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INTERNATIONAL TAX
CASE SUMMARY

INDIA VS SC LOWY P.I. (LUX)

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HEAD OF ACADEMICS

Welcome to the Academy of Tax Law's case and judgment summaries. These documents have been carefully curated to support professionals, students, and researchers navigating the complex landscape of international tax and transfer pricing. At the Academy, we understand that tax law is ever-evolving, with key rulings continuously shaping its practice.

Each summary you'll find here is designed to provide not just the facts, but the context and implications of pivotal legal decisions. These case summaries are created to serve as a valuable resource for legal teams, multinationals, revenue authorities, and academics, offering insights that go beyond the surface. Our goal is to ensure you remain informed and prepared, whether you are dealing with tax planning, dispute resolution, or risk management.

We believe that knowledge is the foundation of sound decision-making, and with these resources, we hope to empower you in your professional journey. As you delve into the analysis, remember that staying ahead in tax law requires not just understanding the rules but how to apply them in a dynamic, global environment.

Thank you for choosing the Academy of Tax Law as your partner in this ongoing learning experience.

Sincerely,
Dr. Daniel N Erasmus

PART 1

SUMMARY

JUDGEMENT SUMMARY

CASE OVERVIEW

Court:	Income Tax Appellate Tribunal, Delhi Bench 'D', New Delhi
Case No:	ITA No. 3568/DEL/2023
Applicant:	SC Lowy P.I. (Lux) S.A.R.L., Luxembourg
Defendant:	Assistant Commissioner of Income Tax, International Taxation, Circle 3(1)(2), Delhi
Judgment Date:	30 December 2024
Full Judgment:	CLICK FOR FULL JUDGMENT
View Online:	CLICK TO VIEW SUMMARY ONLINE

JUDGMENT SUMMARY

The judgment in SC Lowy P.I. (Lux) S.A.R.L. vs Assistant Commissioner of Income Tax (ACIT) revolved around the denial of treaty benefits under the Double Taxation Avoidance Agreement (DTAA) between India and Luxembourg. The central issue was whether the appellant, a Luxembourg-based entity, was entitled to these benefits, given allegations by the tax authorities of treaty shopping, lack of economic substance, and non-beneficial ownership.

The applicant, a Category II Foreign Portfolio Investor (FPI) registered with the Securities and Exchange Board of India (SEBI), declared income from various Indian investments for the 2021–22 assessment year. These included capital gains, business income, and interest income. The tax officer denied the claimed exemptions under the DTAA, asserting that the appellant was a conduit entity with no significant commercial presence in Luxembourg. Key claims included that the appellant was controlled by shareholders in other jurisdictions (notably the Cayman Islands), lacked commercial rationale for being based in Luxembourg, and failed to demonstrate sufficient substance or beneficial ownership.

The tax authorities recharacterised the income and applied higher tax rates, citing provisions under domestic Indian tax laws instead of the DTAA. The core contentions included:

1. Business income from securitisation trusts being taxable as interest income.
2. Denial of capital gains tax exemptions on securities sales.
3. Recharacterisation and higher taxation of interest income from investment funds.

The appellant argued that it was a bona fide tax resident of Luxembourg, supported by a valid Tax Residency Certificate (TRC) and compliance with Luxembourg's tax regime. It contended that treaty benefits could not be denied based on unsubstantiated assumptions of tax avoidance. Citing judicial precedents, it challenged the Revenue's stance, highlighting a lack of evidence for fraud, sham transactions, or absence of economic substance.

The Tribunal analysed the appellant's corporate structure, tax residency, and compliance with DTAA provisions. It considered whether the Principal Purpose Test (PPT), introduced via the Multilateral Instrument (MLI), applied. The Tribunal also reviewed whether the appellant demonstrated genuine economic activity in Luxembourg and beneficial ownership of the income.

Ultimately, the Tribunal upheld the Revenue's decision, denying treaty benefits. It concluded that the appellant's setup lacked commercial rationale, primarily facilitating tax avoidance through treaty shopping. The ruling also emphasised that a TRC alone does not conclusively establish treaty eligibility, particularly under the PPT framework introduced by the MLI.

This judgment underscores the critical importance of demonstrating substance, commercial purpose, and beneficial ownership in cross-border investments. It serves as a cautionary tale for multinationals relying on treaty benefits without robust tax structures and compliance frameworks.

KEY POINTS

OF THE JUDGMENT

BACKGROUND

SC Lowy P.I. (Lux) S.A.R.L. is a Luxembourg-based entity, incorporated in 2015 as a limited liability company. It operates as a Category II Foreign Portfolio Investor (FPI) registered with the Securities and Exchange Board of India (SEBI). The company's investment portfolio includes bonds issued by Indian companies, pass-through certificates from securitisation trusts, and securities in other jurisdictions.

For the assessment year 2021–22, the appellant declared total income from Indian investments comprising ₹10.63 crore in business income, capital gains, and interest income. It claimed tax exemptions and lower rates under Articles 7, 11, and 13(6) of the India-Luxembourg DTAA. The tax returns cited Luxembourg as the principal place of residence and included the Tax Residency Certificate (TRC) to substantiate treaty eligibility.

The Revenue initiated scrutiny after noting a significant tax refund claim. The Assessing Officer (AO) raised concerns over the legitimacy of the appellant's claim, citing a lack of economic substance in Luxembourg. It alleged that the company was established to exploit treaty benefits, serving as a conduit for its Cayman Islands-based parent company. It was further asserted that the appellant had no real control or beneficial ownership over its Indian income, rendering the treaty claims invalid.

The AO disallowed the treaty benefits and recharacterised the income, applying domestic tax rates. The additions were upheld by the Dispute Resolution Panel (DRP), prompting the appellant to approach the Income Tax Appellate Tribunal (ITAT). The appeal contested the denial of treaty benefits and reclassification of income, arguing the validity of its TRC, commercial operations, and compliance with Luxembourg tax laws.

KEY POINTS
OF THE JUDGMENT

CORE DISPUTE

The core dispute concerned the appellant's eligibility for DTAA benefits under Articles 7, 11, and 13(6). The Revenue's denial of treaty benefits was rooted in three principal allegations:

1. **Treaty Shopping:** The AO contended that the appellant lacked economic substance and was effectively controlled by its Cayman Islands-based parent company. This arrangement was seen as a mechanism for tax avoidance, facilitated by Luxembourg's favourable treaty terms with India.
2. **Non-Beneficial Ownership:** The AO argued that the appellant was not the beneficial owner of the income earned from Indian investments. Instead, it was deemed a conduit, merely facilitating the transfer of funds and income to ultimate stakeholders in other jurisdictions.
3. **Commercial Rationale:** The Revenue challenged the business purpose of establishing the appellant in Luxembourg, asserting that the economic outcomes would have been identical if the investments had been made directly from the Cayman Islands. This raised questions about the appellant's genuine operational need to be based in Luxembourg.

The Revenue reclassified the income as follows:

- Business income from securitisation trusts was recharacterised as interest income and taxed under domestic law.
- Capital gains from securities sales were taxed at a flat rate of 30%, rejecting the exemption under Article 13(6).
- Interest income from investment funds was taxed at 40%, denying the lower 10% DTAA rate under Article 11.

The appellant contested these reclassifications, emphasising its TRC and compliance with Luxembourg tax laws. It argued that the Revenue failed to provide concrete evidence of sham transactions or treaty abuse. The case thus centred on the interpretation of "substance," "beneficial ownership," and compliance with DTAA provisions in light of India's evolving tax framework under the MLI.

KEY POINTS
OF THE JUDGMENT

COURT FINDINGS

The Tribunal upheld the Revenue's decision, concluding that the appellant failed to demonstrate sufficient economic substance, beneficial ownership, or commercial rationale for its Luxembourg operations. The key findings were as follows:

1. **Economic Substance:** The Tribunal observed that the appellant's operations in Luxembourg were limited to its legal incorporation, with no substantial business activity, staff, or infrastructure. The bulk of the income was generated from Indian investments, indicating that Luxembourg was chosen primarily for its tax treaty benefits.
2. **Beneficial Ownership:** The Tribunal noted that the appellant lacked independent control over its income. It determined that the funds and income were ultimately intended for the Cayman Islands-based parent company and its investors, making the appellant a mere conduit.
3. **Principal Purpose Test (PPT):** Under the MLI framework, the Tribunal applied the PPT to assess whether the appellant's incorporation in Luxembourg was primarily intended to secure treaty benefits. It concluded that the appellant's structure lacked commercial substance and was inconsistent with the treaty's purpose of avoiding double taxation while preventing tax avoidance.
4. **Reclassification of Income:** The Tribunal agreed with the Revenue's recharacterisation of business income, capital gains, and interest income. It justified the application of higher tax rates under domestic law, citing the denial of treaty benefits.

The judgment emphasised that a TRC alone is insufficient to establish treaty eligibility, particularly in cases involving treaty shopping or lack of substance. The Tribunal's findings underscored the need for taxpayers to demonstrate genuine commercial operations and compliance with anti-abuse measures under the MLI.

KEY POINTS

OF THE JUDGMENT

OUTCOME

The Tribunal dismissed the appellant's appeal and upheld the Revenue's denial of DTAA benefits. The recharacterisation and taxation of the appellant's income were finalised as follows:

1. **Business Income:** ₹2.37 crore, originally claimed as exempt under Article 7, was recharacterised as interest income. It was taxed at 40%, consistent with domestic tax provisions.
2. **Capital Gains:** Short-term capital gains of ₹37.46 crore from the sale of Indian securities, claimed as exempt under Article 13(6), were taxed at 30%. The Tribunal rejected the appellant's contention that these gains were non-taxable in India.
3. **Interest Income:** ₹3.38 crore earned from investment funds, claimed under Article 11 at a concessional 10% rate, was taxed at 40%. The Tribunal held that the appellant failed to establish its status as the beneficial owner.
4. **Interest from Securitisation Trusts:** Income of ₹4.85 crore was recharacterised and taxed at 40%, rejecting the appellant's claim under Section 115AD.

The Tribunal's decision was heavily influenced by the Principal Purpose Test (PPT) under the MLI, which seeks to prevent treaty abuse. It concluded that the appellant's incorporation in Luxembourg was structured primarily to avail tax treaty benefits, undermining the object and purpose of the DTAA.

This judgment reinforces India's strict stance on tax avoidance and highlights the growing importance of substance and beneficial ownership in cross-border taxation. It serves as a critical precedent for similar cases involving treaty benefits and multinational tax structures.

TP METHOD

HIGHLIGHTED (IF ANY)

While transfer pricing (TP) methodologies were not directly debated in this case, the principles underlying tax treaties and allocation of taxable income to jurisdictions were heavily influenced by transfer pricing concepts. Specifically, the dispute raised questions about:

1. **Substance Over Form:** The Revenue invoked a substance-over-form approach, examining whether the Luxembourg entity had sufficient economic activity to justify its claims under the DTAA. This aligns with transfer pricing principles that focus on the actual economic contributions of entities in cross-border arrangements.
2. **Beneficial Ownership and Control:** The assessment delved into whether SC Lowy P.I. (Lux) S.A.R.L. exercised genuine control over the income or whether it functioned as a conduit for its Cayman Islands parent company. This focus on the allocation of rights and responsibilities mirrors the functional and risk analyses fundamental to TP methodologies.
3. **Principal Purpose Test (PPT):** Introduced under the Multilateral Instrument (MLI), the PPT embodies the spirit of transfer pricing by challenging transactions or arrangements lacking a legitimate commercial purpose. The Tribunal concluded that the appellant's Luxembourg entity was structured to exploit treaty benefits without contributing substantive economic value.

Although the case did not involve classic TP adjustments, its implications for multinational enterprises (MNEs) are significant. It underscores the necessity of aligning legal structures with actual business functions and justifying intercompany transactions based on sound economic reasoning. Taxpayers must ensure that their operational and financial arrangements withstand scrutiny under both domestic laws and international anti-abuse frameworks like the MLI.

This case reinforces the need for robust TP policies to mitigate the risk of disputes over income allocation, beneficial ownership, and treaty eligibility, especially when dealing with high-stakes cross-border investments.

PART 2

SIGNIFICANCE

MAJOR ISSUES

AREAS OF CONTENTION

The SC Lowy case presented several critical areas of contention, reflecting broader challenges in international tax compliance. The major issues included:

1. **Treaty Shopping Allegations:** The Revenue's central argument was that SC Lowy P.I. (Lux) S.A.R.L. exploited the India-Luxembourg DTAA to avoid higher taxes in India. The Tribunal scrutinised the appellant's corporate structure, concluding that the Luxembourg entity was a conduit with no substantial economic activity, thereby invalidating its treaty claims.
2. **Tax Residency and Economic Substance:** The appellant relied on its Tax Residency Certificate (TRC) from Luxembourg to establish treaty eligibility. However, the Tribunal determined that a TRC alone was insufficient under the MLI framework. The lack of significant personnel, operations, or infrastructure in Luxembourg raised doubts about the entity's genuine tax residency.
3. **Beneficial Ownership:** A contentious point was whether the appellant was the beneficial owner of the Indian income. The Revenue argued that the income was controlled by the Cayman Islands parent company, making the appellant a mere intermediary. This conclusion was critical in denying the lower tax rates under Articles 11 and 13(6) of the DTAA.
4. **Principal Purpose Test (PPT):** The PPT, introduced via the MLI, played a decisive role. The Tribunal found that the appellant's incorporation in Luxembourg primarily aimed to secure treaty benefits, contravening the treaty's object and purpose. This interpretation set a high bar for demonstrating compliance with anti-abuse provisions.
5. **Income Reclassification:** The recharacterisation of business income, capital gains, and interest income significantly increased the appellant's tax liability. The Tribunal's endorsement of these adjustments underscored the importance of demonstrating substance and commercial purpose in cross-border investments.

These issues highlight the increasing complexity of navigating international tax treaties and underline the importance of meticulous compliance with both domestic laws and evolving global standards.

EXPECTED
OR CONTROVERSIAL?

The Tribunal's decision in this case was expected in some respects but also generated controversy due to its strict application of anti-abuse provisions. With India increasingly enforcing the Principal Purpose Test (PPT) and adopting the Multilateral Instrument (MLI), this ruling reflects the government's growing emphasis on curbing treaty abuse. The scrutiny applied to the appellant's corporate structure and economic substance aligns with global trends in addressing base erosion and profit shifting (BEPS).

However, the judgment has sparked debate for several reasons:

1. **Interpretation of the Tax Residency Certificate (TRC):** Historically, a valid TRC was considered conclusive evidence of treaty eligibility, as established in prior Supreme Court rulings (e.g., Azadi Bachao Andolan). This case marks a shift, with the Tribunal declaring that a TRC alone is insufficient under the PPT framework. Critics argue that this interpretation may erode the trust between contracting states.
2. **Economic Substance Criteria:** The Tribunal's focus on operational substance in Luxembourg, such as the absence of employees or significant infrastructure, has raised concerns. While substance requirements are critical, some argue that smaller holding entities or special purpose vehicles (SPVs) may struggle to meet these standards despite legitimate business purposes.
3. **Increased Compliance Burden:** The judgment underscores the heightened compliance expectations for multinational enterprises (MNEs), especially regarding documentation and justifications for treaty claims. This has been viewed as disproportionately burdensome for entities with genuine commercial operations.

The decision was largely consistent with India's anti-abuse agenda, but its implications extend beyond this case. It sets a precedent for stricter evaluations of treaty benefits, potentially discouraging foreign investors who rely on holding companies in jurisdictions like Luxembourg.

SIGNIFICANCE
FOR MULTINATIONALS

This case has significant implications for multinational enterprises (MNEs) engaged in cross-border investments, particularly those leveraging tax treaties. The Tribunal's findings highlight several key takeaways:

1. **Enhanced Substance Requirements:** MNEs must ensure that their entities in low-tax or treaty-friendly jurisdictions demonstrate substantial economic activity. Mere legal incorporation or holding a TRC will not suffice under the Principal Purpose Test (PPT). This may require employing staff, maintaining offices, and conducting actual business operations in the jurisdiction.
2. **Beneficial Ownership Scrutiny:** The judgment underscores the importance of establishing beneficial ownership over income. MNEs must ensure that intermediary entities have genuine control over their investments and income streams, rather than acting as mere conduits for parent companies.
3. **Risk of Treaty Benefit Denial:** The ruling illustrates how treaty benefits can be denied if an entity's structure is perceived as primarily tax-motivated. MNEs must align their tax planning strategies with the object and purpose of tax treaties, avoiding arrangements that appear artificial or contrived.
4. **Compliance Costs:** The judgment imposes significant compliance burdens on MNEs. Companies must maintain robust documentation to substantiate their economic substance, beneficial ownership, and commercial rationale for cross-border arrangements. This includes transfer pricing documentation and detailed records of operational activities.
5. **Strategic Re-evaluation of Structures:** The case signals the need for MNEs to reassess their holding structures and investment routes. Jurisdictions traditionally favoured for their tax treaties, such as Luxembourg, may no longer provide reliable benefits without strong supporting documentation and substance.

In light of these challenges, MNEs should engage proactively with tax and legal experts to mitigate risks and ensure that their global operations comply with evolving anti-abuse measures like the PPT and MLI.

SIGNIFICANCE

FOR REVENUE SERVICES

The SC Lowy judgment represents a significant milestone for revenue authorities in their efforts to combat tax avoidance and treaty abuse. The decision underscores several key advantages for tax administrators:

1. **Strengthening Anti-Avoidance Measures:** By upholding the Principal Purpose Test (PPT), the Tribunal has empowered revenue authorities to challenge treaty claims based on perceived abuse. This sets a precedent for stricter scrutiny of arrangements that lack commercial substance or economic justification.
2. **Deterrence of Aggressive Tax Planning:** The judgment sends a strong message to taxpayers engaging in aggressive tax planning. By denying benefits to entities viewed as conduits, revenue authorities can deter the establishment of artificial structures designed primarily to secure tax advantages.
3. **Reinforcement of Global Standards:** The case aligns with India's commitment to the OECD's Base Erosion and Profit Shifting (BEPS) framework. By prioritising substance and beneficial ownership, revenue authorities can enhance their credibility in global tax forums and strengthen cross-border cooperation.
4. **Support for Domestic Taxation:** The ruling enables revenue services to prioritise domestic tax laws over treaty provisions in cases of abuse. This helps ensure that India retains its fair share of tax revenue from cross-border transactions, particularly in cases involving capital gains, interest income, and business profits.
5. **Increased Compliance Expectations:** By holding taxpayers to higher standards of documentation and operational substance, revenue authorities can shift the compliance burden onto businesses. This improves enforcement efficiency while reducing opportunities for treaty abuse.

However, the decision also presents challenges for revenue services. It necessitates robust training and resources to effectively apply the PPT and evaluate complex cross-border arrangements. Despite this, the judgment represents a win for tax authorities in their ongoing battle against treaty shopping and profit shifting.

RELEVANT CASES

TIGER GLOBAL INTERNATIONAL VS INDIA

The Delhi High Court ruled in favour of the taxpayer, holding that a valid TRC and compliance with Limitation of Benefits (LOB) provisions were sufficient to claim DTAA benefits. The case emphasised that revenue authorities could not disregard treaty benefits without evidence of sham transactions or fraud.

Tiger Global provides a contrasting precedent to SC Lowy, where the Tribunal denied treaty benefits despite the appellant presenting a valid TRC. This divergence underscores the increasing reliance on the PPT and highlights the higher compliance burdens for taxpayers in India.

VODAFONE INTERNATIONAL VS INDIA

This case involved the taxation of a cross-border transfer of shares between Vodafone and Hutchison, conducted through a Cayman Islands subsidiary. The Supreme Court ruled that India could not tax the transaction as it involved the transfer of offshore assets. The Court emphasised the principle of "substance over form," evaluating the genuine commercial purpose behind the transaction.

The Vodafone ruling underscored the importance of economic substance, which was a key factor in the SC Lowy decision. It also reflects the gradual shift toward anti-abuse provisions in international tax treaties, culminating in frameworks like the Multilateral Instrument (MLI).

PRÉVOST CAR INC. VS CANADA

This case involved a Canadian subsidiary of a Dutch holding company that received dividends from Canada, which were then distributed to shareholders in Sweden and the Netherlands. The Canada Revenue Agency (CRA) argued that the Dutch holding company was not the beneficial owner of the dividends and sought to deny treaty benefits. The Tax Court of Canada ruled in favour of the taxpayer, stating that the Dutch holding company was the beneficial owner, as it exercised control over the income and was not legally obligated to forward the dividends.

The Prévost case mirrors SC Lowy in its focus on beneficial ownership. It contrasts with SC Lowy's outcome, as the court accepted the holding company's claims, highlighting the importance of demonstrating control over income. The case also reinforces the principle that treaty benefits cannot be denied without clear evidence of conduit arrangements.

PART 3

PREVENTION

ENGAGING EXPERTS

Experts play a crucial role in ensuring multinational enterprises (MNEs) remain compliant with international tax laws while mitigating risks associated with disputes.

The SC Lowy case illustrates the complexities involved in cross-border tax arrangements, particularly when treaty benefits are at stake. Engaging tax professionals provides the following advantages:

1. **Compliance with Global Standards:** Experts ensure that intercompany transactions align with OECD guidelines, including the arm's length principle and anti-abuse measures like the Principal Purpose Test (PPT).
2. **Economic Substance Documentation:** Professionals help substantiate the economic activities of holding or investment entities, providing robust evidence of substance and beneficial ownership to withstand tax authority scrutiny.
3. **Strategic Tax Planning:** By aligning business structures with commercial purposes, experts minimise exposure to allegations of treaty shopping or artificial arrangements.
4. **Dispute Resolution Support:** In case of audits or litigation, experts assist in presenting a clear, factual case, backed by comprehensive documentation.

Given the growing complexity of global tax laws and India's strict enforcement of anti-abuse provisions, engaging experts is not just advisable but essential for MNEs operating in multiple jurisdictions.

PREVENTATIVE

MEASURES TO AVOID SIMILAR CASES

Preventing disputes like the SC Lowy case requires robust tax governance, including implementing a Tax Risk Management Framework and a Tax Steering Committee. These measures can help MNEs proactively manage tax risks:

Tax Risk Management Framework:

- Establish policies to ensure compliance with domestic and international tax laws.
- Conduct regular audits to identify and address potential vulnerabilities, such as treaty reliance without adequate substance.

Tax Steering Committee:

- Comprising tax professionals, legal advisors, and business leaders, the committee oversees tax strategy and risk management.
- Ensures alignment of business objectives with tax planning, preventing artificial arrangements that may invite scrutiny.

Training and Awareness:

- Educate key stakeholders on evolving global tax laws, including the Multilateral Instrument (MLI) and anti-abuse provisions.
- Regular updates on compliance best practices minimise unintentional breaches.

These preventative measures, alongside strategic input from tax professionals, can significantly reduce the risk of litigation.

DOWNLOAD FREE BOOK

TAX INTELLIGENCE: THE 7 HABITUAL TAX MISTAKES MADE BY COMPANIES

Tax Intelligence: The 7 Habitual Tax Mistakes Made by Companies" by Dr. Daniel N. Erasmus is a must-read for businesses seeking to navigate the intricate world of tax compliance and risk management. By highlighting common pitfalls and offering strategic solutions, Erasmus equips companies with the knowledge to improve their tax practices and secure financial stability.

PREVENTATIVE

MEASURES TO AVOID SIMILAR CASES

TAX STEERING COMMITTEE

Establishing a tax steering committee can help ensure that tax policies are aligned with the broader business strategy and that transactions are vetted for both commercial and tax implications. A tax steering committee can:

- Review all significant cross-border transactions before they are executed.
- Ensure that tax decisions are made in the context of overall business objectives, not solely for tax savings.
- Monitor changes in international tax laws to ensure ongoing compliance and avoid disputes like this case.

DOWNLOAD FREE E-BOOK

DRIVING TAX COMPLIANCE: THE ESSENTIAL ROLE OF THE TAX STEERING COMMITTEE

The eBook "Driving Tax Compliance: The Essential Role of a Tax Steering Committee" by Prof. Dr. Daniel N. Erasmus, Renier van Rensburg, and Gilbert Ferreira, emphasizes the critical importance of establishing a Tax Steering Committee (TSC) within multinational corporations to ensure tax compliance and manage tax-related risks effectively.

INTERNATIONAL TAX
CASE SUMMARY

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