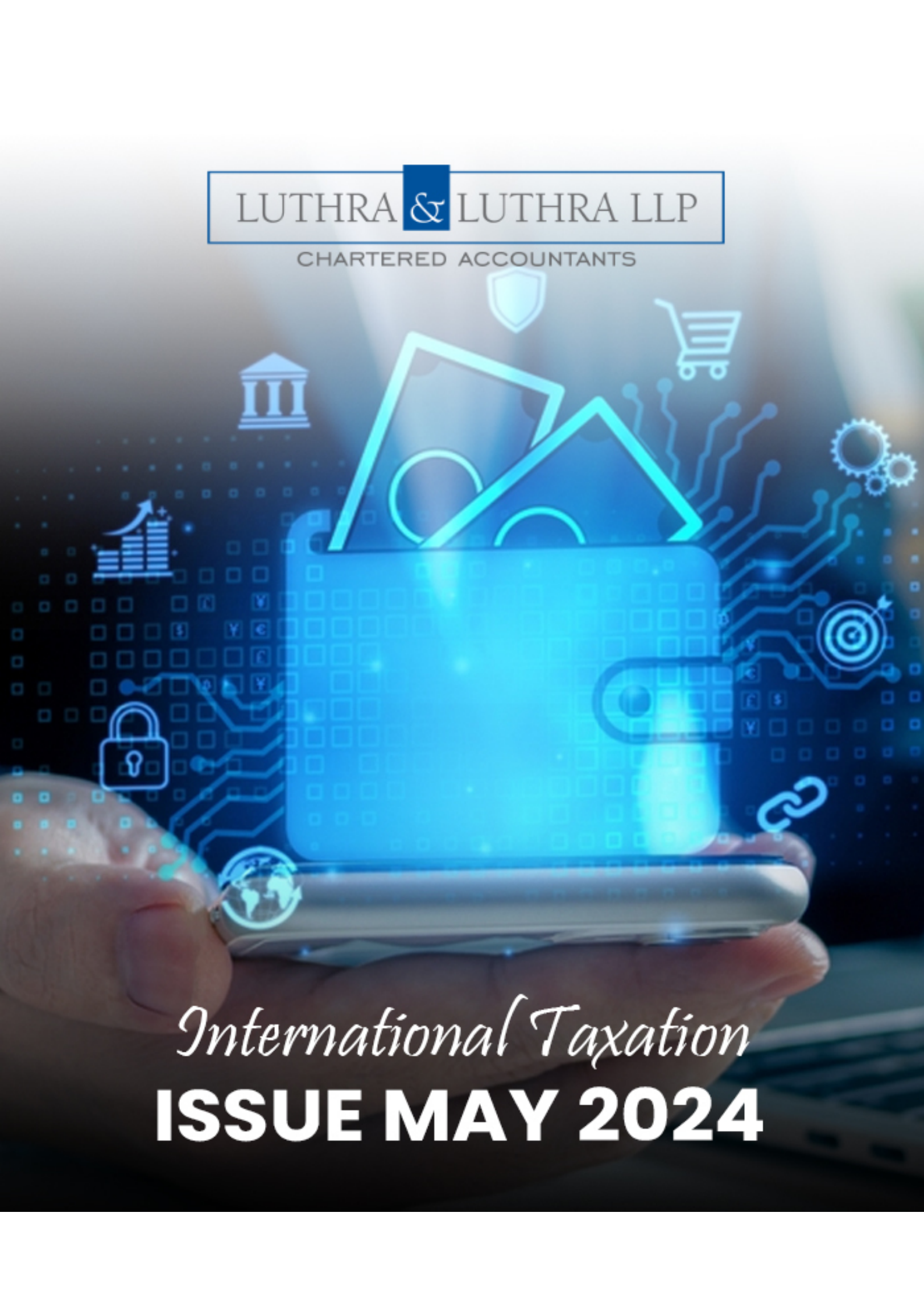


LUTHRA & LUTHRA LLP

CHARTERED ACCOUNTANTS



International Taxation
ISSUE MAY 2024

Highlights



- CBDT extended PAN-Aadhaar linkage deadline to May 2024
- CBDT Circular extends Form 10A & 10AB due date
- CBDT issues compulsory case selection guidelines for 'Complete Scrutiny' for FY 2024-25
- CBDT clarified cases to be done through Computer Assisted Scrutiny Selection (CASS) cycle
- OECD released "Consolidated Commentary on the GloBE Rules" with intended outcomes & illustrations
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News Highlights



CBDT extended PAN-Aadhaar linkage deadline to May 2024

CBDT vide Circular No. 6/2024 modified Circular No. 3/2023 wherein it was provided that consequences of non-intimation of Aadhaar shall apply from Jul 1, 2023. The above said modification allowed the linking of PAN and Aadhaar on or before May 31, 2024 making transactions entered upto Mar 31, 2024 not liable be taxed at a higher rate under Section 206AA/206CC.

CBDT Circular extends Form 10A & 10AB due date

CBDT vide Circular No. 7/2024 extended the due date for filing of Form 10A & 10AB. CBDT, through circular, also clarified that where application is already filed in Form 10AB and PCIT/CIT has not passed an order before the issuance of this Circular, the pending application may be treated as a valid application

and a fresh application may be filed if PCIT/CIT has rejected application on or before issuance of this circular on the account of application being furnished after the due date or the application been furnished under the wrong section code. Additionally, it also provided an option for existing trusts, institutions, or funds that missed the deadline for filing Form 10A for the assessment year 2022-23 to surrender their provisional registration and apply for registration as an existing entity within the extended timeframe.

CBDT issued compulsory case selection guidelines for 'Complete Scrutiny' for FY 2024-25



CBDT issued guidelines for the compulsory selection of returns for complete scrutiny during FY 2024-25. These guidelines cover various cases such as surveys, search and seizure operations, notices under Section 142(1) for non-filing of returns, etc. The circular also provided that the cases shall be selected for compulsory scrutiny by the International Taxation and Central Circle charges following prescribed parameters and procedure with prior administrative approval of the concerned PCIT/PDIT/CIT and the information pertaining to Compulsory Scrutiny may not be transferred to NaFAC unless the case itself is transferred.

CBDT clarified cases to be done through Computer Assisted Scrutiny Selection (CASS) cycle

CBDT clarified that where return has been furnished in response to notice under Section 142(1) and such notice was issued due to the information contained in Non-filers Monitoring System (NMS) Cycle or Annual Information Statement (AIS) or so more, such return will not be taken up for compulsory scrutiny and will be done through Computer Assisted Scrutiny Selection (CASS) cycle.



Indian/Global Updates



OECD released "Consolidated Commentary on the GloBE Rules" with intended outcomes & illustrations

The OECD has released the Consolidated Commentary on the Global Anti-Base Erosion (GloBE) Model Rules for 2023. This comprehensive document includes the Agreed Administrative Guidance issued by the OECD G20 BEPS Inclusive Framework from March 2022 to December 2023. The Commentary aims to explain the intended outcomes of the GloBE Rules, clarify specific terms, and demonstrate the application of these rules to various scenarios. By providing detailed guidance on the interpretation and implementation of the GloBE Rules, the Commentary seeks to ensure a consistent and uniform approach, facilitating coordinated outcomes for both tax administrations and multinational enterprise (MNE) groups.



Transfer Pricing / B E P S



BEPS Action 6 shows steady progress against treaty shopping across jurisdictions

The OECD's latest peer review results on BEPS Action 6 reveal that most tax treaties among the 142 members of the OECD/G20 BEPS Inclusive Framework are already compliant or will soon comply with the treaty shopping minimum standard. The OECD notes that the BEPS Multilateral Instrument (MLI) has significantly expanded the implementation of this standard, now covering 102 jurisdictions and approximately 1900 bilateral tax treaties. The report highlights the BEPS

MLI's crucial role in implementing the Action 6 standard. India reported that out of its 96 tax agreements, 54 meet the minimum standard. India currently uses the Principal Purpose Test (PPT) and aims to adopt the Limitation of Benefit clause through bilateral negotiations in the future.



Issue of the month

“Limitation of Benefit” Clause in Tax Treaties: A Comprehensive Study

Introduction

The critical problem of double taxation, where a certain income was taxed in two different nations, was tackled by the introduction of Double Taxation Avoidance Agreements (“DTAAs”). These DTAAs, signed between two countries for prevention of same income to be taxed twice, have proven to be a valuable resource in the realm of international taxation. However, there was a strong possibility that the benefits under these DTAAs could have been exploited. Therefore, to prevent the possible treaty abuse and limit the benefits of a treaty to only qualified people, these treaties included an anti-abuse provision which was known as “Limitation of benefit” (“LOB”) clause.

What is LOB Clause?

To limit the benefits of a DTAA only to the residents of the contracting states and restricting any other person (resident of any third state) from availing the same, LOB clause was introduced.

The LOB clause is a key feature and an anti-abuse provision in a DTAA which is designed to prevent treaty abuse and which further ensures that the benefits of the DTAA extends only to the legitimate residents of the countries between which such treaty was signed.

This clause lays down the conditions and criteria for a resident to qualify so that it may avail the benefits of DTAA.

The LOB clause can also be considered a tool which prevents the taxpayers from inappropriately reducing tax liabilities ensuring prevention of revenue losses for the country in which the income of a taxpayer was liable to be taxed.

OECD’s Recommendations



OECD in its “Articles 29 – Entitlement to Benefits” of Model Tax Convention has provided detailed provisions as to who shall be eligible to the benefits of a treaty. These provisions, however, shall be subject to various adaptations and different approaches followed by different nations, which aims to prevent the problems caused by “Treaty Shopping”.

OECD has defined the residents who are eligible for the availing of benefits under a DTAA referring to them as “qualified person” in this Article.

A “qualified person”, according to OECD, is a resident of a contracting state for a fiscal year only if such a resident tends to be:

- an individual, or
- contracting states, political subdivisions and their
- agencies & instrumentalities, or
- publicly-traded companies & entities and so on.

Note: The above clauses are subject to certain conditions which are in detail discussed in the “Commentaries on the Articles of Model Tax Convention”.

These provisions also provide disqualification of certain entities towards availing benefits of DTAA and also illustrates as to who can avail the benefits of a treaty other than the above mentioned “qualified person”.

These above provisions can be seen as incorporated in the DTAA with Armenia.

A Prime example of need for Limitation of Benefit Clause – Indo-Mauritius DTAA

The treaty signed between India & Mauritius, before the introduction of LOB clause, was considered to provide an opportunity for treaty shopping as this treaty required the capital gains to be taxed only in the country where the assesses resided and hence excluded levy of Indian income tax on capital gains derived on sale of Indian shares, by residents of Mauritius.

The above provision of DTAA provided a motivation to investors to invest in Indian companies by setting up entities in Mauritius.

This led to a big controversy regarding abuse of Mauritius DTAA. While tax administration as well as judiciary grappled with the problem for long, it was resolved only through insertion of a ‘*Limitation of Benefit*’ clause on 1st April 2017 after a prolonged negotiation between Government of India and Government of Mauritius.

‘*Article 27A – Limitation of Benefits*’ has been introduced in the Indo-Mauritius DTAA to withdraw the advantage from a resident of a Contracting State if its affairs were arranged with the primary purpose to take advantage of DTAA between India and Mauritius.

¹https://read.oecd-ilibrary.org/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017_mtc_cond-2017-en#page50

Sub-Clause (3) of Article 27A highlights conditions for classifying an entity as a shell/conduit company. It specifies that if expenditure on operations in the contracting state is less than Mauritian Rupee(MUR) 15,00,000 or Indian Rupees(Rs.) 27,00,000 in the immediately preceding 12 months, then the resident shall be considered as a shell/conduit company.

Whereas Sub-Clause (4) provides that a company will not be deemed to be a shell company if it is listed in a recognized stock exchange in any one of the Contracting States.

Other examples of different LOB Clauses

LOB has been embedded in many Indian DTAA's to prevent treaty abuse. Some of such clauses are discussed below:

1. United Kingdom of Great Britain & Northern Ireland:

'Article 28C – Limitation of Benefits' in the India-UK DTAA restricts the resident of a contracting state from availing the benefits of the treaty if the main purpose or one of the main purposes of the creation or existence of such a resident or of the transaction undertaken by him, was solely to obtain benefits of the treaty.

2. United States of America:

'Article 24 – Limitation of Benefits' specifies three different tests to provide a resident with the benefits accruing under this treaty.

The tests so embedded in the treaty are:

- The Ownership and Base Erosion Test
- Active Business Connection Test
- Recognized Stock Exchange Test

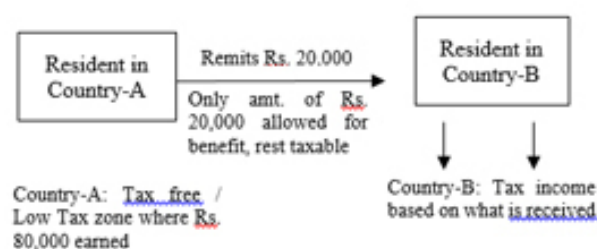
In spite of an entity failing in these above-mentioned tests, the competent authority of the source country may still grant the treaty benefits to an entity if it so determines.

Note: Similar tests also exist in tax treaties with Iceland & Mexico.

3. Singapore:

'Article 24 – Limitation of Relief' in the India-Singapore DTAA provides that if the income from one country say Country-A is either tax-free or taxed at a lower rate in that country and the other country say Country-B taxes that income based on what is received there rather than the full amount, then the tax exemption or reduction in the Country-A shall apply only to the part of the income that is sent or received in the Country-B.

The below given figure explains the above-mentioned clause:



The above treaty also includes Article 24A which lays down the criteria regarding determination of a shell/conduit company and companies which are not to be considered as shell/conduit companies for the purpose of availing benefit under this treaty.

Conclusion

LOB clause in DTAA has been a pivotal step to reduce the incidents of '*treaty shopping*'. The stringency of LOB clause varies significantly from one DTAA to another, depending upon various tax policies and treaty objectives of the contracting states

Legal Corner



In the High Court of Bombay

Vivek Jaisingh Asher vs. Income Tax Officer, Ward 19(3)(1)

Introduction & Brief Facts

Vivek Jaisingh Asher ("**The Petitioner**") along with his brother were tenants in a flat on first floor of a building in Bombay.

A development agreement was executed on 11th August 2014 between the owner of building and the developer. The owner of the building granted development rights to develop the building on terms and condition mentioned in development agreement. The developer was also required to provide permanent alternate accommodation to tenants and occupants as per the agreement.

Consequently, the petitioner was allotted a flat in a new building called "Arkade Rise "on 19th February 2020. The stamp duty of the said flat was 11.68 crores. The Assessee claimed capital gain deduction under section 54F on the ground that surrender of his tenancy rights has fetched a consideration of 11.68 Crores.

For Assessment Year ("**AY**") 2020-21, the petitioner filed its return of income declaring total income of INR 3,11,410/- The case was selected for scrutiny to examine capital gain deduction claimed.

During the course of proceedings, the petitioner received a Show Cause Notice ("**SCN**") dated 23 August 2022 calling upon the petitioner to show cause as to why the stamp duty value of the new flat being 11.68 crores should not be treated as deemed income under section 56(2)(x) of the Income Tax Act ("**The Act**") and deduction under section 54 of the Act be denied.

In response to above, the petitioner filed a reply for the said notice explaining that petitioner has fetched the consideration 11.68 crores on surrender of his tenancy rights which had been invested in the new flat and hence is entitled to deduction under section



54 of the Act. The petitioner also made various submissions during the course of proceedings.

Despite the submissions made by the petitioner, the revenue passed the final assessment order to treat entire stamp duty value as “unexplained investment” under section 69, without making any reference to section 56(2)(x), as stated in show cause notice.

Aggrieved & dissatisfied by the same, the Assessee filed a writ petition before the Honourable High Court (“Hon’ble HC”) of Bombay.

Argument of Revenue

The revenue stated that no further SCN was issued as the order was getting time barred.

Decision of Hon’ble HC

The Hon’ble HC observes that ‘issuance of SCN is not an empty formality’. Its purpose is to give reasonable opportunity to the affected persons to effectively deal with the allegations in the SCN.

The Hon’ble HC holds that principle of reasonable opportunity as envisaged in the statute is fulfilled only when the Assessee has been given the opportunity to rebut the allegations given in the SCN.

Further, The Hon’ble court observes that the original SCN is also defective as it fails to specify the exact provisions under which the Revenue seeks to assess i.e., either under Section 56(2)(x)(a) or Section 56(2)(x)(b), both of which deals with deemed addition. Also points out that revenue had completely

disregarded Section 56(2)(x) and proposed addition under Section 69 of the Act. Thus, Hon’ble HC quashed the assessment-order.

Comment

The SCN fulfills a fundamental requirement to be fulfilled by the income tax authorities, prior to the imposition of any adverse order upon the Assessee. It provides an opportunity to the taxpayer to present its side and counter the proposed action of the tax authorities.

The SCN is crucial as it upholds the principles of natural justice and provides the Assessee an opportunity to produce evidence in support of the specific allegation.

The recent judgment of Hon’ble HC emphasized that order issued without following the procedural requirement may be deemed invalid.

Glossary



Act	Income Tax Act, 1961
A.Y.	Assessment Year
AE	Associated Enterprises
ALP	Arm's Length Price
AO	Assessing Officer
APA	Advance Pricing Agreement
BEPS	Base Erosion and Profit Shifting
CSP	Captive Service Providers
CBDT	Central Board of Direct Taxes
CIT	Commissioner of Income Tax
CAPM	Capital Asset Pricing Model
CUP	Comparable Uncontrolled Price Method
DR	Departmental Representative
DRP	Dispute Resolution Panel
DGIT	Directorate General of Income Tax
DST	Digital Service Tax
DTAA	Double Taxation Avoidance Agreement
FA	Finance Act
GMT	Global Minimum Tax
HC	High Court
ITAT	Income Tax Appellant Tribunal
ITR	Income Tax Return
IRD	Interest Rate Differential Method
ITO	Income Tax Office
JCIT	Joint Commissioner of Income Tax
LOB	Limitation of Benefit

Glossary



MNE	Multi-National Enterprise
MAM	Most Appropriate Method
NR	Non-Resident
OECD	Organisation for Economic Cooperation and Development
PAN	Permanent Account Number
PCCIT	Principal Chief Commissioner of Income Tax
PE	Permanent Establishment
PPT	Principal Purpose Test
SDT	Specified Domestic Transactions
TDS	Tax Deducted at Source
TP	Transfer Pricing
TNMM	Transaction net margin method
TPO	Transfer Pricing officer

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