

SATURDAY INTERNATIONAL TAX GYAN !!!

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SITG No.
129



Limitation of Benefit (LOB)

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What is Limitation of Benefit?

- ❖ LOB provisions has been explained in the **OECD glossary** on tax terms as:
“Tax treaty provisions designed to restrict treaty-shopping opportunities by limiting treaty benefits to persons who meet one of several enumerated tests, which may require minimum level qualifications, e.g., local ownership.”
- ❖ The term ‘**Limitation on Benefit**’ clause is generally not defined under Tax treaties. Specific Articles, may not be titled as ‘Limitation on Benefit’, though in essence, outline various provisions of limiting treaty benefits.
- ❖ LOB is a measure to stop abuse of treaty provisions such as treaty shopping (as discussed in earlier SITG [“Click Here”](#)) and other situations. LOB rule is also one of the recommendations by BEPS Action 6 for preventing treaty abuse by limiting the availability of treaty benefits to entities that meet certain conditions based on legal nature , ownership in, and general activities of the entities.
- ❖ The crux is that to avail the benefit of treaty it should be ensured that there is sufficient link between the entity and its state of residence.

Forms of LOB provisions under Tax Treaties

- ❖ Condition of “**Beneficial ownership**” to be satisfied by income recipient for certain categories of income such as dividend, interest, etc.
- ❖ “Subject to tax condition under the broader “liable to tax” condition vis à vis definition of tax resident.
- ❖ Specific condition to be fulfilled vis à vis exemption from category of income. Eg: Capital gains exemption condition under India Singapore tax treaties.
- ❖ Specific article on LOB dealing with conduit entities or treaty shopping or entities attempting to claim double non taxation.

Significance of LOB provision

- ❖ Significance of LOB clauses under tax treaties is evident from the ruling of SC in the case of **Azadi Bachao Andolan** on ‘Treaty Shopping’
- ❖ **Key observations of SC** –Developed countries tolerate and even encourage treaty shopping possibly for non-tax reasons like encouraging capital and technology inflows and the loss of tax revenues needs to be viewed in light of other non-tax benefits to the economy
- ❖ Treaty shopping is not illegal but rather puts the onus on the Government to evaluate the policy considerations behind permitting or banning it
- ❖ SC drew this inference by noting the absence of LOB Clause in India-Mauritius DTAA in comparison to India-US DTAA – as evidence that if the test of residence was satisfied there was no bar on third country residents taking advantage of the treaty
- ❖ In the Court’s view, where the loss of tax revenue outweighs the non-tax benefits, the Government should renegotiate the tax treaties.

LOB clause under various Indian tax treaties

Sr. No.	Type of LOB Clause	Tax Treaty
1.	In line with US LOB clause i.e.: <ul style="list-style-type: none">• Ownership Test• Active Business Test• Recognized Stock Exchange Test• Competent Authority Test	US, Armenia, Iceland, Tajikistan, Mexico
2.	Main purpose of arrangement is avoiding tax – anti-abuse test	Iceland, Tajikistan, Mexico, Mozambique, Kuwait, Luxembourg, Myanmar, UAE, Saudi Arabia, Syrian Arab Republic & UK
3.	Anti-abuse as well as competent authority test	Finland
4.	Domestic law overrides treaty in case of domestic anti-abuse provisions	Luxembourg Saudi Arabia
5.	Right to tax on foreign source income which is not taxable in other state	Namibia
6.	Income remittance test	Singapore

Our Comments

- ❖ There is absence of Limitation Of Benefit (LOB) Clause in India-Mauritius DTAA in comparison to India-US DTAA as evidence that if the test of residence was satisfied there was no bar on third country residents taking advantage of the treaty
- ❖ Some countries like US has a clear policy that it does not support treaty shopping and insists on including a LOB clause in all of its tax treaties. India-USA DTAA also contains LOB clause.
- ❖ **Different objective tests which are covered in different treaties, namely:-**
 - The Publicly Traded Company test
 - Ownership / Base Erosion Test
 - Active Business Connection Test
 - Derivative Benefit Test
 - Main Purpose Test
- ❖ Because of Multilateral Instruments (MLI) in many treaties limitation of benefit (LOB) would be incorporated, therefore it is suggested that MLI provisions should be read with treaty to decide actual position.

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