Conceptual Framework of Body Shopping in The Indian Context

Abstract

Section 10 A/10B/10AA of the Income Tax Act,1961 provides exemption to IT service companies on their income from exports carried out in free trade zones like Software Technology Parks of India and Special Economic Zones. However the Income Tax Authorities do not recognize the work done by the employees of such companies as exports since the work done by employees on shore that is in the client's premises outside the STPI and SEZ units in India delivering IPR to the client cannot be recognized as export. Moreover they have claimed that deputing software professionals abroad for which billing is done on the basis of time and materials could not be an eligible activity for claiming deduction under section 10A/10AA of the Income Tax and has raised a demand of Rs. 400 crore on Infosys. The tax authorities claim that the software industry employs highly skilled workers and has referred to it as Body Shopping as against exports. On the contrary the industry feels that there is a linkage between onshore and off shore work with respect to software exports. It includes analysis and gathering of software requirements to be done in consultation with the client and by visiting the client's premises. Also services like final software delivery, installation and training need to be done on shore whereas 80 percent of the work like designing, coding and testing of software is done off shore and hence onsite services are an integral part of delivery of IT services and cannot be termed as Body Shopping but Package Exports or Semi-packaged Software. This matter seems to be the source of prolonged litigation between the Software companies of India and The Income tax Authorities of India. If further recognized as Body shopping, it would raise litigation with the service Tax Authorities of India as well. Considering this as a landmark issue in the Income Tax Act and Service Tax Act, it is imperative to understand the conceptual framework of Body shopping in the Indian context.

Keywords : On shore work, Off shore work, Body Shops

Introduction

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The Indian software sector provides a vast range of services of software development as well as resale of software packages developed by foreign suppliers in the domestic market but the export market which accounts for 65% of the total software revenue include custom software development, consultancy and professional services. A majority of Indian software exports also consists of maintenance tasks, enhancements existing systems, development of small applications, providing low level design, coding and testing services. As per section 10 A/10B/10AA of the Income Tax act,1961 certain exemptions have been provided to IT service companies on their income from exports carried out in free trade zones like Software Technology Parks of India and Special Economic Zones. However the Income Tax Authorities do not recognize the work done by the employees of such companies as exports since the work done by employees on shore that is in the client's premises outside the STPI and SEZ units in India delivering the Intellectual property rights to the client, cannot be recognized as exports. Moreover they have claimed that deputing software professionals abroad for which billing is done on the basis of time and materials could not be an eligible activity for claiming deduction under section 10A/10AA of the Income Tax and has raised a demand of Rs. 400 crore on Infosys. The tax authorities claim that the software industry employs highly skilled workers and has referred to it as Body Shopping as against exports. On the contrary the industry feels that there is a linkage between onshore and off shore work with respect to Software exports. It includes analysis and gathering of software requirements to be done in consultation with the client and by visiting the client's premises. Also services like final software delivery, installation and

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Body Shopping: An Overview

As a source of recruitment "Body Shopping: may be defined as "Professional and hi-tech training organizations develop the pool of human resource for the possible employment"

In India, "Combination of onsite and Programming work has been called Body Shopping." It is dominated by males and an executive has referred it as "Young single Man's Game"

As per Financial Dictionary and Wikipedia. org, "Body shopping is the practice of consultancy firms recruiting information technology workers in order to contract their services out on short term bases" It is like Outsourcing.

The prospective employers contact these organizations to recruit the candidates. Otherwise the organizations themselves approach the prospective employers to place their human resources. These professional and training institutions are called body shoppers and these activities are known as body shopping. The body shopping is used mostly for computer professionals. Body shopping is also known as employee leasing activity.

Body Shopping is an Indian way of recruiting IT employees usually from India and placed abroad with various clients on project based assignments. These Indian consultancies or professional organizations who manage to provide skilled workers on behalf of their clients or employers are called 'Body shops' The workers so hired do not indulge into any direct relationship with their contract employers since they are employed by the Body Shop for a particular assignment and later they place them with other clients if a ready project assignment is available else the employee is put on a bench in order to wait for the next assignment or project. There are Body Shop networks which work as an association and supply skilled workers to each other as required in the same region or in different countries.Since these employees of software development services who are called IT professionals or consultants carry out highly labor intensive, monotonous and low paying jobs during the stage of coding and testing or correcting, hiring them is termed as Body Shopping. It indicates the quick and easy purchase of body and not the brain.

India And Body Shopping – History to Present Scenario

The concept of Body shopping in India can be directly related to the history of software exports by Indian companies in 1974 with the establishment of (TCS)Tata Consultancy Services in Mumbai. It was India's first export-oriented software-service company. Many other companies also started exporting software extensively but post liberalization India is considered a major global player in the software and IT industry. During 1996-1999 huge demand originated for people with COBOL, Mainframe and other such technological skills to prevent the systems from being affected by the Y2Kbug. A lot of U.S. Europe based Y2K consulting companies outsourced their manpower requirements to technology companies operating in India. These companies responded to the heavy demand for people by training and recruiting graduates from India generating high profit margins and growth and expanded operations to other IT related businesses. The industry grew on average over 37.5 per cent per year between 1995 and 2000 (Athreye, 2005a), accounted for over 28 per cent of India's GDP growth from 2000 to 2002 (Athreye, 2005b), and had domestic sales revenues of $2.5 billion in 2001-2002. Indian software industry exports accounted for 72 per cent of total Indian software industry sales between 2000 and 2001, and grew from $105 million in 1989 to $9.9 billion in 2002 (Athreye, 2005b).2004) and companies around the world to look to India for IT development, products, and services.

Indian Companies Provide Three Types of Outsourcing Services (Arora Et Al., 2001)

1. Consultancy at client's premises which is also called Body Shopping – The IT professionals act as temporary employees of clients and it enables international clients to maintain secrecy and carry out work in their premises
2. Off Shoring Services or Software Designing and Development entirely done in India- This enables clients to cut on the costs by hiring IT professionals at lower rates from the Indian labour market
3. Off shore and On Shore Services or the mixed pattern- Initially Software experts visit the client's premises and identify the software needs of the clients followed by in-India Software development which are called semi- packaged software exports.

To provide the above services Body Shopping two ways have been adopted:

1. By sponsoring IT workers to enter a particular country on a temporary work visa without any specific job offer or placement. They were "put on the bench" from their arrival till they were placed on a project and similarly even between two projects they would be put on the bench with no stipend.
2. Since 1990s led to the growth of Body Shops consisting of Indian Consultancies engaged in recruitment and placement of IT labours. They functioned as a network of placement agencies. They claimed that they were technology companies hiring workers for their own projects. They often were a hybrid of a labor-placement agent, a software-services provider, a software-development house, and sometimes an IT training institute. They also used benched workers for their own software development or training from time to time, and superficially this made the workers look like their "employees" who might then also be assigned to their "clients."

While the onsite services or the so called traditional Body shopping concept resolved the problems of labour shortage, newer methods of Body Shopping emerged due to changes in the Global IT industry. The need for customized software packages and widening application of Internet in Business operations and processes has made it inevitable for IT professionals to move from one on-site project to another.

Factors Detrimental to The Growth of Body Shopping Business In India

Suppliers decide how much body shopping they are willing and prepared to provide, but they cannot set actual demand. Clients' demand determines how much body shopping is actually realized. The realized demand depends on characteristics like a supplier's size and legitimacy and the needs of specific business segments and geographic markets. Probing into the determinants of Body shopping business would help us understand the operational dynamics of this business.

India's Prominence in the IT industry

One of the key factors that have led to the development of this business in India is revolution in the Indian IT sector. With no barriers to entry, the number of firms in the industry has grown on a large scale. It has emerged as the supplier of customized software development, coding and maintenance services.

Ready supply of skilled Manpower

The Indian education system places special emphasis on engineering degrees especially in the area of Information technology and IT Management Programmes. Thus, ensuring a ready supply of trained and low cost software professionals. Indian professionals have proved excellence in programming and coding skills. Moreover, English being commonly used in Indian schools, colleges and businesses, English speaking software developers are readily available.

Costs of Off Shoring/ Geographic segmentation:

Production costs in IT vary across the nations. The cost of labor, telecommunications, linguistic costs and travel costs vary substantially from India to US or Europe or Australia. The costs of body shopping for India are lower as compared to US or UK. Similarly linguistic costs favor English-Speaking nations.

Business Market Segmentation

Business markets that require close personal activity and interchange, use of local information and equipment demand on site presence and increase the need for Body Shopping whereas software and business process application like finance and accounting can be done from a distance with the help of off site personnel. Such business needs decrease the demand for Body shopping.

Size of the supplier

Large suppliers have greater opportunities to develop and manage relationships with clients, to establish appropriate contracts, to build repeat relationships due to professional staff and offices in other nations who facilitate communication with overseas clients. They have greater exposure to information and exposure to potential clients. Also big houses or large suppliers have created bigger pools of in-house knowledge by training and educating by arranging for the necessary infrastructure to create trained employees for placement abroad.

Incorporated Suppliers/ Public companies

Smaller concerns in the form of partnerships and sole proprietorships have limited capacity to raise finance and the risk taking tendency receive few contracts for body shopping in contrast to incorporated companies which are formally structured, able to develop capabilities and competencies and ability to examine problems tend to be more successful as providers of Body Shopping.

Overseas Office

Body shopping business is more fruitful when it has an overseas base of operations in order to cope up with visa problems, housing facilities and build contacts for generating sales. This makes it easier for them to carry out Body shopping and those suppliers who are widely involved in Body shopping business tend to set up overseas subsidiary.

Quality Orientation

Indian companies are increasingly becoming quality conscious. Companies are taking initiatives to train personnel, to maintain quality work and instill professionalism in skilled technical manpower.

Lack of Trust and Perception of risk

Many clients lack trust in potential sub-contractors of India. They fear the risk of losing important information and prefer on site operations, thus placing greater confidence in Body shopping.

Project Size

Small contracts are not worth sending off shore, that the completion of such contracts on site would be more cost efficient.

Indian professionals have an obsession to work in foreign countries

Body shopping Business is made simpler since Indian software and IT professionals have a craze to work abroad, live in developed societies, earn more, commute in big cars and live in tall apartments or big houses. This fascinates them to migrate to US or Europe for undertaking projects.

Barriers /Risks for Body Shopping Business

There are certain factors that could be cited as threats for this business

1. Change in Visa Policy by the Government.
2. Resistance to Indian programmers in US.
3. Lack of familiarity with the work culture of the West.
4. Body shops find difficulty in attracting and retaining talented software professionals
5. Acquisition of domain knowledge by IT professionals.
6. High costs associated with Indian Labor due to inflation in contrast with countries like Taiwan, Vietnam.

Conclusion

Body shopping does not entitle the supplier to any tax exemption under section 10A/10AA of the Income Tax Act of India. The onus is on Infosys to demonstrate that the customized software Exports developed through integrated off shore and onshore work was different from Body shopping as against the claims made by the Income Tax authorities. The judgment of this case shall have vast reaching implications on Indian Software and IT sector and

shall raise new avenues for taxation of services from this sector. Today, the whole world looks upon the Indian Tribunal for consideration of taxes on revenues from Software Exports.

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