

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2017

PAPER 2.05 – INDIA OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

TIME ALLOWED – 3¼ HOURS

This paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **One** question from **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

Further instructions

- All workings should be made to the nearest month and in Indian Rupees (INR), unless otherwise stated.
- Start each answer on a new page and clearly indicate which question you are answering. 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.
- Marks may be allocated for presentation.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering Parts B and C.
- The first 15 minutes of the exam consists of reading time. You will be allowed to annotate the question paper during this time; however, you will **not** be permitted to start writing or typing your answer, or use a calculator. The Presiding Officer will inform you when you can start answering the questions.

For your information this paper includes:

- **Appendix: Agreement between India and Ireland for the Avoidance of Double Taxation (Article 5: Permanent Establishment)**

PART A

You are required to answer BOTH questions from this Part.

1. Techeve Pvt Ltd (Techeve India) is an Indian private limited company which provides data services for the financial sector, to clients situated around the world. Set up in June 2013, Techeve India achieved great success within its first two years due its development of an innovative and very effective proprietary algorithm. In January 2015, Techeve India's two founders began funding discussions with venture capital investors in the US and in India. At this point, Techeve India's revenues had doubled each quarter for four quarters running.

The best investment offer was from a California-based venture capital firm, Plumeria. However, Plumeria agreed to invest in Techeve India only if the company completed a corporate externalisation; they were concerned that Indian exchange control regulations would limit their exit options if they invested directly in Techeve India. The corporate externalisation involved "flipping" the entity structure, whereby a non-Indian entity would be set up as the parent of Techeve India, and the shareholding of Techeve India would be mirrored at the offshore level.

1 April 2015: Corporate externalisation

The founders of Techeve India deliberated over the option before agreeing to restructure, as they anticipated that non-Indian markets would form 30% of their market base in 2020.

On 1 April 2015 the Techeve India founders set up a Hong Kong-based entity (Techeve HK) in which they each held a 50% shareholding.

The founders then transferred 100% of the shares in Techeve India to Techeve HK. Plumeria invested US\$5 million into Techeve HK, following which the shareholding structure was as follows: Plumeria (40%); Founder 1 (30%); Founder 2 (30%). Most of Techeve HK's value is derived from the shares of Techeve India.

Following the investment, Plumeria was entitled to appoint a nominee director but did not do so until 1 March 2016.

Techeve India also assigned the non-India rights to all IP (including the proprietary algorithm) to Techeve HK, to enable Techeve HK to enter into distribution and licence agreements with non-Indian customers. One of these customers is a large Hong Kong-based bank (HKB Finance), which licenses the algorithm from Techeve HK to develop its own internal software, which it then uses to improve internal processes. Most of Techeve HK's income derives from this client. HKB Finance has no Indian branches. It does have some Hong Kong-resident of customers of Indian origin, many of whom own Indian assets.

1 April 2015 – 29 February 2016

For a period of almost one year following the corporate externalisation, the founders were the only directors of Techeve HK. They attended board meetings remotely from India unless they were travelling, in which case they attended from the US.

Founder 1 acted as the chief executive officer (CEO) of Techeve India and Founder 2 acted as Techeve India's chief operations officer (COO). Neither founder had an operational role in relation to Techeve HK.

Techeve HK has only one employee – a secretary, Mrs Jang, whose responsibility is to receive mail and handle the administrative aspects of the company.

Continued

1. Continuation

1 March 2016 onwards

On 1 March 2016, Mr Andrews, a US resident and citizen, was appointed to the Techeve HK board by Plumeria, as a nominee director. Since this date, board meetings have been held in the Techeve India office, with Mr Andrews dialing in from the US. Founder 1 has a casting vote on the board.

Founder 1 continues to be the CEO of Techeve India and Founder 2 continues to be the COO of Techeve India.

Mrs Jang remains the only employee at Techeve HK.

In February 2017, the Techeve India auditor raised a concern regarding whether Techeve HK is, or has ever been, tax resident in India, and whether Techeve HK's income from HKB Finance has been or should be taxable in India.

You are required to provide the Techeve founders and investors with your responses to the following questions:

- 1) **Should Techeve HK be considered resident in India for the period:**
 - a) **from 1 April 2015 to 31 March 2016; and**
 - b) **after 1 April 2016?**

(15)
 - 2) **What would be the tax consequence of being considered Indian resident, and what measures may be taken to avoid such a scenario?**

(5)
 - 3) **Depending on the response to (1), whether Techeve HK's income from HKB Finance should be taxable in India for the following periods:**
 - a) **from 1 April 2015 to 31 March 2016?**
 - b) **after 1 April 2016?**

(5)
- Total (25)

2. Nostradamus Investments (NI) and Socratik Equity (SE) are two United Kingdom companies that invest in unlisted Indian technology companies through a Mauritius company, India Bulls (IB), in which each holds an equal share. IB was incorporated on 1 June 2016, and has invested in Indian companies regularly since its incorporation. IB's investment portfolio is not expected to exceed fifteen Indian companies in total.

IB has a consultancy agreement with Nitesh Kulkarni Associates (NKA), an Indian securities consultancy based in Mumbai. NKA provides non-binding advice to IB on those Indian companies which are good candidates for private equity investment. IB has also appointed Kotak India (KI) as their local Indian custodian, as per SEBI norms. IB is scheduled to liquidate in 2022, or earlier if it disposes of all of its substantial investments.

IB's investment in Indian companies occurs through a mixture of ordinary equity and compulsorily convertible debentures (CCDs). At any point in time, IB plans to own between 10% and 25% of the equity in each of its portfolio companies. IB expects to receive periodic dividends from the companies in which it invests. From time to time, depending on market conditions, IB will divest itself of some its equity shares (including equity shares that were converted from debentures) and retain the gains, if any. There are no immediate plans to repatriate gains to NI and SE. However, IB expects that it will pass on the dividends it will receive to NI and SE. It is expected that NI and SE will either redeem their interests in IB in 2022 or sell their interests in IB to a buyer resident outside India.

You are required to answer the following questions presented by IB's general counsel:

- 1) **What will be the tax characterisation of the gain, if any, of the sale of equity holdings by IB? Will such a gain be subject to Indian income taxation, disregarding issues relating to Minimum Alternative Tax (MAT)?** (6)
- 2) **Is there a possibility of IB being subject to MAT on the gains, if any, of the sale of its equity holdings?** (5)
- 3) **Will there be Indian tax exposure for NI and SE when they receive dividends from IB?** (3)
- 4) **Will NI and SE be subject to Indian income tax on the proposed redemptions or sales?** (4)
- 5) **Are there any reporting requirements on the Indian companies in which IB has invested, in the event that IB transfers its shares in the Indian companies?** (3)
- 6) **What would be the Indian tax consequences if IB were to transfer its compulsorily convertible debentures (CCDs) in one of its portfolio companies to one or more of the other shareholders?** (4)

Total (25)

PART B

You are required to answer ONE question from this Part.

3. Mahaan Ltd (MH India) is an Indian company that manufactures cricket bats, using a patented willow modification technology that improves the durability of cricket bats and enhances its aesthetic appeal. MH India sells its products in markets worldwide, including sales to the United Kingdom. For its UK sales, MH India has entered into a marketing arrangement with KitSports (KS UK), a UK-incorporated firm. MH India has hired KS UK because of KS UK's unique ability to liaise with cricket clubs in the UK and explain the technical and aesthetic qualities of bats manufactured by MH India. The agreement between MH India and KS UK contains the following clauses:

KS UK will represent MH India in explaining the qualities, technical details, and other attributes of bats manufactured under MH India's patented technology to UK consumers with a view to educating the consumer cricket market and enhancing the reach of the MH brand in the UK.

KS UK charges MH India commissions for orders canvassed by KS UK. KS UK receives orders in the UK and sends the orders to MH India for approval. Once the order is approved, the export commission is paid to KS UK.

MH India uses Logik HK, a Hong Kong company, for logistical support in its worldwide operations, which includes services such as transport, procurement, customs clearance, sorting, delivery and warehousing. MH India pays Logik HK for its services by crediting Logik HK's Hong Kong bank account directly in HK dollars.

MH India has begun a review of its business model for the UK market. One option on the table is for MH India to license its technology to third party cricket manufactures (TPMs) based in the UK. The licensing agreement between MH India and the TPMs would be signed in the UK, and the payment would be made in pounds sterling directly into MH India's UK bank account. The TPMs would use MH India's technology for the bats that they manufacture. The cricket bats would be sold to consumers in the UK under contracts signed between the TPMs and the UK consumers, with both the signing of the sales contracts as well as payments occurring outside India.

Another option is for MH India is to incorporate a subsidiary (MH UK) in the UK to sell its patented bats. MH UK will operate the outlet shop, own the associated land and building, and employ and pay the relevant personnel.

You have been asked the following questions by MH India's legal counsel:

- 1) **What are the Indian income tax consequences, if any, of the export commission payments to KS UK? Is MH India under an obligation to withhold taxes on this payment?** (5)
- 2) **What are the Indian tax consequences, if any, of payments to Logik HK? Is MH India under an obligation to withhold taxes on this payment?** (5)
- 3) **What are the Indian tax consequences for MH India, if any, of:**
 - a) **MH India licensing its patented technology to TPMs; and**
 - b) **TPMs selling bats using this technology to UK consumers?** (5)
- 4) **If MH India wishes to own MH UK directly, what might be the possible Indian tax consequences in terms of receipt of dividends from MH UK? In particular, when dividends received from MH UK are taxed by India, is there a tax credit available in India for taxes paid by MH UK to the UK on its corporate profits? What might be the possible Indian tax consequences if there is a future sale by MH India of its shares in MH UK?** (5)

Total (20)

4. Soukmagic is a company incorporated in Ireland. Its primary operation is a website which facilitates the online sale and purchase of goods on a business-to-customer or customer-to-customer basis.

Soukmagic users are charged a listing fee for hosting products on the platform. This fee is only applicable upon a successful sale via Soukmagic. Users have the option to pay a higher listing fee if they would like to be displayed more prominently on the platform, which is also payable only if the product is sold. The listing process involves no technical oversight or advice from Soukmagic, and is entirely user initiated and automated. Users are able to reach out to Soukmagic customer support if they have any questions.

Users may also purchase advertisement space on the global Soukmagic portal to highlight their goods. Soukmagic's records show that advertising space is only purchased by Indian resident users.

Soukmagic has a subsidiary in India, Souk India Pvt Ltd (Souk India), which provides the following services to Soukmagic and its customers:

- Customer care to its Indian users;
- Assistance with payment collection for Soukmagic in India; and
- Marketing support to Soukmagic for its global operations. This involves providing data relating to the Indian market.

Souk India is paid for all these services on an arm's length basis and pays taxes on its income in India. Souk India employs over 900 employees and plans to hire 600 more over the course of the next five years. Soukmagic has no other presence in India.

The details of the group's income in the 2017/18 accounting year are as follows:

- Souk India's income amounts to INR 3 million. This income derives from services provided to Soukmagic under an outsourcing services agreement.
- Listing fees paid online by Indian payers to Soukmagic total INR 12.5 million, which is paid to Soukmagic without any deductions being made.
- Online sales of advertisement space by Soukmagic to Indian payers amount to INR 2.5 million, which is paid to Soukmagic without any deductions being made.

Soukmagic files a nil return for the 2017/18 accounting year.

Soukmagic's global CFO has asked your opinion regarding the Indian tax consequences of the following revenue sources:

- | | |
|--|------------|
| 1) Soukmagic's listing fees. | (10) |
| 2) The sale of online advertising space. | (10) |
| | Total (20) |

Note: The Double Taxation Agreement (DTA) between India and Ireland has the following definition for technical services:

The term "fees for technical services" means payment of any kind in consideration for the rendering of any managerial, technical or consultancy services including the provision of services by technical or other personnel but does not include payments for services mentioned in Articles 14 and 15 of this Convention.

PART C

You are required to answer TWO questions from this Part.

5. Alpha and Beta are tax resident in the republic of Ploomeria. Keen to be part of the Indian growth story, they decide to set up a Singapore-based limited liability partnership (Singapore LLP) to make investments into listed securities in India. The features of the Singapore LLP are similar to those of an Indian limited liability partnership. Further, Alpha and Beta are solely responsible for the control and management of the Singapore LLP and take all management decisions in Ploomeria.

In the 2016/17 accounting year, the Singapore LLP earns income in the form of dividends and capital gains from shares sold on the stock exchange. The shares were held by the LLP for varying lengths of time, some for less than twelve months and others for more than twelve months, and the Singapore LLP paid securities transaction tax on all sales.

Singapore counsel has confirmed that the Singapore LLP should be treated as tax transparent in Singapore.

You are required to provide your opinion on the following questions:

- 1) **Would the Singapore LLP be considered non-resident in India?** (5)
- 2) **Would the Singapore LLP be allowed the benefit of the India-Singapore tax treaty?** (5)
- 3) **What should be the treatment of the dividend income, long term capital gains and short term capital gains received by Singapore LLP?** (5)

Total (15)

6. Luca Bertolli is UK-resident and a senior manager at an Italian car company, VelocitAuto (VA). VA decides to set up a manufacturing and R&D unit in India, following which Luca is seconded to the Indian entity for six months between May and November 2016. Luca's salary is paid by VA from outside India, with only 40% being sent into the Indian account for day-to-day expenses. After his return to the UK, Luca does not receive any further funds in India. He shuts down his Indian account and repatriates all monies back to his UK account.

Luca would like to ensure that he is compliant with any requirements of Indian tax law.

You are required to answer the following questions:

- 1) **Is Luca taxable in India on his employment income during the secondment period?** (8)
- 2) **Is Luca taxable in India on his worldwide income for the 2017/18 accounting year?** (7)

Total (15)

7. Vector UK, a UK based mobile phone manufacturer, is a parent company in the Vector group and operates through wholly owned subsidiaries in various markets, including India where it operates through Vector India.

Vector India is planning a brand-building exercise in 2017 which will involve advertising expenditure as it promotes its recent innovations in mobile technology. The advertising is planned to encompass a variety of media platforms, including online advertising. Vector India expects to generate sufficient income in 2017 to absorb the expenses incurred in this marketing exercise.

As part of the brand-building exercise, Vector will sponsor the National Badminton Championships (NBC) held annually in New Delhi. The media rights to the NBC are held by Glango Ltd, a company incorporated in the UK. All sponsorship contracts are signed in the UK and payments are made in pounds sterling at a UK bank. Vector India will pay Glango Ltd US\$4 million for the NBC to be named the Vector National Badminton Championship. Other than the holding and transfer of media rights, Glango Ltd does not have any additional activities in the UK or elsewhere.

Vector UK plans to send two of its employees to the Vector India offices for quality control purposes. Vector UK's employees will spend five months in India during the 2016/17 financial year, to ensure that the Vector India R&D facilities meet industry standards. During their time in India, Vector UK's employees will be paid by Vector UK and they will work out of Vector India's offices.

The Vector group's chief tax counsel has asked you the following questions:

- 1) Will Vector India's brand-building exercise have any transfer pricing implications, for Indian tax purposes? (5)**

- 2) Are there any Indian tax consequences resulting from the sponsorship payment to Glango Ltd? Is Vector India required to withhold tax on this payment to Glango Ltd? (5)**

- 3) Are there any Indian tax implications for Vector UK resulting from the quality control work performed by Vector UK employees in India? (5)**

Total (15)

8. Platinum India is an Indian company that is owned 100% by its parent, Platinum France, and is funded through a mixture of equity and debt, both of which are supplied primarily by Platinum France. Platinum India performs high end, customised software research for several clients worldwide.

Platinum India has entered into a management services agreement with Platinum France, under which Platinum France will provide overall supervision and monitoring of Platinum India's deliverables. The work done by Platinum France would not involve any training of Indian personnel, nor does it involve any time spent by its personnel in India.

The Double Taxation Agreement (DTA) between India and France has the following definition for technical services:

The term "fees for technical services" as used in this Article means payments of any kind to any person, other than payments to an employee of the person making the payments and to any individual for independent personal services mentioned in Article 15, in consideration for services of a managerial, technical or consultancy nature.

The DTA between India and France has a Most Favoured Nation Clause.

You are required to answer the following questions:

- 1) Are there any Indian tax consequences (including the application of GAAR provisions), if a foreign company funds its Indian subsidiary through a substantially greater proportion of debt than equity? (6)**
- 2) Will the payments to Platinum France be subject to Indian income taxation as fees for technical services? (9)**

Total (15)

9. **Do the GAAR legislative provisions expand or reduce the scope of the anti-avoidance principles laid down by the Indian Supreme Court in the *McDowell*, *Azadi Bachao Andolan* and *Vodafone* cases? (15)**

Appendix

Agreement between India and Ireland for the Avoidance of Double Taxation (Article 5: Permanent Establishment)

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
2. The term "permanent establishment" includes especially:
 - a) a place of management;
 - b) a branch;
 - c) an office;
 - d) a factory;
 - e) a workshop;
 - f) a mine, an oil or gas well, a quarry or any other place of extraction or exploration of natural resources;
 - g) an installation or structure used for the exploration or exploitation of natural resources;
 - h) a sales outlet;
 - i) a warehouse in relation to a person providing storage facilities for others; and
 - j) a farm, plantation or other place where agricultural, forestry, plantation or related activities are carried on.
3. A building site or construction or assembly project or supervisory activities in connection therewith constitute a permanent establishment only if such site, project or activity last more than six months.
4. An enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if it provides services or facilities in connection with, or supplies plant and machinery on hire used for or to be used in, the prospecting for, or extraction or exploitation of mineral oils in that State.
5. Notwithstanding the previous provisions of this Article, the term "permanent establishment" shall be deemed not to include:
 - a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
 - b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
 - c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
 - d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information for the enterprise;
 - e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

- f) the maintenance of a fixed place of business solely for any combination of activities mentioned in sub-paragraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.
6. Notwithstanding the provisions of paragraphs 1 and 2, where a person - other than an agent of an independent status to whom paragraph 8 applies - is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:
- a) has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 5 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or
 - b) has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise; or
 - c) habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise itself or for the enterprise and other enterprises controlling, controlled by, or subject to the same control as that enterprise.
7. Notwithstanding the preceding provisions of this Article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 8 applies.
8. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, if the activities of such an agent are carried out wholly or almost wholly for the enterprise and the conditions made or imposed between them in their commercial and financial relations differ from those which would have been made or imposed if this had not been the case, that agent shall not be considered to be an agent of an independent status for the purpose of this paragraph.
9. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.