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INTERNATIONAL TAX UPDATE

Indian Direct Tax Board Releases Guidance for PPT under India’s Tax Treaties

Direct Tax Board releases Guidance for application of Principal Purpose Test (PPT) under India's Tax Treaties

- The Multilateral Instrument (MLI) is a global agreement developed under the OECD's Base Erosion and Profit Shifting (BEPS) initiative. Its primary purpose is to update and amend existing tax treaties to prevent their misuse. By signing the MLI, countries agree to introduce provisions that curb tax avoidance strategies, particularly those exploiting loopholes in treaties. For India, the MLI came into force on October 1, 2019, and it has since altered several of India's Double Taxation Avoidance Agreements (DTAAs) with other countries.

- The Principal Purpose Test (PPT) is a core provision of the MLI. Its aim is to prevent abuse of tax treaties. Under the PPT, if a transaction or arrangement is undertaken with the main purpose of obtaining tax benefits, and not for genuine economic or business reasons, the tax benefits can be denied. The PPT applies to most of India's DTAAs either through the MLI or bilateral treaty amendments.

  In order to provide clarity on application of PPT under India’s DTAAs, the government has released the following guidance:

A. **Period for which the PPT provision is applied:** For parity and uniformity, the PPT is intended to be applied prospectively. Accordingly, the PPT provisions under India’s DTAAs shall apply as follows:

a. For DTAAs where the PPT was added through bilateral processes (like Chile, Iran, Hong Kong, China), PPT applies from the date when DTAA or its updated protocol (that includes the PPT) comes into effect.

b. For DTAAs where the PPT was added through the Multilateral Instrument (MLI), the dates of application would depend date of entry into effect of the provisions of the MLI with respect to the DTAA specified in Article 35 of the MLI (as provided).

B. Interaction with treaty-specific bilateral commitments:

India has certain treaty-specific bilateral commitments in the form of grandfathering provisions under the following DTAAs:

i. India-Cyprus;

ii. India-Mauritius; and

iii. India-Singapore

It has been clarified that grandfathering provisions under such DTAA's shall remain outside the purview of the PPT provision and will be governed by the specific provisions of the respective DTAA.

C. Additional guidance for applying the PPT:

It has been clarified that applying the PPT provision requires analyzing the specific facts and context of each case. While deciding on invocation and application of the PPT provisions, for guidance the tax authorities may refer to:

- The BEPS Action Plan 6 Final Report, keeping in mind India's reservations wherever applicable.
- The UN Model Tax Convention Commentary (updated in 2021), specifically Articles 1 and 29, subject to India's reservations wherever applicable.

For more details, kindly refer to Circular No. 01/2025 issued by Central Board of Direct Taxes (CBDT), Ministry of Finance, Government of India.

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