

LUTHRA & LUTHRA LLP

CHARTERED ACCOUNTANTS



International Taxation
ISSUE OCTOBER 2023

Highlights



- CBDT notified Angel Tax Rules with new valuation methods & safe harbor.
- CBDT extended due date for Charitable Institutions' audit & ITR-7 filing.
- CBDT notified Form-6D for Inventory Valuation Report
- CBDT notified Form 71 for claiming TDS credit under Sec.155(20)
- CBDT notified Rules & Forms for search & seizure provisions
- CBDT notified "West Bengal Pollution Control Board" for Sec.10(46) exemption
- Eswatini deposited instrument for the ratification of the Multilateral BEPS Convention
- USA expanded the use of 'CHATBOT' to assist individuals on tax notices
- International Community adopted multilateral convention for facilitation of Global Minimum Tax
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News Highlights



CBDT notified Angel Tax rules with new valuation methods & safe harbor

CBDT vide Notification no. 81 / 2023 dated September 25, 2023, amended Rule 11UA by introducing a mechanism for arriving at a Fair Market Value (FMV) of Compulsorily Convertible Preference Shares (CCPS) from investments of residents & non-residents. The Notification also provides that the valuation of CCPS can also be based on FMV of unquoted equity shares.

CBDT notified Form 6D for Inventory Valuation Report under Section 142(2A)

CBDT vide Notification No. 82 / 2023 dated September 27, 2023, amended Rule 14A to provide Form 6D as Report of Inventory Valuation required to be furnished under Section 142(2A)(ii). Further, CBDT has also amended Rule 14B providing guidelines for determining expenses for special audit to apply for inventory valuation.

CBDT notified Form 71 for claiming TDS credit under Sec.155(20)

CBDT, vide Notification No. 73 / 2023 dated August 30, 2023, inserted Rule 134, to newly introduced section 155(20) by Finance Act 2023. According to the Rule 134, the application shall be made in form no. 71 electronically and shall be furnished to Principal / Director General of Income-tax (Systems) or the person duly authorised. The Rule shall come into force from Oct 1, 2023 and onwards.



CBDT notified Rules & Forms for search & seizure provisions

CBDT, vide Notification No. 70 / 2023 dated August 28, 2023, introduced Rules 13 and 13A in response to amendments in Section 132 made by the Finance Act 2023. Rule 13 outlines procedures and provides Form 6C for income tax authorities to approve any person or entity whose services may be requisitioned for the purposes of Section 132(2)(ii) or any person or entity or registered valuer to whom reference may be made as per Section 132(9D).

Further Rule 13A prescribes the valuation methods in different cases and Form 6CA for submission of valuation report.



Indian/Global Updates



Eswatini deposited instrument for the ratification of the Multilateral BEPS Convention

Eswatini had deposited its instrument of ratification for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS Convention), which now covers around 1900 bilateral tax treaties, thus emphasized its strong commitment to prevent the abuse of tax treaties and base erosion and profit shifting (BEPS) by multinational enterprises.

In addition, Armenia and Côte d'Ivoire had also deposited their instrument of ratification for the BEPS Convention. The BEPS Convention will enter into force on 1 January 2024 for Armenia and Côte d'Ivoire.

USA enhanced the use of 'CHATBOT' to assist individuals on tax notices

The United States Internal Revenue Service (IRS) had introduced enhanced chatbot technology to respond quickly to fundamental inquiries from

individuals who had received notices CP2000, CP2501, and CP3219A regarding potential tax under-reporting and various questions such as what to do if the taxpayer received a notice, what to do if the taxpayer need more time to respond to a notice and how to find out if the IRS received the taxpayer's response.

Earlier, the chatbot provided the taxpayers with self-service assistance for common questions such as: Taxpayer inquires about making payments, Collection notices and general Collection issues.

However, the use of chatbot has now been enhanced to specific notices received by the taxpayers as mentioned above.



Transfer Pricing / BEPS



OECD released sixth annual peer review of BEPS Action 13

OECD released sixth annual peer review of BEPS Action 13 Country-by-Country (CbC) reporting, covering 136 Inclusive Framework members. The review highlighted that over 110 jurisdictions had already introduced legislation to impose a filing obligation on MNE groups with consolidated group revenue of EUR 750 million or more. Further, OECD also clarified that the remaining Inclusive Framework members were working towards finalizing their domestic legal frameworks with the support of the OECD. The review also highlighted that the large number of recommendations made in the first five peer review phases had been addressed and removed.

International Community adopted multi-lateral convention for facilitation of Global Minimum Tax

The OECD had concluded negotiations on a multilateral instrument that will protect the right of developing countries to ensure multinational enterprises pay a minimum level of tax on a broad range of cross-border intra-group payments, including for services.

Adoption of this instrument sets out a comprehensive provision to ensure that developing countries are able to 'tax back' in instances where payments sourced in their jurisdiction are not taxed at a minimum rate in a partner jurisdiction.



Issue of the month



Profit Level Indicator

Introduction

Transfer pricing is a crucial aspect of international taxation and plays a significant role in determining the allocation of profits among multinational corporations' subsidiaries. To ensure that transactions between related entities are conducted at arm's length prices and to prevent profit shifting, tax authorities rely on various methods and tools. One such tool is the Profit Level Indicator (PLI), which helps in assessing the appropriateness of transfer pricing arrangements.

What is Profit level indicator?

A Profit Level Indicator ("PLI") is the ratio of net profit to an appropriate base (e.g. costs, sales, assets). The transactional net margin method relies on a comparison of an appropriate net profit indicator for the controlled transaction with the same net profit indicator in comparable uncontrolled transactions. It is used in transfer pricing to compare the profitability of a controlled transaction between related parties to the profitability of comparable transactions between

unrelated parties. This comparison is used to determine whether the transfer price charged in the controlled transaction is at arm's length.

Importance of Profit Level Indicator (PLI)

PLIs are essential tools used to evaluate whether transfer pricing arrangements comply with the arm's length principle. They provide a quantitative measure to assess whether the profits earned by a subsidiary are in line with what would be expected from a comparable independent entity engaged in similar activities. PLIs help tax authorities and multinational corporations determine whether the prices used in intra-group transactions result in an appropriate allocation of profits.

How to select an appropriate PLI?

The selection of an appropriate PLI depends on the facts and circumstances of the related party transaction involved.



Factors to consider include but are not limited to:

- Characterization of business
- Availability of comparable data
- The extent to which the PLI is likely to produce a reliable measure of arm's length profit.

The determination of the denominator used in PLI is done by considering the company's profit drivers and their independence from the denominator that is used.

Types and Overview of Profit level indicator

Return on assets	Operating profit divided by the operating assets
Return On Capital Employed	Operating profit divided by capital employed
Operating Margin	Operating profit divided by sales
Berry Ratio	Gross profit divided by operating costs

Return on asset ("ROA") and Return on capital employed ("ROCE") may be most reliable if the tangible operating assets have a high correlation to profitability. For example, a manufacturer's operating assets such as property, plant, and equipment could have more impact on profitability than a distributor's operating assets, since often the primary value added by a distributor is based on services it provides, which are often less dependent on operating assets. The difference between the ROA and the ROCE is that the ROA focuses on the assets used, while the ROCE focuses on the amount of debt and equity capital that is invested in the company.

Operating margin and Berry Ratio consist of ratios between income statement items. PLIs based on

income statement items are often used when fixed assets do not play a central role in generating operating profits. This is often the case for wholesale distributors and service providers.

Operating margin has often been used when functions of the tested party are not close to those of the comparables, since differences in function have less effect on operating profit than on gross profit

In general, gross margin has not been favoured as a PLI because the categorization of expenses as operating expenses or cost of goods sold may be subject to manipulation.

The Berry Ratio represents a return on a company's value added functions on the assumption that the company's value added functions are captured in its operating expenses. The Berry Ratio is one of the profitability measures used to test the appropriate PLI for the distributors and service providers. The Berry Ratio assumes that there is a relationship between the level of operating expenses and the level of gross profits earned by distributors and service providers on the assumption that their value added functions are captured in the operating expenses.

Consequently, it is appropriate to use the Berry Ratio if the selling or marketing entity is a distributor and is entitled to a return on its operating expenses alone or if it is a service provider entitled to a return on its costs of provision of its services alone, because such assumption is more reliable for the distributors and service providers than manufacturers.

Examples of PLIs

Here are some examples of how PLIs are used in transfer pricing:

- A company that manufactures and sells goods may use Return on sales or Operating margin to compare its profitability to the profitability of comparable companies that also manufacture and sell goods.
- A company that provides services may use ROA to compare its profitability to the profitability of comparable companies that also provide services.
- A company that licenses intellectual property may use royalty rates as a PLI to compare its profitability to the profitability of comparable companies that also license intellectual property.

Additional considerations

The PLI should be appropriate for the nature of the controlled transaction and the industry in which the tested party operates and should be calculated using consistent accounting principles.

The PLIs of the tested party and the comparable companies should be compared over a comparable period of time.

Further, it is important to identify and adjust for any material differences between the tested party and the comparable companies.

Conclusion

The Profit Level Indicator is a vital tool in transfer pricing analysis, helping multinational corporations and tax authorities assess the appropriateness of transfer pricing arrangements. By comparing the profitability of related entities to independent market benchmarks, PLIs ensure that profits are allocated fairly and in accordance with the arm's length principle. In an era of increasing scrutiny of international tax practices, a well-documented and carefully chosen PLI is essential for both compliance and risk management in the field of transfer pricing.



Legal Corner



Before Hon'ble Income Tax Appellate Tribunal of Delhi

CAE Simulation Training P. Ltd. Vs. DCIT

Introduction And Brief Facts

CAE Simulation Training P. Ltd. (**"the Assessee"**) was engaged in the business of training pilots and also providing services in relation to assessment of pilot candidates for its customers. The Assessee entered into an agreement dated 19.04.2016 with Symbiotics Ltd. UK (**"Symbiotics"**) which was engaged in the business of providing services in relation to profiling and evaluating suitability of candidates for its customers. Symbiotics was required to provide the services related to candidate profiling from their office in UK, by utilising their UK developed and maintained software. Further, the information received from software was then analysed by Symbiotics and converted into "Candidate written report" to be delivered to the Assessee.

For AY 2017-18, the case of the Assessee was selected for scrutiny wherein the Assessing Officer (**"the AO"**) made disallowance of Rs. 1,03,45,058 under section

40(a)(i) of the Income Tax Act, 1961 (**"the Act"**) on account of failure to deduct tax at source (TDS) under section 195 of the Act out of payments made in the nature of royalty under the Act as well as India-UK Double taxation avoidance agreement (**"DTAA"**).

Aggrieved with the order of the AO, the appeal was filed with the Commissioner of Income Tax (**"Ld. CIT"**). The Ld. CIT(A) upheld the order of the Ld. AO. The Assessee being aggrieved with the order of Ld. CIT, presented the appeal before Honourable ITAT (**"Hon'ble ITAT"**).

Arguments of Assessee

The Assessee argued that the definition of royalty under the India-UK DTAA was narrower in scope than the definition provided under the Act. The Assessee contended that they did not have access to the software, equipment, or any other intellectual



property of Symbiotics. The Assessee only received a report via email, and had no control or access to the source code or software used by Symbiotics.

Further, the Assessee highlighted that the report provided by Symbiotics was a result of candidate evaluation based on criteria set by the Assessee. It was not a grant of software or intellectual property rights but rather a service that assess candidate suitability for training. The agreement entered into by the Assessee explicitly states that the Assessee did not have the right to modify, duplicate, or access the source code of the software used by Symbiotics. Therefore, the payments made did not meet the criteria for royalty as per the DTAA.

Arguments of Revenue

The Ld. Counsel contended that the payments made by the Assessee were in the nature of "royalty" as they were made for proprietary tests and customized templates, profiles, and algorithms developed by Symbiotics, which should be associated with the intellectual property. The reports generated by Symbiotic were considered to be copyrighted products as the software was developed and controlled by Symbiotics.

Further, the Ld. Counsel contended that the license codes provided for candidates had an expiry date and the reports issued had a validity period which clearly indicates that the payment was made for the use of intellectual property which should be qualified as royalty.

Hon'ble ITAT Order

The Hon'ble ITAT held that the payment made by the Assessee to Symbiotics for the provision of candidate reports does not qualify as "royalty" under Article 13 of the India-UK Double Taxation Avoidance Agreement (DTAA). Therefore, there is no such requirement for the Assessee to withhold TDS on the payment made to Symbiotics under section 195 of the Act. The Hon'ble ITAT emphasized that the Assessee does not have access to the software, equipment, or intellectual property of Symbiotics. The reports were delivered to the Assessee only in the form of deliverables, which do not constitute a grant of software or intellectual property rights.

Further, it was noted that the software and infrastructure used by Symbiotics were owned and managed outside India, and the Assessee had no control over these resources. The Hon'ble ITAT also highlighted that there is no grant of licence to the Assessee as the agreement explicitly stated that the Assessee did not have the right to modify, duplicate, or access the source code of the software.

Conclusion

Upon analysing the Article 13 of the India-UK DTAA, it becomes evident that payments for specific services, such as receiving reports, may not necessarily fall within the definition of royalty, thus impacting tax obligations. It is necessary to have the right to control the equipment, network, infrastructure etc. and to modify the source code so as to constitute the payment received in consideration as royalty.

Glossary



Act	Income Tax Act, 1961
A.Y.	Assessment Year
AE	Associate Enterprise
ALP	Arm's Length Price
AO	Assessing Officer
BEPS	Base Erosion and Profit Shifting
CbC	Country-by-Country
CBDT	Central Board of Direct Taxes
CCPS	Compulsorily Convertible Preference Shares
CIT	Commissioner of Income Tax
CARF	Crypto-Asset Reporting Framework
CRS	Common Reporting Standard
DGIT	Director General of Income-tax (Systems)
DTAA	Double Taxation Avoidance Agreement
FA	Finance Act
FMV	Fair Market Value
FTA	Federal Tax Authority
HC	High Court
IFSC	International Financial Services Centres
IRS	Internal Revenue Service
ITO	Income Tax Office
JCIT	Joint Commissioner of Income Tax
NR	Non-Resident
NP	Net Profit
OM	Operating Margin
PLI	Profit Level Indicator
PCCIT	Principal Chief Commissioner of Income Tax
PDGIT	Principal Director General of Income-tax (Systems)
ROA	Return on Asset

Glossary



ROCE	Return on Capital Employed
SC	Supreme Court
SOP	Standard Operating Procedure
TDS	Tax Deducted at Source
TP	Transfer Pricing
TPO	Transfer Pricing officer
TNMM	Transaction Net Margin Method
VAT	Value added taxes



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Do write us back your Feedback/Queries/Comments, if any at taxhelpdesk@llca.net

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