STEPHENSON HARWOOD
(Singapore) Alliance

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TIGER-FLIPKART TAX RULING: THE BOTTOM LINE

In a recent landmark ruling, India's highest court has held that Tiger Global's US$1.6 billion exit from Flipkart is not exempt from capital gains taxation in India under the India-Mauritius tax treaty. A lower tax tribunal in India also recently addressed the contentious issue of capital gains taxation under the India-Singapore tax treaty and reached a similar conclusion to deny treaty benefits.

These recent rulings mark a decisive shift in how Indian authorities view tax treaty-based offshore structures used by foreign investors for investing in India, and how the tax treaty benefits claimed by foreign investors will now be evaluated by the Indian tax regulator.

Below is a brief discussion on the Tiger Global ruling and our key take aways for the private equity funds, venture capital firms and other foreign investors navigating this latest development in the Indian investment landscape.

TIGER'S MAURITIUS STRUCTURE

Tiger Global International II Holdings, Tiger Global International III Holdings and Tiger Global International IV Holdings (collectively, "**Tiger Entities**") were Mauritius-incorporated companies and held valid Tax Residency Certificates ("**TRC**") issued by the Mauritius Revenue Authority.

Tiger Entities were structured as pooling vehicles for undertaking long-term investments and had over 500 investors from over 30 jurisdictions. Tiger Entities were also regulated by the Mauritius Financial Services Commission and granted Category 1 Global Business Licences.

Tiger Entities had a board consisting of three directors (two Mauritian residents and one US resident), maintained their principal bank account in Mauritius, held office premises in Mauritius and engaged two employees in Mauritius.

Tiger Entities' investment manager was a US-based entity ("**IM**"). The IM's services were non-binding and subject to the final approval of Tiger Entities' board, and the IM did not have any unilateral right to make decisions on behalf of Tiger Entities.

PURCHASE AND SALE OF FLIPKART SHARES

Between October 2011 and April 2015, Tiger Entities acquired shares of Flipkart Private Limited, a Singapore-incorporated company ("**Flipkart Singapore**"). Flipkart Singapore, in turn, held shares in Flipkart's India entity and accordingly, the value of Flipkart Singapore shares was derived substantially from assets in India.

As part of the Walmart's broader acquisition of majority stake in Flipkart Singapore, Tiger Entities, in 2018, sold their shares in Flipkart Singapore to Fit Holdings S.A.R.L, a Luxembourg-incorporated company related to Walmart.

TIMELINE OF TIGER'S TAX TROUBLES

As the value of Flipkart Singapore shares was derived from assets in India, Tiger Entities' Flipkart exit fell within the ambit of indirect transfer of shares which is taxable under Indian tax laws and accordingly, required a determination of whether any tax treaty benefits are available. Tiger Entities relied on the well-settled position that under the India-Mauritius tax treaty, capital gains from investments made prior to 1 April 2017 were exempt from taxation in India and "grandfathered" from the application of India's new regime of general anti-avoidance rules ("**GAAR**"). Based on this tax position, Tiger Entities approached the Indian tax regulator to obtain a "nil withholding" certificate. The Indian tax regulator denied this request for a "nil withholding" certificate and prescribed a withholding tax rate applicable to Tiger Entities' Flipkart exit.

Tiger Entities then appealed to the Indian Authority for Advanced Rulings ("**AAR**") which also rejected their contention. The High Court, on appeal, ruled in favour of Tiger Entities. The India Supreme Court finally settled the dispute against Tiger on the following key grounds:

+ ***TRC no longer conclusive residency proof:*** Reversing the well-established position of TRC being sufficient proof of legal residence, TRC is now only a necessary condition and not sufficient evidence of residency to claim treaty benefits. TRC does not have a binding force, and a statutory authority or court is empowered to independently enquire into the residency status based on an entity's effective management and control. As such, Tiger Entities' TRC was not held to be sufficient evidence of their Mauritius residence. The "head and brain" of Tiger Entities was found to be in the US and not Mauritius.
+ ***"Grandfathering" protection diluted for pre-2017 investments:*** Even if Tiger Entities' Flipkart investment was made pre-2017 and "grandfathered" under the India-Mauritius Treaty, GAAR overrides any treaty benefit in case of an "arrangement" which yields tax benefits post-2017 irrespective of the date on which such "arrangement" was entered into. Viewing Tiger Entities' offshore structure as an "impermissible avoidance arrangement" lacking commercial substance, GAAR was held applicable to its Flipkart exit.
+ ***If not GAAR, then JAAR:*** Even in cases where GAAR cannot be applied, judicial anti-avoidance rules ("**JAAR**") will apply in parallel and enable courts to evaluate the offshore structure through the lens of "substance over form".

KEY TAKE AWAYS

+ ***Readiness exercise for legacy deals:*** Foreign investors who have used treaty-based offshore structures for their India deals may consider undertaking a fresh review of their deals in light of the recent ruling and re-confirm if tax treaty position previously taken continues to be available. While the ruling dealt with exits under the India-Mauritius treaty, the principles applied by Supreme Court are likely to be relevant beyond exits and extend to other transactions (such as interest payments, dividend distributions) and to other treaty-based jurisdictions with a favourable tax regime (such as Singapore, Cyprus).

  The Indian tax regulator is empowered to re-open tax assessments up to a certain statutory look-back period and in certain circumstances. To the extent, any transaction which can be re-opened by the Indian tax regulator within the statutory look-back period, investors may want to consider lining-up a strategy for dealing with potential tax claims.

+ ***GAAR-proof existing India structures:*** With GAAR's scope seemingly overriding tax treaty benefits, investors using vehicles set up in tax-efficient jurisdictions can anticipate stricter scrutiny and more detailed audit by the Indian tax regulator before granting any tax treaty benefits.

  Investors to consider proactively undertaking a thorough fact-based assessment of their investment structures from a GAAR perspective, such as evaluating independence of the board and decision-making process, scope of local team's control over operational matters, adequate documentation (board meeting minutes, memos, investment committee minutes, etc.) supporting the structure, and demonstrable commercial substance in the jurisdiction. As witnessed in Tiger Entities' case, multi-tiered structures with centralised control vested in the parent company and lacking a real business nexus to the tax treaty jurisdiction may be more vulnerable to GAAR scrutiny.

+ ***Enhanced contractual safeguards going forward:*** For new and ongoing M&A deals, the sell-side can expect the buy-side to seek enhanced contractual protections against any potential tax leakage, such as robust tax representations and warranties on the seller's tax residency status, tax indemnities, W&I insurance for tax indemnities and escrows for the tax withholding amounts (subject to permissible limits under India's foreign investment laws). Given that a TRC is no longer sufficient evidence of residency, sellers can expect buyers to undertake a more detailed tax diligence.

  For fund-level investments, fund managers and sponsors should consider incorporating suitable mechanisms for managing the tax exposure, such as clear provisions on allocation of costs related to taxes and clawback rights.

+ ***Getting a headstart on pre-exit planning:*** Investors counting on high-value exits may need to consider alternative options to preserve their returns, including restructuring their India investments to be routed through other tax-efficient jurisdictions where demonstrable commercial substance and business nexus can be established. To this end, investors would benefit from activating legal structuring and tax diligence workstreams much earlier in their exit timelines.

For the private equity funds and venture capital firms betting on strong India exits, the India playbook demands a more carefully calculated approach towards the choice of offshore structures used, approach to legal and tax diligence, transaction documentation, and mechanism for allocation of tax exposure.

CONTACT US

JAY TAI

Partner, Singapore

+65 6622 6245
jay.tai
@stephensonharwood.com

DIKSHA MAHESHWARI

Associate, Singapore

+65 6622 6234
diksha.maheshwari
@stephensonharwood.com