

Tax Hotline

July 31, 2007

TAXATION OF OUTSOURCING ACTIVITY - MORGAN STANLEY RULING ANALYZED

Further to our hotline “[Supreme Court rules on permanent establishment in the outsourcing industry](#)” dated July 9, 2007, [please click here to read our analysis](#) (published in the Worldwide Tax Daily: 2007 WTD 142-5) of the judgment in the case of *DIT (International Taxation), Mumbai v. Morgan Stanley and Co. Inc.* In its ruling the Supreme Court held that the outsourcing of services such as back-office operations to a captive service provider will not *per se* create a permanent establishment (“PE”) of the parent in India. This was a key consideration, as in case outsourcing were to cause a PE of the non-resident company in India, the global profits of the non-resident company attributable to the PE may have been taxable in India at the rate of approximately 42.23%(approximately). Further, the availability of tax credit for such tax paid in the home jurisdiction may be uncertain, thus potentially leading to double taxation and wiping out the economic advantage of outsourcing to India. The Supreme Court has held that the presence of employees for stewardship functions will not constitute a service PE, whereas deputation of employees may create a service PE. Therefore foreign companies need to be careful in structuring inter-country assignments henceforth. It has also accepted the single-entity approach for the attribution of profits to a PE by ruling that the payment of an arm’s-length price by the nonresident to the PE extinguishes any further attribution of profits to tax.

Hope you find the analysis informative.

Best regards,

Taxteam

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