

LUTHRA & LUTHRA LLP

CHARTERED ACCOUNTANTS



INTERNATIONAL TAXATION ISSUE JULY 2022

Highlights



- Central Government retains tolerance-range at 1% for wholesale traders & 3% for all others for AY 2022-23
- CBDT notifies Form 8A to make application u/s 158AB to defer filing of appeal on identical issues
- ICAI releases exposure draft Guidance Note on report u/s.92E of the Act
- CBDT releases MLI synthesised text for India- Hungary DTAA
- Argentina backs inclusion of crypto assets in International mechanisms for automatic exchange of Information
- Maltese Government to implement specific TP Rules on arm's length principle as per Global standards
- The Evolution of Transfer Pricing in Saudi Arabia
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News Highlights



Central Government retains tolerance-range at 1% for wholesale traders & 3% for all others for AY 2022-23

Central Government retains tolerance range u/s 92C at 1% for wholesale traders and 3% for all other taxpayers for AY 2022-23. The Central Government hereby notifies that where the variation between the arm's length price determined under section 92C of the said Act and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one percent of the latter in respect of wholesale trading and three per cent of the latter in all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for assessment year 2022-2023.

In notification they clarify the meaning of wholesale trading to remove all the doubts.

CBDT notifies Form 8A to make application u/s 158AB to defer filing of appeal on identical issues

CBDT, vide Notification No. 83/2022 dated Jul 12, 2022 renumbered the existing Rule 16 as Rule 15A and inserted a new Rule 16. The new Rule 16 provides that the application, referred to in section 158AB required to be made before the ITAT/High Court, shall be made in Form No. 8A by the AO.

ICAI releases exposure draft Guidance Note on report u/s.92E of the Act

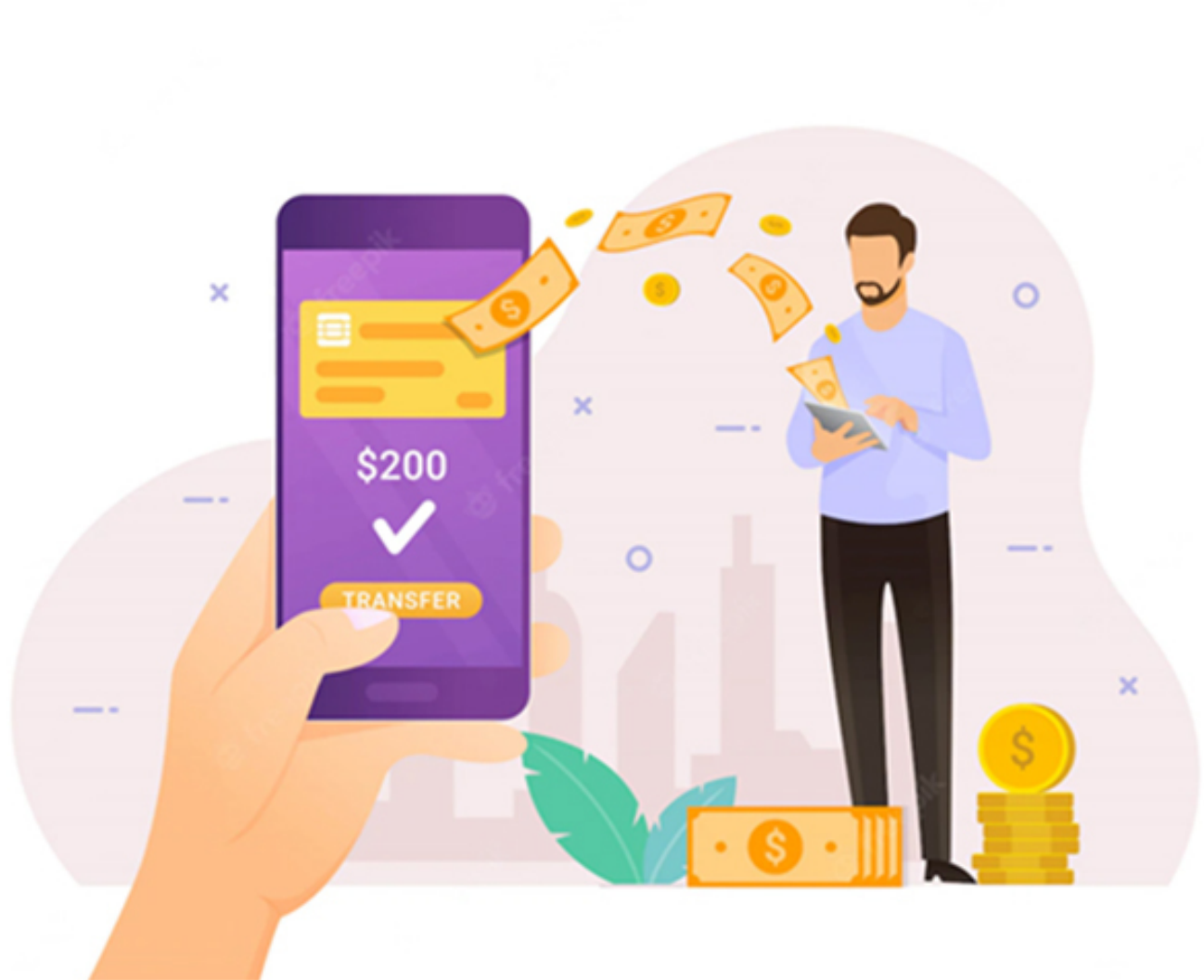
The Committee of ICAI on International Taxation releases exposure draft Guidance Note on report u/s. 92E of the Act and invites comments by 1st August, 2022. This Exposure Draft incorporates amendments made by Finance Act, 2022. It also highlights that a new Sec.158AB has been inserted after Sec.158AA by the Finance Act, 2022 in order to prevent filing of repetitive appeals.



Exposure draft also highlights the amendment made under Finance Act, 2022 that extends the last date for issuing directions/notification for faceless ALP determination u/s.92CA, faceless DRP u/s.144C, faceless appeal/proceedings before the ITAT under Sec. 253/ 255 from March 31, 2022 to March 31, 2024.

CBDT releases MLI synthesised text for India-Hungary DTAA

The Central Board of Direct Taxes (CBDT) has released the synthesized text for India- Hungary DTAA., incorporating the changes made by the MLI on the basis of respective positions taken by both the countries. The MLI provisions that are applicable are included in boxes in the relevant provisions of convention.



Indian/Global Updates



Argentina backs inclusion of crypto assets in International mechanisms for automatic exchange of Information

Argentina's head of Tax Authority has expressed its support for development of measures aimed at including digital currencies, electronic money and crypto assets in the international mechanisms for automatic exchange of information led by the OECD.

Argentina's Central Bank, prevented financial entities from carrying out or allowing their clients to carry out transactions in such digital assets and crypto assets which have not been expressly authorized by it or any other national regulatory entity.

Maltese Government to implement specific TP Rules on arm's length principle as per Global standards

The Maltese government has devoted to implementing explicit transfer pricing rules in harmony with the current global standards related to the arm's length principle. While it does refer to documentation requirements to be issued at a later stage, the Maltese transfer pricing consultation document is silent on whether OECD-style Master file and Local file requirements will be introduced in Malta.

OECD release new transfer pricing profiles for Egypt, Liberia, Saudi Arabia and Sri Lanka

OECD release new transfer pricing profiles for Egypt, Liberia, Saudi Arabia and Sri Lanka. These countries profile focus on countries' domestic legislation regarding key transfer pricing principles, including the arm's length principle, transfer pricing methods, comparability analysis, intangible property, intra-group services, cost contribution agreements, transfer pricing documentation, administrative approaches to avoiding and resolving disputes, safe harbours and other implementation measures. The information contained in these profiles is intended to clearly reflect the current state of countries' legislation and to indicate to what extent their rules follow the OECD Transfer Pricing Guidelines.



Transfer Pricing / B E P S



Netherlands' new TP decree in alignment with OECD

On July 1, 2022 the Dutch Ministry of Finance published a new transfer pricing decree replacing the previous decree providing guidance on, application of the Arm's Length Principle and the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations in alignment with OECD Guidelines.

The Decree reflects the changes as a result of the BEPS project of the OECD, including the Additional Guidance on the attribution of profits to Permanent Establishments issued by the OECD in 2018.

It contains new sections on financial transactions, changes to policy on group services, government support measures in response to the pandemic and textual changes to bring the terminology used more in line with the terminology used in OECD guidelines.

The Decree urges the Dutch tax authorities to be flexible in their approach and not to require the taxpayer to set its transfer pricing with an accuracy that is unrealistic given all the facts and circumstances.

Apart from highlighting the application of arm's length principle and its nuances, the decree also details out TP methods, secondary adjustments, tangible fixed assets and transactions related to them (including difficult to value intangibles), Services within a group, Cost Contribution arrangement (CCA), Group Purchases, Financial transactions, Documentation obligation, early consultation on possible double taxation, etc.

Lesotho deposits an instrument for the ratification of the Multilateral BEPS Convention

Lesotho has deposited its instrument of ratification for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS Convention) thus underlining its strong commitment to prevent the abuse of tax treaties and base erosion and profit shifting (BEPS) by multinational enterprises.

The BEPS Convention will enter into force on 1 November 2022 for Lesotho.



Issue of the month



Foreign Tax Credit

History

When a taxpayer is resident in one country but has a source of income situated in another country, it gives rise to possible double taxation. This arises from the two basic rules that enable the country of residence as well as the country where the source of income exists to impose tax namely: the source rule and the residence rule.

In order to avoid double taxation of the same income in the hands of the taxpayer, it became important to provide relief of taxes paid in another country.

Section 295 of the Income Tax Act gives power to the Board to make rules for the whole or any part of India for carrying out the purposes of this Act. In Sec 295(2), a new clause (ha) was inserted by the Finance Act 2015 through which the power is given to Board to lay down the procedure for granting of relief or deduction, as the case may be, of any income tax paid in any country or specified territory outside India u/s 90 or 90A or u/s 91 against the income tax payable under this Act. With this Statutory power, Rule 128 has been inserted in Income Tax Rules w.e.f. 1 April 2017.

Introduction

Foreign tax shall mean –

- a) In respect of a country or specified territory outside India with which India has entered into an agreement for the relief or avoidance of double taxation of income in terms of section 90 or 90A, the tax covered under the said agreement.
- b) In respect of any other country or specified territory outside India the tax payable under law in force in that country or specified territory in the nature of income tax referred to in clause (iv) of explanation to section 91.



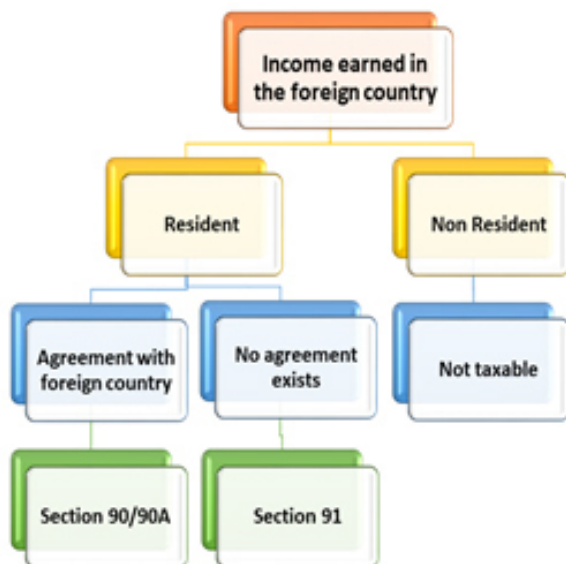


Fig 1- taxability of foreign income

Foreign Tax is tax paid in foreign country on income derived in foreign country by an Assessee. It can also be tax deducted at source in the foreign country on the source of income generated by a resident in foreign country. Such amount of tax which is paid/deducted in foreign country can be claimed as credit against the tax liability in the country of residence. This is known as foreign tax credit.

As per Rule 128 of Income Tax Rules 1962-

An Assessee being a resident of India shall be allowed a credit for the amount of any foreign tax paid by him in a country outside India to avoid double taxation on the same income.

In a case where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India.

Computation of foreign tax credit

The FTC shall be computed for each source of income arising from each country.

The credit allowable is lower of tax payable under the Income Tax Act ("the Act") on such income and actual foreign tax paid on such income.

In case where the foreign tax paid exceeds the amount of tax payable according to the Double tax avoidance Agreement such excess is ignored.

The credit is determined by conversion of currency of payment of foreign tax at Telegraphic Transfer Buying Rate ("**TTBR**") on last date of the month immediately preceding the month in which the tax has been paid.

In the case where tax is payable under MAT/ AMT under the Act, the credit of foreign tax is allowed against such tax in the same manner as is allowable against any tax payable under the provisions of the Act.

Foreign tax in Dispute-

- The FTC shall be available only against the amount of tax, surcharge and cess payable under the Act but not in respect of any sum payable by way of interest, fee or penalty.
- No credit shall be allowed in respect of any amount of foreign tax or part thereof which is in dispute in any manner by the Assessee but the credit of such disputed tax shall be allowed for the year in which such income is offered to tax or assessed to tax in India if the Assessee within six months from

the end of the month in which the dispute is finally settled furnish evidence of settlement of dispute.

Documents to be submitted for claiming FTC: -

In accordance with Rule 128, in order to claim FTC, the taxpayer is required to file following documents **on or before due date of filing of return:**

- A statement of computation of Income of country outside India and foreign tax deducted or paid on such income in form No.67.
- A certificate or statement specifying the nature of income and the manner of tax deducted therefrom or paid by the Assessee from –
 - a) The tax authority of that country or
 - b) The person responsible for deduction of such tax or
 - c) The assessee.

In such case, the assessee also needs to provide acknowledgement of online payment of tax or bank counter foil or challan for payment of tax where the payment has been made by the assessee and proof of deduction of tax where the tax has been deducted.

Form 67

Form 67 is a document that has to be furnished in order to claim FTC by a taxpayer. The statement in form 67 and a certificate or statement as referred above should be furnished on or before the due date of filing return of income under section 139(1) i.e. the original return of income.

Form no. 67 shall also be furnished in a case where the carry backward of loss of current year results in refund of foreign tax for which credit has been claimed in earlier previous year or years.

The CBDT, vide notification no. 9/2017 dated 19 September 2017 has prescribed the procedure for filing Form 67 which have been enumerated here:

- Form 67 is to be prepared and submitted online for taxpayers who are mandated to file their income tax returns electronically;
- Digital Signature Certificate (DSC) or Electronic Verification Code (EVC) is mandatory to submit Form 67;
- Submission of Form 67 shall precede the filing of return of income.

Comments:

FTC rules specify reporting of carry backward of losses of the current year whereby it results in a refund of foreign tax for which credit has been claimed in earlier years.

Further, FTC rules also provide a guideline for granting tax credit if and when the tax dispute in the foreign country is settled against the taxpayer.

Also, the aforesaid rules provide that where income on which foreign taxes are paid is reflected in multiple years, the credit of taxes shall be allowed proportionately.



Legal Corner



LEGAL CORNER

Deputy Commissioner of Income Tax vs Sikka Ports & Terminals Ltd.

Facts of the case:

Sikka Ports & Terminal Ltd. (**'Assessee'**) is engaged in the business of port infrastructure facilities and engineering, construction and consultancy services. During the year under consideration i.e. Assessment Year ("AY") 2013-14, the Assessee gave certain corporate guarantees to third party undertaking the contractual and other obligation of its Associate Enterprise (**'AE'**) and benchmarked the guarantee commission using '**yield spread approach**' (*Yield spread method takes into consideration maximum fee which a borrower would pay, resulting from the spread between the current market interests that would have been payable by the borrower without guarantee and with guarantee*) at 35 basis point i.e. 0.35% on the basis of quotation obtained from Royal Bank of Scotland ('RBS') wherein they have stated that potential financing for a similar direct facility for the Assessee's AE is expected to carry an interest pricing differential of 70 basis points.

The said differential was apportioned between the Assessee and its AE in 50:50 ratio. Accordingly, the arm's length price ("ALP") for issuing corporate guarantee was computed at 0.35%.

The case of the Assessee was selected for scrutiny. The case was referred to Transfer Pricing Officer ('TPO') for determination of ALP. The Ld. TPO held that RBS quote cannot be a sound basis for computing the interest differential as it was dated April 1, 2013 i.e. after the end of relevant previous year. Instead, the Ld. TPO computed ALP of corporate guarantee at 1.5% considering information requisitioned from HDFC Bank and SBI which had quoted 1.80% and 1.08% to 2.1% for all type of guarantees. Accordingly, an upward adjustment of Rs 2,81,99,740 was made in the draft assessment order.

Aggrieved by the order of the assessing officer (**'AO'**) the Assessee filed an appeal before the Ld. Commissioner of Income Tax (Appeals) ("CIT(A)").



The Ld. CIT(A) relying on the case of Hon'ble Bombay High Court CIT vs Everest Kanto restricted the ALP adjustment to the extent of 0.5% .

Aggrieved by the above judgement of CIT(A), a cross appeal was filed by the Revenue and the Assessee, before the Hon'ble ITAT Mumbai Bench.

Assessee's Contentions

- The Assessee contended that the Ld. TPO has erred in treating the guarantee given by Assessee to third party for giving loan to its AE as International Transaction within the meaning of section 92B r.w.s. 92(1) of the Act.
- Further, it was contended by the Assessee that the Ld. CIT(A) has erred in determining the ALP of guarantee commission given by the Assessee on behalf of AE at 0.50% p.a. instead of 0.35%.

Revenue's Contention

- The Ld. AO challenged the order of the Ld. CIT (A) in directing to restrict the TP adjustment of corporate guarantee commission to 0.5% instead of 1.5%.
- Further, it was contended by the that the Ld. CIT(A) has mistakenly relied on the Everest Kanto case which is in violation of provision of Rule 10B(4) of the Income Tax Rules on contemporaneous nature of data as credit rating and the interest rate vary each year.

- Additionally, it was submitted by the AO that the Ld. CIT (A) has arrived at the adhoc rate of 0.5% without adopting any of the methods prescribed in section 92C of the Act which is violation of law.

Hon'ble ITAT

The Hon'ble ITAT on the above contention gave the following decisions:

- The Tribunal quashed the contention of the Revenue by stating that while adopting yield spread approach, it is not necessary that the quotes for the interest rates, with guarantee and without guarantee, strictly be as on the date of entering into transaction. This is because the material factor is the difference between these rates and not the quantum of these rates.
- Further, the Tribunal upheld the contention of the Assessee stating that where the difference between the market interest rate for the guarantor and the guarantee is 70 bps at the end of the relevant previous year, it is reasonable to conclude that such differential would also prevail during the relevant previous year.
- Further, it was held that the quotation obtained from HDFC Bank and SBI are for the bank guarantees and not corporate guarantees given to bank to support bank guarantees. The aforesaid guarantees are materially different.

- Additionally, it was held that the right comparable for application of CUP would have been the corporate counter guarantee issued to the bank for the benefit of an AE. However, since the revenue wrongly rejected yield spread method, the Tribunal refused to deal with 'clearly defective application of CUP method'.

- Hence, the benchmarking of corporate guarantee was upheld at 0.35% as adopted by the Assessee is in the light of yield spread approach.

Comments

Indian TP regulations do not provide for any benchmarking method for guarantee transactions. However, the Indian tax authorities have often used external comparable guarantee rates provided by banks as the comparable uncontrolled price for benchmarking the transaction of guarantee fees whereas at Tribunal level, bank guarantee has been differentiated from that of corporate guarantees.

In the instant case, Mumbai ITAT has upheld the use of yield spread method for benchmarking corporate guarantee by reiterating the fact that the rate differentiation is only an approximation and every variation in such rates need not affect the variation between with guarantee and without guarantee interest rates.

Further, it has been reiterated in the above case that bank guarantees are not comparable to corporate guarantees.



Glossary



Act	Income Tax Act, 1961
A.Y.	Assessment Year
ALP	Arm's Length Price
AO	Assessing Officer
ACIT	Assistant Commissioner of Income Tax
BEPS	Base Erosion and Profit Shifting
CBDT	Central Board of Direct Taxes
CIT	Commissioner of Income Tax
FTC	Foreign Tax Credit
FY	Financial Year
IT	Income Tax
ITAT	Income tax Appellate Tribunal
ITO	Income Tax Officer
ITR	Income Tax Return
ITBA	Income Tax Business Application
MNE	Multinational Enterprises
MAP	Mutual Agreement Procedure
OECD	Organisation for Economic Co-operation and Development
PCIT	Principal Commissioner of Income Tax
PAN	Permanent Account Number
TDS	Tax Deducted at Source
TPO	Transfer Pricing Officer
SLP	Special Leave Petition
UK	United Kingdom
US	United States

GET IN TOUCH

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