

# Tax Hotline

September 29, 2004

## OUTSOURCING - FINAL TAX CLARIFICATION ISSUED

The dust seems to be settling in on the controversies surrounding taxation of Business Process Outsourcing ("BPO") operations in India. On September 28, 2004, the Central Board of Direct Taxes ("CBDT") in India issued Circular no. 5 of 2004 ("Circular") clarifying the taxation of foreign companies having BPO units in India. The Circular is in line with the draft circular dated August 9, 2004 that was issued for public comments. With the issuance of the Circular, the controversial circular no. 1 of 2004, which differentiated between core and non-core/incidental services, stands withdrawn with immediate effect.

The Circular clarifies that the non-resident/foreign entity outsourcing operations to India would be liable to tax in India only if the BPO unit constitutes its Permanent Establishment ("PE") as per the provisions of Article 5 of the Double Taxation Avoidance Agreement ("DTAA") between India and the country of residence of the foreign company. As per the Circular, profits of a foreign 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. For this purpose, the meaning of arm's length price would be the same as defined in Section 92F(ii) of the Indian Income Tax Act, 1961, ("ITA") 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 ITA.

Laudatory in its intent, the Circular, nonetheless, is still silent on some crucial issues that could be addressed by the CBDT to bring certainty of tax implications for the foreign investors. For example, the Circular has not addressed the issue of taxation of BPO units set by foreign entities coming from non-treaty countries, extent of attribution, etc. These issues would continue to be stumbling blocks at the lower income tax authorities level. However, withdrawal of the original circular, which sought to attribute higher profits to core activities outsourced to India, is a welcome move.

Source: Circular No. 5 /2004 (F.No.500/67/2003-FTD), dated September 28, 2004

## DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.

## Research Papers

### Littlel International Guide (India) 2024

November 08, 2024

### Unmasking Deepfakes

October 25, 2024

### Are we ready for Designer Babies

October 24, 2024

## Research Articles

### The Bitcoin Effect

November 14, 2024

### Acquirers Beware: Indian Merger Control Regime Revamped!

September 15, 2024

### Navigating the Boom: Rise of M&A in Healthcare

August 23, 2024

## Audio

### Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

### Renewable Roadmap: Budget 2024 and Beyond - Part I

August 26, 2024

### Renewable Roadmap: Budget 2024 and Beyond - Part II

August 26, 2024

## NDA Connect

Connect with us at events, conferences and seminars.

## NDA Hotline

Click here to view Hotline archives.

## Video

### "Investment return is not enough" Nishith Desai with Nikunj Dalmia (ET Now) at FI8 event in Riyadh

October 31, 2024

### Analysing SEBI's Consultation Paper on Simplification of registration for FPIs

September 26, 2024

