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Recent Judicial Developments Shaping Entitlement to Tax Treaty Benefits

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Introduction

Entitlement to tax treaty benefits has long been one of the most litigated issues in Indian international tax jurisprudence. While the Indian government consistently reiterates its commitment to promoting foreign investment and ensuring tax certainty, disputes surrounding treaty eligibility continue to proliferate. Avoiding double taxation of income in cross border transactions is one of the factors which has a significant impact on viability of a business deal / transaction.

This article examines some significant recent developments shaping entitlement to tax treaty benefits in India. It focuses on three core areas presently attracting judicial scrutiny: (i) fiscally transparent entities such as LLCs and partnerships, (ii) incorporation and enforceability of the Principal Purpose Test (PPT) introduced via 'The Multilateral Instrument' (MLI), and (iii) the treatment of indirect transfers under tax treaties.

Fiscally Transparent Entities – Entitlement to Tax Treaty Benefits

To access the benefits of a tax treaty, a non-resident taxpayer must first demonstrate that it is a "resident" of the treaty partner jurisdiction. A core component of this test is the requirement to be "liable to tax" in that jurisdiction.

This condition, simple on its face, becomes complex when the treaty claimant is a fiscally transparent entity, such as the Limited Liability Company (LLC) incorporated in the United States of America (US). These entities are not taxed in their own hands but in the hands of their members or partners; hence, determining whether the entity itself is "liable to tax" becomes an interpretational challenge.

Indian tax authorities have accordingly denied tax treaty benefits to such fiscally transparent entities on the ground that the entity claiming treaty relief is not itself the taxable unit under domestic tax law, and therefore it is not "liable to tax" within the meaning of the tax treaty and accordingly it is not a resident under a tax treaty.

A recent significant ruling dealing with tax treaty eligibility of LLCs is the ruling of the Income Tax Appellate Tribunal (Tax Tribunal or ITAT) in General Motors[1], where the Tax Tribunal held that a LLC incorporated in US was a resident of US and hence, eligible to claim the benefits under India-US tax treaty in respect of technical services fees earned from India. The Tax Tribunal noted that an LLC may opt to be treated either as a 'pass-through entity' or as a 'corporation'. Considering that US law itself provides an option for the LLC to be classified either as a corporation or a fiscally transparent entity, this confirms that an LLC is liable to tax in US. The Tax Tribunal noted that since the obligation to discharge the tax liability shifts to the shareholders or members only if an LLC is treated as a partnership for US tax purposes, an LLC is effectively 'liable to tax' in US. The Tax Tribunal acknowledged that under US laws a Tax Residency Certificate (TRC) is not issued to a disregarded entity with no US members or partners. However, the Tax Tribunal noted that the taxpayer satisfied all the requirements of a body corporate, held a valid TRC and hence, was a person resident of US under Article 4 of the tax treaty.

The NITI Aayog, in a policy report[2], has recommended that entitlement of LLCs to tax treaty benefits be clarified and expressly affirmed, recognising the practical realities of global investment structures and India's need to remain competitive as an investment destination.

The overarching principle that what ultimately matters is whether the income is subjected to comprehensive taxation in the residence country was also affirmed by the Tax Tribunal in the Linklaters[3] ruling. In this case, the Tax Tribunal extended treaty benefits to a LLP incorporated in the United Kingdom (UK) and held that a UK LLP or partnership would qualify for tax treaty benefits so long as the entire profits of the firm are effectively taxed in the UK, irrespective of whether such taxation occurs at the partner level based on the partners' personal attributes or directly in the hands of the firm / LLP.

Principal Purpose Test (PPT) and the MLI – enforceability in India

A major ongoing controversy concerns whether PPT introduced by the OECD's Multilateral Instrument ('MLI') automatically modifies India's tax treaties or whether each treaty must be specifically amended through a separate domestic notification. The PPT is an anti-abuse provision enabling tax authorities to deny treaty benefits where any of the 'principal purposes' of an arrangement was to obtain 'tax benefits' unless providing such benefit

is in accordance with the object and purpose of the relevant provision of the tax treaty.

Recently, the Tax Tribunal in the case of Sky High Appeal XLIII Leasing Company Ltd[4], has held that the provisions of MLI were not enforceable in the absence of a specific notification by the Government of India under section 90(1) of Income-tax Act, 1961 (IT Act). The Tax Tribunal relied on the Supreme Court's landmark ruling in Nestle SA[5] , where it was held that the Most Favoured Nation (MFN) clause cannot automatically apply in the absence of an enabling domestic notification expressly incorporating the change into the relevant tax treaty.

The Tax Tribunal compared MFN clause and the MLI and noted that both introduced modifications to tax treaties and therefore require explicit domestic legislative action. The Tax Tribunal held that the MLI does not automatically amend a bilateral tax treaty and a specific notification under Section 90(1) of the IT Act is necessary to incorporate the PPT into a tax treaty. Absent such notification, the PPT does not have force of law and cannot be invoked to deny tax benefits under the concerned tax treaty.

The Tax Tribunal observed that even if for the sake of argument, provisions of MLI are read into the tax treaty, PPT could not be applied to deny tax treaty benefits to the Taxpayer. It observed that the quantum of tax benefit is not the only decisive factor for the PPT. PPT requires a clear demonstration, supported by objective facts, that the main purpose of the arrangement was to secure treaty benefit and that such benefit was contrary to the object and purpose of the Tax Treaty; PPT is not intended to be triggered merely because a transaction is structured in a tax-efficient manner.

The Tax Tribunal in this case held that the transactions were 'commercially driven' and squarely within the contemplated purpose of the tax treaty provisions. A Taxpayer claiming benefit under Articles 8 (Shipping and Air Transport) and 12 (Royalties and fees for technical services), which are specifically designed to exempt aircraft-leasing income from the ambit of source-based taxation, is not seeking to subvert the treaty. Rather, the Taxpayer is availing a benefit that the Tax Treaty itself was designed to confer.

The Tax Tribunal also stated that 'TRC' is a conclusive proof of residency of foreign taxpayers unless it is a case of 'treaty shopping' or 'fraud'. Thus, it is inconceivable to presume that Irish tax authorities were not familiar with the PPT and would have issued a TRC without application of mind. Therefore, in the absence of very compelling reasons, the TRC will be presumed to be a valid ground for allowing benefits of the Tax Treaty even after notification of MLI.

It remains to be seen how higher courts ultimately resolve this conflict. The controversy goes to the very heart of the relationship between international tax treaty obligations and domestic incorporation mechanisms under Section 90 of the IT Act. The Supreme Court's reasoning in Nestle SA (supra) that MFN clause cannot automatically modify a bilateral treaty in the absence of a specific domestic notification may need to be reassessed in light of the fundamentally distinct character of the MLI. Unlike an MFN clause, which is merely a conditional provision embedded within a bilateral tax treaty through a protocol, the MLI is a separate, multilateral treaty instrument negotiated and ratified by India through a formal treaty-making process, and expressly designed to amend, or supplement existing bilateral tax treaties.

A key question that higher courts may need to consider is whether the MLI, by virtue of its legal status as a ratified international obligation, can be regarded as self-executing, thereby, operating to modify bilateral treaties automatically once a tax treaty is notified as a Covered Tax Agreement for applicability of MLI or whether it must still undergo individual, treaty-specific domestic notifications to attain enforceability. This will require a close re-examination of the ruling in the case of Nestle SA (supra) in its proper context, as that decision did not involve a multilateral instrument like the MLI.

The resolution of this issue will therefore carry significant implications not only for the applicability of the PPT, but also for the future architecture of India's tax treaty policy.

Indirect Transfer – tax treaty perspective and emerging litigation

Before 2012, indirect transfers, ie transfers between two non-residents involving shares of a foreign company deriving value from underlying Indian assets, were neither expressly covered nor taxable under Indian domestic income tax law (ie IT Act). The Supreme Court in Vodafone International Holdings[6] categorically held that, in the absence of a specific statutory "look-through" provision, tax authorities did not have jurisdiction to tax capital gains arising to a non-resident from the transfer of shares of a foreign company, even if such company held assets situated in India.

Subsequently, Parliament enacted a retroactive amendment to Section 9(1)(i) of the IT Act, thereby nullifying the effect of the Vodafone ruling. This amendment introduced an explicit indirect transfer taxation regime, deeming gains arising from the transfer of shares or interests in a foreign entity to be taxable in India if such foreign entity derives "substantial value" from assets located in India. Under this framework, a share or interest in a foreign entity is considered to derive substantial value from India if, on the specified valuation date, (i) the value of Indian assets exceeds INR 100 million, and (ii) such Indian assets represent at least 50% of the total value of the foreign entity.

Notably, despite this significant overhaul of domestic law, no corresponding amendments were made to India's network of tax treaties to incorporate a similar look-through rule for taxing indirect transfers. This has given rise to a fundamental issue: can gains from indirect transfers be taxed in India under a tax treaty's capital gains article when the relevant tax treaty does not expressly include an indirect transfer or look-through provision?

In other words, in the absence of treaty-level modification, taxpayers contend that such gains continue to fall within the residuary clause of the capital gains article, taxable exclusively in the state of residence, whereas the Indian tax authorities increasingly argue for a broader, substance-oriented interpretation aligned with the amended domestic law.

One of the most high-profile tax cases on indirect transfers pending before the Supreme Court is Tiger Global[7] , where the dispute centres on whether treaty

relief under the India–Mauritius tax treaty shields indirect transfers of Indian assets. Given the stakes involved, this judgment will have profound implications for global private equity and venture capital structures investing in India. Supreme Court has completed the hearing, and its verdict is awaited.

In contrast to the uncertainty in Tiger Global (supra), the recent ruling of the Tax Tribunal in the case of eBay Singapore[8] brings important clarity to the interpretation of capital gains taxation under the India–Singapore tax treaty. The Tax Tribunal reaffirmed the established position, previously endorsed in Sofina S.A.[9] and Sanofi Pasteur Holding SA[10] that absent a specific "look-through" clause, indirect transfers fall under the residuary clause of the capital gains article of India-Singapore tax treaty. This means capital gains from indirect transfers are taxable only in the seller's residence jurisdiction unless the treaty contains an express immovable-property or substantial-value clause. In the Sanofi ruling, it was held that in absence of non-obstante clause in the retrospective amendments made in IT Act in 2012, amended provisions cannot override provisions of tax treaty.

A plain reading of most tax treaties suggests that the taxation of indirect transfers should be governed by the residuary clause unless expressly carved out. However, in an era increasingly focused on 'substance over form', a taxpayer must be able to demonstrate a genuine commercial rationale for operating through intermediate jurisdictions and tiered structures. The evidence of business purpose, control of downstream investments, and the economic substance of holding companies will play a key role in future litigation.

Conclusion

The international tax environment has shifted decisively towards 'substance over form'. Courts and tax authorities globally are moving away from mechanical or literal interpretations and instead emphasise on economic substance, commercial rationale and genuine business purpose. This trend will undeniably shape how Indian authorities and courts approach entitlement to tax treaty benefits.

Given this landscape, businesses must adopt a holistic approach to tax risk management. Proper structuring at the outset, meticulous implementation, and continuous monitoring of tax treaty positions can significantly enhance tax certainty and minimise tax disputes.

In essence, eligibility for tax treaty benefits in India is no longer merely a legal formality, it is increasingly a question of demonstrating real legal and economic substance behind cross-border structures and transactions.

The views expressed are personal

1. *General Motors Company USA v ACIT, [2024] 166 taxmann.com 170 (Delhi - Trib.)*
2. *Working paper titled 'Enhancing Certainty, Transparency, and Uniformity in Permanent Establishment and Profit Attribution for Foreign Investors in India', issued by the NITI Aayog in October 2025*
3. *Linklaters LLP v DCIT, [2023] 150 taxmann.com 222 (Mumbai-Trib.)*
4. *Sky High Appeal XLIII Leasing Company Ltd v ACIT, ITA No. 1122 / Mum / 2025.*
5. *Nestle SA v AO, [2024] 165 taxmann.com 334 (SC).*
6. *Vodafone International Holdings BV v UOI, [2012] 341 ITR 1 (SC).*
7. *AAR v Tiger Global International II Holdings (SLP (C) No. 2640 of 2025)*
8. *eBay Singapore Services (P.) Ltd v DCIT, [2025] 179 taxmann.com 346 (Mumbai-Trib)*
9. *Sofina SA v ACIT, [2020] 185 ITD 650 (Mumbai - Trib.).*
10. *Sanofi Pasteur Holding SA v DCIT, [2013] 354 ITR 316 (Andhra Pradesh High Court)*

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