require the vendor to obtain additional cover for specified liabilities. Vendors are often reluctant to obtain client specific insurance cover. Upon entering into contract the client is named as the beneficiary in the policies.

Term and Termination

This is one of the most important clauses in a BPO agreement, as the business plans of both the parties can be adversely affected by an early termination of the agreement. The customer would be apprehensive about granting the service provider the right to terminate the agreement, as termination would necessitate the search for another service provider. Similarly, the service provider would have engaged employees and agents and invested in infrastructure based on the expected revenues from the customer. However, both parties would also like to have an exit option if the relationship is not favorable.

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a. Automatic Renewal: As discussed earlier, the agreements in the BPO market are usually for a long time period and have high rates of renewal. The agreements usually specify the term of the agreement and provide for automatic renewal, unless the parties expressly terminate the agreement.

b. Termination for Default: The agreement should grant an aggrieved party the right to terminate the agreement if the other party commits a material default or there is a material breach of its representations and warranties. Such material default on the part of the service provider would include: continued failure to comply with service levels, a change of control of the service provider, and a violation of exclusivity obligations. Material default by the customer would be continued nonpayment of service fees.

c. Termination for Convenience: The parties may also have a right to terminate the agreement, even if there is no default by the other party. Such termination would usually require the payment of an early termination fee and sufficient notice to the other party.

d. Transition: If the relationship between the parties comes to an end, either due to termination or due to expiry, the parties may provide for a transition phase during which the service provider would continue to provide services for a particular period of time. In this phase, the service provider may be required to train certain persons designated by the customer, provide documentation of the processes, and do other acts that are required for a smooth transition. The customer would insist on having the right to purchase the assets and infrastructure that are being used to provide the services and also have the right to employ the persons on the team that were providing such services.

e. Effect of Termination: The agreement should also specify the effects of termination on various aspects such as payment of outstanding fees, escrow, IP and confidential information, and current work orders.

Governing Law and Jurisdiction

Parties would typically prefer to have the agreement governed by the laws of, and be subject to, the courts in their respective home countries. As a compromise, they may agree to have the agreement governed by the laws of a foreign country that has no nexus with the parties or the agreement. Normally, the courts would give effect to the intention of the parties as expressed in the agreement entered into by them except when there are strong reasons to justify disregard of the contractual agreement of the parties. [59]. When choice of law is bonafide, legal and not against public policy, such choice is generally upheld by the Indian courts. Whether or not the law chosen has some connection with the transaction is one of the important issues considered by the courts, while deciding the bonafide intention of the parties.

Alternate Dispute Resolution (ADR)

Parties resort to alternate dispute resolution (ADR) mechanisms such as arbitration rather than resorting to the traditional legal systems due to the high cost and time required for resolving disputes.

[59] Modi Entertainment Network and Anr. Vs. Respondent: W.S.G. Cricket PTE. Ltd. decided by Supreme Court of India on January 21,2003.

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Arbitration is usually held in accordance with the Rules of the International Chamber of Commerce (**ICC**) or the London Court of International Arbitration (**LCIA**) for international commercial arbitration. More recently, parties subject themselves to arbitration in the Singapore International Arbitration Centre (**SIAC**).

Enforcement of Foreign Awards and Judgments

If there is a dispute between the parties that is subject to arbitration or litigation, the award or decree must be enforced against the losing party. Such enforcement can occur within or outside of India.

a. Enforcement of Foreign Awards in India: India is a signatory to the New York Convention on The Recognition and Enforcement of Foreign Arbitral Awards, 1968 (NYC). Thus, if a party receives a binding award with respect to a commercial dispute from another country that is a signatory to the NYC and is recognized as a reciprocating country by India, the award would be enforceable in India. However, the courts in India may refuse to enforce a foreign award under certain conditions such as incapacity of the parties, noncompliance with the agreed arbitration procedure, non-adherence to the principles of natural justice, among others. Enforcement may also be refused if the subject matter of the award cannot be settled upon by arbitration under the laws of India or if the award's enforcement would be contrary to the public policy of India.

b. Enforcement of Foreign Judgments in India: A foreign judgment may be enforced by filing a suit upon judgment under section 13 of the Code of Civil Procedure, 1908 (**CPC**); or by proceedings executed under Section 44A of the CPC, provided that the judgment is rendered by a court in a "reciprocating territory." A "reciprocating territory" is one that is deemed by the Government of India to be a "reciprocating territory" under section 44A of the CPC. For instance, the U.K. has been deemed by the Government of India to be a "reciprocating territory," while the U.S. has not been considered as such.
However, a foreign judgment cannot be enforced in India under certain circumstances, such as when the judgment has not been pronounced by a court of competent jurisdiction, the decision is not on the merits of the case, the principles of natural justice have been violated, or when the judgment violates public policy.

c. Enforcement of Awards and Judgments Outside India: To determine the modalities for the enforcement of an Indian award or judgment in a foreign jurisdiction, it is necessary to examine the procedural laws of the foreign country in question.

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V. GOING FORWARD

Presently, the BPO industry is in an evolutionary phase. The estimated growth of this industry is positive, yet in order to ensure that the industry moves in a favorable direction it is important that the different problems and hindrances that have surfaced are handled properly. At this juncture, it is important that the interest level and the positive attitude are maintained. A research report released by Forrester in September 2003 stated that while business process outsourcing initiatives may result in significant cost savings, some expertise is overhyped. A survey conducted by this research firm found that companies experimenting with BPO complain of inflexible contracts, difficulty managing vendors, and a lack of performance metrics.[60] But these problems are not without solutions. For example, vendors are now experimenting with flexible new models that ensure that contract prices are structured based on actual success rates achieved in the respective processes being handled. Some vendors are even taking up contracts where billing rates are linked to the actual reduction in the total cost of ownership (TCO) achieved by a particular process. These new value-based models are diametrically opposed to the traditional per seat fixed-cost model.[61] In this manner, the contracts - which the outsourcers find inflexible - can be virtually done away with since the TOC-based contracts from the outset will itself be based on returns.

Various problems, which take a toll on the industry, include attrition and poor infrastructure facilities in developing countries like India. According to NASSCOM, call centers have an attrition rate of 30-35%, but the NFO study pegs the attrition rate at more than 50%. According to NASSCOM, “other than the natural rate of the attrition, ‘poaching’ of employees, ‘burnout’ and high stress environments are causing an increasing churn rate.”

The study states that the high levels of attrition will stabilize once the industry matures. As the opportunities decline, employees will remain in their jobs and opt for progression within the organization. The immediate requirement, however, is to thatch out a people management structure that will cater to the needs of this nascent industry.[62] With the government’s proactive attitude, the infrastructure of countries such as India is likely to go through a transformation.

Further, hindrances such as the anti-outsourcing wave in the U.S. are also more a consequence of a depressed economy, not a backlash against outsourcing.[63]

In spite of the problems that have emerged in the BPO industry, companies are expected to increase their spending on BPO to capitalize on the advantages it offers. Overall, BPO revenues will hit $146 billion in 2008, according to Forrester estimates.[64]

On this positive note it is appropriate to state that the BPO industry is here to stay and mature soundly.

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[60] http://www.destinationcrm.com/articles/default.asp?ArticleID=3447, visited on September 25, 2003.

[61] http://www.expresscomputeronline.com/20030714/cover.shtml, visited on September 25, 2003.

[62] http://www1.economictimes.indiatimes.com/cms.dll/html/uncomp/articleshow?msid=124097, visited on September 25, 2003.

[63] *Ibid 9.*

[64] http://www.nwfusion.com/news/2003/0902bpohype.html, visited on September 25, 2003.

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