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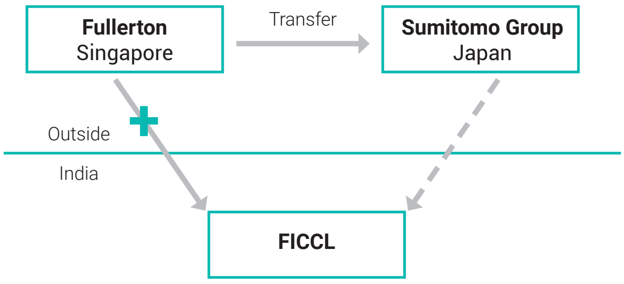
PPT in Focus: When Commercial Reality Trumps Formal Presence

The Mumbai Income Tax Appellate Tribunal (ITAT) delivered a significant ruling in the case of Fullerton Financial Holdings Pte. Ltd. ('Fullerton' or 'Assessee'), a Singapore-based investment holding company, regarding its eligibility to claim long-term capital gains ('LTCG') exemption under Article 13(4) of the India–Singapore Double Taxation Avoidance Agreement (DTAA). This decision has important implications for cross-border investors using Singapore as an investment hub for Indian operations.

Facts in Brief:

- Fullerton, a Singapore-based investment holding company belonging to the Temasek Group, ultimately owned by the Government of Singapore.
- Fullerton made a long-term investment in Fullerton India Credit Company Ltd. ('FICCL') during FY 2009–10, i.e., prior to 1 April 2017.
- During the FY 2021-22, Fullerton sold its entire shareholding in FICCL to a third party, Sumitomo Mitsui Financial Group ('Sumitomo Group') resulting in LTCG.
- The Assessee claimed exemption from capital gains tax under Article 13(4) of the India–Singapore DTAA.
- The tax authorities denied the treaty benefit, alleging that the Assessee was a shell/conduit company and failed the Principal Purpose Test ('PPT') under Article 24A.
- The Tax Officer initiated the case, which then moved to DRP and finally before the Mumbai ITAT for final determination.



Case Journey

Tax Officer:

- *Not in favour:* The Tax Officer denied the capital gains tax exemption, asserting that Fullerton lacked commercial substance in Singapore and functioned as a conduit company created primarily to avail treaty benefits. The Tax Officer further applied the Principal Purpose Test (PPT) under Article 24A of the India–Singapore DTAA to reject the company's claim.

> *PPT is a treaty anti-avoidance rule that allows tax authorities to deny DTAA benefits whenever obtaining a tax advantage is the principal purpose of a transaction. It focuses on the intent behind the transaction. If the transaction lacks real commercial rationale and one of the principle purpose of undertaking the same is to secure a treaty benefit, the relief can be refused.*

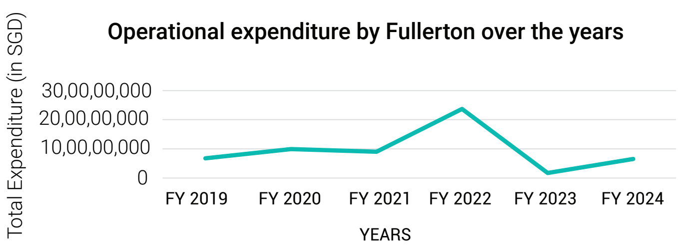
Dispute Resolution Panel (DRP):

- *Not in favour:* The DRP upheld the conclusions of the Tax Officer stating that the entity had insufficient economic substance, no employees, and lacked genuine control or management in Singapore. As a result, DRP affirmed taxation of the capital gains in India under section 9(1)(i) of the Income tax Act, 1961

Arguments Before the Tribunal

Fullerton challenged findings of lower authorities before the Tribunal, contending that the denial of treaty benefits on the grounds of Principal Purpose Test ('PPT') was unsustainable, as the arrangement was driven by genuine commercial considerations and not by a predominant tax-avoidance motive. In support, it submitted that:

- The investment preceded April 1, 2017, and therefore qualified for grandfathering under Article13(4);
- It operated as a bona fide investment holding company with independent decision-making powers exercised in Singapore;
- Its operational expenditure consistently exceeded SGD 200,000 (as reflected in the graph below), meeting DTAA's substance requirement;



- Board meetings and strategic decisions were conducted in Singapore;
- The investment and exit were commercial decisions, not tax-avoidance arrangements;
- Its ultimate beneficial owner is the Government of Singapore, through the Temasek Group, leaving no scope for treaty abuse allegations.

Decision of the Tribunal:

The Tribunal affirmed PPT compliance, ruled in favour of Fullerton and restored LTCG exemption under Article 13(4). Key observations included:

- Fullerton satisfied PPT, as the investment and subsequent sale were driven by genuine commercial considerations, with treaty benefits being only incidental and not the primary objective.
- Economic substance was demonstrated through operational expenditure which was much higher than the annual limit of SGD 200,000;
- Control and management were exercised in Singapore, not elsewhere;
- The allegation of Fullerton being a conduit or shell entity was unfounded;
- Sovereign ownership by the Government of Singapore further reduced the possibility of treaty misuse.

Key Takeaways

- The Tribunal held that the capital gains on sale of FICCL shares were exempt from tax in India due to the grandfathering clause under Article 13(4) and therefore India do not retain taxing rights over capital gains on pre-2017 investments by Singapore entity.
- The Tribunal held that the arrangement was not tax-motivated, aligning with OECD BEPS Action Plan 6 principles- 'Preventing the Granting of Treaty Benefits in Inappropriate Circumstances' and treaty benefits cannot be denied unless tax advantage is the principal purpose.
- Operational expenditure above SGD 200,000 and documented governance satisfied the DTAA's substance test, countering Revenue's claim that Fullerton was a shell or conduit.
- Board meetings and strategic decisions occurred in Singapore, meeting the legal test for central management and control, and reinforcing Fullerton's eligibility for treaty benefits.
- As part of the Temasek Group, ultimately owned by the Government of Singapore, the entity lacked indicators of treaty shopping.

Our Perspective

This decision reinforces the importance of maintaining commercial substance, economic presence, and documented governance for entities claiming DTAA benefits. It also reaffirms that grandfathered investments under the India–Singapore DTAA enjoy continued protection from capital gains taxation in India, provided PPT and other treaty requirements are satisfied. The ruling is expected to provide clarity and reassurance to foreign investors using Singapore-based holding structures for long-term, substantive investments in India.

Authorised by

AMEET BAID
ASA

CHANDANDEEP KAUR
ASA

ISHMEET KAUR
ASA