

Tax Alert

Issue 87 | January 2025

Guidance on the application of the Principal Purpose Test (PPT) in India's Double Taxation Avoidance Agreements

On 21st January 2025, the Government of India, through Circular No. 01/2025, provided guidance on the application of the Principal Purpose Test (PPT) under India's Double Taxation Avoidance Agreements (DTAAs).

India ratified the OECD Multilateral Instrument (MLI) in 2019 which amended all its DTAAs at one go, except for certain DTAAs, such as the Mauritius-India DTAA, which would be amended through bilateral negotiations.

A key amendment under the MLI relates to the introduction of the PPT. Under the PPT, a benefit 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 the DTAA.

In 2024, Mauritius and India signed a Protocol to align with the OECD/G20 Base Erosion Profit Shifting (BEPS) recommendations, thereby introducing the PPT. The Protocol created some uncertainty regarding the application of the PPT and this led to the Protocol being put on hold until further clarification. This new circular is a welcome development and provides some clarity to investors regarding the PPT. Below are the key highlights of the circular.

Grand-fathered investments are excluded from the application of the PPT

The circular clarifies that grandfathering clauses in India's DTAAs, including the India-Mauritius DTAA, are excluded from the PPT's application. As such, the grandfathering provisions will continue to be governed by the respective DTAA clauses, ensuring that pre-existing investments in shares acquired before 01 April 2017 – in the case of the Mauritius/India DTAA, retain their benefits without interference from the PPT.

PPT to be applied prospectively

The circular clarifies that for DTAAs where the PPT has been incorporated through bilateral processes, the PPT will apply prospectively and will take effect from the date of entry into force of the DTAA or the amending protocol incorporating the PPT.

Our comments

The circular provides certainty that capital gains arising on the sale of grandfathered shares under the India-Mauritius DTAA will continue to benefit from the tax exemption and will not be under the purview of the PPT.

Another challenge under the Protocol was the retrospective application of the PPT. This guidance now clarifies that the PPT is intended to be applied prospectively. Hence, the language of the Protocol signed in 2024 would need to be suitably amended to align with the said intention.

Our comments (continued)

However, it remains unclear whether the PPT can be invoked and applied on dividend income arising on grandfathered investments. We hope that this will be clarified through the Protocol or through additional guidance. Any other benefits under the DTAA, such as tax exemption arising on gains on the sale of securities (other than shares) or reduced withholding tax rates on interest income and dividend income, will be subject to the PPT, once the Protocol comes into force.

Investors using the Mauritius International Financial Centre (IFC) for investments in India are advised to review their structures to avoid unforeseen issues. Maintaining adequate documentation of the commercial rationale, demonstrating sufficient economic substance in Mauritius, and meeting beneficial ownership requirements remain essential to safeguard DTAA benefits and mitigate potential risks in the changing tax environment.

To access our tax alert on the 2024 India-Mauritius Protocol, please click [here](#).

How we may help?

Our tax specialists are available to discuss the implications of this circular and its impact on your investments under the India-Mauritius DTAA. Please reach out to us for tailored advice.



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