



**CBDT Issues Key Guidance on  
the Principal Purpose Test  
under India's Double Taxation  
Avoidance Agreements**

On January 21, 2025, the Central Board of Direct Taxes (“CBDT”) issued a Circular to provide guidance on the Principal Purpose Test (“PPT”) under India’s Double Taxation Avoidance Agreements (“DTAAs”).

The Circular is most welcome as it provides important clarifications regarding the prospective application of the PPT and its interaction with existing provisions.

## **What is the PPT?**

The PPT is a provision designed to prevent the abuse of tax treaties by denying treaty benefits if one of the principal purposes of an arrangement or transaction is to secure a tax benefit, unless granting that benefit is in line with the treaty’s underlying purpose. The PPT applies to any tax treaty where it has been incorporated, either via the Multilateral Instrument (“MLI”) or through bilateral processes. The test operates on the principle that tax benefits should only be granted when the arrangement serves a genuine economic purpose.

## **Key points clarified in the Circular**

### **1. Prospective Application**

The PPT will be applied prospectively from the date the relevant tax treaty or protocol enters into force. For India, the MLI entered into effect on October 1, 2019.

### **2. Grandfathering Provisions**

Investments made before April 1, 2017, under certain treaties (notably the India-Mauritius, India-Singapore, and India-Cyprus DTAAs) will remain protected under grandfathering provisions. These provisions ensure that capital gains from the sale of shares acquired before this date will not be subject to the PPT, providing certainty for existing investments made under previous treaty terms.

### **3. Case-by-Case Assessment**

The application of the PPT will be assessed on a case-by-case basis by tax authorities. Each transaction will be scrutinised considering facts and circumstances, and whether the primary purpose was to obtain a tax benefit.

### **4. Interaction with Specific Bilateral Commitments**

The circular also clarifies that certain treaty-specific commitments, including grandfathering provisions, are not affected by the PPT. These provisions will remain governed by the specific terms of the respective treaties, ensuring that longstanding agreements are not disrupted.

## **Our perspective on its impact on the India-Mauritius Tax Treaty**

Applying the clarifications brought by the Circular in the context of the India-Mauritius tax treaty, the CBDT has provided key insights that ensure stability for Mauritius-based investors.

It confirms that investments made before April 1, 2017, would be shielded from the PPT, allowing them to continue benefiting from the favourable tax provisions of the treaty without disruption.

However, for investments made after this date, the PPT would be applicable, meaning businesses must demonstrate genuine commercial intent behind their transactions to preserve their tax advantages.

These clarifications provide the necessary assurance that Mauritius will remain an attractive jurisdiction for investment into India, while aligning with global tax standards.

While the Circular provides useful guidance, it is important for investors to proactively review their cross-border transactions to ensure compliance and seek expert advice to navigate the evolving landscape.

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