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NEWS ALERT

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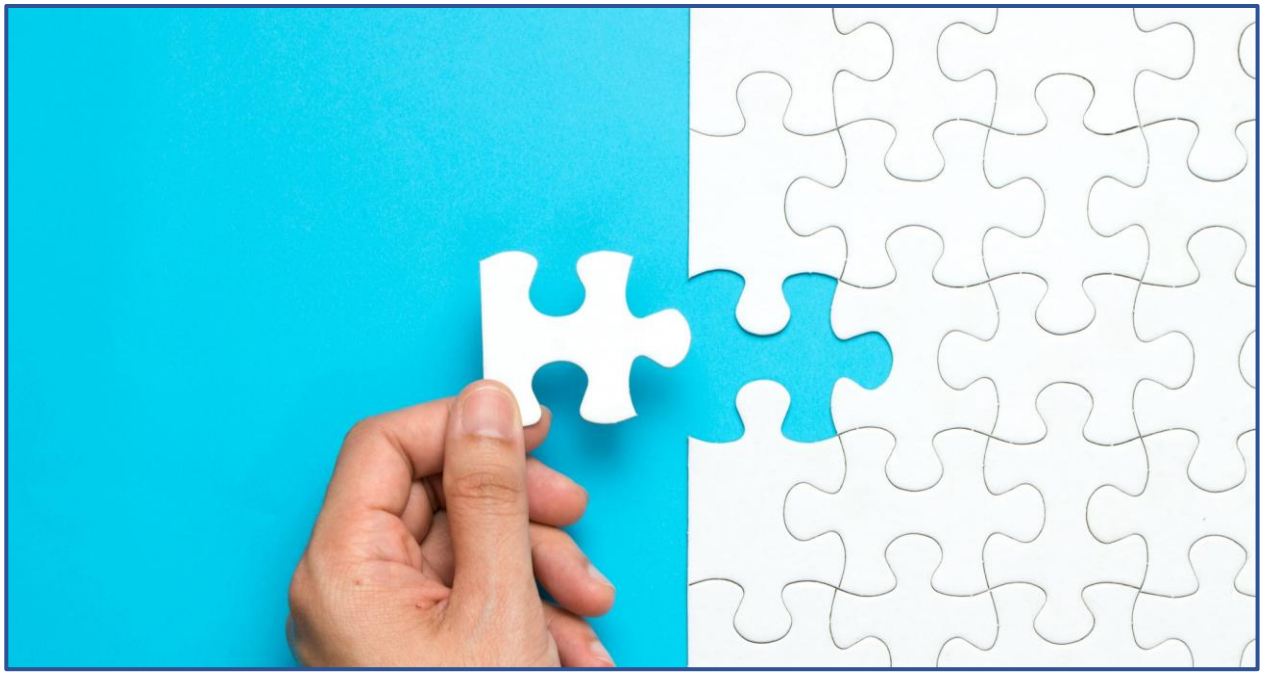

Provisions of MLI held as unenforceable in the absence of a separate notification

The Mumbai Tribunal recently rendered a landmark judgment in the context of enforceability of the Multilateral Instrument. The Tribunal expounded the principle that amendments to the DTAA are not automatically applicable unless separately notified in the domestic tax law, although both India and Ireland have ratified the MLI. This judgement also discusses the Principle Purpose Test under the India – Ireland DTAA to conclude that the PPT article is not triggered merely because a transaction has been structured in a tax efficient manner. The Tribunal also upheld the sanctity of the Tax Residency Certificate to grant the benefits under the India – Ireland DTAA, even after the MLI is notified.

The team at JMP Advisors is pleased to bring to you a gist of the decision in the case of TFDAC Ireland II Limited vs DCIT (International Tax)[1]

Facts of the Case

The taxpayer is a tax resident of Ireland, holding a valid Tax Residency Certificate ('TRC') and engaged in the business of leasing of aircrafts. The taxpayer had entered into three operating lease agreements with an Indian airline operator. During FY 2021-22, the taxpayer had filed its return of income declaring the lease rental income as exempt under Double tax avoidance agreement between India and Ireland ('India - Ireland DTAA') on the following grounds:

- The lease rentals did not constitute 'royalty' under Article 12 of the India - Ireland DTAA;
- The taxpayer did not constitute any Permanent Establishment ('PE') in India;
- Without prejudice to above, the lease rentals formed part of profits from operations in international traffic and hence were exempt under Article 8 of the India - Ireland DTAA

The tax officer invoked the PPT clause of the Multilateral Instrument ('MLI') to deny DTAA relief to the taxpayer on the premise that the principal purpose of the taxpayer's incorporation in Ireland was to obtain the benefits of the India Ireland DTAA. The tax officer further alleged that the taxpayer had a PE in India.

Multilateral Instrument

The Mumbai Bench of the Income Tax Appellate Tribunal ('Tribunal') undertook a detailed analysis of whether the provisions of the MLI could modify the India Ireland DTAA so as to invoke the PPT and deny treaty relief to the taxpayer. The Hon'ble Tribunal observed that even though both the countries have notified the DTAA and MLI, the amendments in the DTAA consequential to the MLI have not been separately notified as required under the Indian domestic law.

Reiterating the principles laid down by the Supreme Court in Nestle SA[2], the Hon'ble Tribunal highlighted that treaties including multilateral agreements like the MLI, do not become automatically operative in the domestic law. For MLI provisions to have effect in India, a specific notification under Section 90(1) is an 'indispensable precondition'. The manner in which the amendments are implemented continue to remain within the sovereign domain of each contracting state. The Tribunal also referred to the OECD Commentary on the MLI which recognises the role of each jurisdiction's domestic law in determining how the MLI takes effect and expressly acknowledges that a 'synthesised text' is a non-binding explanatory aid. In the absence of a notification incorporating the PPT and MLI-based modifications into the India Ireland DTAA, the Mumbai Tribunal held the tax officer's attempt to deny treaty benefits unsustainabl

Principal Purpose Test

Without prejudice to the above conclusion, the Tribunal observed that PPT is triggered only where the principal purpose of entering into an arrangement was to obtain the treaty benefits as separate from genuine commercial considerations. The Tribunal placed reliance on the Bombay High Court judgment in the case of Bid Services[3] wherein it was held that treaty benefits

[1] ITA No 1198/Mum/2025 and others
[2] 134 taxmann.com 292 (Del Trib.)

cannot be denied merely because the ultimate parent entity is outside the jurisdiction of the Special Purpose Vehicle. In the taxpayer's case, substantive functions coupled with commercial rational for setting up functions in Ireland demonstrated a broader strategy and not an India-specific manoeuvre to access the treaty. Accordingly, the Tribunal held that PPT must be applied based on facts and the treaty's object and purpose, not merely on the existence of tax benefits. Since the taxpayer had genuine commercial operations in Ireland and there was no clear evidence of treaty abuse, the tax officer's claim was dismissed.

Permanent Establishment

With respect to the tax officer's contention that the aircrafts leased to the airline operator in India constituted a fixed place PE for the taxpayer, the Mumbai Tribunal provided a comprehensive and factual analysis guided by judicial precedents and language of the treaty. The Tribunal analysed the provisions of Article 5 of the India Ireland DTAA defining the term 'PE' and also drew references to the Supreme Court judgments in the case of Formula One World Championship[3] and Hyatt International Southwest Asia Ltd[4]. The Tribunal noted that the Hyatt ruling reaffirmed several essentials for establishing a PE i.e. the fixed place must reflect a degree of stability and permanence, the non-resident must have the place at its disposal and the place must be used for conducting core business activities. Applying these principles, the Tribunal evaluated the taxpayer's lease agreements with the Indian airline operator and the factual matrix around the control and operation of the aircraft. The Tribunal observed that the aircraft, once delivered, was subject to the airline operator's exclusive operational control for the lease duration. The taxpayer had no right to use, access or deploy the aircraft for its own economic activity. According to the Tribunal, these elements were insufficient to conclude that any fixed place in India was at the disposal of the taxpayer.

Shipping Income vs Business Income

Further, the Tribunal found that even if a PE were assumed to exist in India, Article 8 would nonetheless preserve exclusive taxation rights for Ireland in respect of the rental income.

In this context, the Tribunal analysed the taxpayer's alternative plea for taxation of the lease rentals as profits from international traffic as per Article 8 of the India Ireland DTAA. The Tribunal noted that unlike the OECD Model Convention which grants exclusive taxing rights only for 'profits from the operation of ships or aircraft in international traffic', the India Ireland DTAA specifically and disjunctively includes 'rental' of aircraft as a qualifying income head. The Tribunal emphasized that Article 8(1) covers both operation and rental of aircraft, without the requirement that the taxpayer itself be an operator in international traffic. The Tribunal further examined the treaty definition of 'international traffic', which excluded only those cases where an aircraft is 'operated solely between places in the other Contracting State'. Given that Indian airline operator, operated as an international carrier and the aircraft in question formed part of a mixed-use fleet serving both international and domestic routes, the Tribunal ruled that the 'solely' condition was not breached. The Tribunal further observed that Article 8 functions as a specific allocation rule which overrides the general rule for taxing business profits under Article 7 of the DTAA.

3 [2023] 453 ITR 461
4 Civil Appeal No. 9766 of 2015 (SC)

Once Article 8(1) applies, the source state i.e. India is entirely precluded from taxing the profits from the rental of the aircraft and the right to tax is allocated exclusively to the State of residence of the lessor i.e. Ireland. Further, the Tribunal observed that the object and purpose of a treaty must be ascertained in a holistic and purposive manner, having regard to the intention of the Contracting States. In the present case, a perusal of Articles 8 and 12 of the India-Ireland DTAA shows that the DTAA provisions are consciously different from the OECD and UN Model Conventions to the extent that the India-Ireland DTAA limits the source country's taxing rights in respect of income from leasing of aircrafts.

Based on the above observations, the Tribunal ruled that the PPT clause of the MLI could not be applied without a specific notification under Section 90(1) of the Act. It upheld that no PE was constituted for the taxpayer in India, since operational control rested with the airline operator. The Tribunal further concluded that under Article 8 of the India–Ireland DTAA, income from aircraft lease rentals in international traffic would be taxable only in Ireland, not India, thereby protecting treaty relief for the taxpayer.

JMP Insights - *This judgment will help to set a precedent for applicability of MLI provisions to DTAAs. As ruled by SC in Nestle's case, the amendments to DTAAs are not automatically applicable, unless these are separately notified, in order to make these enforceable under the domestic tax law. Further, it reinforces the OECD stance that synthesized text of DTAAs is not a legal document and is prepared only for the purpose of a facilitating understanding of the implications of the MLI on a DTAA.*

On the issue of genuineness of business transactions, this ruling has once again upheld the sanctity of a valid TRC issued by the tax authorities of a country, which cannot be put to doubt in the absence of any evidence of misuse of DTAA benefits.

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Should you wish to discuss any of the above issues in detail or understand the applicability to your specific situation, please feel free to reach out to us on coe@jmpadvisors.in.

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JMP Advisors offers advice in international taxation, domestic taxation, transfer pricing, mergers and acquisitions, Goods and Services Tax (GST), business laws and exchange control regulations and foreign investment consulting. We specialize in fiscal strategy, policy foresight and advocacy matters and are trusted advisors to high net worth families. Our team at JMP Advisors takes pride in being the best at what matters most to clients - technical expertise, innovative solutions, consistent, high quality service, reliability and ease of doing business.

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