THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2016

PAPER 2.05 – INDIA OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

TIME ALLOWED – 3¼ HOURS

You should answer **FIVE** out of the nine questions: **BOTH** questions from Part A; **ONE** question from Part B; and **TWO** questions from Part C.

Part A questions are worth 25 marks each. Part B questions are worth 20 marks. Part C questions are worth 15 marks each.

You should aim to spend approximately half of your exam time answering Part A, and the remaining half answering Parts B and C. The amount of time you spend answering each question should correspond broadly to the number of marks available for that question.

Start each answer on a new page. If you are using the on-screen method to complete your exam, you must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.

All workings should be made to the nearest month and US Dollar, unless the question requires otherwise.

Marks are specifically allocated for presentation.

PART A

You are required to answer BOTH questions from this Part.

1. Alchemy UK Ltd (Alchemy UK), a company incorporated in the United Kingdom, manufactures telephones that facilitate conference calls among a large number of users. Alchemy UK's phones use proprietary software technology. Alchemy UK's business model consists of selling its phones to markets around the world, using a dedicated sales team headquartered in London. The technology development related to Alchemy UK's conference call enabling features occurs in three distinct stages:

    1) The primary research and development (R&D) work is commissioned in India and is performed by scientists and engineers recruited locally.

    2) The work product received from India is sent to a technological services firm in Jersey, which processes the technology using complex mathematical algorithms and sends the processed product to Alchemy UK.

    3) Alchemy UK performs final customisation and manufacture of its proprietary conference call enabled phones.

    Both the R&D work in India, and the technology processing work in Jersey, require frequent access to information contained in a central software system maintained by Alchemy UK in London.

    Alchemy UK's R&D work in India is conducted by a fully owned subsidiary, Alchemy India Ltd (Alchemy India), whose employees perform research functions relating to the development of telephone exchange technology. Alchemy India is paid an arm's length fee by Alchemy UK for its services. Alchemy India pays access charges to Alchemy UK, in order to receive access to information from Alchemy UK's central software system. The access charges paid by Alchemy India are calculated on a cost basis without any profit markup.

    The technological services performed in Jersey are conducted by Lassnet, a company incorporated in Jersey. For the past five years, Alchemy UK's relationship with Lassnet has been governed by an information supply contract, under which payment is made in Pounds Sterling directly into Lassnet's bank account in Jersey. Lassnet's employees are based in Jersey, and perform all the software processing work in Jersey.

    Alchemy UK also has a fully-owned subsidiary in Hong Kong, Alchemy HK, which makes accessories and back-up components for various types of phone used for conference calling. Alchemy HK uses an unrelated third party, SRK Ltd (SRK), for marketing activities in India. SRK is a start-up company based in Mumbai, and intends to become the pan-Indian marketing arm of major international and domestic telecom companies in India.

    SRK and Alchemy HK have signed an agreement which gives Alchemy HK ultimate managerial control over any Alchemy-related marketing activities in India. SRK cannot make representations or warranties in its dealings with Indian customers without prior approval from Alchemy HK. SRK has also agreed to a confidentiality clause designed to protect Alchemy's proprietary technology. SRK is prohibited from marketing products that compete with products supplied in India by the Alchemy group. However, SRK can work for suppliers of telecom products that do not compete with the products sold by the Alchemy group. The Alchemy account supplies 80% of SRK's revenues; however, this proportion is expected to change once SRK adds other customers to its roster.

    In January 2016, Alchemy UK rationalised its operations by transferring all of its shares of Alchemy India to Alchemy HK for no consideration. Alchemy India has made losses in the last three years.

Continued

1. Continuation

You are required to give the General Counsel of the Alchemy group your responses to the following questions:

1) **Are there any Indian tax implications for Alchemy UK, resulting from the research functions performed by Alchemy India employees?** (5)

2) **Are there any Indian tax implications resulting from the access charges paid by Alchemy India?** (3)

3) **Are there any Indian tax consequences resulting from Alchemy UK's payments to Lassnet?** (6)

4) **Are there any Indian tax implications resulting from the work done by SRK for Alchemy HK?** (6)

5) **Will Alchemy India lose its ability to carry forward and offset its losses after the transfer of Alchemy India shares to Alchemy HK?** (5)

Total (25)

2. Pascal Vector Ltd (PV UK) is a financial investment vehicle incorporated in the United Kingdom and has clients worldwide. PV UK has invested in the Indian stock market since 2010, and is a qualified foreign portfolio investor under the relevant Securities and Exchange Board of India (SEBI) regulations. PV UK, under the SEBI regulations, has appointed a custodian of securities and a designated bank in India. The custodian and the bank perform similar functions for a number of other foreign portfolio investors operating in the Indian stock market. The vast bulk of PV UK's investment in the Indian stock market is in the form of stocks which it has held for more than a year. In 2012, PV UK began selling some of the stocks which it has held for more than one year. PV UK has continued to buy and sell stock on the Bombay stock exchange, and has paid the securities transactions tax on these sales. PV UK has never paid income tax on its sales in the Indian securities market. In 2015, PV UK was served with demand notices from Indian revenue authorities, requesting the repayment of unpaid taxes based on Minimum Alternate Tax (MAT). PV UK did not reply to this notice, on the advice of its accountants in India.

In 2016, PV UK is considering a significant commercial revamp of its Indian operations. It has decided to firm up its presence in the Indian securities market by incorporating an Indian entity (PV India). PV India is intended to function as the Indian arm of the PV group, sourcing local talent from leading management schools to execute its research and sales functions. In mid-2017, in the event that PV India's business shows signs of success, PV UK plans to inject additional equity into PV India of $4 million at a price of $100 per share, with no share premium. At a later point after mid-2018, PV UK would like to sell PV India to a suitable purchaser, if a sufficient offer is received.

PV UK has approached you for advice regarding the following questions:

1) **What steps should PV UK take in relation to the demand notices received from the Indian revenue authorities?** (6)

2) **What Indian tax implications will result from the proposed $4 million capital infusion into PV India?** (3)

PV UK has hired a UK financial advisory firm, Symphony, to advise it on its Indian-related operations. Symphony is a limited liability partnership formed under English law. The associates and principals of Symphony work on issues relating to India, in both the UK and India; most of the work in India is conducted in meetings at venues in Mumbai owned by third parties. In the 2015/16 fiscal year, Symphony's partners have spent a total of four weeks in India. The firm's associates have spent a total of six weeks in India, all of which was spent on financial advisory work.

3) **What are the Indian tax implications of the work performed by Symphony for PV UK?** (6)

PV UK would like to know the most tax efficient manner in which to conduct the proposed sale in 2018 or later, if it decides to sell. Since PV UK does not have a firm timeline in mind, it is open to long-term structural solutions offering tax savings on its exit from the Indian market.

4) **The directors of PV UK have asked you to advise the company regarding possible holding structures, and to comment on the Indian judicial attitude and potential GAAR application to tax planning for exit.** (10)

Total (25)

PART B

You are required to answer ONE question from this Part.

3.

1) **You have been asked to present a paper to a group of experienced international tax consultants, explaining (with examples) the impact of the 2015 Finance Act amendments on the indirect transfer provisions in the Income Tax Act (ITA), delineating the manner in which it differs from the previous legislative provisions.** (10)

2) **You have also been asked to explain the potential impact on Indian tax law, if incorporated into Indian law, of the BEPS provisions relating to:**

   (a) **permanent establishments;**
   (b) **transfer pricing; and**
   (c) **the mandatory dispute resolution of tax disputes.** (10)

Total (20)

4. **You are required to write a memorandum on Indian anti-avoidance measures. Your memorandum is aimed at the Head of Tax Compliance at a United Kingdom-based company looking to invest in India, and should address the following issues:**

1) **The Head of Tax Compliance has learned that Indian judgements on tax avoidance often take their cues from English case law. Do the Indian cases on tax avoidance show that Indian judiciary is prepared to be more aggressive and go beyond the English judicial position?** (10)

2) **With what level of discretion are revenue authorities permitted to act, under the proposed General Anti-Avoidance Rule (GAAR)?** (7)

3) **How would the GAAR interact with Indian tax treaties?** (3)

Total (20)

PART C

You are required to answer TWO questions from this Part.

5. NIFTY UK is a United Kingdom-based business and management information services company that offers services in India. NIFTY UK's operations in India are conducted through its Mumbai office, and NIFTY UK pays all taxes applicable to a foreign company in India. In July 2015, in order to rationalise its operations in India, NIFTY UK incorporated a marketing company in India, whose brief was to help package, customise and sell the information generated by NIFTY UK's Indian office. A 60% share of this entity, NIFTY India, is held by NIFTY UK, with the rest held by its unrelated Indian partner, Vivaad Pvt Ltd (Vivaad). All applicable foreign investment and exchange permissions have been obtained.

In July 2016, NIFTY UK intends to raise additional finance from banks based in Jersey, in order to finance its operations in the UK and Indian markets. In India, NIFTY UK will use a portion of the funds to expand its Indian office workforce as well as to lend on to NIFTY India for its operations. In addition to the loan received from NIFTY UK, NIFTY India plans to raise additional money through the issue of compulsory convertible debentures (CCDs) to NIFTY UK, with the intention that the CCDs might be transferred to the joint venture partners in the future, as Vivaad does not wish to dilute its stake in NIFTY India.

Recently, NIFTY UK has been considering exiting the Indian market altogether, and closing both its India office and NIFTY India. If the exit does occur, NIFTY UK will have the option of creating its business information content in the UK and pay Furlong Satellite Networks (FSN) to transmit Indian business information programmes on its network using FSN's satellite infrastructure. FSN is based in Hong Kong but transmits to customers in India. Alternatively, NIFTY UK may pay Crossbeam Satellite Network (CSN), based in Singapore, for a similar service. A decision on which network to use has not yet been made. From a technical perspective, as well as in terms of reach and advertising prospects, there is little to choose between the two networks. The final decision will therefore be impacted by a tax savings analysis.

You are required to provide the Finance Director of NIFTY UK with answers to the following questions:

1) **What are the tax withholding requirements on the interest payments arising from the loans?** (4)

2) **What are the Indian tax implications of the planned transfer of the CCDs to the Indian joint venture partners?** (4)

3) **What are the Indian tax implications of the proposed payments to FSN and CSN, in the event that NIFTY UK exits from India? Is there a withholding obligation for NIFTY UK?** (7)

Total (15)

6. A United Kingdom-based company has recently begun operations in India though a Bangalore office, and has sought your advice regarding some tax procedure questions. The recipients of your advice are not experts in Indian tax law, although they will have a basic understanding of the subject. You should explain the context in which you discuss the applicable tax provisions, while offering as much detail as possible in your advice.

   1) **Can a non-resident company approach the Authority for Advance Rulings (AAR) on a tax controversy relating to the General Anti-Avoidance Rule (GAAR)? Can the company rely on the AAR's ruling for the tax treatment of other, similar transactions?** (3)

   2) **In a transfer pricing case, does the possibility of a writ petition exist and, if so, on what grounds?** (6)

   3) **If a tax demand applies, can a stay be granted on the recovery proceedings until the Appellate Authority has given its decision?** (6)

Total (15)

7. Agrigator plc (Agrigator), a company headquartered in the United Kingdom, specialises in creating customised software for clients around the world. Agrigator's software consists of a complex series of algorithms that assists its clients, mainly taxi aggregators, in calibrating local taxi services with customer demand in real time. Agrigator provides its customised business software on a secure website, which the clients can access remotely and run the software according to their needs. The Indian clients do not have access to the software source code. Agrigator charges an access fee for the software, which is transferred under an online contract that is signed through an electronic signature by the Indian clients. The server on which the database is held is in the UK.

   In early 2017, Agrigator plans to deepen its engagement in India, while leveraging its software services. Agrigator is at an advanced stage of negotiation regarding a joint venture with Bangalore Super Cabs, an Indian company, for a taxi scheme focussed on the commute of working women that will result in a subsidy from the central government. The subsidy is provided directly by the central government to meet part of the acquisition costs of a fully secure fleet of taxis, fitted with emergency call buttons and sophisticated tracking technology. The joint venture company will be an Indian company. The financial viability of the project depends upon the government subsidy.

   Agrigator's long term plans depend on gaining more visibility in the Indian market, and it is willing to invest in marketing and advertising efforts intended to raise its profile in the urban Indian segment. Accordingly, Agrigator will be one of the major sponsors for the Bangalore Cricket League (BCL).The media rights to BCL are held by Quark Ltd (Quark), a company incorporated in Mauritius. All sponsorship contracts are signed in Mauritius and payments are made in US Dollars at a bank in Mauritius. Agrigator will pay Quark $2 million for its name and logo to be displayed prominently on the BCL Cup. Other than the holding and transfer of media rights, Quark does not conduct any other activities.

   You are required to answer the following questions:

   1) **Is the sale of Agrigator's software in the 2015/16 financial year subject to Indian income taxation?** (5)

   2) **Is the central government subsidy, assuming it is granted, subject to Indian Income Tax?** (4)

   3) **Is the payment by Agrigator to Quark subject to Indian Income Tax? Is there a withholding obligation for Agrigator?** (6)

Total (15)

8. The Sigma group, a leader in call centre services, has a holding company in the United Kingdom and subsidiaries in India and the Philippines. The Indian subsidiary, Sigma India, was set up in December 2015 with a small amount of capitalisation. The Sigma group has gained a significant reputation for its call centre business in Europe and the United States, and is confident that its Indian venture will be profitable in the near future because of its legacy clientele.

Your advice is sought on the assumption that Sigma India will build up significant cash reserves in the future. The Sigma group seeks to determine the most tax efficient manner in which the distributable profits of the Indian business can be repatriated to the UK. It is proposed that any future cash infusion into Sigma India should be in the form of compulsory convertible debentures (CCDs), which would subsequently be redeemed.

You are required to answer the following questions:

1) Will the redemption of the CCDs have any Indian tax consequences? (5)

2) If the repatriation instead occurs through a share buyback, can a buyback by Sigma UK be subject to Indian taxation? (5)

3) If Sigma India pays a dividend to Sigma UK, can Sigma UK receive a tax credit for the Indian tax paid on the dividend? (5)

Total (15)

9. Menset Ltd (Menset) is a company headquartered in India, and is the parent company of Truebill Ltd (Truebill), based in Mauritius. Truebill acts as the financial clearing house for Menset and its subsidiaries worldwide. Most of its income is derived from interest on loans to group companies, as well as investments in the securities markets worldwide. Menset has appointed its director, Mr Kumar, as the person in charge of the group's Mauritius operations. Truebill and Menset have entered into a management services agreement, under which Menset has agreed to provide strategic business advisory services to Truebill for an arm's length fee.

Truebill has nine members on its board of directors, four of whom are based in India. None of the four directors based in India work for Menset in any capacity. Of the remaining five directors, three are lawyers based in Mauritius and two are based in the United Kingdom. The Chairman and Managing Director are Mauritius residents. Truebill holds meetings in Mauritius twice per year. However, throughout the year Menset, through Ravi Kumar, provides strategic business advice to Truebill. To date, all of Menset's strategic advice has been followed by Truebill, although the management services agreement contains a clause granting Truebill directors the unconditional right to reject any advice given by Menset which they deem to be illegal or improper.

You are required to comment on whether Truebill will be considered resident in India under the Income Tax Act 1961, assuming that the Income Tax Act (ITA) provisions on Place of Effective Management (POEM), and any draft guidelines issued under these provisions, are applicable. (15)