

International Tax and Transfer Pricing

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Multilateral Instrument provisions cannot modify a Tax Treaty unless separate notification under section 90(1) issued by CBDT

Sky High Appeal XLIII Leasing Company Ltd. vs. ACIT(IT) [2025] (177 taxmann.com 579) (Mum. Tribunal)
In favour of assessee

Brief facts

The assessee, an Ireland based company was engaged in the business of leasing aircraft to operators worldwide. It held a Tax Residency Certificate (**TRC**) issued by the Irish Revenue Authorities. The assessee had entered into dry operating lease agreements with an Indian Associated Enterprise (**AE**). The assessee filed its return declaring Nil taxable income. In the tax return a stand was taken that the lease rentals from the dry operating leases did not constitute “royalty” as per Article 12(3)(a) of the India-Ireland Tax Treaty, which expressly excludes payments for the use of aircraft. In the absence of a Permanent Establishment (**PE**) in India, the income from leasing aircraft would not be taxable in India under Article 7.

The AO invoked Articles 6 and 7 of the Multilateral Instrument (**MLI**) on the premise that the principal purpose of the assessee's incorporation was to obtain the benefits of the India-Ireland Tax Treaty and Principal Purpose Test (**PPT**) was not satisfied.

Argument of the assessee

The Supreme Court of India in the decision of Nestle SA (155 taxmann.com 384) has held that a notification under section 90(1) is necessary and a mandatory condition for a court, authority, or tribunal to give effect to a Tax Treaty or any protocol changing its terms or conditions, which alters the existing provisions of law. In absence of separate notification under section 90, the beneficial tax treatment granted by another Organisation for Economic Co-operation

and Development (**OECD**) country would not automatically apply to the Tax Treaty. In such an event, the terms of the earlier Tax Treaty require to be amended through a separate notification under section 90.

India-Ireland Tax Treaty was duly notified in the Official Gazette on 11th January 2002. The MLI was notified separately on 9th August 2019. Although the India-Ireland Tax Treaty is indeed a “Covered Tax Agreement” within the meaning of the MLI, as there is no separate notification which has been issued under section 90(1) in respect of India-Ireland Tax Treaty. Accordingly, MLI amendments cannot be applicable to India-Ireland Tax Treaty.

Argument of the Income tax department

By virtue of the MLI's notification alone, Articles 6 and 7 and the PPT automatically becomes part of the India-Ireland Tax Treaty. Unless it is established that the principal purpose of incorporation of the assessee in Ireland was not to take benefit of the India-Ireland Tax Treaty or that the grant of the benefit under the India-Ireland Tax Treaty is not in accordance with the object and purpose of the said Tax Treaty, the beneficial provisions of the Tax Treaty will not be available

Held

Articles 6 and 7 of the MLI cannot be invoked against the assessee because, although both the Tax Treaty and the MLI are notified, there is no specific notification which has been issued by the CBDT under section 90(1). As per the Supreme Court of India in Nestle SA, separate notification under section 90(1) is a mandatory precondition to be complied with. The “synthesized text” is merely explanatory and has no legal force in absence of such notification under section 90(1).

Even assuming the PPT applied, the assessee has produced a valid Irish TRC and demonstrated genuine commercial substance in Ireland (licensed manager, Irish directors/advisers, operations and risks). Accordingly, obtaining Tax Treaty relief was not a principal purpose contrary to the Tax Treaty's object. The aircraft leases are dry operating leases (not finance leases/interest), and the assessee has no PE in India.

Accordingly, the lease income is not taxable in India, and the assessment must proceed without MLI based curtailment of Tax Treaty relief.

CNK Comments

The Delhi Tribunal in another recent decision in case of Kosi Aviation Leasing Ltd. & Ors. vs. ACIT (IT) [TS-1296-ITAT-2025 (Del)] dealt with a similar issue and relying on this Mumbai Tribunal decision held that the MLI could not modify the Tax Treaty in the absence of a specific country-wise notification under section 90(1).

Both the above decisions have heavily placed reliance on the observation made by the Supreme Court in case of Nestle SA wherein it was held that a notification under section 90(1) is a mandatory condition to give effect to any modification to a Tax Treaty (generally done by way of a protocol signed between the treaty partners).

The MLI is a multilateral instrument which modifies various treaties signed by India and was duly notified by India vide Notification No.57/2019 dated 9th August 2019. The MLI modifies the relevant Tax Treaty only if and when the other treaty partner also includes the Indian treaty in its MLI document of ratification. The Tribunal's reasoning, without referring to the said notification, implies that the MLI would remain inoperative until a separate bilateral notification is issued. The said interpretation arguably is inconsistent with India's ratification process. The issue thus remains open and may warrant further judicial examination by High Court or CBDT clarification, to align domestic interpretation with India's international treaty obligations. Therefore, readers are advised to consider the implications of the MLI while undertaking any cross-border transactions as the decision of Tribunal does not seem to be correct interpretation of law.

Transfer Pricing

Notional interest addition because of transfer pricing adjustment would not trigger taxability in the hands of non-resident, where the taxability as per Tax Treaty requires actual receipt of interest

Volkswagen Aktiengesellschaft vs. DCIT [2025] (177 taxmann.com 312) (Mum. Tribunal)

In favour of assessee

Brief facts

The assessee was a tax resident of Germany. It was engaged in the manufacture and worldwide sale of Volkswagen brand vehicles, their components, and related engineering products. The assessee had entered into international operations of automotive components and capital goods to its Indian AE. It had also extended External Commercial Borrowings (ECBs) to another Indian AE. The assessee received actual interest from Indian AEs on delayed receivables as well as on ECB. Interest received from Indian AEs was offered to tax in India at the concessional rate of 10% as per Article 11 of the India-Germany Tax Treaty.

The TPO made transfer pricing upward adjustment by increasing rate of interest on the ECBs and delayed receivables.

The assessee before the Tribunal argued that interest taxability as per Article 11 of the Tax Treaty is only on payment basis. Where the interest representing upward transfer pricing adjustment will never be paid to the assessee, there cannot be any taxation of such interest in the hands of the assessee.

Held

As per Article 11 of the Tax Treaty, interest is taxable in the other contracting state only when it is "paid" to a resident of that state. The term "paid," as clarified in the OECD Commentary, implies actual payment or

discharge of an enforceable obligation to put funds at the creditor's disposal. Since the Tax Treaty specifically uses "paid" and not "accrued," domestic accrual-based taxation cannot override the Tax Treaty. Chapter X of the Act, dealing with transfer pricing, is not a charging provision, it merely determines Arm's Length Price (ALP), and the income must still be chargeable under the Act or Tax Treaty. In absence of actual payment, the notional addition made by the TPO does not constitute taxable income under Article 11. Accordingly, transfer pricing adjustment made by the TPO was untenable.

CNK Comments

This decision may not be entirely correct in holding that only interest "paid" is covered under the Tax Treaty. Article 11 specifically provides that where the consideration for interest exceeds the arm's length amount, the excess may be taxed in accordance with domestic law. Therefore, the Tribunal ought to have examined whether such notional or deemed income could still fall for taxation under domestic provisions. Further, if Article 11 were considered inapplicable, the taxability should have been evaluated under other relevant Articles such as Article 7 (Business Profits) or Article 21 (Other Income).

outstanding receivable from the AEs. The TPO made transfer pricing adjustments by computing the ALP by adding notional interest on outstanding receivables from AE.

Held

Where the assessee had not charged interest on outstanding receivable from AE beyond credit period, no addition qua interest can be made by the TPO on receivables outstanding with AE.

CNK Comments

This is a timely decision considering that TP authorities are trying to tax outstanding receivables blindly in scrutiny in the last couple of years. Where the assessee has not charged interest on outstanding/ delayed receivables from non-AEs, it could rely on the above decision and argue that no addition of interest should be made on outstanding/ delayed receivables from AEs.

No addition can be made by the TPO on outstanding receivable from AE beyond credit period, where the assessee had not charged similar interest on outstanding receivable from non-AE

Acme Cleantech Solutions (P.) Ltd. vs. NFAC [2025] (177 taxmann.com 95) (Delhi Tribunal)

In favour of assessee

Brief facts

The assessee was a provider of telecommunication equipment, comprehensive passive infrastructure solutions to wireless telecom players and related services to mobile operators in India as well as overseas. The assessee had entered into international transactions with its AE. The assessee had certain



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