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DIRECT TAX ALERT

January 22, 2026

Supreme Court denies capital gain exemption for an indirect transfer of shares of an Indian company by a Mauritian Investment Fund by applying GAAR to pre-2017 arrangement

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Supreme Court denies capital gain exemption for an indirect transfer of shares of an Indian company by a Mauritian Investment Fund by applying GAAR to pre-2017 arrangement

The Supreme Court, in a landmark ruling, in the case of Tiger Global, dealt with the AAR's jurisdiction to reject an advance ruling application where the underlying transaction is viewed as prima facie, of tax avoidance. The decision carries important implications for the claim of Tax Treaty benefits in connection with an income stream arising out of inbound cross-border investment, particularly in relation to the evidentiary value of a TRC and the potential application of GAAR even in respect of pre-April 1, 2017 investments.

Background

- Tiger Global International II Holdings, Tiger Global International III Holdings, and Tiger Global International IV Holdings[1] ("the taxpayer") are private companies limited by shares, incorporated in Mauritius, holding a valid Tax Residency Certificate ("TRC") issued by the Mauritius revenue authority, primarily set up to undertake investment activities with a view to earning long-term capital appreciation and investment income. The taxpayer held a Category 1 Global Business License in Mauritius and activities were regulated by the Financial Services Commission of Mauritius.

- The taxpayer held shares of Flipkart Private Limited incorporated in Singapore ('Flipkart Singapore'), which derived substantial value from underlying assets in India (Flipkart India and other companies). These shares were acquired by the taxpayer over the period 2011 to 2015. In 2018, the taxpayer transferred its shares in Flipkart Singapore to Fit Holdings SARL, a Luxembourg entity.

- Prior to transfer, the taxpayer approached the tax Authorities for a nil withholding tax certificate which was denied, pursuant to which the taxpayer approached the Authority for Advance Rulings ("AAR") to seek a ruling on the chargeability of gains to tax in India under the India–Mauritius Tax Treaty ("tax treaty").

- The AAR rejected the application at threshold, holding that the transaction was prima facie designed for tax avoidance and therefore, not fit for admission within the AAR's jurisdiction[2].

- In its order, the AAR observed that the effective control and management of the taxpayer was not in Mauritius, but in the United States, on the basis that the sole Director of the ultimate holding company situated in the USA was a signatory to the Mauritius bank account and was the beneficial owner of the taxpayer. Further, the board of directors of the taxpayer in Mauritius were merely puppets. In the absence of any Foreign Direct Investment in India, there was neither any business operations in India nor any taxable revenue generated in India. The taxpayer was a conduit entity set up for tax avoidance by availing the tax treaty benefits.

- The taxpayer challenged the AAR's rejection before the Delhi High Court. The Delhi High Court quashed the AAR ruling and held that the transaction was not designed for the avoidance of tax and capital gains from the transfer of shares acquired prior to April 1, 2017 stood grandfathered under the tax treaty.

- Aggrieved by the Delhi High Court's ruling, the Revenue filed an appeal before the Supreme Court ("SC").

[1] [2026] 182 taxmann.com 375 (SC)

[2] Proviso (iii) to Section 245R(2)

Issue under consideration

- Whether the AAR was justified in rejecting the advance ruling application as not maintainable, by prima facie treating the transaction (sale of shares of a Singapore company substantially deriving value from India assets), by a Mauritius company controlled by an American company, as an arrangement for tax avoidance, and consequently declining to enquire into whether the resulting capital gains were taxable in India under the Income-tax Act,1961 ("the Act") read with the relevant provisions of the Tax Treaty.

Revenue's contention

- Article 4(1) of the Tax Treaty permits the Indian Tax authorities to examine whether the taxpayer is a resident of Mauritius by applying Mauritian domestic law. As the source State, India retains sovereign authority to determine taxability under its domestic law. A Tax Treaty only allocates taxing rights between Contracting States and does not amount to abdication of such sovereign taxing power.

- The source State (India) retains the authority to examine treaty abuse and lack of commercial substance, even where treaty benefits are claimed. Grant of treaty benefits and scrutiny for abuse operate in distinct spheres.

- A TRC is only prima facie evidence of residence and does not override the "substance over form" Principle. Issuance of a TRC does not foreclose enquiry into actual control and management or application of substance tests. Treaty benefits may be denied where gains arise in India but escape taxation elsewhere due to the absence of capital gains tax.

- Mauritian law recognizes control and management as determinative tests of residence; however, the criteria is non-exhaustive.

- Circular 789[3] was a policy measure to provide certainty to Financial Institutional Investors ("FIIs") and similarly placed investors. It does not extend to business investments or indirect transfers, and Circular 1 of 2003[4] is also silent on indirect transfers.

- Section 90(4) and section 90(5) of the Act prescribing TRC and other documentation for claiming Tax Treaty protection are not conclusive and do not confer immunity from scrutiny under General Anti-Avoidance Rules ("GAAR").

- Only pre-2017 "investments" and not pre-2017 "arrangements" are protected from GAAR applicability. Treating every pre-April 1, 2017 share acquisition as immune from GAAR, even where transfer occurs later, is flawed. GAAR Rules (Rule 10U) distinguishes between "investment" exclusions and "arrangement" scrutiny, with Rule 10U(2) enabling GAAR application notwithstanding the vintage of the initial investment.

- After the 2017 amendment to the Tax Treaty, direct transfers are governed by Articles 13(3A)/(3B), while indirect transfers fall under Article 13(4). Article 13(4) does not contain a Limitation of Benefit (LOB) Clause. The LOB clause, effective April 1, 2017, operates as a treaty-based Specific Anti-Avoidance Rule (SAAR) for direct transfers and shell/conduit tests. It was stated to be inapplicable to indirect transfers, hence requiring examination under the Act once abuse is established.

- The *Azadi Bachao Andolan*[5] case was stated to relate to portfolio investments by FIIs/mutual funds and not cross-border or business transactions involving indirect transfer. Circular 789 was issued to restore investor confidence in capital markets and was not intended to cover indirect transfers.

[3] CBDT Circular 789 dated April 13, 2000

[4] CBDT Circular 1 dated February 10, 2003

[5] Azadi Bachao Andolan v. UOI [2003] 263 ITR 706 (SC)

- Reliance placed on the *Vodafone*[6] judgement to support substance-over-form review, piercing the corporate veil, and scrutiny of sham/conduit entities as part of Indian tax jurisprudence capable of legislative codification.

- Even where Mauritius regulates licensees, the power to deny treaty benefits rests with India, where treaty abuse is established. Treaty benefits were stated to be available for genuine arrangements but denied where abusive.

Taxpayer's contention

- Article 4 of the Tax Treaty lays down a mandatory and exclusive rule for determining residence, based on whether a person is "liable to tax" under the laws of Mauritius. Accordingly, India cannot refuse to treat an entity as a Mauritian resident if it is regarded as such under Mauritian law.

- Once a valid TRC is issued by the Mauritian authorities, Indian authorities are precluded from going behind it to re-examine residence or treaty entitlement. Reliance was placed on section 90(4) and section 90(5) of the Act to submit that the documentation requirements for claiming Tax Treaty benefits are exhaustively prescribed under the Act. The AAR's enquiry into "head and brain" and ultimate beneficial ownership (as against legal ownership) of income effectively required Indian authorities to interpret Mauritian laws (including the Financial Services Act, 2007) to test "liability to tax" in Mauritius, which is impermissible. Such determination, it was contended, lies within the exclusive domain of the Mauritian authorities; unless where a taxpayer is established as a resident of both the contracting states.

- Reliance was placed on Circular 789 and the Press Release dated March 1, 2013, as well as the SC decision in the case of *Azaadi Bachao Andolan* upholding the validity of Circular 789. The SC decision in the case of *Vodafone* was relied upon to reiterate the "look at" principle and the limited scope for disregarding structures except where they are sham or colourable devices.

- Domestic law principles such as "lifting the corporate veil" or "substance over form" cannot override tax treaty provisions unless the treaty itself provides for such limitations. The Tax Treaty is a self-contained code for allocating taxing rights. Treaty abuse concerns were addressed only through the 2016 Protocol to the Tax Treaty, effective from April 1, 2017. The amended provisions operate prospectively and do not affect gains arising from investments made prior thereto.

- GAAR applies prospectively as Rule 10U(1)(d) grandfathers income from transfer of pre-2017 investments. Rule 10U(2) does not dilute this protection. Any contrary interpretation would render Rule 10U(1)(d) otiose.

- Pre-2017 investments are protected from application of GAAR under the Act, and consequently, from denial of treaty benefits under GAAR.

- The jurisdictional bar for rejecting the maintainability of an AAR application requires a clear prima facie finding of a transaction designed for tax avoidance which was not established. Therefore, the AAR was not justified in rejecting the application for advance ruling at the threshold.

Supreme Court's Ruling

- At the very beginning of its decision, the SC has stressed on India's sovereign taxing powers to be exercised within the framework of domestic law and treaty obligations. The SC also took note of the evolution of the Tax Treaty regime over time, including policy and treaty-level measures introduced to address concerns around misuse of treaty benefits in complex cross-border investment structures. The SC has stated that it is in light of such legal, economic, and policy backdrop that the dispute relating to the Tiger Global's case has been considered.

TRC is not conclusive evidence of Tax Residency

- The SC held that the TRC is not conclusive to establish tax residency. The TRC is not binding on any statutory authority or Court unless the authority or Court enquires into it and comes to its own independent conclusion.

- The principles outlined by the Circular 789 and the SC decision in the case of *Azaadi Bachao Andolan* have been overturned by the subsequent amendments under the Act, introduction of GAARs and amendment to the Tax Treaty.

[6] Vodafone International Holdings B.V. v. UOI [2012] 341 ITR 1 (SC)

Applicability of GAAR to pre-2017 arrangements

- Grandfathering from GAAR is available only in respect of income arising from the transfer of an "investment" made prior to April 1, 2017. However, such grandfathering is not available where the structure is characterised as an "arrangement", in which case GAAR scrutiny can apply irrespective of when the arrangement was entered into, and the duration for which it has existed is not determinative. The cut-off date of investment mentioned under Rule 10U(1)(d) stands diluted by Rule 10U(2), if any tax benefit is obtained based on such arrangement. There exists a distinction between passive investments eligible for grandfathering and active, arrangement-based structuring, which remains susceptible to GAAR testing even if set up prior to April 1, 2017.

- The SC clarified that with respect to certain arrangements, even if one could technically argue that GAAR does not apply, the provisions under Judicial Anti-Avoidance Rules could still apply.

- The business intent behind a transaction serves as strong evidence of whether the transaction is deceptive or an artificial arrangement. The commercial motive behind a transaction often reveals its true nature.

- The SC observed that in the current case, the taxpayer seeking exemption from the Indian Income tax while, at the same time, contending that the transaction is also exempt under Mauritian law, runs contrary to the spirit of the tax treaty and presents a strong case for the tax department to deny the benefit, as such an arrangement is impermissible.

- The GAAR provisions shift the burden onto the taxpayer to disprove the presumption of tax avoidance. In the present case, there is a clear and convincing prima facie evidence to demonstrate that the arrangement was designed with the sole intent of evading tax and the Taxpayer failed to furnish sufficient material to rebut this presumption.

- The SC held that Section 96(2) places the onus on the taxpayer to disprove the presumption of tax avoidance. In the present case, there is a clear and convincing prima facie evidence to demonstrate that the arrangement was designed with the sole motive of evading taxes, and the taxpayer had failed to produce sufficient evidence to rebut the preposition.

- Towards the end, the SC observed that while a taxpayer is permitted to plan transactions to lawfully avoid tax, such planning must be carried out through a mechanism that is permissible in law and conforms to the framework prescribed under the Act, rules, and notifications. Where the mechanism is found to be illegal or a sham, it ceases to qualify as "permissible avoidance" and instead falls within the scope of "impermissible avoidance" or tax evasion.

Conclusion

- The SC held that where the transaction resulting in capital gains is found to be pursuant to an impermissible tax avoidance arrangement, the taxpayer would not be entitled to claim exemption under Article 13(4) of the Tax Treaty.

- The SC affirmed AAR's finding that there exists a prima facie case of tax evasion and concluded that AAR was justified in rejecting the advance ruling application at the threshold as not maintainable as per proviso (iii) to Section 245R(2). Accordingly, capital gains arising from transfers effected on or after April 1, 2017, are taxable in India under the Act read with the Tax Treaty.

Additional observations by Justice J B Pardiwala

- Additionally, Justice J B Pardiwala fully concurred with the judgment authored by Justice R. Mahadevan. In his concluding remarks, Justice Pardiwala emphasises that tax sovereignty is an inherent attribute of an independent nation, and its effective exercise, especially in cross-border contexts, has become increasingly critical in today's geo-economic environment.

- He highlights that while international treaties shape the framework for taxation, they should not result in dilution of India's sovereign right to tax income sourced from its territory, and safeguards such as limitation of benefits provisions, GAAR override clauses, ensure right to tax digital economy (Significant Economic Presence, Equalisation Levy, digital services tax provisions), protection of source taxation, inclusion of tax credit mechanism and not exemption mechanism, renegotiation and exit clauses, avoidance of MFN

provisions, clear permanent establishment definitions, and alignment with domestic law and constitutional principles to prevent treaty abuse and tax base erosion.

- He further suggested that prior to entering into any tax treaty, conduct a cost–benefit analysis covering revenue implications, impact on domestic industry, and long-term strategic considerations, etc., along with instituting a robust treaty monitoring and review mechanism to review treaty abuse and changing business trends. It is also suggested to consult stakeholders to ensure that treaties will reflect broader public and economic interests.

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For any queries in relation to this tax alert, please feel free to reach out.

DHRUVA INSIGHT

The SC's ruling in *Tiger Global* underscores India's sovereign right to tax. Cross-border transactions involving India-linked value are likely to be subject to closer scrutiny by tax authorities, with a sharper focus on the commercial rationale for undertaking the transaction. Multinational groups may need to reassess their holding and transaction structures where treaty benefits are sought to be availed on all income streams (including and not limited to direct/ indirect transfer, dividend, interest etc), with greater emphasis on demonstrating commercial substance through robust documentation.

The decision is also fact-specific, with the SC's observations being closely linked to the factual matrix before it. That said, it lays down an important binding principle that a TRC is not conclusive by itself and does not preclude an independent enquiry into treaty eligibility and the surrounding substance of the arrangement, including the commercial justification for setting up the structure (eg SPV structure) and the exits.

Going forward, it will be important to watch how this ruling is applied in the post-MLI environment. As far as Mauritius tax treaty is concerned, the Protocol incorporating the Principal Purpose Test (PPT) clause has not yet come into effect. It is important to note that Circular 1/2025, dated January 21, 2025, clarified that the grandfathering provisions under Mauritius, Singapore and Cyprus tax treaties will remain outside the purview of the PPT. However, legacy structures may continue to face scrutiny under GAAR and judicial anti-avoidance principles.

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