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Besides having good revenue flows, it's also critical to avail of benefits extended to start-ups by the government. We take look at how to structure your start-up to make the most of tax benefits

Q: I am a 35-year-old businessman. I have just started a KPO. At present, we work from the US and India. But going forward, I am not sure about the structuring of my start-up. How should I structure my business to avail the maximum tax benefits? Please advice.
— Name withheld on request

Nishith Desai replies

I would first like to congratulate you on your new business venture in the KPO sector, a sector brimming with potential and fast catching up with the revenue-generating BPO sector. I assume that you are an Indian resident and would want to structure your operations in a manner that will capture the entire group value in the Indian company. The role of the US company would primarily concern marketing and to the extent required, that of rendering certain onsite services or job-transitioning services for customers in the US. There are several tax benefits that you could avail of in India, as KPO services are categorised as Information Technology Enabled Services (ITES) and are thereby entitled to several tax incentives that have been granted to ITES companies. A KPO unit could be set up under the Software Technology Parks of India (STPI) or Special Economic Zone (SEZ) scheme. With regard to STP units, the entire export profits of such units are exempt from tax, but only until March 31, 2009 while a graded tax holiday for 15 years from the year of operation is available to units set up in SEZs. The STP units have to pay Minimum Alternate Tax (MAT) of 10% on their book profits whereas SEZ units are exempt from paying MAT. However, the Finance Bill 2007 has restricted the tax holiday under the SEZ regime solely to "new" units set up in SEZs, thereby clarifying that existing STP units that propose to migrate to an SEZ would not be entitled to the tax holiday. You may consider setting up either a branch or a subsidiary of the Indian company in the US. A branch would be regarded as a Permanent Establishment (PE) of the Indian company in the US. The profits of the US branch will be taxable in India though you will get a tax credit in India for the taxes paid by the branch in the US as well as the branch profits tax paid in the US. On the other hand, if you set up a subsidiary, the Indian company will have to pay tax only as and when the US subsidiary distributes dividends to the Indian company. Such dividends would be subject to 15% withholding tax in the US, which will be available for tax credit in India. If you are likely to send your employees to the US for extended periods of time, this could trigger a PE exposure in the US for the Indian company. Thus, you should do a comprehensive PE analysis based on the operations you wish to undertake. In general, it is better to set up a subsidiary rather than a branch, from a limitation of liability perspective. It is essential that the Indian KPO company enter into detailed service agreements with the US customers who would be outsourcing their services to it. The service agreement must document the nature of the outsourcing transaction, the type of knowledge processes that are being outsourced, the scope of services to be rendered, the pricing structure for the services, the governing law, the place of arbitration and other such conditions that would govern the relationship with your customer. You should also have an inter-company service agreement between the US and the Indian company, under which the Indian company should pay an arm's length fee to the US company for the services rendered by it. I wish you good luck in your endeavour.



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