ITAT Delhi clarifies position on allowability of treaty benefit post applicability of Principal Purpose Test introduced through the amendment in Multilateral Instruments

The Delhi bench of Tribunal, recently in the case of **S.C. Lowy P.I. (Lux) S.A.R.L. v. ACIT[1],** analysed the principal purpose test ('PPT') introduced by way of amendment in the Multilateral Instruments ('MLI') while deciding on the allowability of benefit of India-Luxembourg tax treaty.

Facts of the case

The taxpayer, a limited liability company incorporated in Luxembourg in the year 2015 was a wholly owned subsidiary ('WOS') of an investment company registered in the Cayman Islands, the ultimate holding entity was an offshore fund registered in the Cayman Islands. The taxpayer was registered with SEBI as a Category II – Foreign Portfolio Investor in India.

During the assessment year 2021-22, the taxpayer had filed return of income in India disclosing its Indian income, claiming the benefit of India-Luxembourg tax treaty with respect of income earned under various heads as under:

- Business income – Not taxable in India in absence of a Permanent Establishment ('PE') in India as per Article 7.
- Interest income – Chargeable to tax in India @ 10% according to rate prescribed in Article 11.
- Capital gains on sale of securities - Not taxable in India in view of Article 13(6).

During the assessment proceedings, the Indian tax authorities have denied the benefit of India-Luxembourg tax treaty to the taxpayer holding that the taxpayer (a) was not the beneficial owner of the income (b) was merely a pass through/ conduit entity (c) did not have any commercial rationale/substance in Luxembourg and (d) entire scheme of arrangement was for the purposes of tax avoidance through treaty shopping.

[1] ITA no. 3568/Del/2023

Taxpayer's contentions before the Tribunal:

- The taxpayer is tax resident of Luxembourg and regularly files its return of income in Luxembourg and offers to tax worldwide income therein.
- The taxpayer is incorporated in the year 2015 i.e., much before the implementation of MLI.
- The taxpayer has made substantial investments all over the world in as much as 86% of its total investments are in jurisdictions outside India.
- The investment and business related decisions are being taken by the taxpayer independently without any control from its holding company.
- Taxpayer placed reliance on the decision of the Delhi High Court in the case of **Tiger Global**[2], wherein the High Court carried out a detailed analysis of the relevant articles of the India-Mauritius DTAA, judicial precedents and CBDT Circulars and observed that the TRC[3] and LOB provisions should suffice for the eligibility of treaty benefit unless the Revenue/tax authorities substantiate that the transaction under consideration a sham or colourable device.

Revenue's contentions before the Tribunal:

- The taxpayer is incorporated in Luxembourg for the purposes of claiming treaty benefit, while it is controlled by the holding company situated in the Cayman Islands.
- The decision of the Delhi High Court in the case of Tiger Global, relied upon by the taxpayer is not applicable in this case since the facts are distinguishable.
- Since the MLI have been amended for the year under consideration, PPT as prescribed in Article 29 of the tax treaty must be satisfied for granting treaty benefit.

Decision of Tribunal

The Delhi bench of Tribunal, relying on the High Court ruling in case of Tiger Global, held that the taxpayer holding a valid TRC of Luxembourg would be entitled to the benefit of India-Luxembourg tax treaty, observing as under:

- Taxpayer was incorporated in the year 2015 and had made substantial investments not only in India but in various countries across the world;
- the taxpayer regularly filed return of income in Luxembourg and offered to tax

[2] Tiger Global International III Holdings v. AAR: 468 ITR 405 (Del.)
[3] Tax residency certificate

worldwide income therein;

- the taxpayer exercised independent control over its investments and income earned therefrom;
- taxpayer continues to exist till date in Luxembourg and continues to hold substantial investments;
- taxpayer has incurred substantial operational expenditure vis., consulting fees, legal and litigation fees, other professional fees etc. in Luxembourg;
- With regard to the PPT clause introduced Article 29 of the tax treaty by MLI, the Tribunal observed that the tax authorities did not bring on record any cogent material to prove that obtaining treaty benefit was one of the principal purposes of the taxpayer. Hence the taxpayer is entitled to the treaty benefit.

VA Comments

The decision of the Tribunal is landmark since it is the first precedent, wherein the Tribunal dealt with the principal purpose test enunciated in the MLI introduced in any tax treaty. With regard to the PPT introduced by the MLI, Tribunal held that the onus is on the tax authorities to prove the obtaining treaty benefit was one of the principal purpose of the taxpayer for entering into any arrangement.

The Tribunal negating the contention raised by the Revenue regarding PPT emphasised that where the taxpayer is a tax resident of any jurisdiction having a commercial rationale/substantial presence in that jurisdiction, it would be entitled to claim the treaty benefit. It is not open for tax authorities to recharacterize the nature of any income, unless it is proved that the arrangement entered into by the taxpayer is a sham.

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For any further information/ clarification, please feel free to write to:

Mr. Neeraj K Jain, Senior Partner : neeraj@vaishlaw.com

Mr. Kunal Pandey, Principal Associate : kunal.pandey@vaishlaw.com

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Corporate, Tax and Business Advisory Law Firm

DELHI

1st, 9th, 11th Floor,
Mohan Dev Building, 13, Tolstoy Marg,
New Delhi, 110001 (India)

+91-11-42492525
delhi@vaishlaw.com

MUMBAI

106, Peninsula Centre,
Dr. S.S. Rao Road, Parel,
Mumbai, 400012 (India)

+91 22 42134101
mumbai@vaishlaw.com

BENGALURU

105 -106, Raheja Chambers,
#12, Museum Road,
Bengaluru, 560001 (India)

+91 80 40903588/89
bangalore@vaishlaw.com

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