THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2019

MODULE 2.05 – INDIA OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

TIME ALLOWED – 3¼ HOURS

This exam 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. The Presiding Officer will inform you when you can start answering the questions.
- You should assume that all regulatory requirements, including those relating to foreign exchange, have been fulfilled in the facts provided in the questions.

For your information this paper is accompanied by:

Agreement between India and Singapore for the Avoidance of Double Taxation

PART A

You are required to answer BOTH questions from this Part.

1. MyCard Inc. (MCI) is a part of United States-based MyCard group, and is incorporated in Delaware. MCI is engaged in the business of facilitating the authorisation, clearing and settlement of MyCard's card transactions globally, including in India.

MyCard Pte Ltd (MC Singapore) is a Singapore entity and an indirect subsidiary of MCI. MyCard Service Pvt Ltd (MC India), an Indian company, is a 99% owned subsidiary of MC Singapore and renders certain marketing, liaison and support services to MC Singapore. MC Singapore acts as the group's regional headquarters for the Asia Pacific, Middle East and Africa (APMEA) region and carries out the group's principal business of transaction processing and payment related services under a family of products in the APMEA region. MCI has also set up a liaison office (LO) in India, which acts as a communication channel between MCI and customer banks and solely carries out liaison activities.

The MyCard Business is structured as an open bankcard association, in which the cardholder and merchant relationship is managed principally by MC Singapore's customers - primarily banks and financial institutions, in the APMEA region. MC Singapore does not issue cards, extend credit to cardholders, set cardholder fees or determine interest rates or fees charged to cardholders using MyCard products.

MC Singapore will provide services to Indian customers pursuant to Master License Agreements (MLAs), which MC Singapore signs with each Customer in the APMEA region including those based in India. Under the terms of each MLA:

- MC Singapore will charge transaction processing fees to its customers, relating to the authorisation, clearing and settlement of transactions.

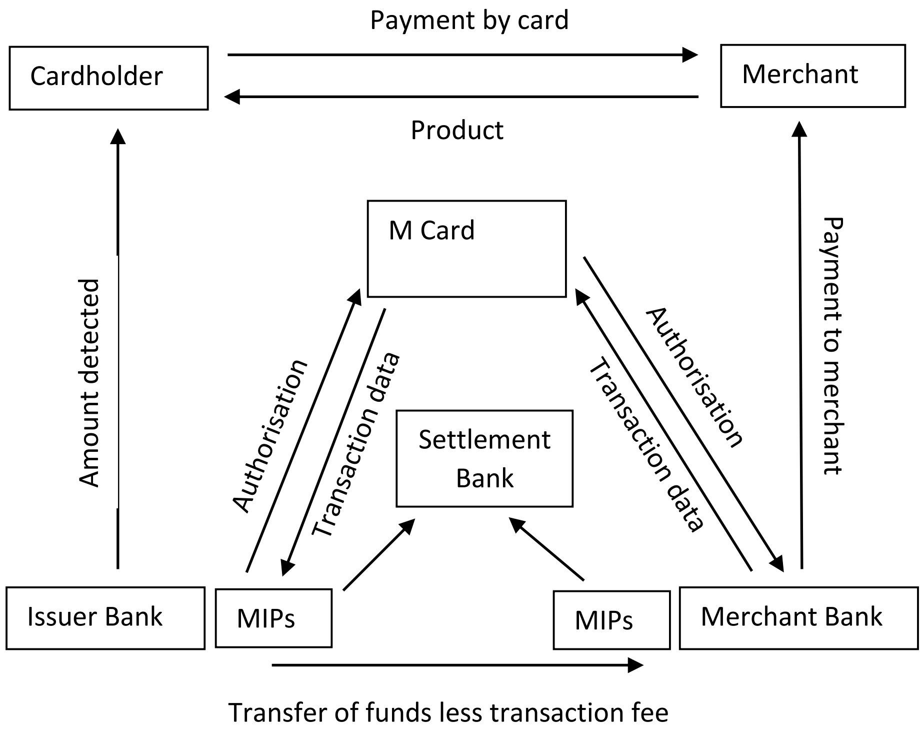
- MC Singapore will receive assessment fees for building and maintaining a processing network that serves the needs of customers globally, for setting up and maintaining a set of rules that govern the authorisation, clearing and settlement process for every payment transaction, in order to maintain the integrity and reputation of its network and also to guarantee settlement between the member banks and customers for payment transactions processed by MyCard.

- MC Singapore will provide each customer with a MyCard Interface Processor (MIP) that connects to the MyCard worldwide network and processing centres based in India and outside India.

MC India owns and maintains the MlPs placed at the customers' locations in India. Each MIP is approximately the size of a desktop computer and is installed at the customer's location in India. MC Singapore will facilitate the authorisation, clearing and settlement of payment transactions through the network and processing centres.

Continuation

1. Continued



MCI's management team has approached you with following questions:

1) **Do MC Singapore or MCI have any tax exposure in India? Do MC Singapore or MCI's activities create a permanent establishment (PE) in India under the provisions of Article 5 of the India-Singapore double taxation agreement (DTA), in relation to the services to be rendered for card payment transactions involving customers in India? If so, what would be the nature of the PE?** (8)

2) **What should be the basis for the attribution of profits in India? Will remuneration on an arm's length basis impact upon the further attribution of global profits in India?** (7)

3) **Would the fees (processing fees & assessment fees) to be received by MC Singapore from its Indian customers be taxable under the provisions of domestic tax law or the DTA between India and Singapore? Would any tax withholding at source be required on the amounts to be received by the taxpayer?** (5)

4) **What implications would arise if MC Singapore was resident in a country with which India does not have a DTA?** (5)

Total (25)

2. Vector, a company based in the United Kingdom and an industry leader in the manufacture of plastics and polymers, is owned equally by two UK-resident individuals, Pamela and Quentin. Vector owns 80% of the equity shares of Nexus, another UK-based company that operates, either by itself or in collaboration with others, several factories outside the UK. Two UK-resident individuals, Frankie and Robert, own 16% and 4% equity in Nexus respectively. Nexus has an Indian branch that owns and operates two factories in India which are involved in polymer manufacturing. The Indian business accounts for 80% of the assets of Nexus.

Pamela and Quentin have been approached by purchasers from the United States (the purchasers). For commercial and regulatory reasons, the purchasers would like to own the Indian business through Vector rather than through Nexus. There is no immediate move to sale, but the purchasers hope to complete the transaction by the end of 2019.

To prepare for the sale, Pamela and Quentin intend to merge Nexus with Vector, with all Nexus assets and liabilities moving to Vector, Nexus ceasing to exist, and the remaining Nexus shareholders receiving shares in Vector according to an agreed formula. It is expected that, owing to the difference between the fair market value of Nexus shares and Vector shares, the value addition to the share portfolios of Frankie and Robert will be to the extent of US$2 million and US$500,000 respectively. The Indian assets will account for 20% of the assets of Vector after the merger.

Vector's shareholders will thereafter sell their shares to the purchasers' wholly owned Mauritius subsidiary (M). M will inject additional funds into Vector through subscription to Vector's redeemable debentures. The debentures will be redeemed in successive tranches over the next five years.

The general counsel of Vector has approached you, with the following questions:

1) **What are the Indian tax consequences, if any, for Nexus of its merger with Vector? In particular, can Nexus take advantage of the non-discrimination provision in the India-UK double taxation agreement?** (6)

2) **What are the Indian tax consequences of the merger, if any, for Vector?** (5)

3) **What the Indian tax consequences of the merger, if any, for Frankie and Robert?** (5)

4) **What are the Indian tax consequences, if any, of the sale of Vector shares to M?** (4)

5) **What are the Indian tax consequences, if any, of the redemption of debentures by Vector over the next five years?** (5)

Total (25)

PART B

You are required to answer ONE question from this Part.

3. E Smart UK is a United Kingdom-resident company that runs social media ad campaigns for celebrity clients in the UK and the United States. E Smart UK has a number of employees who run campaigns on behalf of celebrities on various social media platforms. The social media campaigns require a considerable amount of face-to-face interaction between E Smart UK employees and celebrity clients.

In January 2018, E Smart UK set up a wholly-owned subsidiary in India (E Smart India) to take advantage of Indian talent at a lower cost. E Smart India hired graduates from liberal arts colleges in India and trained these employees to undertake first cut media campaigns for E Smart UK's clients, supervised by senior employees in the UK. The Indian employees conducted research on all aspects of the social media profiles of the products endorsed by E Smart UK clients. The activities of the Indian employees were confined to background research on the endorsed products and were based on instructions received from E Smart UK. The Indian employees did not meet with or interact directly with any of the E Smart UK clients. E Smart UK has paid an arm's length fee to E Smart India for its services. In order to train the Indian employees in social media research, E Smart UK sent its employees to India on deputation for 40 days in the financial year 2018-19. The E Smart UK employees reported to the chief executive officer of E Smart India, but their salaries continued to be paid by E Smart UK.

To fund its Indian business, E Smart UK has borrowed money from a UK bank and then made an onward loan to E Smart India, with E Smart UK and E Smart India paying arm's length interest on their respective borrowings. E Smart India has also received a capital subscription at a ratio of 2:1 over book value, and the excess over the book value has been accounted in E Smart India's books as a share premium. The E Smart group has also provided E Smart India with an automated software platform that will assist E Smart India in conducting its social media reseach functions. The platform is owned by E Smart Jersey, a wholly-owned subsidiary of E Smart UK, and is maintained on servers in Jersey. The platform is completely automated and does not require any processing by ESmart Jersey employees. E Smart India has paid an arm's length access fee to E Smart Jersey.

The general counsel for the E Smart Group has approached you with the following questions:

1) **What are the Indian tax consequences, if any, of E Smart India performing the social media functions for E Smart UK clients?** (5)

2) **What are the Indian tax consequences, if any, of E Smart UK sending its employees to E Smart India on secondment?** (5)

3) **What are the Indian tax consequences, if any, of the loan interest payments from E Smart UK to the UK bank and from E Smart India to E Smart UK? What are the Indian tax implications of the capital subscription in E Smart India?** (5)

4) **What are the Indian tax consequences, if any, of the access fee paid by E Smart India to E Smart Jersey?** (5)

Total (20)

4. X Pte Ltd (XPL), a Singapore-based company, is in the business of providing offshore drilling services. For the provision of these services XPL deploys drilling rigs and human resources under contract. XPL owns one drilling rig (XD), which is currently deployed in the Middle East. XPL has been awarded a new contract by an Indian oil and gas company for drilling an oil well situated in an Indian Exclusive Economic Zone. The duration of the contract is 150 days, with the option to extend the contract for 30 days twice.

Y Pte Ltd (YPL), another Singapore company, owns the YD oil rig. XPL has entered into a bareboat charter contract with YPL for the charter hire of the YD rig for a period of one year. The charter hire agreement was executed between XPL and YPL in Singapore, and permits deployment of the YD rig anywhere in the world except for high-risk jurisdictions. XPL has deployed the YD rig for undertaking operations under the drilling services contract with customer in India.

The YD rig entered Indian waters in January 2019 and the drilling services commenced soon thereafter. The YD rig was deployed in India for a period of approximately 60 days during the 2018-19 financial year, and is expected to be deployed for approx. 120 days during the 2019-20 financial year. Upon completion of the offshore drilling services by XPL, the YD rig will be shipped out of India.

XPL's general counsel has approached you to answer the following questions relating to the Indian tax implications of the activities described:

1) **What is the taxability in India of the income from the contract with the Indian oil and gas company in the hands of XPL for the 2018-19 and 2019-20 financial years, under the provisions of the Income Tax Act 1961?** (5)

2) **Will any change in the tax implications result from the application of the India-Singapore double taxation agreement?** (4)

3) **What are the tax implications in India, including withholding tax, of the payments to made by XPL to YPL for the bareboat charter of the YD rig?** (6)

4) **What would be the tax implications in India, including withholding tax, of the payments to made by XPL to YPL if the YD rig had been chartered with a crew?** (5)

Total (20)

PART C

You are required to answer TWO questions from this Part.

5. Gokul India Ltd (GI), an Indian resident company, has fifty Indian equity shareholders of whom one shareholder, Mr Gokul, an Indian resident, holds 80% of the equity shares. GI has set up a wholly owned subsidiary in Mauritius, Gokul Mauritius (GM), which performs financial services for companies worldwide. GM has had a turnover of $50 Million annually over the last five years. 60% of GM's employees are resident in India, consuming nearly 60% of its payroll expenses. 20% of GM's world wide assets are situated in India. GM's board of directors consists of eleven members, consisting of four nominees of GI (all resident individuals in Mauritius), Mr Gokul, five CPAs based in the United States and one employee, the CEO, resident in Mauritius. The books of accounts are maintained in Mauritius. Most of the board meetings take place in Mauritius, with the non-Mauritius directors participating through video conferencing.

GI pays Vortex, a United Kingdom resident company, for services relating to the marketing of its financial services under a contract entered into, signed and registered in Mumbai. Vortex advises GI on developing a strategic commercial relationship with the banks and financial institutions in the UK and is paid on a commission basis; the commission consists of a percentage of the fees earned by GI from its UK financial customers. Vortex has no office or employees in India. In January 2019, GI terminated its relationship with Vortex and paid it a severance amount denominated in pounds sterling, deposited electronically into a UK bank.

GI's management team seeks your advice on the following questions:

1) Will GM's profits be subject to Indian taxes, and on what grounds? (5)

2) Will the commission received by Vortex be subject to Indian taxes, and on what grounds? (5)

3) Will the severance payment to Vortex be subject to Indian taxes, and on what grounds? (5)

Total (15)

6. **A consortium of businesses has approached you to write a brief note on the impact of BEPS on the Indian international tax treaty system going forward. In particular, they are interested in the following:**

1) What are the conditions that must be satisfied for the Multilateral Instrument (MLI) to amend Indian tax treaties? (6)

2) If an Indian tax treaty is amended by the MLI to include the Principal Purpose test or the Limitation of Benefits test, how will these rules interact with the Indian general anti-abuse rules (GAAR)? In cases in which the Principal Purpose test under the treaty is satisfied, can GAAR still override the treaty? (9)

Total (15)

7. I Co, an Indian Company, recently acquired a business in Austria, which was previously held by a Singapore holding company (S Co). The acquisition was be leveraged by borrowing from banks in India. S Co had a valuation of US$100 million, of which US$30 million was in the form of undistributed reserves and surplus.

I Co set up a special purpose vehicle (SPV) in Singapore and injected the required capital in the form of equity shares totaling US$30 million and redeemable preference shares of US$70 million. The SPV then acquired Hold Co for US$100 million, merged Hold Co into its structure, and then restructured a majority of the equity in its Austrian subsidiary into a debt instrument which is compulsorily and mandatorily convertible into equity. The debt instrument carries an interest coupon rate which is deductible as an expense in Austria.

After the acquisition the SPV declared the dividend of US$30 million out of the undistributed reserves available to I Co, on which I Co claimed underlying tax credit under the India-Singapore double taxation agreement. The cash outflow of I Co is US$70 million (the US$100 million invested, minus US$30 million dividend received), whereas the cost of acquisition remains US$100 million. The SPV utilises interest received from the Austrian subsidiary for the redemption of redeemable preference shares (RPS).

You are required to answer the following questions:

1) **Will the choice of jurisdiction (i.e. Singapore) for the setting up of the SPV be regarded as without any substantial commercial purpose? Justify your answer with appropriate reasoning relating to the facts given above.** (5)

2) **Can the presence of the SPV be ignored by treating it as an accommodating party? Can a comparison be made for this purpose by considering acquisition by I Co directly of the holding company or Austrian entity?** (5)

3) **If the SPV is accepted as a separate legal entity and with commercial substance, can the choice of capitalising the SPV as equity or RPS be subjected to the general anti-abuse rule?** (5)

Total (15)

8. Abakus Inc. (Abakus UK), a United Kingdom company, is planning to invest in Vestry, an Indian company, through its investment company and wholly owned Indian subsidiary, Abakus India. Vestry owns a factory in India that manufactures industrial chemicals and acids.

As part of its due diligence, Abakus UK has been informed by its lawyers in India that, three years earlier, Vestry converted from a partnership into a company. All assets and liabilities of the partnership were transferred to the company at book value and the partners received shares in the company in the same proportion as their previous shareholdings in the partnership. Vestry did not pay any tax to the Indian government on its conversion. The due diligence also revealed that Vestry has had accumulated losses from the years before its conversion which have not yet been absorbed. The draft share purchase agreement between Vestry shareholders and Abakus India stipulates that Vestry shareholders will pay the capital gain on the sale of Vestry shares promptly to the Indian government and confirm the receipt to Abakus.

Abakus UK's lawyers are concerned that an Indian tax exposure may exist because no tax was paid at the time of the conversion, and have approached you with the following questions:

1) **Will the investment in Vestry result in any further tax liability for Abakus?** (5)

2) **If Vestry is profitable in the future, can it absorb the losses incurred before the conversion?** (5)

3) **Will any Indian tax liability arise if, during the next three to five years, Abakus UK takes direct control of Vestry by merging Abakus India into Vestry?** (5)

Total (15)

9. Pardeep and his wife Neelam are both individuals residing in India, and are Resident and Ordinarily Resident in India under the provisions of section 6 of the Income Tax Act 1961. Pardeep and Neelam have a son, Sanjeev, who is currently studying in the United States.

Pardeep has set up a Limited Liability Company in the US, KC LLC, which is organised in Maryland and in which he is the 100% owner. Sanjeev does not hold any share of KC LLC but is allowed to be a partner and share in KC LLC's profits under the relevant law. The profits of KC LLC are shared by Pardeep and Sanjeev, with Pardeep receiving 75% of profits and Sanjeev the remaining 25%. KC LLC is treated as a pass-through entity for US tax purposes. KC LLC is engaged in the business of providing student recruitment services to various universities in the US and abroad. Since Pardeep is not US-resident, he is considered a non-resident alien for US tax purposes. US tax law requires non-resident aliens to pay US income tax only on US-source incomes. Pardeep will be subjected to income tax in the US on his share of profits in KC LLC, irrespective of whether such profit has been distributed or not.

Neelam has a sole proprietorship concern, M Consultants (MC), which in engaged in the business of providing information and support services to Indian students applying for student visas to study internationally.

KC LLC and MC have entered into a service agreement, under which MC is to provide KC LLC with assistance in undertaking its business activities in India.

Pardeep seeks your advice on the following questions:

1) **What are the Indian income tax consequences for Pardeep of receiving income from KC LLC? Are there any Indian tax implications for KC LLC in relation to its earned income?** (10)

2) **Will Indian transfer pricing provisions apply to the transactions between KC LLC and MC, and on what grounds, given that MC is a sole proprietorship concern?** (5)

Total (15)