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Direct Tax Alert

August 29, 2025

Mumbai Tribunal holds PPT inapplicable without domestic notification

The Mumbai ITAT recently delivered a significant decision[1] in a batch of appeals involving several Irish aircraft leasing companies that had leased aircraft to an India airline. The detailed judgement addresses pivotal issues such as the applicability of the BEPS Multilateral Instrument, satisfaction of the Principal Purpose Test, constitution of a Permanent Establishment in India, and the availability of treaty benefits under the India-Ireland Double Taxation Avoidance Agreement.

Facts of the case

- The Appellants were foreign companies incorporated in Ireland engaged in aircraft leasing business ('the Appellants'). The Appellants leased aircraft to Indian airline pursuant to operating leases arrangement entered in February 2019.
- The Appellants hold valid Tax Residency Certificates ('TRCs') issued by the Irish revenue authorities. Further, the Appellants were set up in line with industry practices, being professionally managed and catering to multiple jurisdictions (India, China, Korea).
- The Appellants had declared 'Nil' taxable income, contending that
  (i) lease rentals were excluded from 'royalty' under Article 12(3)(a) of the India–Ireland DTAA ('the Treaty'),
  (ii) business profits taxable only in Ireland as no Permanent Establishment ('PE') existed in India, and

[1] *Sky High Appeal XLIII Leasing Company Limited v. ACIT* [TS-1085-ITAT-2025(Mum)]

(iii) without prejudice, exempt under Article 8(1) of the Treaty (International Traffic) as income from aircraft operations.

- The Assessing Officer ('AO') denied treaty benefit by invoking the Principal Purpose Test ('PPT') under Articles 6 and 7 of the Multilateral Instrument ('MLI') and held that the Appellants were incorporated in Ireland principally to access benefits under the Treaty citing various factors such as the parent being based in the Cayman Islands, common directorships, outsourced operations and outsourced lease management.
- The Dispute Resolution Panel ('DRP') upheld the above view, and consequently, the final assessment order was issued denying treaty benefits and holding that
  - the rentals constituted as 'royalty' under the domestic law,
  - the Appellants have a fixed place PE in India
  - Article 8 was inapplicable since the lessee was a domestic airline, and
  - the leases were in fact finance leases.
  - As a result, the Appellants were in appeal before the Mumbai bench of the Income-tax Appellate Tribunal ('the Tribunal').

Key Issues for Consideration before the Tribunal

- Whether Articles 6 and 7 of the MLI i.e., PPT could be invoked to deny benefits under the Treaty to the Appellants?
- Whether the lease arrangements could be characterised as dry operating leases or finance leases?
- Whether the presence of leased aircraft in India gave rise to a fixed place PE of the SPVs in India?
- Whether Article 8(1) of the Treaty excluded such income being profits from the operation of aircraft in international traffic, from tax in India?

Taxpayer's Contentions

- The lease agreements were entered into prior to the effective date of the MLI in India (1 April 2020), and hence these provisions could not be applied to the transactions under consideration.
- The Treaty although a Covered Tax Agreement ('CTA') within the meaning of the MLI, the consequences of MLI (including the changes accepted by both India and Ireland) have not been separately notified by way of a protocol to the Treaty.
- Reliance was placed on the Supreme Court's ruling in *Nestlé SA*[2]. In this landmark ruling, the Supreme Court while construing the effect of 'Most Favoured Nation' clauses in the light of subsequently negotiated treaties with Organisation for Economic Co-operation and Development ('OECD') member states, had held that the consequences of a subsequent treaty must be separately notified. Since no notification had been issued giving effect to Articles 6 and 7 of the MLI in the context of the Treaty, the PPT provisions could not be enforced[3].
- Without prejudice, even if the PPT were assumed to apply, the incorporation of the Appellants in Ireland was driven by genuine commercial reasons and not for the purpose of tax avoidance. The choice of Ireland was mainly driven by the fact that it was an established hub of the global

[2] *[2023] 458 ITR 756 (SC)*

[3] *Dhruva tax alert on Nestle SA*

leasing industry, given its recognised aviation ecosystem, regulatory environment, and strategic advantages.

- Leasing operations were not limited to India but also extended to China and Korea, demonstrating that incorporation in Ireland was not India-centric and hence not with the Treaty benefits in mind. Professional services, remarketing, and operational support were obtained from reputed global service providers in line with the industry practices consistent with global industry norms. Thus, its presence in Ireland reflected a genuine commercial base.
- The Revenue's emphasis on the ultimate parent being based in the Cayman Islands was misplaced. As clarified by OECD Base Erosion and Profit Shifting ('BEPS') commentary and the Bombay High Court in the case of *Bid Services Division (Mauritius) Ltd.*[4], the location of the parent entity does not, by itself, establish treaty abuse.
- The Appellant held a valid TRC issued by the Irish Revenue Authorities, which, under settled jurisprudence, constituted conclusive evidence of residence and entitlement to treaty benefits, absent any finding of fraud or sham.
- The arrangements were dry operating leases and the lease rental income was specifically excluded under Article 12(3)(a) of the Treaty. Reliance was placed on the Special Bench decision in *InterGlobe Aviation Ltd*[5].
- No fixed place PE existed in India as the entire business was carried out and managed in Ireland. Without prejudice it was argued that even if a PE were assumed, Article 8 of the Treaty exempted profits derived from the operation of aircraft in international traffic from taxa in India.

Revenue's Contentions

- Both the Treaty and the MLI had been duly notified under the domestic law. Since the Treaty was identified as a CTA, Articles 6 and 7 thereof were automatically applicable. No further notification was necessary for their operation. Reliance was placed on the OECD's explanatory statement clarifying that the MLI modifies treaties alongside existing DTAAs and does not function like an amending protocol.
- Unless the Appellant could establish that its incorporation in Ireland was not primarily to obtain Treaty benefits, the treaty protection could not be granted. The Appellant was a conduit, with ultimate control resting in Cayman Islands, amounting to treaty shopping and lack of commercial substance. The Appellant lacked employees and physical infrastructure and had outsourced all management functions undermined it's claim that it was managed from Ireland.
- Basis the terms of the leases, they should be characterised as finance leases and thus in the absence of the Treaty benefits, the lease rentals would be taxable as 'royalty' under domestic law.
- The aircraft leased by the Appellants constituted a fixed place PE in India since they retained repossession and inspection rights, amounting to control over assets located in India. Further, the aircrafts were operated and registered in India, and the leasing business had a continuous presence in the Indian market.
- Article 8 of the Treaty, which provides for taxation of profits from the operation of

[4] *[2023] 453 ITR 461 (Bom.)*

[5] *[2022] 95 ITR (T) 586 (Delhi-ITAT) (SB)*

aircraft in international traffic, was not applicable since the lessee was a domestic carrier and thus the Appellant's leasing activity was not linked to 'international traffic.'

Decision of the Tribunal

Application of MLI

- The Tribunal, after examining the legal framework of the MLI and its ratification procedure, observed that the MLI does not replace or rewrite the CTA but operates to modify it, provided both countries have ratified and deposited their notifications with the OECD depository. The MLI provisions become effective only when there is a matching notification from both the countries, and thus, its applicability has to be established on a case-to-case basis.
- The Tribunal emphasized that under the constitutional scheme, a DTAA or any protocol that alters its terms does not automatically become enforceable in India, and a separate notification under Section 90(1) is indispensable for any subsequent modification to be given effect domestically. The Tribunal recognized that the MLI 'modifies' existing treaties but clarified that it is not itself an amending protocol to any specific DTAA.
- The Tribunal relied extensively on the Supreme Court's ruling in Nestlé SA (supra) and held that any subsequent treaty-based modification requires a separate notification under domestic law. While both the DTAA and MLI were separately notified, no notification was issued to incorporate Articles 6 and 7 of the MLI into the India–Ireland DTAA. Therefore, PPT provisions could not be applied.

Application of PPT

- Notwithstanding the conclusion regarding inapplicability of the MLI, the Tribunal observed that even if the MLI were assumed to apply, the operation of the PPT is fact-specific and must be tested in light of the object and purpose of the treaty.
- The PPT is, by its very language, a general anti-abuse rule of last resort, to be invoked only where it is reasonable to conclude that one of the principal purposes of an arrangement was to obtain treaty benefits in a manner contrary to the object and purpose of the treaty provisions. The PPT is not a blunt instrument, and it must be applied in light of the object and purpose of the treaty.
- The Tribunal found that the Appellant was managed in Ireland through a reputed service provider, with Irish-based directors, bankers, and legal advisors, which were substantive elements of its operational structure. The Appellant undertook genuine leasing operations, incurred expenditure, assumed risks, and was not a mere conduit.
- The issuance of a TRC by Irish authorities was held to be conclusive evidence of residency absent fraud, in line with *Azadi Bachao Andolan*[6] and *Vodafone International Holdings BV*[7]. Aviation ecosystem in Ireland provided a valid commercial rationale for incorporation, and the Cayman parentage or outsourcing routine functions did not establish treaty abuse.
- While the amount of tax benefit can be a relevant factor, it cannot in itself decide applicability of PPT. The PPT requires clear proof, backed by facts, that the main purpose of the arrangement was to obtain

[6] *[2003] 263 ITR 706 (SC)*

[7] *[2012] 341 ITR 1 (SC)*

the treaty benefit and that such benefit goes against the intent of the treaty. In this case, no such evidence was provided, and therefore, the Revenue's contention was dismissed.

On Lease Characterisation

- The Tribunal rejected Revenue's contention that leases were finance leases, noting that they were structured as dry operating leases consistent with industry norms. The mere allocation of certain risks or long-term leasing terms did not change the legal character of the contracts.
- The Tribunal held that the Appellant was the legal and beneficial owner of the aircraft, duly registered with the DGCA. The lease rentals were therefore not 'royalty' under section 9(1)(vi) but constituted business income.

On PE and Article 8(1) Application

- The Tribunal ruled that the mere presence of leased aircraft in India did not amount to a fixed place PE of the Appellant. The repossession rights and inspection rights were contractual protections, not indicators of a fixed place of business.
- The Tribunal clarified that Article 8 could not be excluded merely because the lessee was a domestic airline. The leasing business itself was international in character, and the appellant, being an Irish resident, was entitled to DTAA protection.

Dhruva Comments

- This ruling represents a significant development in the evolving landscape of tax jurisprudence, especially since the MLI has come into existence.
- MLI is a very innovative instrument and modifies several tax treaties in a very short time. Determination of whether the MLI is modifying a tax treaty is a complex exercise, and to address this concern, the tax administrations have prepared 'synthesised texts'. It is widely acknowledged that the synthesised texts are not 'legally binding' and the tribunal reaffirms this. Hence, taxpayers cannot simply rely on the synthesised text and need to be careful in identifying the extent to which the MLI impacts the tax treaty.
- The Appellant has succeeded in applying the ratio laid down by the Supreme Court in the case of Nestle SA (supra) in its favour. The effect of the Tribunal ruling is that, in the absence of a specific notification assimilating the MLI provisions into the domestic law. Mere fact that India has signed and ratified the MLI does not, by itself, alter the operation of an individual treaty. Thus, unless the Central Government notifies specific amendments to each CTA, MLI provisions cannot be enforced.
- BEPS project primarily addressed aggressive tax planning structures. The MLI provisions reflect this theme and make it difficult to avail a tax treaty benefit or deny the benefit with respect to such aggressive tax planning structures. The Tribunal's order on the applicability of MLI provisions provides relief to the Multinational Enterprises ('MNEs') from the anti-avoidance provisions. However, the MNEs need to be watchful as the relief could be temporary. It will be interesting to see the strategy adopted by the tax administrations, as the Tribunal order has the effect of holding off the implementation of the globally agreed-upon BEPS project.
- Disputes regarding the application of PPT are new, and the Tribunal's finding is a significant development in Indian jurisprudence on PPT. The Tribunal observed that even if obtaining a tax

benefit was one of the principal purposes of the arrangement, granting such a benefit would still be in line with the very object and purpose of the India–Ireland Treaty. In the instant case, the Treaty itself reflects a deliberate sovereign policy choice to encourage the aircraft leasing business, as evidenced by the exclusion of aircraft rentals from the definition of royalties under Article 12 and the favourable provisions under Article 8. The Tribunal order can help defend well-established business models from the application of PPT. The Tribunal has placed reliance on the OECD examples on PPT, which also serves as good guidance for defending the applicability of PPT.

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