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Tax Flash News

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In the absence of any evidence to rebut the commercial substance, the treaty benefit granted basis the tax residency certificate

Executive summary

The Delhi Bench of the Tribunal in the case of *SC Lowy P.I. (Lux)*[1] addresses critical issues concerning treaty benefits under the India-Luxembourg treaty, as amended by the Multilateral Instrument, which contained the amended preamble and the principal purpose test.

The Revenue denied the treaty benefits, alleging tax avoidance and conduit arrangements.

However, the Tribunal upheld the taxpayer's reliance on tax residency certificate (TRC), operational substance, and judicial precedents emphasising the need for substantive evidence to counter claims of treaty abuse.

[1] *SC Lowy P.I. (Lux) SARL v. ACIT* (ITA No. 3568/Del/2023). Source: Taxsutra

Facts of the case

The taxpayer was a limited liability company incorporated under the Luxembourg laws and registered as a Category II Foreign Portfolio Investor (FPI) with SEBI.

In its tax return for assessment year (AY) 2021-22, it claimed the benefit of the India-Luxembourg treaty (the treaty) in respect of interest income, business income, and capital gains.

The tax officer denied the treaty benefits, alleging treaty shopping, lack of beneficial ownership, and insufficient commercial substance.

The applicable treaty as amended by the Multilateral Instrument (MLI) contained the amended preamble and the principal purpose test (PPT) in the Limitation of Benefit (LoB) article.

The amended preamble to the treaty *inter alia* provided that the treaty is not intended to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements).

The provisions relating to PPT provides that the treaty benefits will not be granted if it is reasonable to conclude, based on relevant facts and circumstances, that one of the primary purposes of a transaction or arrangement was to obtain those benefits. However, the benefits may still be allowed if it is established that granting them aligns with the relevant treaty provisions' objectives and purpose.

Revenue's Contentions

The arrangement was a tax-avoidance through treaty shopping mechanism and the taxpayer's presence in Luxembourg lacked commercial substance.

The taxpayer was a conduit company with no real control over income, and the real beneficial owners of the income were residents of tax havens (Cayman Islands with which India has no tax treaty).

TRC alone does not establish eligibility for treaty benefits if the entity lacks economic substance.

The Delhi High Court decision in the case of *Tiger Global*[2] relied by the taxpayer is distinguishable based on the facts. Also, the treaty involved in that case was the Indian-Mauritius treaty.

[2] *Tiger Global International III Holdings* v. *AAR* [2024] 468 ITR 405 (Del)

Taxpayer's Contentions

In view of the following facts, it cannot be said that incorporation of the taxpayer in Luxembourg was with one of the principal purpose to obtain the treaty benefit that would otherwise not have been available:

- The taxpayer was incorporated in Luxembourg in 2015, well before the MLI came into effect.
- It is a board managed company with its legal seat and registered office in Luxembourg.
- The taxpayer operates as a step-down subsidiary of a Cayman Islands-based special purpose vehicle for pooling funds from various investors.
- It was established as an investment holding company focused primarily on distressed assets and aimed to expand its investment activities in regions such as Europe, the UK, India, and Italy.
- The taxpayer made its first investments in India during the financial year 2018-19, primarily in securitization trusts and securities issued by Indian companies. However, 86% of its investments are in jurisdictions outside India.
- It has filed tax returns and paid taxes in Luxembourg on its global income, including income from Indian investments and other jurisdictions.
- It is both the legal and beneficial owner of its investments, made using funds raised through capital and share warrants.
- It has incurred significant operational expenses in Luxembourg, such as consulting, legal, and administrative costs, including office rent, banking fees, and accounting charges.
- It continues to operate in Luxembourg and holds substantial investments to date.

It was the legal and beneficial owner of investments and income. The tax officer has failed to demonstrate any material or evidence suggesting that the taxpayer was under a contractual or legal obligation to transfer its interest income to the shareholder. In fact, no dividend was declared by the taxpayer in the assessment year under consideration.

Relied on rulings such as *Azadi Bachao Andolan*[3] and *Tiger Global*, which upheld the sanctity of TRCs and limited the Revenue's ability to deny treaty benefits without substantive proof of abuse or sham transaction.

[3] *UoI* v. *Azadi Bachao Andolan* [2003] 263 ITR 706 (SC)

Decision

The Delhi Bench of the Tribunal referred to the Delhi High Court decision in the case of *Tiger Global* and held that the Revenue has to accept the TRC issued by the competent authority. The Revenue should not exceed the requirements outlined in the LoB article unless they bring on record the cogent and convincing evidence demonstrating that the taxpayer is acting as a conduit.

In the instant case, the Revenue has not brought any material on record to indicate that the taxpayer was in substance a conduit except expressing their views and presumptions.

The facts highlighted by the taxpayer (as discussed above) established that it was a stand-alone entity and is not dependent on or the conduct of the holding company.

In view of the above, the treaty benefits could not be denied.

Our comments

The decision reinforces that treaty benefits cannot be denied based on assumptions or allegations without compelling evidence.

This decision underscores the need for a balanced approach in applying anti-abuse provisions, ensuring that legitimate business arrangements are not adversely impacted by aggressive tax positions.

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