

Govt can rein in tax treaty abuse despite PPT: Experts

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THE CENTRAL BOARD of Direct Taxes (CBDT) has clarified that the principal purpose test (PPT) provisions, designed to prevent tax treaty abuse, will apply prospectively only to the double taxation avoidance agreements (DTAAs) that include a PPT clause. It also stated that the PPT will not affect any other treaty provisions that may deny its benefits to taxpayers.

However, experts say that the authorities can still oppose DTAA benefits to taxpayers (companies) involving “grandfathered investments”, which they feel are of genuine tax abuse, by using other anti-abuse rules under the domestic laws, namely general anti-abuse rules (GAAR), specific anti-abuse rules (SAAR), and judicial anti-abuse rules (JAAR). The CBDT clarified on March 15 that GAAR, SAAR, and JAAR continue to operate independently.

“It appears that the CBDT through this clarification (issued on March 15) seeks to abundantly make it clear that it retains its sovereign right to examine transactions involving grandfathered investments and PPT cannot be a smoke-screen to curtail the sovereign’s rights,” said Aravind Srivatsan, tax leader, Nangia Andersen.

Grandfathered investments, in the context of DTAAs, refer to investments that are



exempt from new rules or regulations such as PPT because they were made before the changes took effect. These investments continue to be governed by the previous treaty rules, protecting investors from sudden regulatory shifts.

The PPT is a key component of international tax regulations, a part of the base erosion and profit shifting (BEPS) framework. The PPT evaluates whether a business arrangement serves a legitimate commercial purpose or is primarily structured to evade taxes. If tax avoidance is the main objective, treaty benefits may be denied. In January, the CBDT had issued a detailed circular on this matter.

The CBDT had then clarified that PPT would be applicable prospectively (and not retrospectively) from the date “multilateral instrument” (MLI), which introduced PPT rules, came into force (October 2019). It also said that grandfathering provisions under a few treaties — with Mauritius, Singapore, Cyprus — will be

outside the purview of PPT.

Last week’s clarification states that the January 2025 circular is applicable only in the context of PPT-related aspects and it did not have any impact on other treaty-related implications and GAAR-related aspects.

“However, practically, it is observed that tax authorities have been applying PPT equivalent tests for grandfathered transactions as well to challenge treaty benefits on the pretext that they are sham,” said Abhishek Mundada, partner, Dhruva Advisors, adding that these matters are pending before various appellate forums, including the Supreme Court. Mundada says that GAAR provisions are not applicable to grandfathering provisions and to that extent, both PPT and GAAR test ought not to be applicable for such provisions under the select tax treaties (Mauritius, Singapore, and Cyprus).

Amit Maheshwari, tax partner, AKM Global, said that by explicitly stating that the PPT will not apply retrospectively and that grandfathering provisions will be respected, the CBDT seeks to remove concerns about potential tax disputes arising from past transactions. “However, foreign companies doing business in and with India should analyse the PPT along with LOB (limitation of benefits) conditions to prepare for potential tax issues in the future,” he added.

