



CBDT Issues New Guidelines for PPT under DTAA

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Why in News?

The [Central Board of Direct Taxes \(CBDT\)](#) has introduced new guidelines for applying the [Principal Purpose Test \(PPT\)](#) under [India's Double Tax Avoidance Agreements \(DTAAs\)](#), aiming to prevent tax avoidance.

- These guidelines apply prospectively, with specific exemptions for treaties with [Cyprus](#), [Mauritius](#), and [Singapore](#) due to grandfathering provisions.

What is the Principal Purpose Test (PPT)?

- **Principal Purpose Test:** The PPT is part of international tax rules aimed at **preventing misuse of tax treaties**.
 - Under the [Base Erosion and Profit Shifting \(BEPS\)](#) framework, the PPT checks whether a **business arrangement is genuinely commercial or created mainly to avoid taxes**.
 - If the primary purpose is **tax-saving**, **treaty benefits can be denied**.
- **New Guidelines:**
 - **Applicability of PPT:** The PPT provisions will apply prospectively, meaning past investments, particularly those before 1st April 2017, will remain unaffected and not face retrospective scrutiny.
 - **Grandfathering Provisions:** Treaties with **Singapore, Mauritius, and Cyprus are excluded from PPT** due to specific bilateral commitments.
 - Investments made under these treaties before specific dates will follow the original treaty provisions.
 - **Reference to Global Standards:** The new guidelines encourage tax authorities to refer to international tax frameworks, including the **BEPS Action Plan 6** and the [UN Model Tax Convention](#), when applying the PPT provisions.

What are Double Tax Avoidance Agreements (DTAAs)?

- **About:** DTAA is a treaty between two countries that helps taxpayers **avoid double taxation**.
 - For example, an NRI earning dividends from investments in India would typically face taxes in both India and the US. However, with a DTAA, they are taxed in only one country based on the agreement's terms.
 - This helps **NRIs avoid hefty taxes in two nations and reduces tax evasion**.
 - DTAAs cover various income types, including business profits, dividends, interest, royalties, and capital gains.
 - Each agreement specifies which **country can tax certain income**, usually granting the primary right to the country of origin while allowing the residence country to tax at a reduced rate.
- **India and DTAAs:** India has signed **94 DTAAs** with countries including Australia, France, Germany, Japan, Mauritius, the USA, and the UK.

Base Erosion and Profit Shifting (BEPS) Framework

- The BEPS framework, an initiative led by the [Organisation for Economic Co-operation and Development \(OECD\)](#) with the backing of the [G20](#), seeks to address **global tax avoidance** strategies employed by multinational corporations.
 - BEPS refers to strategies where **multinationals minimize tax by shifting profits to low-tax regions** or creating payments that can be subtracted from taxable income, like [royalties](#).
 - **BEPS Framework** established in 2016, it unites **147** countries (including India) to tackle tax avoidance. The framework consists of two key pillars:
 - **Pillar One:** Reallocation of profits to countries with consumer presence.
 - **Pillar Two:** [Global Minimum Corporate Tax \(GMCT\) of 15%](#) for MNEs.
- **BEPS Action 6** tackles treaty shopping and sets minimum standards for the BEPS Inclusive Framework members.
 - It provides rules to prevent treaty abuse and guides jurisdictions on tax policy considerations before entering into tax agreements.

UN Model Tax Convention

- It provides a framework for **negotiating bilateral tax treaties**. It aims to avoid **double taxation** and **prevent tax evasion**, with a focus on developing countries.
- It offers guidelines on taxing rights between countries and standardizes rules for income taxation, helping nations resolve cross-border tax issues.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Prelims

Q. With reference to India's decision to levy an equalization tax of 6% on online advertisement services offered by non-resident entities, which of the following statements is/are correct? (2018)

1. It is introduced as a part of the Income Tax Act.
2. Non-resident entities that offer advertisement services in India can claim a tax credit in their home country under the "Double Taxation Avoidance Agreements".

Select the correct answer using the code given below:

- (a) 1 only
- (b) 2 only
- (c) Both 1 and 2
- (d) Neither 1 nor 2

Ans: (d)