F. No. 500/05/2020/FT&TR-II
Government of India
Ministry of Finance
Department of Revenue
Central Board of Direct Taxes
Foreign Tax & Tax Research Division-II

New Delhi, 21st January, 2025

Subject: Guidance for application of the Principal Purpose Test (PPT) under India's Double Taxation Avoidance Agreements-reg.

The Multilateral Convention to Implement Tax Treaty Related Provisions to Prevent Base Erosion and Profit Shifting ("MLI") entered into force for India on 1st October 2019. The MLI modifies some of India's Double Taxation Avoidance Agreements (DTAAs). A key provision of the MLI is the Principal Purpose Test (PPT), which seeks to curb revenue leakage by preventing treaty abuse. While the PPT is included in most of India's DTAAs through the MLI, it is part of some other DTAAs through bilateral processes.

2. The PPT reads as follows:

Notwithstanding the other provisions of this Convention (or Agreement), a benefit under this Convention (or Agreement) shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention (or Agreement).

3. The PPT envisages denial of benefits under a DTAA where it is reasonable to conclude, having considered all the relevant facts and circumstances that one of the principal purposes of an arrangement or transaction was to obtain a benefit, directly or indirectly, under a DTAA. Where this is the case, however, the last part of the PPT provision allows the person to whom the benefit would otherwise be denied the possibility of establishing that obtaining the benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the convention. The PPT is intended to ensure that DTAAs apply in accordance with the objects and purpose for which they were entered into, i.e. to provide benefits in respect of bona fide exchange of goods and services, and movement of capital and persons.

4. The determination of whether one of the principal purposes for entering into transaction(s) or arrangement(s) is to obtain tax advantage(s) should be based on an objective assessment of the relevant facts and circumstances. In order to provide clarity and certainty on the application of the PPT provision under India's DTAAs, the following broad guidance is provided:

A. Period for which the PPT provision is envisaged to be applied:

For ensuring parity and uniformity in the application of the PPT provision under India's DTAAs, it is clarified that the PPT provision is intended to be applied prospectively. Accordingly, the PPT provision under India's DTAAs shall apply as follows:

a. For DTAAs where the PPT has been incorporated through bilateral processes (such as Chile, Iran, Hong Kong, China, etc.) from the date of entry into force of the DTAA or the Amending Protocol incorporating the PPT, as the case may be.

b. For DTAAs where the PPT has been incorporated through the MLI-from the date of entry into effect of the provisions of the MLI with respect to the DTAA specified in Article 35 of the MLI, as under:

i. with respect to taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs on or after the first day of the previous year that begins on or after the latest of the dates on which the MLI enters into force for the Contracting Jurisdictions to the DTAA:

ii. with respect to all other taxes levied by India for previous years beginning on or after the expiration of a period of six calendar months from the latest of the dates on which the MLI enters into force for the Contracting Jurisdictions to the DTAA.

For India, the date of entry into force of the MLI is 1st October 2019. The date of entry into force for the DTAA partner needs to be ascertained using OECD's MLI database. For the above purposes, previous year shall be as defined in section 3 of the Income-tax Act. 1961.

The aforesaid period for the application of PPT shall however, be subject to the interaction of such provisions with Treaty Specific Bilateral commitments as provided for below.

B. Interaction of the PPT provision with certain Treaty-Specific Bilateral Commitments:

India has made certain treaty-specific bilateral commitments in the form of grandfathering provisions under the following DTAAs, as on date:

i. India-Cyprus DTAA;
ii. India-Mauritius DTAA; and
iii. India-Singapore DTAA.

These commitments, as reflected in the bilaterally agreed object and purpose of such grandfathering provisions, are not intended to interact with the PPT provision as such. Therefore, it is clarified that the grandfathering provisions under such DTAAs shall remain outside the purview of the PPT provision, being governed, instead, by the specific provisions in this regard of the respective DTAA itself.

C. Additional/Supplementary Sources of Guidance:

The application of the PPT provision is expected to be a context-specific fact-based exercise, to be carried out on a case-by-case basis, keeping in view the objective facts and findings. In this regard, besides the BEPS Action Plan 6 Final Report, subject to India's reservations, wherever applicable, tax authorities may refer to the Commentary to Articles 1 and 29 of the UN Model Tax Convention (updated in 2021) as additional/supplementary sources of guidance while deciding on the invocation and application of the PPT provision, subject to India's reservations, wherever applicable.

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Copy to:

i. PS to FM/OSD to FM/PS to MoS(F)/OSD to MoS(F)
ii. OSD to Revenue Secretary
iii. Chairman, CBDT and all Members, CBDT
iv. All Pr.CCsIT/CCsIT/Pr.DGsIT/DGsIT with a request to circulate among all officers in their regions/charges.
v. All Joint Secretaries/CsIT/Directors/ Deputy Secretaries/ Under Secretaries of CBDT
vi. Web Managaer, ADG(S)-4,O/o Pr.DGIT(Systems), Delhi with a request to place the circular on https://www.incometax.gov.in
vii. CIT(M&TP), Official Spokesperson of CBDT
viii. JCIT, Data base Cell for placing it on www.irsofficersonline.gov.in
ix. The Guard File

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