Legal and Tax Considerations in Outsourcing

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1 Introduction

Outsourcing is not new; it is as old as the ancient trade routes to China and India. Trading with the East provided the produce and products that were not farmed or manufactured in the West. Although it involved physical products, support services, such as banking, brokering, and logistics, were required on the global scale to make the trading easier. The consumers, traders, and producers started relying on other parties to perform those services; thus begun services outsourcing. While individuals and organizations can perform some activities themselves, they rather have those activities performed by others, because others can do it better and/or cheaper. As Adam Smith put it, “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” (Smith 2000, p. xviii).

The roots of modern day outsourcing are in subcontracting, joint ventures, and strategic partnership. As products became complex and componentized, manufacturers started subcontracting individual components to external organizations. Subcontractors enhanced the subcontracted components thorough process and product innovations and increased dependence of the manufacturers on them. The two sides, being dependent on each other, entered into joint ventures and strategic partnership to ensure long-term relationships and pre-empt potential competitors. The development of efficient transportation and logistics systems on the global scale fueled this process. In 1970s and 80s, routine manufacturing activities started being outsourced to companies in East Asian countries such as Japan, South Korea, Taiwan. With the development of information technology and voice/data communications infrastructure on the global scale, it has become
possible now to outsource routine service activities, such as IT/IS development and business processes, to the companies, both onshore and offshore, that can perform those activities with equal quality but in a much more cost-effective manner.

Figure 1: Offshore Outsourcing Structures