

Question 1

Ambal Dairy Company Ltd (“Ambal”) is one of the largest milk producing companies in India. It uses the latest technology to automate milking-related tasks and monitor the cows for more accurate decisions about health and nutrition. These technology assisted techniques have shown improved profitability, animal health, lifestyle and milk quality.

Kirisudu (Pvt) Ltd (“Kirisudu”) is a company incorporated in Sri Lanka, which is in the business of producing milk for the local market. The board of directors of Kirisudu has realised that as the company uses traditional methods in its milk production process, the costs involved are very high. Accordingly, the company had entered a “Technology Transfer Agreement (TTA)” with Ambal to automate its processes. Based on the TTA, Kirisudu will be obtaining the following products/services from Ambal.

Nature of product/service	Price	Payment terms
Initial set-up cost Ambal will build the framework and technology platform to introduce technology to the milk production process. This is required for the purpose of collaborating through technical guidance and to obtain both tangible and intangible co-operation from Ambal.	USD 300,000	At the time of entering the TTA
Running royalties After the technology transfer, Kirisudu will be required to pay a royalty to Ambal for the use of the technology.	USD 0.5 per every liter of milk produced	At the end of every month
Brand use charges Kirisudu will be allowed to use the “Ambal” brand for its milk products.	USD 1 per every liter of milk sold using the “Ambal” brand	At the end of every month

Financial information for the Y/A 2020/21

The employees of Ambal were in Sri Lanka at the milk production facility of Kirisudu from May 2021 to February 2022, in order to set up the framework and technology platform.

Kirisudu was able to use the technology introduced from 1 January 2022 when producing milk. The company was of the view that using the Ambal brand for its high-end milk products would increase its market share in that segment. Accordingly, the Ambal brand was used on certain products and brand use charges were paid as agreed.

Details for the quarter ended 31 March 2022 were as follows.

Month	Milk produced using new technology (in liters)	Milk products sold with Ambal brand (in liters)
January 2020	4,000	270
February 2020	8,000	530
March 2020	9,500	610

Ambal has incurred the following expenses relating to the project with Kirisudu.

	USD
Costs (including airfare) in relation to employees in Sri Lanka	73,500
General administrative costs including employee cost in India	7,800
Cost of equipment used in the project (as material)	156,000

The finance director of Ambal is of the view that it would have been more tax efficient if they had subcontracted the work relating to the initial set-up process. Suriya (Pvt) Ltd (Suriya) is an independent subcontractor in Sri Lanka who undertakes similar projects for other customers in Sri Lanka. The amount quoted by the subcontractor for this project was USD 250,000 (including the cost of equipment). If the initial set-up process had been subcontracted to Suriya, the employees of Ambal would have had to visit Sri Lanka only for about 5-7 days.

(Assume USD 1 = Rs. 350)

(Extracts of Articles 5, 7, 12 and 15 of the double tax treaty between Sri Lanka and India is given in Annexure 1 (pages 11-13) for your reference)

Required:

(a) Analyse if Ambal is required to pay income tax in Sri Lanka on the following income:

- (i) Initial set-up fee
- (ii) Running royalties and brand use charges

Support your answer citing relevant statutory provisions of the Inland Revenue Act No. 24 of 2017 and articles of the double tax treaty between Sri Lanka and India. (9 marks)

(b) Assess the taxable income and income tax liability including remittance tax of Ambal as a non-resident company in Sri Lanka for the Y/A 2021/2022. (8 marks)

(c) Evaluate the tax exposure for Ambal in Sri Lanka if the initial set-up process had been subcontracted to Suriya. (3 marks)

(d) Advise whether the employees of Ambal India who were working in Sri Lanka from May 2021 to February 2022 are liable to pay personal income tax in Sri Lanka. (5 marks)