CBDT Issues New Guidelines for PPT under DTAAs

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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)