THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2015

PAPER 2.05 – INDIA OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

TIME ALLOWED – 3¼ HOURS

- You should answer **FOUR** out of the seven questions.
- Each question carries equal marks.
- Start each answer on a new sheet of paper. 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.

1. Azura UK Ltd (Azura UK) is a UK incorporated company that makes polymer cables for the transport industry. Azura UK owns wholly owned subsidiaries in India (Azura India) and Hong Kong (Azura HK). Azura UK has entered into a contract with Diplock Ltd, a company incorporated in the Cayman Islands, under which Azura UK has undertaken to manufacture the latest state of the art polymer cables for supply to Diplock.

In order to complete the Diplock order, Azura UK has to conduct complex technological research into the strength of its polymer cables. Azura India has been chosen to conduct this research using its own employees and lab facilities in Bangalore. In return for this research, Azura India will receive arms-length compensation from Azura UK. In September 2015, Azura UK plans to inject equity into Azura India to the extent of $5 million, to ensure that the research operations of Azura India are sufficiently funded.

Azura UK will also send two of its senior professionals to Bangalore for sixteen weeks during the 2015-16 financial year, to ensure that the Bangalore lab facilities are secure and compliant with the relevant quality standards required for such research. In addition, Azura HK will depute one of its senior employees to work in Bangalore for the same time period and perform the same functions as those undertaken by the Azura UK professionals. The Azura UK and Azura HK employees will continue to receive salaries from their respective employers during their time in India. Both sets of employees have entered into tax equalization agreements with their respective employers.

To conduct the scientific research, Azura India needs access to Silicasoft, a technical software application. Silicasoft will then be modified by Azura India's engineers for their needs. Silicon Technology Ltd (STL), a company incorporated in the United Kingdom, produces and markets Silicasoft worldwide. Azura India plans to purchase Silicasoft from STL. Silicasoft is digitally transferred to STL's customers with a license agreement, signed and concluded online on a UK-based server. The license agreement allows Silicasoft customers to download Silicasoft to their computers and make a backup copy. Customers are prohibited under the license agreement from making copies of Silicasoft other than the backup copy, and from transferring Silicasoft to any other person.

One of Azura India's employees, Mr Harishankar Desai, was given stock options in July 2012 to buy 1,000 shares in Azura India at the end of the vesting period of three years. Mr Desai would like to exercise his options (i.e. convert his options into Azura stock) as soon as they vest in him in July 2015, and then sell his Azura stock soon after. Azura India's shares are not traded on a public exchange. Mr Desai lives in Bangalore and has spent 90% of his time in Bangalore in each of the past ten years.

You are required to give Azura your responses to the following questions:

1) **Are there any Indian tax implications for Azura UK resulting from the research functions performed by Azura India employees, or the work conducted by the Azura UK and Azura HK employees?** (6)

2) **What are the Indian tax consequences of the additional capital subscription in Azura India by Azura UK?** (3)

3) **What are the Indian tax implications of the salaries received by the Azura UK and Azura HK employees, and of the tax equalization agreements?** (5)

4) **Would the sale of Silicasoft be subject to taxation in India? Does Azura India have any withholding obligations with respect to this purchase?** (4)

5) **What would be the Indian tax consequences of (a) the grant of stock options to Mr Desai in July 2012, (b) The vesting of the stock options in Mr. Desai in July 2015, c) The exercise by Mr Desai of his options (to convert his stock options into Azura stock) in July 2015 and (d) the sale of Azura stock by Mr Desai soon after the exercise of his options?** (7)

Total (25)

2. The Raven Vector Group (RV Group) provides global financial advisory services in the areas of credit research, risk measurement and risk planning. The RV Group consists of a holding company in the United States (RV USA), and subsidiaries in the Cayman Islands (RV Cayman) and the United Kingdom (RV UK). The RV Group management is seeking to invest in India by acquiring a suitable financial advisory business. Two potential Indian targets are Armaan Research India Ltd (Armaan RI) and Armaan Analytics India Ltd (Armaan AI). Armaan RI undertakes financial research that is outsourced from investment banks and the corporate finance divisions of companies. Armaan AI performs complex financial data analysis for clients interested in risk management and risk planning.

The two Indian companies are part of the Armaan Group, which has a holding company in Jersey (Armaan Jersey). Armaan Jersey owns a subsidiary in Mauritius (Armaan Mauritius). Armaan Mauritius owns Armaan RI and a subsidiary in the United States, Armaan US, Inc. (Armaan US). Armaan US owns Armaan AI. The corporate structure of the Armaan Group has developed in this manner as a result of acquisition history and commercial convenience. Armaan Jersey traditionally makes its acquisitions and exits though Mauritius. While Armaan Mauritius acquired Armaan RI in 2006, Armaan US was acquired in 2008 for its workforce skills in analytics and data analysis. It was then decided in 2010, for management related reasons, that Armaan US should acquire and control Armaan AI. In terms of net asset values worldwide, Armaan RI holds \$20 million, Armaan AI holds \$10 million, Armaan Mauritius owns \$30 million and Armaan US owns \$35 million. Armaan Jersey's assets are not significant for tax purposes.

60% of Armaan Jersey is owned by Mr Mahesh Kashyap, a UK resident, and the remaining 40% by Mr Ridley Bingham, also a UK resident. In negotiations between the RV Group and the Armaan group (led by Mr Kashyap), it transpired that the RV Group seeks 100% ownership, whether direct or indirect, of Armaan RI and Armaan AI for operational reasons. For regulatory and operational reasons, the RV Group would like to own the two Indian business through different entities. The RV Group also seeks a substantial stake in the holding company, Armaan Jersey. Mr Bingham does not want to sell his shares in Armaan Jersey, but has no objections to Mr Kashyap selling his shares.

To address the commercial considerations discussed above, the proposal currently being considered is for the transfer of the Indian businesses to occur through three transactions. The first transaction (Transaction 1) would comprise the sale of Armaan RI shares by Armaan Mauritius to RV Cayman Islands. The second transaction (Transaction 2) would comprise the sale of Armaan US shares by Armaan Mauritius to RV UK. The third transaction (Transaction 3) would comprise the sale of Mr Kashyap's Armaan Jersey shares to RV USA. The proceeds from Transaction 1 and Transaction 2 will be distributed by Armaan Mauritius to Armaan Jersey, which in turn will distribute the proceeds proportionately between Mr Kashyap and Mr Bingham.

You are required to provide advice to Mr Kashyap, the lead negotiator for Armaan, regarding the following:

1) **Assuming that the sequential sales transactions are treated as such under Indian tax law, would any Indian tax implications result? Mr Kashyap seeks to protect himself where possible against Indian tax exposure.** (7)

2) **Assuming that the sequential sales transactions are treated as such under Indian tax law, would any Indian tax implications result from the dividends being sent upstream by Armaan Mauritius and Armaan Jersey?** (5)

3) **Would the sequential sales transactions be considered as a tax avoidance device by the Indian authorities?** (7)

4) **If the sequential sales were to be subject to Indian GAAR rules, would there be any additional Indian tax consequences?** (6)

Total (25)

3. Cruishank Links Ltd (CL), a UK resident company, and Sundar Projects (SP), an Indian resident company, are in negotiations with Vikram Remington Ltd (VR), an Indian resident company, to build a hydrocarbon plant near Hyderabad on a turnkey basis (meaning that the plant is to be supplied to VR as complete). The contracting parties expect construction of the plant to take four years. CL and SP have presented themselves to VR as a consortium, and will bring different functions and capabilities to the project. CL, a leading manufacturer of heavy machinery, will manufacture and supply the plant and machinery for the project, and provide the engineering designs and technical specifications required for the machinery's correct and safe use. SP will provide technical and support services to the project, and will organise installation and commissioning of the plant and machinery in India. The project will be funded by Indian and UK banks under a composite multicurrency facility. CL will utilise part of the funding to purchase parts from third party vendors for the plant and machinery.

In accordance with industry practice, VR will sign a single contract with the consortium and the specific functions and tasks of CL and SP as mentioned above will be laid out in the appendices. A separate payment schedule for each of the tasks of CL and SP will be included in the contract, and CL and SP will be paid separately for the completion of their respective tasks.

During the negotiations, VR has insisted on the following conditions which, as VR is in a strong negotiating position, will be difficult for CL and SP to oppose (although VR is willing to be flexible in instances where the tax stakes are high):

1) CL and SP are to be severally and jointly liable (including liquidated damages) for all deliverables on the project. The consortium will have to provide a performance guarantee covering all deliverables.

2) VR would like the consortium to nominate a project director after the equipment from the United Kingdom has reached India. The project director will hold overall responsibility for the implementation of the project. The project director will report to a panel of members nominated by both CL and SP.

3) A single, comprehensive insurance policy is to be taken out, to cover risks to the project.

4) All risk relating to the consignment of the equipment from the UK is to be with CL. VR is to perform acceptance tests after the equipment has been supplied to India. Upon successful completion of the acceptance tests, title to the machinery will pass to VR and installation work will begin.

You are required to advise the group finance director of CL on the following issues:

1) **CL has learnt that Indian tax law can subject an 'Association of Persons' (AOP) to taxation. CL would like you to explain the circumstances in which a group of persons acting together can be classified as an 'Association of Persons'.** (5)

2) **Is there a risk that CL and SP will be classified as an AOP under Indian tax law, considering the proposed contractual structure?** (5)

3) **If CL and SP are to be classified as an AOP, what Indian tax consequences will result for CL?** (4)

Continued

3. Continuation

4) **If CL and SP are not classified as an AOP, will CL be subject to tax in India for either the supply of machinery or providing the engineering design and technical specifications? In particular, CL is concerned about the proposed contractual provision regarding the transfer of title to the machinery, and seeks advice on re-negotiating it to avoid adverse tax consequences.** (7)

5) **Would CL have to withhold Indian tax on the interest in respect of its borrowings?** (4)

Total (25)

4. Lainlyn Ltd, a UK resident company, seeks to acquire an Indian company. Lainlyn would like to have a clear idea about the manner in which share acquisitions and shareholder-company transactions are taxed in India. You have been asked to prepare a detailed memorandum of law for the general counsel of Lainlyn on the following questions:

1) **Are there any additional Indian tax consequences (including the application of GAAR provisions, assuming that GAAR is operational) if a UK company funds its Indian subsidiary through a substantially greater proportion of debt than equity?** (5)

2) **What are the Indian tax consequences of the Indian subsidiary buying back shares from its UK parent company?** (4)

3) **What are the Indian tax consequences of a UK parent company transferring the shares in its Indian subsidiary (for nil consideration) to another subsidiary in a foreign jurisdiction (Foreign Sub)? Discuss the issue from the perspectives of both the UK parent and Foreign Sub.** (5)

4) **What are the Indian tax consequences of a UK company transferring the shares in its Indian subsidiary to an unrelated company in a foreign jurisdiction for consideration? What are the consequences if shares in the Indian subsidiary are held through a holding company in Mauritius, and the Mauritius company transfers the shares in the Indian subsidiary to an unrelated company in a foreign jurisdiction for consideration?** (6)

5) **What are the Indian tax consequences of the Indian subsidiary issuing compulsorily convertible debentures (CCDs) to its UK parent, in terms of the future transfers of the CCDs by the UK parent to other shareholders, if any, in the Indian subsidiary?** (5)

Total (25)

5. Thadhak Ltd (TH India) is an Indian company that manufactures cabinet keys and stainless steel locks, and sells its products globally. TH India has a wholly owned subsidiary, TH UK, in the United Kingdom. TH UK is profitable and intends to declare dividends during the 2015-16 financial year. TH UK has three divisions that play different roles in TH India's global business.

The first division is concerned with export promotions for the European market (excluding the United Kingdom), and charges TH India export commissions for orders canvassed by the employees of TH UK. The TH UK employees canvass orders and send the orders to TH India for approval. Once the order is approved by TH India, the export commission is paid to TH UK.

The second division is concerned with inspection, testing and certification (ITC) services for the products manufactured by TH India. TH India's products have to go through three stages before they can be sold in the European market. The products are inspected by qualified professionals, tested in laboratory conditions for their strength and reliability, and their product capabilities are verified by independent certifiers. The ITC services division arranges for all three services by paying third party service providers and monitoring their work. TH UK charges a fee to TH India for the arrangement of these services. The fee includes the payments made to the third party service provides and a mark-up for the supervisory and monitoring work done by TH UK.

The third division operates an outlet shop in the United Kingdom selling TH India branded products to customers in the United Kingdom.

Over the course of a review of its international operations in 2015, TH India decides to rationalize its operations by designating TH Singapore as the holding company for TH UK. TH Singapore was incorporated in April 2015. TH India will continue to hold all shares in TH Singapore. TH India’s decision to hold TH UK shares through TH Singapore was taken because the TH India management considers TH Singapore to be the best entity to execute its exit options should it choose to divest its investment in the United Kingdom. In July 2015, TH India intends to transfer all shares in TH UK to TH Singapore for no consideration. TH India has entered into negotiations with a US buyer to sell TH UK. If the negotiations go well, TH Singapore is expected to sell its stake in TH UK to the US buyer by the end of 2015. For the financial years 2015-2016, TH Singapore is expected to incur an expenditure of $40,000, mainly in the form of legal and accounting expenses. A majority of TH Singapore’s board members are resident legal and financial professionals in Singapore.

You are required to present a paper to TH India's finance director, answering the following questions:

1) **Are there any Indian tax consequences resulting from the export commission earned by TH UK?** (4)

2) **Are there any Indian tax consequences resulting from the fee payments to TH UK for the ITC services?** (4)

3) **What are the Indian tax consequences, in terms of receipt of dividends from TH UK? In particular, when dividends received from TH UK are taxed by India, is a tax credit available in India for taxes paid to the United Kingdom by TK UK on its corporate profits?** (5)

4) **What are the Indian tax consequences of the transfer by TH India of its shares in TH UK to TH Singapore?** (6)

5) **If TH Singapore sells its stake in TH UK by the end of the year, will any Indian tax implications result from this sale?** (6)

Total (25)

6. Global Cables (GC) is a leading UK company in the manufacture, installation and assembly of steel suspension cables and heavy machinery for infrastructure projects. GC has entered into a contract with Goa Port Development (GPD), an Indian company, for the installation and construction of jetties and associated port equipment. While GC will supply the machinery (the title to the machinery will pass outside India), GC has subcontracted, with GPD's consent, the installation and assembly part of the work to an Indian company, India Cables (IC). IC has considerable expertise in the Indian port sector and has acted as a sub-contractor on numerous Indian port projects. The contract between GC and IC provides that IC will employ its own personnel, will be responsible to GC for its part of the project, and will supervise its portion of the work. However, GC's contract with GPD provides that GC will be responsible for the successful completion of the overall execution of the project. GC plans to send two of its employees to Goa for two months in the 2015-16 financial year to ensure the completion of the project.

GC has also entered into a contract with another Indian company, Mumbai Petro Ltd (MP), for the installation of suspension bridges and underwater cables relating to oil exploration off the coast of Mumbai. GC entered into preliminary negotiations with MP in April 2015 and began preparatory work in May 2015. The preparatory work includes surveys and project due diligence that will continue until October 2015. GC will send its personnel over to Mumbai in the months of November and December 2015, to supervise the installation work.

GC intends to enter into a contract with Mr Silverman, a Jersey tax resident who has considerable expertise in the petroleum industry. Mr Silverman will consult on GC's contract work for MP. The contract between Mr Silverman and GC will terminate in 2018. Under the agreement, which will be concluded in the UK, an annual fixed consultancy fee to Mr Silverman will be made from the United Kingdom directly to Mr Silverman's bank account in Jersey. If the contract with Mr Silverman is terminated early by GC, Mr Silverman will receive a lump sum by way of compensation. The termination sum will be paid by GC directly into Mr Silverman's Jersey account.

GC is considering subscribing to OilWrite, an online subscription service based in the United Kingdom. Regular updates of OilWrite are accessed by OilWrite's customers via OilWrite's UK-based website. OilWrite collates information on best practices in the global petroleum construction industry. OilWrite utilises a software program which converts publicly available information on the petroleum construction industry into spreadsheets and interactive graphs, enabling professionals in the industry to keep abreast with changing business practices.

You are required to provide your opinion regarding the following questions asked by the finance director of GC:

1) Does GC have a potential Indian tax exposure relating to the work done for GPD? (4)

2) Does GC have a potential Indian tax exposure relating to the work done for MP? (5)

3) How will the proposed annual payments to Mr Silverman be treated under Indian tax law? Is there a tax withholding responsibility for GC? (6)

4**) Are the proposed termination payments to Mr Silverman taxable in India? Is there a withholding tax responsibility for GC?** (5)

5) Are there any Indian tax implications resulting from the subscription payments to OilWrite? Are there any withholding obligations for GC? (5)

Total (25)

7. An UK-based private equity fund is considering making long term strategic investments in India, which would involve routing funds to India through tax-efficient jurisdictions. The two jurisdictions currently under consideration are Mauritius and Singapore.

Before any concrete steps are taken, the fund's in-house counsel has requested a paper from you, addressing the following issues:

1) **What are the respective advantages of routing investments through Mauritius and Singapore in terms of dividends, interest and exit options?** (6)

2) **Can the Indian government challenge the tax residency certificate issued by the Mauritius government under any circumstances?** (4)

3) **Explain the 'look through' and 'look at' approaches mentioned in the Vodafone judgment.** (5)

4) **Will GAAR allow for a 'look through' approach to tax planning?** (6)

5) **Is there any clarity in Indian law regarding the impact of retrospective tax amendments on tax treaty entitlements?** (4)

Total (25)