



CBDT ISSUES GUIDANCE ON APPLICATION OF PRINCIPAL PURPOSE TEST

The Central Board of Direct Taxes has recently released a Circular providing guidance on the implementation of Principal Purpose Test ('**PPT**') provisions within the framework of India's Double Taxation Avoidance Agreements ('**DTAAs**') with other Countries.

The concept of PPT was introduced by the Organisation for Economic Co-operation and Development ('**OECD**') as part of the BEPS Action Plan to combat tax evasion and treaty abuse. The PPT acts as a means for denying treaty benefits if one of the principal purposes of the arrangement or transaction is to obtain the treaty benefit, unless granting the treaty benefit is in accordance with the object and purpose of the DTAA.

CURRENT DEVELOPMENT

Prospective application of the PPT

The Circular clarifies that the PPT provision is intended to be applied prospectively — i.e., when the PPT provision is effective in the treaty, as follows:

Particular	Date of entry into force
DTAAs where PPT has been incorporated through bilateral process	Applicable from the date of entry of the DTAA <i>or</i> the amending protocol incorporating the PPT
DTAAs where PPT has been incorporated through Multilateral Instrument (' MLI ')	(i) PPT for <i>taxes withheld at source</i> would be applicable on or after the first day of previous year beginning after the latest of the dates on which the MLI enters into force for contracting jurisdiction to the DTAA
	(ii) PPT for <i>taxes other than withheld at source</i> would be applicable to previous years starting six months after the latest of the dates on which the MLI enters into force for Contracting jurisdiction to the DTAA

Interplay of the PPT with grandfathering provisions under DTAA

India's DTAA with certain Countries (Mauritius, Cyprus, and Singapore) were revised to grant the source country the authority to tax capital gains from the sale of shares acquired on or after April 1, 2017. However, Capital gains from shares acquired before this date were grandfathered, limiting taxation rights



to the country of residence. In order to clarify uncertainties regarding the application of the PPT to the said grandfathering provisions, the Circular specifies that, in India's DTAA with Mauritius, Singapore, and Cyprus, the particular grandfathering provision is excluded from the scope of the PPT.

Key take aways:

- The application of PPT would not affect the eligibility of tax exemption in India as per the grandfathering provisions under the DTAA.
- Past investments made under existing treaties will not be subjected to retrospective treatment under the PPT framework.
- PPT provisions will be applied prospectively.



Disclaimer: This direct tax alert is only for general informational purposes, and nothing in this edition could possibly constitute legal advice (which can only be given after being formally engaged and familiarizing ourselves with all the relevant facts).

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