LUTHRA & LUTHRA LLP

CHARTERED ACCOUNTANTS

International Taxation

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News Highlights

CBDT Amend e-Advance Rulings Scheme

CBDT vide Notification No. 38/2023, made amendments to the e-Advance Rulings Scheme, 2022. The purpose of these amendments was to address situations where Members of the Board for Advance Rulings (BAR) having different opinions on specific matters. According to amendment, if the Members of a BAR have different opinions then the BAR shall refer the matter to the PCCIT (International Taxation). The PCCIT shall then nominate one Member from any other BAR to assist in resolving the differences.

CBDT Notified Rs.25 Lac for leave encashment exemption under Sec.10(10AA)

CBDT, vide Notification No. 31/2023, issued a revised exemption limit under Section 10(10AA) for leave encashment received by non-government employees on retirement. The new exemption limit is set at Rs.25 Lac. Prior to this notification, the exemption limit for leave encashment was Rs.3 Lacs. This notification shall be effective from Apr 1, 2023.

CBDT Notified e-Appeals Scheme, 2023 and amends Rules 45 and 46A along with Form No. 35

CBDT issued a notification regarding the e-Appeals Scheme, 2023 to incorporate the changes suggested by the Finance Act, 2023.

Additionally, the CBDT has amended the Rules 45 and 46A to accommodate the newly created position of JCIT(A) regarding their authority and responsibilities in handling appeals in specified cases.

To support the implementation of the e-Appeals Scheme, 2023, the CBDT had also made amendment Form No. 35.

CBDT issued Guidelines on online gaming winnings

The CBDT issued guidance regarding winnings from online games under section 194BA. The guidelines cover various aspects including the computation of Net Winnings, taxation of borrowed money, treatment of bonuses and referrals, and more.

Additionally, the CBDT has notified Rule 133, which outlines formulas for calculating Net Winnings in Online Gaming for the purposes of Sections 115BBJ and 194BA. The Rule also provides formulas for TDS under Section 194BA, applicable at different stages such as the first withdrawal, subsequent withdrawals, and year-end. Furthermore, the Rule clarifies the circumstances in which the net winnings will be considered zero.

CBDT proposed 5 more valuation methods in Rule 11UA

The CBDT released Draft Rule 11UA to implement the amendment made to Section 56(2) (viib) by the Finance Act, 2023. The amendment is to incorporate the inclusion of consideration received from non-residents for the issuance of shares into section 56(2) (viib) of the Income-tax Act, 1961. Proposed rules now include 5 more valuation methods with respect to valuation of shares, available for non-resident investors, in addition to the DCF and NAV methods of valuation The Draft Rules also propose safe harbour provision of 10%, valuation report by the Merchant Banker for the purposes of Rule 11UA. The notification also lists down entities which are excluded from section 56(2) (viib)

CBDT amends Rule 11UAC of Income Tax Rules, 1962

CBDT recently issued Notification No. 35/2023. This notification brought changes to Rule 11UAC (4), effective from April 1, 2023. The rule had reference to an exception to the applicability of Section 56(2)(x).

The amendment specified that Section 56(2)(x) will not be applicable to "any movable property, specifically equity shares, of either a public sector company or a company received by an individual from a public sector company, the Central Government, or any State Government under strategic disinvestment."
The Amendment shall come into force from 1st April 2023 and onwards.

Indian/Global Updates

Sierra Leone joined the Global Forum as 168th member

Sierra Leone became the 168th member of the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum).

Sierra Leone will participate on an equal footing and is committed to combatting offshore tax evasion through the implementation of the internationally agreed standards of exchange of information on request (EOIR) and automatic exchange of financial account information (AEOI).

Sierra Leone will also join the Africa Initiative, a programme of work launched in 2014 to support domestic revenue mobilisation and the fight against illicit financial flows in Africa through enhanced tax transparency and exchange of information.

Viet Nam deposited BEPS MLI ratifying instrument

The Instrument of ratification for the Multilateral Convention had been deposited by Viet Nam to Prevent Base Erosion and Profit Shifting (BEPS Convention) which will enter into force on 1 September 2023.

OECD informed that as on Jun 1, 2023 1200 treaties concluded among the 81 jurisdictions had ratified, accepted or approved the BEPS Convention and had already been modified by the BEPS Convention and around 650 additional treaties will be modified once the BEPS Convention will have been ratified by all signatories.

Uzbekistan joined the Inclusive Framework on BEPS

Uzbekistan joined the OECD/G20 Inclusive Framework on BEPS and had committed to addressing the tax challenges arising from the digitalisation of the

economy by joining the two-pillar plan to reform the international taxation rules and ensure that multinational enterprises pay a fair share of tax wherever they operate.

Uzbekistan will participate on an equal footing with all other members of the Inclusive Framework in implementation of BEPS package of 15 measures.

Transfer Pricing / B E P S

Global Forum launched Model Administrative Compliance Strategy for effective information exchange

A Model Administrative Compliance Strategy had been developed by Global Forum Secretariat (GFS) to assist jurisdictions in developing, improving and implementing their own administrative compliance strategy to ensure the effectiveness of the Standard for Automatic Exchange of Financial Account Information in Tax Matters (AEOI).

GFS launched the Methodology for implementation of the risk-based approach to administrative compliance and risk matrices, that can be used to develop or improve the risk assessment approach of the jurisdictions. 181 delegates from 59 jurisdictions attended this event and the assessment tool and its user guide are available on demand to all interested jurisdictions in English.

The Model Strategy, the CRS Notification Tracking tool, and the Methodology for implementation of the risk-based approach launched this year complement the Toolkit for the Implementation of the Standard for Automatic Exchange of Financial Account Information, which was released in 2021.

SGATAR and AIIB joined global fight against tax evasion as observers of Global forum

The Study Group on Asia-Pacific Tax Administration and Research **(SGATAR)** and the Asian Infrastructure Investment Bank **(AIIB)** became the 22nd and 23rd observers of the Global Forum on Transparency and Exchange of Information for Tax Purposes **(Global Forum)** respectively.

SGATAR and AIIB will participate in Global forum plenary meetings and other major events and will contribute to the international information exchange as a powerful tool to tackle cross-border tax evasion and improve domestic resource mobilization in Asia and beyond.

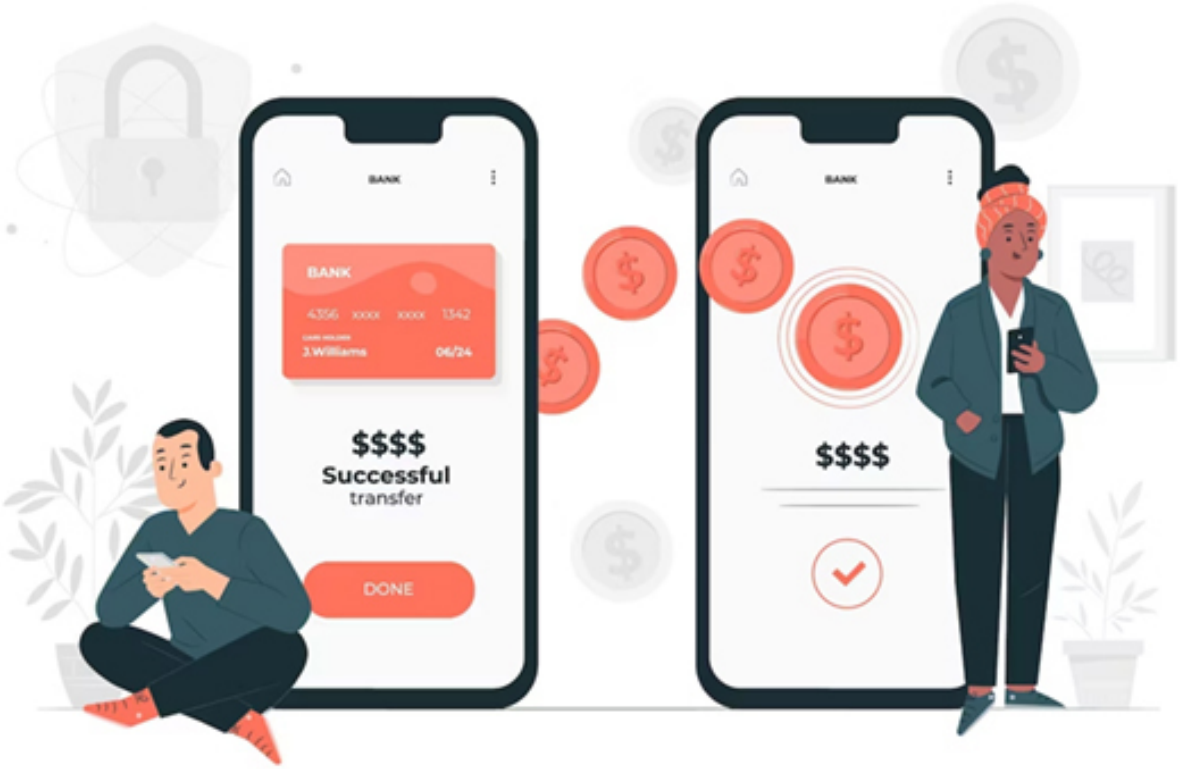
NADT hosted G20 event on International Tax in collaboration with South Centre

National Academy of Direct Taxes (NADT), Nagpur in collaboration with South Centre organised a two-day

event on International Taxation on the 1 and 2 June, 2023 a Geneva-based intergovernmental policy research think-tank of 55 developing countries, including India.

Indian tax administrators and policy makers agreed on the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF). The event was attended by International tax experts from the United Nations Tax Committee, Tax Justice Network Africa, West African Tax Administration Forum and Independent Commission for Reform of International Corporate Taxation, as panellists.

The discussions during the event focussed on the ramifications of the Two-Pillar Solution for the developing economies and also included a workshop on Tax Treaty Negotiations. The event also included a cultural evening showcasing the vibrant culture of the state of Maharashtra to the participants and concluded with an excursion for the foreign delegates to explore the rich heritage of Nagpur



Issue of the month

Issue of the month

Transfer Pricing in the process of Merger and Acquisition

Introduction

Merger and acquisition **('M&A')** involves the process of combining two companies into one. It is usually bundled into one term, but they are fundamentally very different. In merger another company ceases to exist but in later case both continues to hold their legal structure.

The core objective of combining two or more entities is to beat the competition and achieve synergy. International M&A has gain the popularity among multinational enterprises **('MNEs')** considering the need of expanding the global business while increasing their market share globally.

While undertaking the international M&A, the parties must ensure that they have proper mechanism in the place to comply with the international tax laws and transfer pricing provisions in order to avoid the penal consequences due to non-compliance. Transfer pricing provisions becomes crucial when the M&A is undertaken between associated enterprises as it is necessary to undertake the transactions at arm's length and other non-compliance may attract penalties on both the entities.

In the case of GlaxoSmithKline(GSK) the tax authorities had challenged the transfer price of acquisition of the SB Pharmco Puerto Rico. As per the US tax authorities the consideration paid to SB Pharmco Puerto Rico was not at arm's length and has shifted the profit in the form of over payment of patent. Later on, the case reached the Supreme Court of Canada where discussion was made on applicability of the arm's length principles and it was remanded back to the lower authorities for determination of arm's length.

The case of GSK was settled with additional payment of interest and penalty.

There are another cases of international courts as well where M&A transactions were in appeal on the ground that it was not undertaken at arm's length and additional tax payment were required to settle the dispute. Some of the cases are judgement of Federal Court in the case of IBM and IBM Australia, US Tax Court in the case of Coca Cola etc.

Some of the Transfer Pricing considerations during M&A process

1. Review of Transfer pricing policies and documentation

It is important to understand the transaction to be undertaken during the M&A between associated enterprises considering the transfer pricing compliances of respective country.

Some provisions may contradict but in order to avoid any penal consequences the transaction must be structured considering the transfer pricing provisions of respective country and along with proper documentation.

2. The inter-company transaction must have economic substance

The transactions must have a business purpose and depict the commercially substance of undertaking the transaction. If the inter-company transaction fails to meet the economic substance it may results to transfer pricing penalties.

3. Assess the Impact of Transfer Pricing Laws and Regulations

The impact of transfer pricing laws and regulations should be assessed during the M&A process to determine the potential tax exposure of the transaction. This includes a review of the transfer pricing filing requirements in the jurisdictions where the company operates.

4. Review of inter-company agreements

Agreement is the base for transactions undertaken between the associated enterprises and this helps to establish that the transactions are undertaken as per the terms and conditions laid down in the agreement.

Further, this will help in maintaining proper documents as required under transfer pricing provisions to support that it comply with the relevant provisions.

5. Consider the Impact of Business Restructurings

A restructuring generally involves the transfer of assets, functions and risks from one related entity to another related entity.

Proper consideration of transfer pricing regulations in the corporate restructuring must be considered in order to avoid the penal consequences.

6. Acquisition of Intangibles

The company may acquire marketing intangibles, such as trade names or market recognition which can significantly affect the companies functional profile and can provide it economic benefits such as increase in sales. The acquisition may require transfer pricing adjustments therefore while acquiring a company with intangibles careful consideration of transfer pricing provisions is necessary.

Conclusion

In conclusion, compliance with transfer pricing provisions is crucial when it comes to international transactions, particularly in the context of mergers and acquisitions. As businesses expand their global footprint and engage in cross-border activities, it becomes imperative to ensure that intercompany transactions are conducted at arm's length.

Adhering to transfer pricing regulations helps maintain transparency, fairness, and consistency in cross-border transactions, while also mitigating the risks of tax disputes and penalties.

Legal Corner

Sapien Funds Ltd Vs CIT(International Taxation)

INTRODUCTION AND BRIEF FACTS[1]

Sapien Funds Limited **('Assessee')** is a Mauritius based company having its permanent establishment in Mauritius. It is managed by Sapien Capital (Mauritius) Limited **('SCML')**, and both SCML and its directors are tax residents of Mauritius.

The Assessee is a Collective Investment Vehicle regulated by the Financial Service Commission of Mauritius. It is also authorized by the SEBI to act as a Foreign Portfolio Investor in India.

The Assessee has no establishment in India, and its investors are from various countries around the world, none of whom are residents of India. The fund's activities in India are limited to investments in government securities, exchange-traded cash equities, and trades in exchange-traded derivatives, equity, and currency. The books of accounts of the fund are maintained in Mauritius.

The management company and the fund do not have a permanent establishment in India, and all their substantive functions, decision-making processes, approvals, control, and management are carried out outside India.

The assessee had declared an exempt income of Rs. 12,93,77,569/- on account of gains on currency derivatives and the interest income on bonds for the AY 2017-18. The assessment of the assessee was competed u/s 143(3) after accepting the exempted income and assessed the total income as NIL.

Later on, the Ld. CIT, u/s 263, held that the AO has not properly examined the claim of the assessee and cited the following reasons:

[1]TS -308-ITAT-2023 (DEL)

1) The scheme of arrangement employed by the assessee is a tax avoidance through treaty shopping mechanism

2) The assessee company is just a conduit and the real owner is the shareholders/investors who are tax residents of different countries

3) The TRC is not sufficient to establish the tax residency if the substance establishes otherwise.

4) The assessee company is also not a beneficial owner of income as control and dominion of fund is not with the company.

5) There is no commercial rationale of establishment of assessee company in Mauritius as the commercial outcomes would be identical irrespective of location of funds.

Further, it was held that income would be chargeable to tax in India on gross basis at the rate given u/s 115A the Act because assessee was not entitled to benefit of Article 11 of the India- Mauritius DTAA.

CONTENTIONS OF REVENUE

Before the Hon'ble ITAT, Revenue contended that the assessee is not entitled to avail benefits under India-Mauritius DTAA because:

- Assessee is not a resident for tax purposes because of non-fulfillment of condition of "liable to tax" criteria.
- It is a classic case of treaty shopping to avoid payment of taxes by exploiting tax treaties.
- . Revenue stated that the assessee company is not the beneficial owner of income because the control and dominion of the fund is not with the company. And that there is no commercial rationale for establishing the assessee company in Mauritius since the commercial outcomes would be identical regardless of the location of funds.
- A Tax Residency Certificate **('TRC')** alone was insufficient to establish tax residency if the actual substance of the arrangement indicated otherwise

Further it was argued that the company was engaging in tax avoidance and was not the beneficial owner of the income. Company was a conduit because the company's 21 investors were not tax residents of Mauritius, reliance on Vodafone international holdings v union of India (2012)341 ITR1(SC) was placed this this regard where it was held that to ascertain the taxability of cross border transaction business activity as whole was required to be ascertained.

ARGUMENTS OF ASSESSEE

On the contentions raised by the Revenue, the Ld. AR for assessee argued that currently there is no definition of "liable to tax" in the Income Tax Act. However, Finance Act 2021 inserted a provision which define the term "liable to tax" and this amendment will take prospective effect from April 2021.

Ld. AR further contended that TRC shall constitute sufficient evidence for accepting the status of residence as well as beneficial ownership for applying DTA benefits.

The ld. AR relies on CBDT Circular 789 of April 13, 2000 which defines the resident as a person liable to taxation in a state based on domicile, residence, place of management, or similar criteria and states that the DTAA applies to residents of both India and Mauritius.

Ld. AR also mentioned that foreign institutional investors and investment funds operating from Mauritius are considered as residents of Mauritius under the DTAC.

DECISION OF Hon'ble ITAT

After considering the facts and contentions of the parties, Hon'ble ITAT held that the assessee company is entitled to treaty benefits as the tax exemption is provided by the resident country. Further, the afore-said exemption doesn't give an automatic right to the revenue authorities to tax the income in the contracting state.

Hon'ble ITAT further placed reliance on the ruling of the Hon'ble Delhi High Court in a case of **Blackston Capital Partners(Singapore) VI FDI Three Pte Ltd V ACIT in CM Appeal 7332/2002** wherein it was held thc TRC is the only evidence required to be eligible for th benefit under the DTAA.

The Hon'ble ITAT also rejected the CIT's finding that th company was a conduit because the company's 1 investors were not tax residents of Mauritius.

Moreover, the ITAT criticized the CIT's attempt t question the TRC and go behind it, stating that it i contrary to the consistent policy and assurances c. the Indian government to foreign investors

CONCLUSION

This ruling provides the clarity on the application of tax treaties and strengthens the position of foreign investors for tax purposes. This judgement has reaf-firmed the eligibility of the assessee to avail benefits under the India-Mauritius DTAA based on TRC that is considered valid evidence of tax residency.

Glossary

Act	Income Tax Act, 1961
A.Y.	Assessment Year
AE	Associated Enterprises
ALP	Arm's Length Price
AO	Assessing Officer
AIIB	The Asian Infrastructure Investment Bank
BEPS	Base Erosion and Profit Shifting
CBDT	Central Board of Direct Taxes
TDS	Tax Deducted at Source
GFS	Global Forum Secretariat
ITO	Income Tax Office
TP	Transfer Pricing
TPO	Transfer Pricing officer
PCCIT	Principal Chief Commissioner of Income Tax
JCIT	Joint Commissioner of Income Tax
MTC	Model Tax Convention
EOIR	Exchange of Information on request
AEOI	Automatic Exchange of Financial Account Information
IIR	Income Inclusion Rule
UTPR	Undertaxed Profits Rule
CIT	Commissioner of Income Tax
FSSAI	Food Safety and Standards Authority of India
SC	Supreme Court
SGATAR	The Study Group on Asia-Pacific Tax Administration and Research
HC	High Court
NADT	National Academy of Direct Taxes
TRC	Tax Residence Certificate
DTAA	Double Taxation Avoidance Agreement
SCML	Sapien Capital (Mauritius) Limited

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DELHI

A-16/9 & A-16/4, Vasant Vihar, New Delhi – 110 057.
+91-11-42591800, 42591818
delhi@llca.net
www.llca.net