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Lowy: the first PPT-case

Melanie Massant (KU Leuven) · Monday, March 24th, 2025

On December 30th of last year, the Indian Income Tax Appellate Tribunal was the first "quasi judicial institution" to apply the PPT to a treaty-shopping arrangement.[1] The case concerned a dispute between a Luxembourg-based holding company, SC Lowy, and the Indian tax authorities.

<u>Facts of the case</u>

The Luxembourg holding company, SC Lowy, is owned by a company located on the Cayman Islands and has made investments all over the world, including in India.

Due to those investments in India, SC Lowy receives business income, capital gains and interest, for which it claims a reduction or exemption on the basis of articles 7, 13(6) and 11, resp., as provided by the Luxembourg-India double tax treaty. However, the Indian tax authorities denied these tax treaty benefits, arguing that a) the arrangement constitutes unacceptable treaty shopping, b) SC Lowy is just a conduit, c) the tax residency certificate received by SC Lowy is not sufficient to establish tax residency, d) SC Lowy is not the Beneficial Owner of the income received, and e) there is no commercial rationale for the establishment of SC Lowy. (§14)

For the interposition of SC Lowy to constitute unacceptable treaty shopping, as asserted by the Indian tax authorities, the arrangement must however fulfill the following two tests foreseen in the Principal Purpose Test, which was included in art. 29 of the Luxembourg-India double tax treaty:

- It must be reasonable to conclude that obtaining the treaty benefits foreseen by the Luxembourg-India double tax treaty was one of the principal purposes of the arrangement;
- It must be established that granting the treaty benefits in these circumstances would contradict the object and purpose of the relevant treaty provisions.

According to SC Lowy the first test of the PPT was not fulfilled. The tribunal agreed with SC Lowy and based its conclusion on the following findings (§17-19) regarding SC Lowy:

- it was incorporated as a holding company in Luxembourg in 2015 and is registered in India as a "Foreign Portfolio Investor"
- Only 13.9% of all of its investments are located in India
- It has incurred substantial operational expenditure relating to investments in Luxembourg in the nature of consulting fees, legal and litigation fees, other professional fees apart from other administrative expenses such as rent paid for office premises, bank account charges, accounting fees, etc.

- It exists till date in Luxembourg and continues to hold substantial investments.

Given that the first test of the PPT is not fulfilled, the tribunal concludes that the PPT cannot be applied to deny the relevant treaty benefits. In addition, the tribunal also concluded that SC Lowy was the Beneficial Owner of the income and thus not a mere conduit and that the tax residency certificate was sufficient to establish its tax residency.

On the basis of the tribunals analysis, the Indian tax authorities could thus not deny the treaty benefits provided by the India-Luxembourg double tax treaty.

An analysis in line with the OECD/UN Commentaries on the PPT

The OECD/UN Commentaries try to clarify the application of the PPT, thereby providing some examples. The analysis of the tribunal in the Lowy case seems to be in line with these Commentaries.

- In examples G, H and K of the OECD/UN Commentaries on the PPT (§ 182), a corporation is interposed between a principal shareholder and its investments. The OECD refers to the objectively observable factors of this interposed company that may indicate the presence of an economic activity, such as personnel, assets, functions, risks and activities, to then conclude that the first test of the PPT was not met. These factors often fall under the term "economic substance". While there is no consensus on the importance of the economic substance of an interposed company for the analysis of the first test of the PPT, according to the OECD Commentaries, it does seem to matter whether the interposed company has sufficient economic substance to carry out the investments for which it was formed.

The Indian tribunal also seems to hold this view, referring to the "substantial investments" and associated significant expenses of the interposed Luxembourg holding company, SC Lowy, including professional fees, as well as administrative expenses such as rent for office premises, bank charges, accounting fees, etc., which indicate the effective exercise of an economic activity, i.e. the investment in various assets around the world.

- Example D of the OECD/UN Commentaries deals with a "collective investment vehicle" established in State R with a "diversified portfolio of investments" of which 15% consists of shares of companies that are resident in State S. Under the treaty between R and S, the withholding tax on dividends is reduced. In the specific example, according to the OECD/UN, it would not be reasonable to deny the company the treaty benefit unless the investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining a benefit.

In this example, the OECD/UN considers the limited number of investments by the interposed company in State R that could result in a treaty benefit (in this case, only 15%) to be a relevant factor in concluding that obtaining the tax benefit was not a primary purpose for interposing the company (under the aforementioned proviso). Also in the Lowy case, the Indian tribunal refers to the fact that the investments in India represent only 14 % of the total investment portfolio held by the Luxembourg holding company.

- In line with OECD/UN examples D and K, the tribunal also referred to the fact that SC Lowy had filed its tax returns and paid taxes on its income in its state of residence, i.e. Luxembourg.

These three aspects – the economic substance of the interposed company, the limited percentage of investments that would result in the tax benefit, and the fact that the interposed company pays its taxes in its state of residence – were seen by the tribunal, in line with the OECD/UN examples, as important factors in concluding that obtaining the tax benefit was not one of the principal purposes for the interposition of SC Lowy.

In addition to these three aspects, it also appears to be important for the tribunal that SC Lowy was registered as a Foreign Portfolio Investor. Such investors are subject to certain Indian regulation. This is reminiscent of the OECD/UN's assumption that listed companies are not formed with the purpose to engage in treaty shopping (OECD/UN Comments on Art. 29, § 15), presumably because listed companies are subject to strict regulation.

Moreover, in line with the OECD/UN Commentaries, the tribunal relies on an objective analysis, based on facts and circumstances, to determine whether obtaining the treaty benefit was one of the principal purposes for the interposition of the SC Lowy, as opposed to a purely subjective analysis based on the intentions of the taxpayers. Moreover, the Indian government recently confirmed in a circular of January 2025, regarding the application of the PPT in Indian tax treaties, that the PPT analysis requires a "context-specific, fact-based exercise" to be conducted on a case-by-case basis, "taking into account the objective facts and circumstances." In the same circular, the Indian government confirms that tax authorities may refer to Action Plan 6, as well as the UN Commentaries on the PPT, as additional or supplementary guidance in applying the PPT.

Conclusion

The conclusion of the first PPT-case is in line with what could have been expected on the basis of the OECD/UN Commentaries and the examples included therein. As prescribed by the Commentaries and implied by the examples, the tribunal applies an objective analysis, taking into account the economic substance of the interposed company, as well as its limited number of investments that could rely on the relevant treaty benefit and the fact that it pays its taxes in Luxembourg, to come to the conclusion that obtaining the treaty benefits provided by the Luxembourg-India double tax treaty was not one of the principal purposes of the interposition of SC Lowy.

However, it will not always be as clear whether obtaining a treaty benefit was one of the principal purposes of interposing a company. What if, for example, a taxpayer receives treaty benefits by interposing an existing company with economic substance between itself and its investments? Or what if a tax benefit applies to 80% of the investments and the interposed company does not have any economic substance? The OECD/UN Commentaries do not provide an answer to these and many other situations that could potentially fulfill the first test of the PPT.

Moreover, there is even more controversy surrounding the second test of the PPT. Since the first test was not met in the case at hand, the tribunal does not discuss the second test.

We will thus have to wait for future cases that will hopefully provide more clarity on the application of both the first and the second test of the PPT.

Since caselaw is highly context specific and dependent on the jurisdictions where the arrangement takes place, it would however be preferable for the OECD/UN itself to resolve any ambiguities or uncertainties by clarifying the PPT application in the OECD/UN Commentaries.

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Conflict of interest: the author declares no conflict

[1] *SC Lowy P.I. (LUX) S.A.R.L., vs. ACIT*, 30 December 2024.

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This entry was posted on Monday, March 24th, 2025 at 10:00 am and is filed under India, Luxembourg, Principal purpose test, Uncategorized
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