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Recent developments in international taxation: India

Introduction

2024 has been an eventful year in the Indian tax landscape, with several major legislative and judicial developments. Issues concerning entitlement to tax treaty benefits have occupied centre stage, with several major legislative and judicial developments in this regard.

The government has also proposed a new Income-tax Bill, which proposes to replace the Indian Income-tax Act, 1961 ('IT Act'). While India has not taken any steps towards the implementation of Pillar Two, the unilateral withdrawal of the equalisation levy (a form of digital services tax) underscores its commitment towards the Pillar One solution. Lastly, the newly elected Government of India has taken several steps to promote the Indian International Financial Services Centre (IFSC), which includes granting or extending several tax benefits for the same.

This report deals with these key developments.

Tax treaty entitlement in the spotlight

The Mauritius Protocol

Over the past few decades, Mauritius has been among the key sources of foreign direct investment into India. The India–Mauritius Tax Treaty has historically provided Mauritian investors several tax incentives for investing in India, which included a capital gains exemption in India from the sale of Indian company shares acquired prior to 1 April 2017. Notably, the India–Mauritius Tax Treaty is not a covered tax treaty under the multilateral instrument (MLI), and hence the principal purpose test (PPT) does not presently form a part of the treaty.

On 7 March 2024, the Indian and Mauritian Government signed a protocol (the 'Protocol'), which sought to introduce the PPT to the India–Mauritius Tax Treaty. The Protocol stated that it would apply 'without regard to the date on which the taxes are levied or the taxable years to which the taxes relate'.

The exact language adopted in the PPT created ambiguity as to whether the PPT would apply retrospectively to concluded transactions as well. However, the Protocol has since been withdrawn from the government's official website and has not entered into force to date. It may be noted that, even if the PPT is not incorporated into the India–Mauritius Tax Treaty, Indian revenue authorities have the power to deny treaty benefits by invoking India's General Anti-Avoidance Rules (GAAR) if the main purpose of the concerned arrangement was obtaining a tax benefit. GAAR, however, would not be applicable to investments made prior to 2017 (discussed further below).

PPT to apply prospectively

While several of India's tax treaties are covered under the MLI, ambiguity has persisted regarding whether the PPT could be retrospectively applied for past transactions (ie, transactions that have concluded prior to the PPT coming into force). Unlike the provisions of

GAAR (which are only applicable to investments made post 2017), the language of the PPT in the MLI does not clarify whether it can impact past transactions.

Dispelling uncertainty in this regard, the Government issued Circular No 01/2025 (the 'Circular') clarifying that the PPT will only be applied prospectively from the date when the MLI enters into force in relation to the concerned tax treaty. In particular, the PPT would apply (1) from the date on which the MLI enters into force with respect to withholding tax liabilities, and (2) six months from the date on which the MLI enters into force for all other taxes.

On the issue regarding interplay of specific anti-abuse rules with the PPT, the Circular acknowledges that India's tax treaties with several jurisdictions (such as Cyprus, Mauritius and Singapore) contain specific anti-abuse provisions (in the form of limitation of benefits clauses) that deal with 'grandfathering' provisions under the treaty. Such matters would be governed by the specific rules agreed by the contracting states, and the PPT would not be applicable to such taxes.

Notably, the Circular also clarifies that, in interpreting the PPT, reliance can be placed on the commentary to Articles 1 and 29 of the United Nations Model Tax Convention. This demonstrates the Indian government's preference towards the UN Commentary over the OECD Commentary.

Tiger Global and Blackstone – high-stakes litigation before the Supreme Court
In the midst of the above-mentioned legislative developments, judicial developments regarding tax treaty entitlement are also in the limelight. In August 2024, the Delhi High Court ruled a high-stakes international tax dispute in favour of Tiger Global Investment Holdings, a Mauritius entity, where the High Court held that the gain derived by Tiger Global from the sale of Flipkart Private Limited, a Singaporean company, was exempt from tax in India in light of the India–Mauritius Tax Treaty. While such instances of 'indirect transfer' (ie, transfer of a foreign company deriving substantial value from Indian assets) are taxable under Indian domestic tax law, Tiger Global claimed benefits under the India–Mauritius Tax Treaty on such a sale.

The Delhi High Court's ruling overturns the order of the Authority for Advance Ruling (AAR), which refused to provide a ruling to Tiger Global on the ground that its sale of Flipkart shares were prima facie a tax avoidance mechanism. Notably, the Delhi High Court in January 2023 had also ruled in favour of Blackstone Group in a high-stakes tax treaty dispute concerning the India–Singapore Tax Treaty.

However, both these rulings of the Delhi High Court have been stayed by the Indian Supreme Court, and as a result do not have precedential value presently. In Tiger Global's case, the Additional Solicitor General made the following key arguments before the Supreme Court:

- a tax residency certificate (TRC) cannot be regarded as a 'magic wand' for claiming treaty benefits, and tax authorities should be entitled to evaluate whether the 'head and brain' of the taxpayer claiming treaty benefits is in the country of residence;
- Circular 789 of 2000 (which clarifies that Mauritian entities holding a TRC issued by Mauritian authorities will be entitled to tax treaty benefits and be regarded as beneficial owners of the income so earned) should be applicable only to 'foreign

institutional investors' and not to Mauritian entities that are 'global business licence' holders; and
- while 'investments' made prior to 1 April 2017 are grandfathered from the application of GAAR, such grandfathering does not extend to colourable arrangements that have been put in place prior to 1 April 2017.

On the other hand, counsels for Tiger Global made the following arguments:

- once the relevant Mauritian tax authorities are satisfied that the taxpayer is a resident of Mauritius and grant a TRC accordingly, Indian tax authorities should not be entitled to challenge such a determination and evaluate the 'head and brain' of the taxpayer. The only instance where Indian tax authorities should be entitled to examine the residential status is when such taxpayer can be regarded as a resident of India under Indian domestic tax law as well;
- Circular 789 of 2000 continues to be good law, and the same has not been withdrawn by the Government. The said Circular is clear in its scope of granting tax treaty benefits to Mauritian entities holding a TRC issued by Mauritian tax authorities; and
- it is natural for the money invested by Tiger Global to have been sourced internationally, and this has always been the policy objective of the Indian Government while soliciting foreign investment from Mauritius as well. Merely because the directors of a Mauritian entity act in consultation with individuals/entities outside Mauritius cannot lead to an inference that such directors are mere puppets.

The Supreme Court has heard arguments from both sides in Tiger Global's case and has reserved the same for judgment. The matter concerning Blackstone is yet to be heard by the Supreme Court. The decision of the Supreme Court is eagerly awaited, and is expected to settle the jurisprudence concerning entitlement to tax treaty benefits.

Tax tribunal ruling on PPT

In a first-of-its-kind ruling, the Delhi bench of the Income-Tax Appellate Tribunal (ITAT) was called upon to evaluate a tax dispute wherein Indian tax authorities invoked the PPT and disallowed tax treaty benefits. The case concerned a Luxembourg company (Lux Co) which was registered as a foreign portfolio investor (FPI) and held investments in various asset classes in India. The tax authorities invoked the PPT and denied benefits under the India–Luxembourg Tax Treaty to Lux Co on the ground that it was set up by its holding entity (located in the Cayman Islands) solely for the purpose of obtaining benefits under the India–Luxembourg Tax Treaty, and therefore Lux Co was essentially a sham/conduit entity.

Ruling in favour of Lux Co, the ITAT noted that out of the total investments made by Lux Co globally, only approximately 14 per cent were made in Indian assets. Furthermore, Lux Co has consistently filed its income tax returns in Luxembourg, offering its global income to tax, and has also incurred adequate operational/administrative expenditure in Luxembourg as well. Consequently, it could not be said that obtaining a tax benefit under the India–Luxembourg Tax Treaty was one of the principal purposes of the arrangement.

It remains to be seen whether Indian tax authorities take recourse to the PPT more frequently going forward.

The Income-tax Bill 2025

In a significant legislative development, the Indian Government has recently introduced the Income-tax Bill, 2025 (the 'Bill'). The Bill aims to replace the Income-tax Act, 1961 ('IT Act'), which is the primary central legislation concerning taxation of income in India. Over the past 65 years, the IT Act has been amended more than 4,000 times, with several provisions being left redundant with the efflux of time. While the Bill is not expected to make any substantive changes to the tax rates or policies, certain notable features of the Bill include:

- **Length of statute**: The length of the IT Act is significantly reduced under the Bill from the erstwhile word count of 512,535 words to 259,676 words. The total number of chapters under the IT Act are also sought to be reduced from 47 to 23. In reducing the length of the statute, a key mechanism has been removal of redundant provisions from the statute book;
- **Curbing legalese**: An effort has been made to use simpler English words and grammatical structure to enhance the readability of the law; and
- **Optically simpler:** Several sections under the IT Act are sought to be rationalised in the form of tables and formulae to make it optically easier to grasp the law.

The Bill is presently being reviewed by a select parliamentary committee and is expected to be effective from the tax year beginning 31 March 2026. While the transition of such a significant and mammoth statute can lead to practical difficulties, the government thus far has been proactive in issuing FAQs and engaging in wide-ranging consultation with industry participants.

Huge backlog of tax disputes at lower appellate forums

With a view to enhance transparency, efficiency and accountability in tax assessments, the Indian Government introduced a 'faceless assessment' mechanism in 2019. The newly introduced mechanism sought to eliminate a physical interface between taxpayers and the tax officer carrying out the tax assessment. While its introduction undoubtedly has noble intentions, the faceless assessment regime currently faces a significant backlog of tax disputes. This is particularly so at the level of the Commissioner of Income-Tax Appeals (CIT(A)), which is the first appellate authority for income tax disputes.

There is also a large backlog of tax disputes concerning non-resident taxpayers before the ITAT, which is the second appellate authority for income-tax disputes. Non-resident taxpayers have an option to pursue an appeal before the 'dispute resolution panel' (DRP), a collegium of three senior ranking tax officers, rather than the CIT(A). The IT Act requires a tax officer to first pass a 'draft assessment order' in case of a non-resident taxpayer, and to pass a final assessment order only upon issuance of directions by the DRP (which could take six to nine months from the date when a reference has been made to the DRP). Until the DRP issues its directions, there is no tax demand due from the taxpayer.

In this regard, there has been a major interpretational dispute concerning the limitation period for concluding tax assessment proceedings in cases where a non-resident taxpayer chooses to make a reference to the DRP. On the one hand, litigants have successfully argued before various High Courts that the limitation for passing an 'assessment order' must refer to the final assessment order, and that the entirety of the proceedings before the DRP must conclude before such limitation period. On the other hand, tax authorities contend that, in such cases,

the limitation period prescribed for passing an assessment order must only refer to the 'draft assessment order' and not the final assessment order.

The Supreme Court has heard arguments on this matter and has reserved its judgment. The fate of thousands of income tax appeals hinges on this verdict.

In the midst of such a huge backlog of tax disputes, the Indian Government introduced a tax disputes settlement scheme titled *Vivad se Vishwas*. The scheme offered taxpayers a chance to settle their disputes by making a tax payment determined by basis-prescribed formulae. The deadline for submitting applications under this scheme is over.

Pillar One and Two

In a significant move, India has abolished the equalisation levy, which was a form of digital service tax imposed by India on online digital advertising (6 per cent equalisation levy) and e-commerce services (2 per cent equalisation levy). It is estimated that the equalisation levy generated approximately INR 68bn in tax revenue in the past two years alone (approximately $795m).

While the withdrawal of the equalisation levy comes amidst global tensions concerning potential trade tariffs being imposed by the United States, the Indian Government has clarified that the same has no bearing on the decision to withdraw the equalisation levy. The 2 per cent equalisation levy was withdrawn in mid-2024 (ie, prior to the present US administration coming into force) on account of the practical challenges arising due to the ambiguous nature of the provision, whereas the government claims that the 6 per cent equalisation levy has been withdrawn in accordance with India's commitment towards the Pillar One framework (which requires participating jurisdictions to withdraw unilateral digital services taxes).

With the future of the Pillar One framework presently appearing uncertain, and several major global economies continuing to impose unilateral digital services taxes, it remains to be seen whether the Indian Government re-evaluates its decision to withdraw the equalisation levy.

There has been no legislative development concerning the Pillar Two framework.

The International Financial Services Centre

In a bid to promote the Indian IFSC, the Indian Government has introduced several tax relaxations and has further extended the sunset date for various tax benefits provided to units set up in IFSC as follows.

Extension of sunset clauses

Prior to the enactment of the Finance Act 2025, the IT Act provided for several benefits to IFSC units such as the following:

- a tax holiday on transfer of an aircraft or ship leased by an IFSC unit if such unit has commenced its operations by 31 March 2025;
- tax exemptions on certain specific income streams (such as income from transfer of securities, other than shares) for an investment division of an offshore banking unit registered as foreign portfolio investors and which has commenced its operations by 31 March 2025;

- tax exemptions for non-residents on royalty or interest earned from leasing of an aircraft or ship to an IFSC unit, if such unit has commenced operations by 31 March 2025; and
- tax exemptions for non-resident and IFSC units on capital gains arising from the transfer of equity shares of a company based in the IFSC, which is engaged in leasing of an aircraft and has commenced its operations by 31 March 2026.

The Finance Act has extended the aforesaid sunset dates to 31 March 2030.

Inter-company loans between IFSC units with group entities
The IT Act provides that any loan or advance by a closely held company to its shareholder (holding at least 10 per cent of the voting power) is deemed as dividend in the hands of such shareholder. However, an exemption is available if the lending of money is a substantial part of the business of the company, and the loan or advance to the shareholder is made in the ordinary course of its business.

The Finance Act, 2025 has excluded from the ambit of deemed dividend any borrowing between two group entities where one of the group entities is a finance unit or finance company set up in the IFSC as a global or regional corporate treasury centre, and the parent or principal entity of such group is listed on a stock exchange outside India.

Tax-neutral relocation of retail schemes and exchange traded funds
The IT Act enables tax-neutral relocation of offshore funds to IFSC where the resulting fund is registered as a Category I/II/III Alternative Investment Fund (AIF). The Finance Act also extends the tax exemption on transfer of assets by an offshore fund to a resulting fund set up as a retail scheme or an Exchange Traded Fund (ETF) in accordance with the IFSC Authority (Fund Management) Regulations 2022.