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Tax Flash News

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Principal Purpose Test introduced in MLI requires separate notification for the applicable tax treaty

Executive summary

The OECD/G20 adopted the Multilateral Instrument (MLI) to implement tax treaty related measures to prevent base erosion and profit shifting (BEPS), including the Principal Purpose Test (PPT).

India and Ireland ratified and notified the MLI in 2019, designating the India-Ireland tax treaty (the Treaty) as a Covered Tax Agreement (CTA) under the MLI, accordingly the Revenue applied PPT provisions in the case of *Kosi Aviation*[1], and denied the Treaty benefit. The Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) rejected the application of PPT sans separate notification for the applicable Treaty.

A similar issue came before the Mumbai Bench of the Tribunal in the case of *Sky High*[2] where the Tribunal relying on the Supreme Court ruling in *Nestlé SA*[3], held that a separate notification under the Income-tax Act, 1961 (the Act) is a mandatory requirement for giving effect to the MLI provisions. Even though the MLI had been notified and the Treaty was

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[1] *Kosi Aviation Leasing Ltd* v. *ACIT* (ITA No. 994/Del/2025). There was batch of 75 appeals with *Kosi Aviation* as the lead case.
[2] *Sky High Appeal XLIII Leasing Company Ltd.* v. *ACIT* [2025] 177 taxmann.com 579
[3] *AO* v. *Nestle SA* [2023] 458 ITR 756 (SC)

designated as CTA, in the absence of a separate notification for the Treaty, the PPT cannot be invoked to deny the Treaty benefits.

The Revenue's counsel raised some additional aspects to distinguish the decision of the Mumbai Tribunal. The Delhi Bench of the Tribunal did not find a substance in these arguments and held that a separate notification is required under the Treaty.

Additionally, the Tribunal held that the lease rental qualifies as profits derived from the operation of aircraft in international traffic as per the specific language of the Treaty and thus, not taxable in India.

Facts of the case

The taxpayer, a tax resident of Ireland, was engaged in the business of leasing commercial aircrafts. It entered into an Aircraft Specific Lease Agreement (ASLA) with an Indian airline company (the lessee).

The rental income was claimed by the taxpayer to be not taxable in India under the Treaty.

The tax officer invoked the PPT to deny the Treaty benefits. The tax officer also denied the exemption under Article 8 of the Treaty (dealing with the taxability of the profits derived from the operation of aircraft in international traffic) and characterised the lease as financial lease, alleging that the rentals paid by Indian lessee were in the nature of interest. Additionally, the tax officer alleged that the taxpayer has a permanent establishment in India[4].

Relevant Treaty provisions

As per Article 8(1) of the Treaty, the profits derived by an Irish enterprise from operation or rental of aircraft in international traffic and the rental of containers and related equipment which is incidental to the operation of aircraft in international traffic are taxable only in Ireland.

Further, the term "international traffic" means transport by aircraft operated by an enterprise from one Contracting State, except when the aircraft is operated solely between locations within that Contracting State.

As per the PPT provision, a treaty benefit shall be denied if one of the principal purposes of any arrangement/transaction was to obtain that benefit—unless it can be established that granting such benefit aligns with the purpose and intent of the relevant treaty provision.

[4] The issue relating to permanent establishment and characterisation of lease has not been discussed in this note.

Revenue's contentions

Invocation of MLI

India has notified the MLI provisions on 9 August 2019 under section 90(1) of the Act. Thus, the PPT should be applicable, based on such notification. There is no need for a separate notification for each treaty.

The MLI was introduced to implement BEPS measures efficiently, since amending numerous bilateral treaties individually would be cumbersome. Unlike an amending protocol to a single treaty, the MLI operates parallel to the treaty, modifying only those provisions where countries' positions match. Any conflict between existing treaty provisions and the MLI is resolved through the compatibility clause and the MLI provisions take precedence over the treaty provisions.

Section 90(1) of the Act allows India to enter into both bilateral and multilateral agreements without restriction, including specifying future effective dates. Since MLI only modifies existing treaty concessions to curb tax avoidance, no fresh notification was strictly required — the Central Government nonetheless issued a notification on 9 August 2019 to implement the MLI.

India has followed the practice of issuing a single omnibus notification under section 90(1) to implement multilateral agreements (e.g., SAARC Agreement 2011, MAAC[5] 2012, CbCR 2017), rather than separate notifications for each country. Global practice also supports omnibus notification; countries like Ireland and South Africa followed similar processes.

The Note by OECD Directorate of Legal Affairs clarifies that MLI is a multilateral treaty applied alongside the existing bilateral tax treaties, modifying them in a synchronised way.

The Supreme Court's decision in *Nestle SA* concerned Most Favoured Nation (MFN) clause, which is different; there is no practice of issuing separate notifications for MLI. Thus, that said ruling does not apply in the instant case.

The amendment to section 90 by the Finance Act, 2020 recognised MLI's coming into force from the financial year 2020–21, reinforcing the validity of the 2019 notification.

[5] Mutual Administrative Assistance in Tax Matter

Income from operation of aircraft

The definition of “international traffic” under the Treaty works only in wet leases, where the lessor itself operates the aircraft. Applying it to dry leases (where the lessee operates the aircraft) creates absurdity. The word “rental” should be read only in the context of activity ancillary or integral to active operations, not a pure dry lease where the lessor does not operate the aircraft.

Taxpayer’s contentions

Non-applicability of MLI

MLI-based changes could apply only if specifically notified under section 90(1) for each treaty. General notifications, or India identifying the treaty as CTA under the MLI, were insufficient to apply the MLI’s modifications (PPT, particularly),

The Supreme Court in Nestle SA clearly held that a separate notification under section 90(1) is mandatory for any amendment to the treaty provisions. MLI alters bilateral treaties; therefore, each amendment to a treaty must be notified separately.

The multilateral agreements cited by the Revenue (SAARC, MAAC, CbCR) are distinguishable as unlike MLI, those agreements did not amend substantive taxpayer rights under the treaties.

SAARC agreement was signed by all members with identified scope–there was no uncertainty like MLI’s matching principle, the effective date, CbCR was notified under section 286(9) of the Act, which allows notification of MLI.

The OECD itself clarifies that domestic legal requirements prevail, regardless of international practice. Foreign countries’ omnibus notification practice cannot override India’s domestic law.

If the Revenue relies on Finance Act, 2020 amendments to section 90, then the 2019 notification would be invalid, since it pre-dates the amendment and there was no enabling provision at that time.

Reliance was placed on the Tribunal decision in the case of *Sky High*.

Income from operation of aircraft

As the income derived was from the rental of aircraft in international traffic by an Irish enterprise, the Treaty allocates exclusive taxing rights to Ireland.

The OECD Model Convention links exemption only to operations, but the Treaty in the instant case expressly includes rental as a separate and independent activity. Reading in a requirement that the lessor must also be an operator (wet lease) would make the word 'rental' meaningless.

As held in *Sky High* and *Sunflower Aircraft Leasing Ltd.*[6], if aircraft is not used solely within India/ Ireland, it qualifies as "international traffic". In the instant case, there is no restriction in the ASLA prohibiting international use.

Tribunal's decision

MLI Position

Referring to the *Nestle SA* and *Sky High* decisions, the Tribunal held that the Act requires a specific notification for each treaty modification; omnibus notification is insufficient. Therefore, provisions like the PPT under the MLI cannot be invoked without a separate notification for the applicable treaty.

The Revenue contends that the MLI operates alongside existing treaties, modifying their application in line with BEPS measures, and that no further negotiations are needed. The OECD guidance indicates that MLI provisions override the treaty provisions in case of conflict. In effect, the MLI alters or amends the treaty, and such changes attain legal force only upon issuance of a notification under section 90(1) of the Act.

The Tribunal accepted the taxpayer's contention that other multilateral agreements cited by the Revenue, such as the SAARC agreement, are not comparable and should be distinguished.

India's implementation of the MLI must follow domestic legislative procedures, and global practices—such as omnibus notifications—do not suffice. The OECD also clarifies that domestic law must be followed to give effect to MLI-induced treaty changes.

[6] *Sunflower Aircraft Leasing Limited* v. *ACIT (International Tax)* [2025] 177 taxmann.com 728 (Mumbai Tribunal)

Prior to the amendment to section 90(1) by Finance Act 2020 there was no substantive mechanism to assimilate MLI into domestic legislation.

Income from operation of aircraft

Relying on the decision in the case of *Sky High*, the Tribunal held that under Article 8 of the Treaty, the rental income derived by an Irish lessor from leasing aircraft in international traffic to an Indian lessee is taxable only in Ireland and not in India.

The Tribunal rejected the Revenue's contention that Article 8 applied only to wet leases or active operation by the lessor, holding that the broader treaty language was intentionally adopted, and must be given effect.

The taxpayer provided a certificate from the lessee confirming that the leased aircraft were operated in "international traffic", satisfying the Treaty conditions.

Our comments

The Delhi Bench of the Tribunal has further reinforced the position taken by Mumbai Bench in the case of *Sky High* that MLI provisions cannot be invoked unless a separate notification is issued for the applicable treaty by evaluating and disagreeing with the additional arguments of Revenue on this aspect.

It is likely that the Revenue will file an appeal against the Tribunal decisions before the respective High Courts. Till the dispute attains finality, the Revenue may continue to invoke the MLI provisions in various tax treaties.

KPMG in India addresses:

Ahmedabad
Commerce House V, 9th Floor, 902, Near Vodafone House, Corporate Road, Prahlad Nagar, Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Hyderabad
Salarpuria Knowledge City, Orwell 6th Floor, Unit-3, Survey No 83/1, Plot No 2, Raidurg, Hyderabad – 500 081.
Tel: +91 40 6111 6000

Noida
Unit No. 501, 5th Floor, Advant Navis Business Park, Tower-A, Plot# 7, Sector 142, Expressway Noida, Gautam Budh Nagar, Noida – 201 305.
Tel: +91 0120 386 8000

Bengaluru
Embassy Golf Links Business Park, Pebble Beach, 13/02, 'B' Block, 1st & 2nd Floor, Off Intermediate Ring Road, Bengaluru – 560 071
Tel: +91 80 6833 5000

Jaipur
Signature Towers, Office No. 402, Fourth Floor, S Plot No. DC-II, Lal Kothi District Shopping Center, Tonk Road, Jaipur – 302 001
Tel: +91 141 – 672 1000

Pune
9th floor, Business Plaza, Westin Hotel Campus, 36/3-B, Koregaon Park Annex, Mundhwa Road, Ghorpadi, Pune – 411 001.
Tel: +91 20 6747 7000

Chandigarh
Elante Offices, Unit No. A505, 5th Floor, Plot No.178-178A, Industrial Area Phase-1, Chandigarh – 160 002.
Tel: +91 172 664 4000

Kochi
Syama Business Centre, 49/179, 3rd Floor, NH 47, Bypass Road, Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Chennai
KRM Towers, Ground, 1st, 2nd, & 3rd Floor, No. 1, Harrington Road, Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Kolkata
Unit No. 604, 6th Floor, Tower – 1, Godrej Waterside, Sector – V, Salt Lake, Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
Lodha Excellus, Apollo Mills Compound, 2nd Floor, N M Joshi Marg, Lower Parel, Mumbai- 400 011.
Tel: +91 22 3989 6000

Vadodara
Ocean Building, 303, 3rd Floor, Beside Center Square Mall, Opp. Vadodara Central Mall, Dr. Vikram Sarabhai Marg, Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
PR heights, 4th Floor, NH 16 Service Rd, opp. Manipal Hospital Road, Tadepalle, Andhra Pradesh – 522 501.
Tel: +91 0864 536 2000

Gurugram
Building No.10, 8th Floor, DLF Cyber City, Phase II, Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

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KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Lower Parel, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000