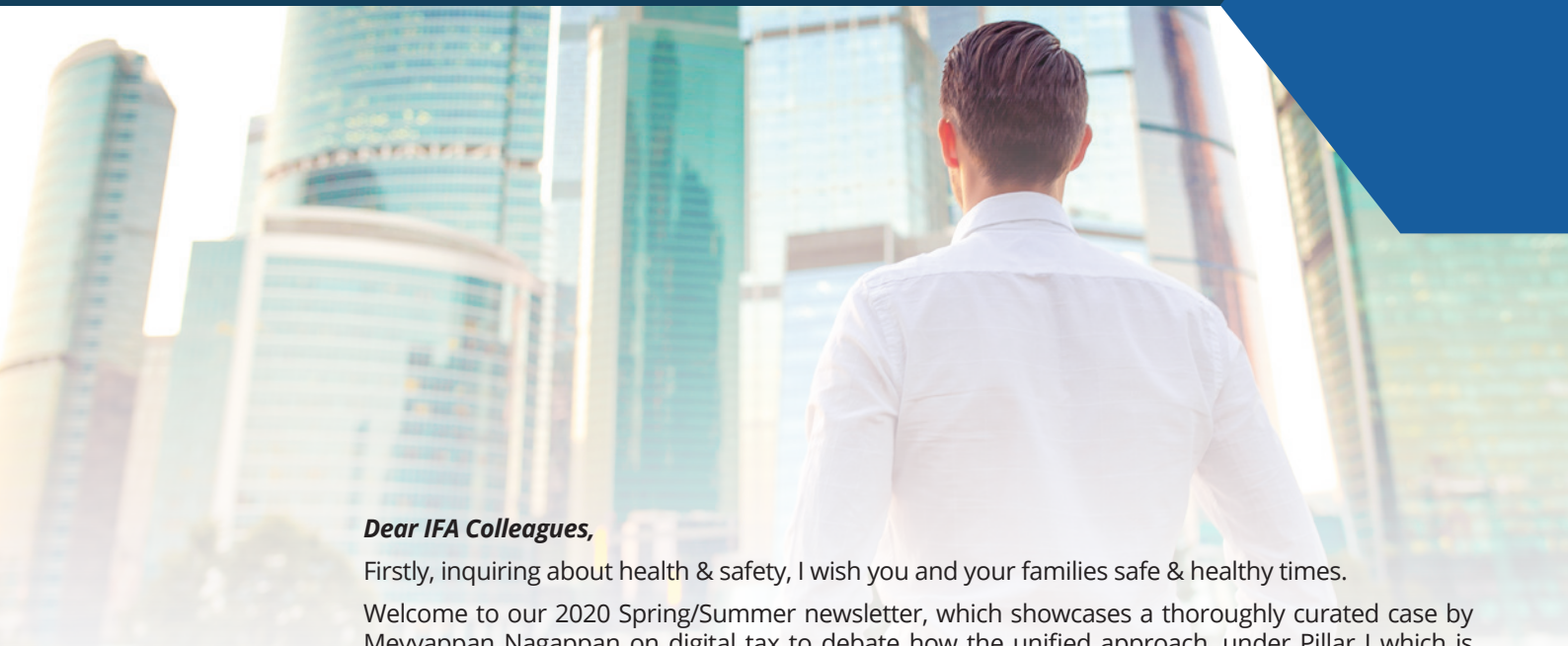


# NEWSLETTER

APRIL 2020 / IFA INDIA / ISSUE 7



**Dear IFA Colleagues,**

Firstly, inquiring about health & safety, I wish you and your families safe & healthy times.

Welcome to our 2020 Spring/Summer newsletter, which showcases a thoroughly curated case by Meyyappan Nagappan on digital tax to debate how the unified approach, under Pillar I which is awaiting consensus shall apply, relevance of subscriber base, allocation of revenues between jurisdictions, interplay of treaty and more importantly, what are the key takeaways for MNEs having business interests in India. Whilst we all shall wait for final outcome of the debate on profit attribution, our experts lead by Mr. K. Varshney, CA. R. Sanghvi & Dr. A. Mehta debate on finer aspects, expressing a cautious, though firm view on various aspects. Reading the case study, what attracted my attention most was Mr. Varshney's views, though, expressed in his personal capacity that though India has taken a principled position to not subject itself to mandatory arbitration, an alternate mechanism ought to be in place to address the vexed issue of double taxation. I trust you enjoy the case study as much as I did.

Our section on updates include OECD update on country positions on MLI ratification, Transfer Pricing guidance on financial transaction & an update on profit attribution project. It also contains highlights of India's Union Budget & significant update in important jurisdictions – Singapore, South Africa, U.S. and others. We have added a new feature to this section providing suitable links.

Section 3 has update on India Finance Act 2020 provisions impacting cross-border matters, particularly expansion of equalisation levy. IFA had an opportunity to host Department of Revenue officials & Experts for its annual post-budget session and settlement scheme, Vivad se Vishwas.

Due to ongoing health restrictions, our annual 2020 event which we had postponed to July stands canceled. I am confident, we shall deliver an event in early 2021, which shall more than make up for this year. As you would have heard from Central IFA, the 2020 Cancun Congress stands canceled. In midst of closure, we are experiencing surge in IFA webinar events with excellent exposition of knowledge sharing by members and experts. Notable amongst them being IFA supporting "Liber Amicorum: Nishith Desai Tax Series" to coincide with its founder's 70<sup>th</sup> birthday. IFA is grateful to its most hardened patron, Nishith bhai, who pioneered deep research on the subject of international tax.

Kindly follow events calendar on IFA Global ([www.ifa.nl](http://www.ifa.nl)) and IFA India ([www.ifaindia.in](http://www.ifaindia.in)) websites to re-confirm the updated and latest schedule/events calendar.

As I close this communication, I am tempted to pen a few (unsolicited) reflections –

Anxious & unusual times bring best of human nature to rise to the challenge. Leadership & wisdom should guide us to Engage with people in the Right way, at the Right time, with the Right information.

Take care of yourself, your loved ones and stay confident that humanity shall get through this, together.

Sincerely & best wishes.



**MUKESH BUTANI**

*Chairman,  
India Branch*



**PARESH PAREKH**  
*Editor-in-Chief*

**Dear Readers,**

IFA Newsletter Team wishes you and your loved ones great health! We hope all of you are working from home and staying indoors so as to flatten COVID-19 curve!

Our team is pleased to present you for your home reading a very insightful and informative second edition of IFA Newsletter for the year 2020! The issue of digital tax is indeed topical with several countries in Europe (including France) and India introducing digital tax. Keeping this in perspective, the latest issue opens with the case study on Digital Tax by Mr. Meyyappan Nagappan. We are delighted to share the views of Mr. Kamlesh Varshney (Senior Tax Professional), MBA (IIM Lucknow), LLB; Rashmin Sanghvi (Partner, Rashmin Sanghvi and associates) and Dr. Amar Mehta (Senior Tax Adviser) covering several practical and insightful aspects on this topic.

This Newsletter also contains few of the key international updates and developments, and an update on the IFA conferences and Webinars held till date. While we have covered the upcoming IFA events, kindly follow events calendar on IFA Global ([www.ifa.nl](http://www.ifa.nl)) and IFA India ([www.ifaindia.in](http://www.ifaindia.in)) websites to check if these would be held as scheduled or shall be held as webinars.

Again welcome back and have happy reading while you are at home!

Stay Home! Stay Safe & Flatten the curve!

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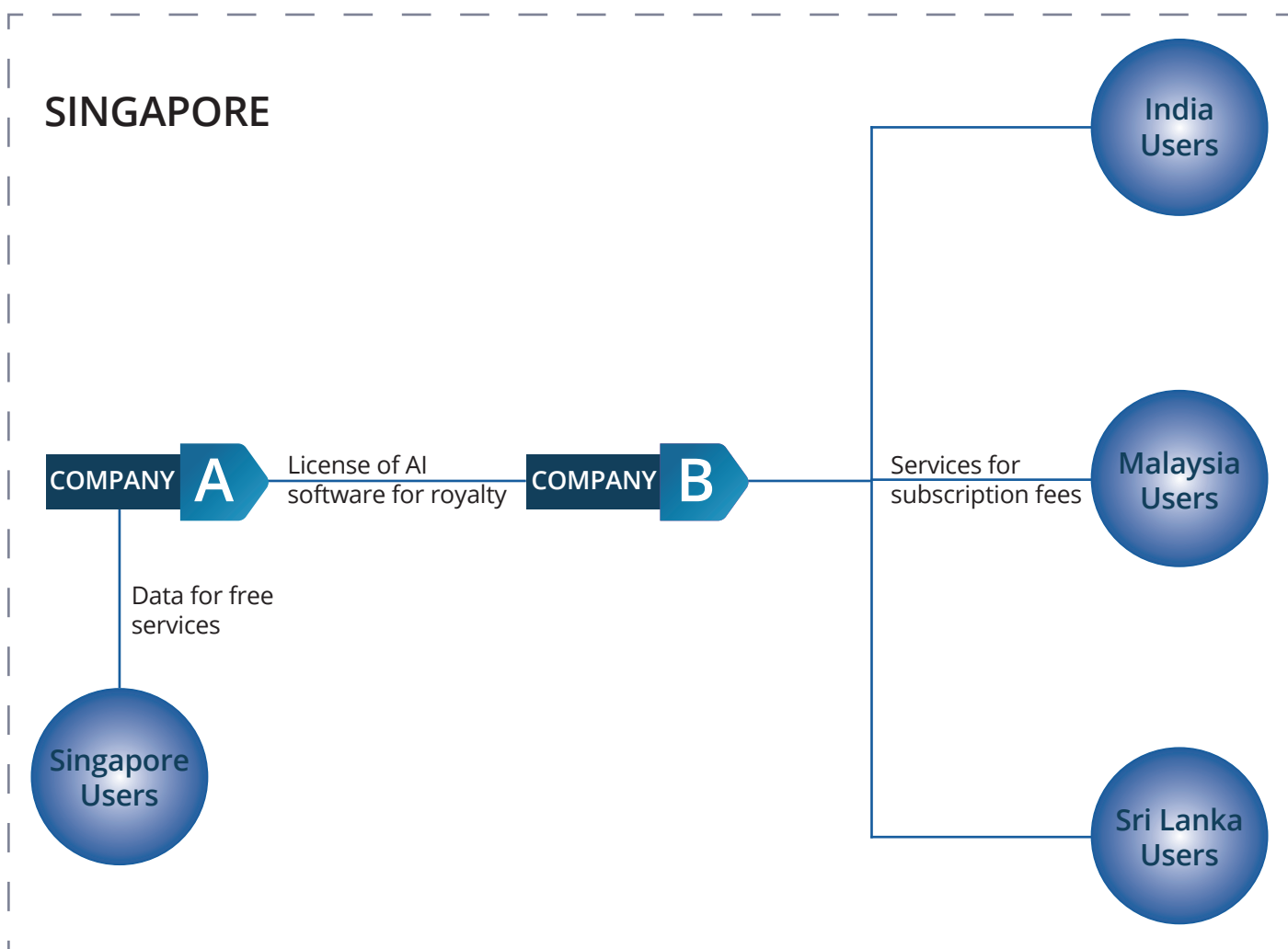
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# DIGITAL TAX

## CASE STUDY, QUESTIONS & EXPERTSPEAK

*By Meyyappan Nagappan*



## BACKGROUND

The tax challenges due to digitalisation of the economy were identified as one of the main areas of focus for the Base Erosion and Profit Shifting Action Plan. The March 2018 Interim Report was followed by the January 2019 proposals grouped into Pillar I and Pillar II. After receiving feedback from the public consultation on the two Pillars, these proposals were further developed into the Unified Approach (“UA”) in the consultation document in October 2019. India also regards a non resident having ‘Significant Economic Presence’ (“SEP”) in India to construe to establish a business connection in India under the Indian Income Tax Act, 1961.

The Unified Approach is a significant shift from the existing international tax position and is likely to have wide ranging consequences. The BEPS plan shifted from merely plugging holes that led to base erosion to now attempting to achieve a better allocation of taxing rights between countries, with a focus on the contributions of the market jurisdictions. However, the proposal in the current form raises several questions, including whether the ultimate result of the exercise would be a fair allocation of taxes for countries, in line with where the value creating activities are carried out, and whether apart from being a fair result for companies, does it increase uncertainty.

## FACTS OF THE CASE

- Company A is a resident of Singapore, formed under the laws of Singapore. It is an advanced digital research and development company with the best Artificial Intelligence experts around the world working for it.
- It has been developing artificial intelligence software by providing free services to Singapore users for many years. As a result, the AI software has become efficient at recognising patterns in Tamil, Malay, and English. Consequently, the software has emerged as an efficient and easy to use translation tool.
- The initial data sets were the most valuable for the AI to recognise speech and text patterns. Incremental data sets were of only additional value with diminishing marginal returns.
- With a view to commercialise the software and fund the next round of research and development investment, Company A set up a Subsidiary in Singapore, Company B. This also served the purpose of protecting Company A from any liability that may arise from the conduct of business.
- Company B obtained the software on a license and provides these services to users in Sri Lanka and Malaysia, in exchange for subscription fees. Company B paid significant amount of royalties to Company A for the right to use the advanced AI software.
- Company B did not wish to any other markets at this stage till the software was proven to be a success in Srilanka and Malaysia which were smaller economies and first it targeted outside Singapore. Accordingly, advertisements promoting the app were targeting only in these jurisdictions.
- It also did not offer all the functionalities offered by Company A in Singapore. Only translation between Tamil or Malay into English were possible or vice versa. However, translations between Malay and Tamil directly was not offered.
- In this context, several users from India in Tamil Nadu having both business and personal relationships in Singapore became aware of the app and began using it on a subscription basis. They began using it on a sizeable scale in their business operations in the south east Asian region. Further, the app became popular and a mass of semi literate individual users used it as a means of further augmenting their English learning.
- Many even managed to access the unrestricted services of Company A by using virtual private networks. While the services of Company A were restricted by geo-location to Singapore, it is difficult for such company to track where users are present if they use a VPN as it masks their location.

## CONTENTIONS OF THE INDIAN TAX AUTHORITIES

The Indian tax authorities now contend that Company A and B have a significant economic presence in India under domestic law.

- They also contend that under the Unified Approach, as group Company A & B have to attribute a portion of the residual income to India since it is a market jurisdiction and that together as a group they satisfy the user threshold for it to apply (although individually they do not).
- Tax authorities further argue that the total income of the group should be attributable to India in proportion to the number of users in India compared to total users outside of India both under SEP and Unified Approach.

## CONTENTIONS OF THE TAXPAYER

- Company B may have a SEP under domestic law, however, the India-Singapore DTAA does not permit the taxation of its income without a physical presence. Even in such a situation only minimal profits may be attributable since Company B has little net profits after making the royalty payments to Company A.
- Company A does not meet the thresholds of SEP set out under domestic law and in any case is protected by the treaty.
- With respect to the Unified Approach, the group argues that India was not a market they intended to target and advertisements were never placed in India. They also produce board resolutions stating that the company planned to target only Malaysia and Sri Lanka.
- They also argue that Company A in any case also prevented users from outside India accessing its services through geo-location restrictions. In the case of use of VPN it is difficult to prove location of users to be conclusively in India. Further, there are no rules like with Online Information Database Access and Retrieval Services (OIDAR) under law to establish location of user and therefore there are no rules to establish nexus with India. In such a situation, as a group they do not meet the user threshold required for the Unified Approach to apply.
- The group also argues that Unified Approach only applies to consumer facing businesses and in this case both businesses and consumers use the service. Further, all data collection and exploitation is outside of India. Considering the even mix of businesses and individuals who use the app, they should not be considered a large consumer facing business and therefore are outside the scope of the Unified Approach.
- Further, they state that the services provided by Company A and Company B differ and should be considered as two different products while segmenting the global accounts on a business line or regional basis. Additionally, Company A and Company B cater to two different regional markets. Therefore the profits of Company A should not be counted for the purposes of calculating residual profit that may be apportioned for activities carried out in India by Country B.



# QUESTIONS & EXPERTSPEAK



**KAMLESH VARSHNEY**  
Senior Tax Professional,  
MBA (IIM Lucknow), LLB



**RASHMIN SANGHVI**  
Partner,  
Rashmin Sanghvi and Associates



**DR. AMAR MEHTA**  
Senior Tax Advisor

# 1

***Assuming that the Unified Approach becomes an international multilateral treaty in its current form, what would be the outcome of the arguments of Company A and Company B under current Indian law on taxability of their incomes? Specifically, is there sufficient nexus with India established, both factually and under Indian law, for such a tax to be imposed?***

**KV:** First of all I must clarify that discussion is still going on in G20-OECD inclusive framework and it is not sure what would be the final outcome of consensus solution for digital taxation.

In our domestic laws as well, significant economic presence (SEP) nexus is postponed to assessment year 2022-23 i.e., financial year 2021-22. It is expected that final consensus would be reached by December 2020. Hence, at that stage, there may be a need to notify the threshold under our SEP nexus provision in a manner that gives us taxing rights in all cases where taxing right is given by G-20 OECD final consensus solution.

If we assume that current proposal of G-20 OECD becomes a consensus solution and the threshold under

Indian SEP nexus provision allows us taxing rights in all such cases, then company A and company B cannot claim that they should be examined separately for SEP nexus. As per the current proposal, the group as a whole needs to be examined to satisfy SEP nexus. Since the rules for establishing SEP nexus are not yet made in India, it would not be proper to comment if these two companies or their group pass the nexus test.

**RS:** A NR's foreign business income may be taxable in India only when both of the following conditions are satisfied:

***That income is taxable under the (Indian) Income Tax Act ("ITA")***

**AND**

***That income is taxable under the Double Tax Avoidance Agreement ("DTAA")***

The case study relates to providing AI software services for translation from one language to another. Following phrases under Section 9(1)(i) Explanation 2A(i) will be applicable: "transaction in respect of ... services ... carried out by a NR with any person in India ...". Now one needs to compute the revenue earned from India & see whether it exceeds the threshold (yet to be provided under rules).

Assuming that the threshold conditions to be prescribed under ITA are satisfied, following further computation will be required.

The revenue earned by A&B will be divided between:

- i. AI software development – comparable to production in "Bricks & Mortar" business; and
- ii. Provision of services & collection of subscription revenue from India – comparable to sales function in Bricks & Mortar business. Only the 2nd part of profits will be taxable in India. (See second Proviso to Explanation 2A)

The UA will become enforceable if & when ALL of the following steps have been taken & completed:

- i. UA is accepted by BEPS Action Task Force One;
- ii. MLI is amended;
- iii. India & Singapore both sign amended MLI; and
- iv. India & Singapore both notify each other for applicability of the amended MLI.

On completion of these four steps, India – Singapore DTA will stand modified to this extent. Yet UA itself is incomplete. There are some formulae & computations involved for computing the taxable amount or the "Profits Attributed to India". In absence of those details, the process remains incomplete.

We may assume that all necessary details will be drafted & incorporated in the MLI. Then India is a Marketing Jurisdiction for the group of Companies A & B. A portion of their profits will be taxable in India.

**AM:** At this point of time, the OECD's Unified Approach is still work in progress. Hence, it seems rather premature to fully envisage and comment upon the Indian tax implications for the two Singapore companies based on an assumption that the Unified Approach would be

eventually incorporated (through MLI 2 or bilaterally) into the contemporary tax treaty between India and Singapore.

While we await further development in this area, it would be helpful to note that the Unified Approach focuses on the MNE group's residual profit i.e. taxation at the group level. Hence, to make international taxation in the digital economy fair and effective, intra-group transactions (such as the licensing arrangement between the two Singapore companies) would need to be disregarded.

If company B accepted subscriptions from the Indian customers knowingly that they were resident of India, then it should not make any difference that company B did not intend to target the Indian market. In such a case, Company B may be regarded as having nexus with India.

In the present case, however, India appears to be more like the traditional 'source jurisdiction' rather than the digital economy concept of 'market jurisdiction'. That impression is based on the fact that company A does not derive much insights/ value from the data generated by the customers from India (or for that matter, even from the customers from Malaysia and Sri Lanka).

It seems relevant to examine two aspects:

- (i) If the two companies (Company A and Company B) are not targeting the Indian customers, they are not aiming any marketing activities at the Indian customers, and if the Indian customers subscribe to the services of the two companies in an unsolicited manner, could any amount of 'deemed residual profit' be regarded as arising in India?
- (ii) Could the two Singapore companies be regarded as having a 'distribution function' specifically vis-à-vis the Indian market?

If the findings for both the above-mentioned aspects are in the negative, then could the two Singapore companies be regarded as having earned 'Amount A' and 'Amount B' (as discussed in the OECD's Unified Approach) in India?

Unfortunately, at this stage, we are wandering in an uncharted territory, and we have more questions than answers. That is the case, because the OECD is yet to define (for the purposes of the Unified Approach) the meanings and scope of the terms "deemed residual profit", "deemed routine profit", etc. Also, the formula for income allocation to the market jurisdictions is still work in progress.

## 2

**What thresholds should be in place to determine large consumer facing business in the above context for inclusion within the scope of Pillar 1?**

**KV:** In my view there should not be too many thresholds and the threshold should also not be very high. A very high threshold would dilute the impact of current exercise and the market economies would not be benefited. We should keep in mind that any solution should be simple to implement and also should last for at least 10-15 years. Any solution which does not address the problem by having a high or multiple thresholds would not be a lasting solution.

**RS:** I reject UA as unjust, unfair, too complicated & hence not worthy of becoming part of DTA.

Still, one can always assume that it may become a part of MLI - DTA.

In such a situation, I would suggest following as a threshold: Indian revenue exceeding Rs. 1 crore. If number of users is to be considered, the threshold may be total users exceeding 10,000 in a financial year.

**AM:** The threshold for triggering taxation in the market jurisdiction should be high enough so that only the

large corporations operating in the digital economy are brought within the scope of the Unified Approach. The start-ups and the small and medium enterprises play very important role for digital development and innovation. They may find it difficult to cope up with the compliance burden. Hence, the threshold should be high enough to target only the large (top 50 or 100?) companies in the digital economy.

Also, the threshold should be based on two criteria:

- (i) an MNE groups' global revenue (global threshold), and
- (ii) the gross revenue from a particular jurisdiction (jurisdiction threshold).

In other words, if an MNE group's global revenue is below the global threshold, then the Unified Approach should not apply in case of that MNE group. Also, if an MNE group's revenue in a particular jurisdiction is below the jurisdiction threshold then that jurisdiction should not be entitled to tax the income of the MNE group.

## 3

**How would the allocations differ in the current case for Company A and B depending on whether the segmenting of global accounts is done on a business line or regional basis? How should profits be allocated to products that are used by both individual consumers and businesses as set out in the case above? Should the products of Company A and B considered different and therefore their revenues segregated? For the same reason should the customers of Company B not be considered as customer of Company A?**

**KV:** If MNC group's profitability varies materially across business lines or across business segments, there would be a need to use segment accounts for working out the profit to be allocated to market jurisdictions. This issue is being discussed in G20-OECD inclusive framework.

If the products are mainly used by consumers then such products are likely to be included in the scope even if some businesses use them as intermediaries. To illustrate, the translation software is targeted to consumers and for that advertisement expenditure is also incurred. Just because some of the software is bought by business for business purpose would not take such sale out of the scope.

Since the solution that is likely to emerge would be applicable at group level and not at company level, it is the customers of the MNC group that would be seen and not the customers of company A or company B separately.

**RS:** As an anti-avoidance measure - a group and all revenues of the group should be considered. The fact that in the present case study, formation of subsidiary B is bonafide - should not affect the tax exposure. No segmental accounting, no regional accounting. Only issue should be: Total Revenue collected from India; or total subscribers / users from India.

**AM:** Since the Unified Approach covers only the 'consumer facing businesses' (B-to-C) and not the enterprises' dealings with the business customers (B-to-B), it seems that the companies would need to prepare segmental financial information (i.e. two segments: (i) enterprise segment, and (ii) consumer segment. If the two Singapore companies are liable to pay tax in India in respect of their income in the consumer segment, then the onus should be on them to prepare the segmental information in respect of the business segments (i.e. enterprise segment and consumer segment) as well as the regions/ jurisdiction.

## 4

**Would your answer change if Company A and B were not incorporated in Singapore but in a non-treaty jurisdiction?**

**KV:** In a non-treaty situation, our domestic law would apply and we need not follow the G-20 OECD inclusive framework approach for attribution of profit to nexus created on account of SEP. Relevant rules for SEP nexus and for attribution of profit are yet to be made in India.

**RS:** Yes. In case of a non-treaty jurisdiction, these companies will not get treaty protection of having a PE/SEP as per MLI. Amended ITA will be wider in coverage. Incomes of A & B would be covered (subject to thresholds) and be taxable in India.

**AM:** If Companies A and B were from a non-treaty jurisdiction, then the tax liability would need to be determined in accordance with the relevant provisions of the Indian Income Tax Act, 1961 (e.g. Sec. 9) and the Income Tax Rules, 1962 (e.g. Rule 10). In such a case,

the concept of 'significant economic presence' would be relevant.

**Re: Significant Economic Presence (SEP)**

It seems that the two Singapore companies may not have the SEP in India in accordance with that expression defined in Explanation 2A of the Act prior to the Finance Bill, 2020, if the Singapore companies software is located outside India and the Indian customers' data is processed outside India. In such a situation, it might be possible to take a view that (i) the two Singapore companies do not provide any services in India, and (ii) the Singapore companies software is not downloaded in India. However, the revised scope of the SEP (as stipulated in the Finance Bill, 2020) would negate those arguments.

## 5

**How should a market be defined? Should it be the intention of Company A and B with respect to serving or targeting a particular matter? How can companies control whether and where they have a taxable presence? Does the inability to control taxable presence create uncertainty for businesses?**

**KV:** Inability to control taxable presence is not important. What is important is revenue from a particular country for in scope business. There could be plus factor for passing nexus test and that could be based on advertisement spend but we are not sure at this stage.

**RS:** Intention & advertisement are not material in considering Connecting Factor (Nexus) to grant taxing jurisdiction to India.

If a company gets subscription revenue exceeding the threshold (Rs. One Crore or such other figure as may be determined); it cannot reasonably argue that it has no Nexus in India. Its ability or inability to control taxable presence is irrelevant in taxation. If it earns revenue from India, it has to pay tax in India.

**AM:** As stated in the answer to Question 1 above, if company B accepts subscriptions from the Indian consumers knowingly that those consumers are resident of India, then it should not matter that company B did not intend to target the Indian customers. In other words, the actual conduct should be more relevant than the initial/ stated intent.

Use of VPN by the Indian customers, as a valid defence for Company B, may be questionable. If company B's global revenue in the consumer facing segment and its revenue from the Indian customers (in the consumer facing segment) exceed the respective threshold amounts, then company B should be liable for taxation in India. However, there might be practical difficulties for ascertaining the revenue and income from the Indian consumers if company B does not accept subscriptions from the customers if it knows that they are resident of India (but, by using VPN, those customers have disguised themselves as customers of Singapore). If based on the information available with company B, company B genuinely believes that none of its subscribers are from India, then its claim that its income is not taxable in India appears bonafide. In such a situation, the burden of proof should shift to the Indian tax authorities, and the Indian tax authorities may not be in position to discharge that burden.

## 6

***Does the ultimate result of the application of Pillar I principles in its current form achieve the goal of fair allocation of taxes to different jurisdictions by aligning taxes with value creation?***

**KV:** The intention is right. We need to see the outcome. The outcome should be simple and long lasting which takes care of interest of developing countries.

**RS:** No. I believe that UA is unfair.

**AM:** As the OECD's work in respect of Pillar I and the Unified Approach is still work in progress, and since the various jurisdictions are yet to reach consensus, it is premature to answer this question.

## 7

***What would be takeaways for companies and tax policy officials from this example and how can the Unified Approach be improved?***

**KV:** Dispute prevention is very important aspect of this approach. While India and many other countries are not in favour of arbitration, there is need to put in place a multilateral body consisting of representatives of countries who could prevent disputes in calculation of various amounts (A, B and C) at the inception stage. I understand that G20-OECD inclusive framework is already working on it.

**RS:** There are too many uncertainties. Results are unpredictable. We will need to wait till both – ITA & DTA are finalised.

UA could be scrapped and a simple system can be as under:

If a Non Resident Digital Corporation does business with Indians and if prescribed thresholds are crossed; then it is liable to tax in India. A flat tax (say 3%) on gross revenue earned from India should be fair. This will simplify administration & compliance and give certainty to tax payers.

**AM:** If the companies in the digital economy do not wish to accept customers from certain jurisdictions, then they should prohibit use of VPNs by the customers. In that case, the customers would not be able to hide/disguise their location. Netflix has implemented that policy (not necessarily for tax reasons). In such a case, those companies should be able to mitigate compliance burden in those jurisdictions.

As regards the Unified Approach, it is still in the early stage and the jurisdictions are yet to reach consensus. Hence, it would be interesting to see further developments in near future.



# INTERNATIONAL TAX UPDATES

BY  
SAURAV BHATTACHARYA  
SUDARSHAN RANGAN

## I. OECD

### ***OECD Update on Multilateral Instrument (MLI) Ratification and MLI Signatories***

Portugal, Cyprus and Saudi Arabia are some of the major countries that recently deposited their instruments for ratification for the MLI BEPS convention. The detailed list of countries that have ratified and deposited their instruments along with the effective date of entry into force can be tracked on the OECD website [www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf](http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf).

Further, North Macedonia signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) thereby becoming the 94th jurisdiction to join the Convention. The updated list of the members of the parties who are signatory to the MLI can be tracked on the OECD website [www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf](http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf).

### ***OECD Releases Transfer Pricing Guidance on Financial Transactions<sup>[1]</sup>***

The OECD released Transfer Pricing Guidance on Financial Transactions: inclusive framework on BEPS: Actions 4, 8-10. The BEPS Action Plan reports on Action 4 – Limiting Base Erosion involving Interest Deductions and Other Financial Payments and Actions 8-10 – Aligning Transfer Pricing Outcomes with Value Creation specifically mandated subsequent work on transfer pricing aspects pertaining to financial transactions. Therefore in line with the mandate stipulated, the OECD has released this transfer pricing guidance report on financial transactions. This particular report will be added along with the OECD Transfer Pricing Guidelines. The guidance report *inter alia* focuses on recognizing the accurately delineated financial transaction which was introduced as part of the BEPS Action plan. Further, the report also covers issues pertaining to other financial transactions such as Treasury functions, Cash pooling, Guarantees, Pricing of loans, Captive insurances etc. The

guidance report endeavours to maintain consistency and uniformity on transfer pricing aspects of financial transactions entered by a Multinational Enterprise.

### **OECD status update on BEPS Action Plan 1 – Tax Challenges Arising from the Digitalization of The Economy** <sup>[2]</sup>

The OECD BEPS Inclusive Framework (IF) released a statement during January 2020 pursuant to its meeting on their existing work to arrive at a consensus-based solution with regard to the tax challenges from the digital economy. The IF affirmed its commitment to reach an agreement on a consensus-based solution by the end of 2020. Further, the IF also agreed upon on the Unified Approach on Pillar 1 and Pillar 2 proposed by the OECD tax committee last year. The commitment to arrive at a solution comes in lieu of the statement proposed by the United States to the OECD Secretariat, late last year on resorting to Pillar 1 solution as a safe harbour option, thereby the uncertainty of a consensus-based solution arose in the global tax community. With this commitment IF brings back the OECD BEPS IF work on track especially the Unified Approach as a foundation to arrive at a consensus-based solution. The next step is to arrive at the key policy features of the Unified Approach proposal during the July 2020 meeting at Berlin.

## II. Asia

### **Hong Kong: Budget 2020 tax proposals**

Financial Secretary of the Government of Hong Kong Special Administrative Region proposed the budget for 2020/21.<sup>[3]</sup> The key aspects of the budget proposals are the following:

- Waiver of the business registration fee for 2020-21: Under this proposal, local companies registered under the one-stop-shop registration scheme will be eligible for a waiver of the business registration fees.
- One-off tax reduction: Under this proposal, one-off reduction of profits tax, salaries tax and tax under personal assessment for the year of assessment 2019/20 by 100%, subject to a ceiling of \$20,000 per case. The proposed reduction will reduce taxpayers' amount of tax payable for the year of assessment 2019/20

### **Singapore: Budget 2020 tax proposals**

Singapore Budget 2020 was delivered to Singapore Parliament recently. Some of the key proposals inter alia are as follows:<sup>[4]</sup>

- Extension of the Double Tax Deduction for Internationalization (DTD<sub>i</sub>) scheme till 31 December 2025. Under the DTD<sub>i</sub> scheme, businesses are

allowed a tax deduction of 200% on qualifying market expansion and investment development expenses, subject to approval from Enterprise Singapore or the Singapore Tourism Board (“STB”).

- Extension of tax incentives for venture capital funds and venture capital fund management companies. To continue encouraging venture capital funding for Singapore-based companies, the Section 13H scheme and Fund Management Incentive will be extended until 31 December 2025.
- Tax deduction scheme for Research and Development – Currently incentives for R&D expenditure are provided by a weighted deduction of 200% on these expenditures. The budget as now proposed to increase these weighted deductions to 250% of the R&D expenditure.
- Capital Gains exemption on the sale of ordinary shares- Singapore does not tax gains on disposal of ordinary shares subject to satisfying certain conditions stipulated under Section 13Z of ITA. To provide upfront certainty to companies in their corporate restructuring, the scheme under Section 13Z will be extended to cover disposals of ordinary shares by companies from 1 June 2022 to 31 December 2027. The scheme though is not applicable for shares of a company which is into the business of trading, holding, developing immovable properties in Singapore or abroad.

## III. Australia

### **Tax Payer Alert on non-arm's length arrangements and schemes connected with the DEMPE of intangible assets**

The Australian Tax Office (ATO) released a taxpayer alert on intangible assets.<sup>[5]</sup> The alert focuses on aspects pertaining to arrangements that concerns:

- Bifurcation of intangible assets and mis-characterization of Australian DEMPE activities.
- Cost contribution arrangements.

The ATO considers that these transactions do not appropriately remunerate Australian entities for functions performed, assets used and risks assumed in connection with intangible assets. They may also involve the migration of Australian intangible assets and associated rights to international related parties on non-arm's length terms or in a manner intended to avoid tax in Australia. Two arrangements concerning the bifurcation of intangible assets and non-recognition of DEMPE activities in Australia are considered as examples and highlighted as to how taxes are being avoided in Australia.

## IV. Europe

### **European Union updates the list of non-cooperative tax jurisdictions<sup>[6]</sup>**

The European Union as part of its commitment to improving tax good governance on a global level evaluates jurisdictions based on tax good governance standards through three factors – tax transparency, fair taxation and real economic activity. It publishes a list of non-cooperative jurisdictions, in order to maximise efforts against tax fraud, evasion and avoidance. Recently, the EU Finance Ministers updated this list. As part of the updated list, 12 jurisdictions have been added to the list of non-cooperative tax jurisdictions: American Samoa, Fiji, Guam, Oman, Samoa, Trinidad and Tobago, US Virgin Islands, Vanuatu; Cayman Islands, Palau, Seychelles and Panama. These jurisdictions have failed in their commitment to live up to the tax governance standards set by the EU. Further around 12 jurisdictions such as Bahamas, Bermuda, Vietnam etc. have been delisted from the list as they have complied with the good governance standards.

### **European Court of Justice Ruling: Tax Loss Set-off - Aures Holding**

Recently the European Court of Justice (CJEU) in the case of Aures Holding<sup>[7]</sup> held that freedom of establishment under the EU law (Article 49 of the Treaty on the Functioning of The European Union) does not require a Member State to take into account tax losses accrued by a company in the Member State of prior tax residence. The request was submitted in proceedings between the Aures Holdings and the Czech Republic tax authority concerning the latter's rejection of a claim for tax-loss by Aures Holdings which sought to deduct from its taxable profits in the Czech Republic the losses incurred by it in Batavia when it was a tax resident of Netherlands.

The Tax Appellate Directorate of the Czech Republic Kingdom denied the loss claim made by Aures Holdings on the grounds that the change of tax residency from the Netherlands to the Czech Republic does not entitle Czech to allow the losses, since under the Czech Republic tax laws such cross-border losses can be entertained only under situations envisaged under the EU Merger Directive which is transposed in its domestic law. The change of tax residency through changing the place of effective management is not envisaged under the EU directive, and therefore the Czech tax authorities denied the cross-border loss claim on the grounds of a mere transferring of the place of management to Czech Republic from the Netherlands.

The CJEU ruled in favour of the Czech Republic tax court and held that freedom of establishment does not require a Member State (Czech Republic) to take into account tax losses accrued by a company in the Member State of prior tax residence (Netherlands) as it will amount to tax advantage and claim of loss twice.

## V. Americas

### **United States Of America (USA): Regulations Relating to Withholding and Reporting Tax on Certain U.S. Source Income Paid to Foreign Persons**

The USA Treasury and the Internal Revenue Service (IRS) issued final regulations (TD 9890) relating to FATCA reporting and chapter 3 regulations.<sup>[8]</sup> Final regulations provide guidance on certain due diligence and reporting rules applicable to persons making certain U.S. source payments to foreign persons, and guidance on certain aspects of reporting by foreign financial institutions on U.S. accounts. The final regulations affect persons making certain U.S.-related payments to certain foreign persons and foreign financial institutions reporting certain U.S. accounts. The final regulations inter alia address on a collection of foreign taxpayer identification number, limitation on benefits for treaty claims, third party withholding certificates and withholding statements, electronic signatures etc.

## VI. Africa

### **South Africa: Budget 2020 Tax Proposals**

South Africa's Minister of Finance delivered his 2020 Budget on 26 February 2020. Some of the key taxation proposals are<sup>[9]</sup>:

- Dividends received by individuals from South African companies are generally exempt from income tax, but dividends tax, at a rate of 20%, is withheld by the entities paying the dividends to the individuals. Dividends received by South African resident individuals from REITs (listed and regulated property-owning companies) are subject to income tax and non-residents in receipt of those dividends are only subject to dividends tax.
- Most foreign dividends received by individuals from foreign companies (shareholding of less than 10% in the foreign company) are taxable at a maximum effective rate of 20%. No deductions are allowed for expenditure to produce foreign dividends.
- Revised thin capitalization rules wherein Interest deduction to be restricted to 30% of EBITDA in line with the global principles particularly factoring BEPS Action Plan 4. Further, the proposal for the thin capital revision is placed for public comments.<sup>[10]</sup>
- The participation exemption related to the disposal of shares in a company that ceased to be a resident and dividends arising from previous tax-deductible expenses will be disallowed. Further, the foreign company dividend participation exemption will not be available to REITs.

## SECTION 2

- [1] OECD (2020), Transfer Pricing Guidance on Financial Transactions: Inclusive Framework on BEPS Actions 4, 8-10, OECD, Paris. <http://www.oecd.org/tax/beps/transfer-pricing-guidance-on-financial-transactions-inclusive-framework-on-beps-actions-4-8-10.htm>
- [2] OECD (2020), Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy – January 2020, OECD/G20 Inclusive Framework on BEPS, OECD, Paris. [www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf](http://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf)
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- [8] <https://www.federalregister.gov/documents/2020/01/02/2019-27979/regulations-relating-to-withholding-and-reporting-tax-on-certain-us-source-income-paid-to-foreign>
- [9] <https://www.sars.gov.za/AllDocs/Documents/Budget/Budget%202020/Budget%20Tax%20Guide%202020.pdf>
- [10] <http://www.treasury.gov.za/documents/National%20Budget/2020/Tax%20Treatment%20of%20Excessive%20Debt%20Finance.pdf>



# FINANCE ACT, 2020 KEY HIGHLIGHTS

By: Utkarsh Mehta



## ***Deferring the provision of Significant Economic Presence ('SEP') and modification thereto:***

The concept of SEP, which constituted business connection ('BC') in India, was introduced in Indian Income tax Act ('the Act') with effect from 1 April 2019. However, determination of SEP of a non-resident in India was subject to fulfillment of certain threshold limits. Since the discussion on this matter is still pending at G20 – OECD BEPS project, the threshold limits are not yet notified under the Act. The final report by G20 – OECD is expected to be issued by December 2020 and thus Finance Act 2020 has deferred the provisions of SEP by one year.

Further, one of the conditions to trigger SEP currently is 'systematic and continuous soliciting of business activities or engaging in interaction with users in India through digital means'. Finance Act 2020 has included offline means as well. The following are the illustrative list of business activities that may create SEP risk (consequently BC risk) after the amendments:

- Non-residents availing Business Process Outsource/ Knowledge Process Outsourcing service for customer support to redress the grievance of its Indian customers.
- Non-residents availing tele-shopping service in India to advertise and promote goods in India.

## ***Amendment on scope of operations carried out in India:***

Non Residents having BC in India shall be taxable only on such part of income as is reasonably attributable to 'operations carried out in India'. Currently, there are no specific guidelines under the Act on income which is reasonably attributable to BC in India. New explanation have now been inserted by Finance Act 2020 to provide clarity on scope of operations carried out in India which states that the income attributable to the operations carried out in India shall include income from:

- such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India;
- sale of data collected from a person who resides in

India or from a person who uses internet protocol address located in India; and

- (iii) sale of goods or services using data collected from a person who resides in India or from a person who uses internet protocol address located in India.

### ***The above amendment will take effect from A.Y 2021-22.***

In light of the above amendment, Multinational companies carrying out aforesaid activities would have to scrutinize/ monitor the business activities closely and evaluate whether such a change would impact the activities or not.

### ***Scope of Advance Pricing Agreement ('APA') and Safe Harbour Rules ('SRH') expanded:***

Allocation of profits to BC / Permanent Establishment ('PE') in India is one of the important issues to be addressed. Central board of Direct tax had earlier issued rules for allocation of profits to BC/ PE which has failed to create much impact. The existing provisions of APA and SHR, which were introduced to create certainty for the tax payers, are currently applicable only for international transactions. In order to create certainty for taxpayer Finance Act 2020 has expanded the scope of applicability enabling CBDT to notify safe harbour rules or enter into APAs for profit attribution to PE/ BC in India or property in India or asset or source of Income in India or any capital asset situated in India.

In light of the amendment, taxpayers who have already concluded APAs covering all the functions/ risks or all international transactions have been considered for determining arms-length price, may need to re-visit their existing APA and consider filing of new APAs application for foreign company/ PE to optimise certainty.

The amendment for SHR will be applicable with effect from Assessment Year ('A.Y.') 2020-21 and the amendment for APA will apply for all the agreement concluded on or after 01 April 2020.

### ***Preponement of due date of filing Transfer pricing report:***

Finance Act 2020 has amended the law to prepone the due-date of filing transfer pricing accountant's report (i.e. Form 3CEB) from 30 November to 31 October of the relevant A.Y. Accordingly, even transfer pricing study reports would have to be prepared and maintained on or before 31 October of the relevant A.Y.

However, since master file has to be filed on or before the due date of filing Income Tax Return, the due date for filing master file (i.e. form 3CEAA) continues to be 30 November of the relevant A.Y.

### ***The above amendment will take effect from A.Y. 2020-21.***

Exclusion of PE of non-resident bank for the purpose of Thin Capitalisation:

The concept of Thin capitalisation was introduced in Indian Income tax laws with effect from 01 April 2018 pursuant to BEPS Action 4. This was intended to address Base erosion and profit shifting through use of intra-group finance arrangements by exploiting the tax rule that interest is allowed as tax deduction whereas dividend is not.

With the introduction of this concept, interest paid to the Associated Enterprises ('AE') is allowed only to the tune of 30% of Earnings before Interest, Depreciation, Tax and Amortisation ('EBIDTA'). The definition of AE includes enterprises who have advanced loan for more than 51% of the book value of the total assets of the recipient. Consequently, PE of non-resident bank is also covered under definition of AE.

Various representations were received to exclude PE of non-resident banks from Thin capitalisation and thus to avoid genuine hardship, PE of non-resident bank has been excluded, with effect from A.Y. 2021-22, for the purpose of Thin Capitalisation.

However, whether the above exclusion also applies to loan taken directly from non-resident bank (not an Indian PE) remains uncertain.

### ***Abolishment of Dividend Distribution Tax ('DDT'):***

The concept of DDT regime was re-introduced in the Act from April 2003 as it was easier to collect the tax at single point. Since then, there always existed an uncertainty for foreign holding companies, to avail tax credit of DDT paid in India in their home country.

With the advent of technology and availability of easy tracking system, Finance Act 2020 has amended the law to move to classical system of levying tax on shareholders for dividend declared on or after 01 April 2020. With this move, all the foreign holding companies, which are currently not required to pay any tax on dividend income in India, will be liable to pay tax on said income. Consequently, tax paid in India will be allowed as credit in home country in accordance with respective tax treaties.

### ***Modification in scheme of Dispute Resolution Panel ('DRP'):***

DRP objections can presently be filed when there is a variation to income or loss as shown by the taxpayer in his return of income. Finance Act 2020 now amends section 144C to provide that DRP objections can be filed

## SECTION 3

in case of 'any variation' prejudicial to the interest of taxpayer (Thus covering penalty orders etc).

### ***Further, all the non-residents can now file DRP objections.***

The above amendments will take effect from A.Y 2020-21. Accordingly, the amendment shall apply to any draft assessment order passed on or after 1 April 2020.

### ***Modification in residency rules:***

Currently, citizens of India or the person of Indian origin are considered as non-resident if they visit India and stay for less than 182 days in previous year.

There may be instances where an individual having substantial economic activities in India manages his/her stay in India (for a period close to 182 days) so as to remain non-resident and avoid paying tax on global income in India. In order to avoid such arrangements leading to revenue loss to the government, Finance Act 2020 has amended the law to reduce the number of days of visit to 120 days in a year.

### ***The above amendment will be effective from A.Y 2021-22.***

### ***Changes in definition of royalty:***

Royalty definition under Income tax currently excludes

'any consideration for sale, distribution or exhibition of cinematographic films'. Thus, the same is taxable only if there is business connection in India and said income is attributable to such business connection.

Due to such exclusion, royalty is not taxable in India even if the DTAA gives India the right to tax such royalty. Finance Act 2020 deletes such exclusion with effect from A.Y. 2021-22.

With this move, any income from sale, distribution or exhibition of cinematographic films will be taxable in India irrespective of BC.

### ***Insertion of preamble of Multilateral Instrument ('MLI') in domestic tax law:***

Section 90 and 90A of Indian Income tax Act empowers government to enter into tax treaties with foreign countries or specified associations. Pursuant to the power granted, India has signed MLI on 07 June 2017 and deposited the ratified copy with OECD on 25 June 2019.

### ***India has also adopted to modify the preamble of its existing tax treaties through MLI.***

In order to achieve the MLI modification, Section 90 and 90A of Indian Income-tax Act has been amended to include MLI preamble text.



# IFA CONFERENCES EVENTS

## IFA India Earlier Held Events:

**DATE:** February 3, 2020

**PLACE:** New Delhi, India

**EVENT:** Finance Bill 2020 Discussion

**DESCRIPTION:** Panelists for the discussion were Mr. Ajay Vohra, Mr. Mukesh Butani, Mr. G C Srivastava, Mr. Kamlesh Varshney, Mr. Vijay Iyer, moderated by Mr. Arun Giri.

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• Finance Bill 2020 Discussion at IIC, New Delhi

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• Masterclass on FTS held on January 11, 2020 (1)

**DATE:** January 11, 2020

**PLACE:** IFA India Academy, Noida, India

**EVENT:** Study Circle Meeting - India Master Class on "Taxation of Fee for Technical Services (FTS)"

**DESCRIPTION:** The Study Circle had Mr. Ajay Vohra, Sr. Advocate as Expert Faculty. It was moderated by Ms. Ishita Farsaiya and Mr. Joseph K. Antony and assisted by Dr. Shashwat Bajpai (YIN Team).

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• Masterclass on FTS held on January 11, 2020 (2)

## IFA Worldwide Earlier Held Events:

**DATE:** March 17, 2020

**PLACE:** London, United Kingdom

**EVENT:** KCL/CIOT-ADIT/IFA International Tax Conference

**DESCRIPTION:** Program topics include Emerging GAARs in international tax, Taxation and the digital economy, International tax dispute resolution now and looking ahead & Tax aspects of future UK trading relations.

**WEBSITE:** [www.adit.org/jointconference](http://www.adit.org/jointconference)

**E-MAIL:** [events@tax.org.uk](mailto:events@tax.org.uk)

**DATE:** March 10, 2020

**PLACE:** Lisbon, Portugal

**EVENT:** The judicial approach to tax justice: Concerns, challenges and compromises

**DESCRIPTION:** Dulce Neto, President of the Portuguese Supreme Administrative Court

**WEBSITE:** [www.afp.pt](http://www.afp.pt)

**E-MAIL:** [afp@afp.pt](mailto:afp@afp.pt)

**DATE:** March 6, 2020

**PLACE:** Lisbon, Portugal

**EVENT:** Exchange of information and the new reporting duties on taxpayers and intermediaries: limitations to tax, bank and professional secrecy and to the right to privacy

**DESCRIPTION:** Speaker Dr. Antonio Menconca Mendes, Secretary of State for Fiscal Affairs.

**WEBSITE:** [www.afp.pt](http://www.afp.pt)

**E-MAIL:** [afp@afp.pt](mailto:afp@afp.pt)



# IFA INDIA BRANCH NEWS LETTER

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## IFA-INDIA

International Fiscal Association - India (IFA-India) is a society registered in Delhi (India) under the Societies Registration Act, 1860. It operates in India through its Head Office in the National Capital Region (NCR) and four regional chapters in North, South, East and West. IFA-India is governed by an Executive Committee which presently has 26 members with 6 elected office bearers among them. IFA-India is engaged in promoting better understanding on the subject of international tax and the related fiscal laws. It organises conferences, seminars, workshops, training courses and encourages discussions and conversations through various other modes like webinars and social media. The membership includes tax administrators, tax policy experts, tax court judges, and tax professionals from corporates and from consultancy. It has set up an International Tax Academy at Noida where regular learning and knowledge sharing programs are held on the theme subject.

## IFA

IFA-India is a part of International Fiscal Association headquartered in the Netherlands (IFA). Established in the year 1938 as a non-profit organisation, IFA provides a neutral and independent platform where representatives of all professions and interests can meet and discuss international tax issues at the highest level. IFA has played an essential role in both, the development of certain principles of international taxation and in providing possible solutions to problems arising in their practical implementation. Its objects are study and advancement of international and comparative law with regard to public finance, specifically, international and comparative fiscal law and the financial and economic aspects of taxation. IFA seeks to achieve these objects through its Annual Congresses and the scientific publications relating thereto as well as through scientific research. Although the operations of IFA are essentially scientific in character, the subjects selected take account of current fiscal developments and changes in local legislation.

The membership of IFA now stands at more than 12,000 from 106 countries. In 62 countries, including India, IFA members have established IFA branches and IFA-India is one of those 62 branches world over. IFA-India has also taken initiatives to encourage young IFA members and Women IFA members to participate in its initiatives through YIN (Young IFA Network) and WIN (Women IFA Network).

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