AMENDMENT IN INDIA-MAURITIUS TREATY

(Written by CA. Parul Jolly)

Mauritius was always considered to be a preferred jurisdiction for structuring investments into India due to liberal business and economic opportunities offered by Mauritius and also due to the benefits given in India-Mauritius Double Taxation Avoidance Agreement (DTAA). Mauritius tops the list of countries which account for most FDI in India. The reason for the same is the benefit given in Article 13(4) of the DTAA between the two countries which provides that gains derived by resident of Mauritius on alienation of property (other than immovable property, business property of a permanent establishment and ships and aircrafts) shall be taxable only in Mauritius. As per domestic laws of Mauritius, Capital gains are not taxable, therefore, if any person resident in Mauritius transfers shares of an Indian Company, capital gains shall not be taxed in India due to the benefit given under DTAA and would also not be taxable in Mauritius in accordance with the domestic law of Mauritius. Thus, the capital gains tax benefit promoted treaty shopping and became an important consideration while structuring investments into India. The benefits given in the DTAA were always subject to litigation, however, Circular no. 780 dated 13th April 2000 issued by CBDT and Supreme Court decision in Azadi Bachao Andolan endorsed treaty shopping and permitted the assesse to use treaty benefits on production of Tax residency Certificate from Mauritius.

However, recently the Mauritius route for inbound investments was again put on the scanner. With the introduction of General Anti Avoidance Rules (GAAR) in India, the issue was again highlighted. The Government of both countries renegotiated the terms of DTAA and on 10th May 2016, Central Board of Direct Taxes (CBDT) released a press release announcing that a protocol for amendment in India Mauritius DTAA has been signed. The key highlights of the amendments are as under:-

1. Source-based taxation of capital gains on shares: With this Protocol, India gets taxation rights on capital gains arising from alienation of shares acquired on or after 1st April, 2017 in a company resident in India with effect from financial year 2017-18, while simultaneously providing protection to investments in shares acquired before 1st April, 2017. Further, in respect of such capital gains arising during the transition period from 1st April, 2017 to 31st March, 2019, the tax rate will be limited to 50% of the domestic tax rate of India, subject to the fulfilment of the conditions in the Limitation of Benefits Article (LOB). Taxation in India at full domestic tax rate will take place from financial year 2019-20 onwards.

2. Limitation of Benefits (LOB): The benefit of 50% reduction in tax rate during the transition period from 1st April, 2017 to 31st March, 2019 shall be subject to a LOB Article, whereby a resident of Mauritius (including a shell / conduit company) will not be entitled to benefits of 50% reduction in tax rate, if it fails the main purpose test and bonafide business test. A resident is deemed to be a shell/ conduit company, if its total expenditure on operations in Mauritius is less than Rs. 2,700,000 (Mauritian Rupees 1,500,000) in the immediately preceding 12 months.

3. Source-based taxation of interest income of banks: Interest arising in India to Mauritian resident banks will be subject to withholding tax in India at the rate of 7.5% in respect of debt claims or loans made after 31st March, 2017. However, interest income of Mauritian resident

banks in respect of debt-claims existing on or before 31st March, 2017 shall be exempt from tax in India.

In order to determine whether the change in the DTAA would have an impact on FDI, it is imperative to understand the corresponding capital gain taxation benefit under DTAA applicable to other countries from where FDI flows into India.

Country	Cumulative Inflows (April 2000- December 2015) (Amount Rupees in crore)	% of total inflows	Capital gain clause for sale of shares in DTAA
Mauritius	465,163	32.65%	Earlier, taxability in COR* and now COS**
Singapore	238,352	16.73%	Taxability in COR but with LOB Clause
U.K.	112,934	7.92%	Both COR and COS has right to tax as per their domestic laws
Japan	100,384	7.04%	COS is given right to tax
USA	89,983	6.32%	Both COR and COS has right to tax as per their domestic laws
Netherlands	91,183	6.4%	Principal right is with COR, however limited taxing rights are given to COS as well.
Cyprus	41,952	2.94%	COR is given right to tax
Germany	43,549	3.05%	COS is given right to tax
France	24,960	1.75%	Taxing rights given to COR subject to conditions
UAE	17,720	1.24%	COS is given right to tax
TOTAL FDIs FROM ALL COUNTRIES	14,24,600		

- COR – Country of Residence
- COS – Country of Source

From the perusal of above data, it is clear that out of all the major FDI countries, only Singapore, Mauritius and Cyprus give right to tax gains from alienation of shares to the country of residence. On 1 November 2013, India blacklisted Cyprus for not disclosing crucial information on money transferred by Indian citizens conducting business in Cyprus and who are suspected for tax evasion. The DTAA with Singapore already has a LOB clause to avoid treaty shopping. All other countries taxes gains on share in country of residence. Thus, the protocol brings in parity the tax impact on sale of shares under India-Mauritius DTAA with other countries. This change would in our view not hamper the overall FDI inflows into India but would result in reduced FDI from Mauritius. Having said that, the Government must be given credit for protecting the investments that have been made prior to this amendment.

Article 6 of the protocol to the India-Singapore DTAA states that the benefits in respect of capital gains arising to Singapore residents from sale of shares of an Indian Company shall only remain in force so long as the analogous provisions under the India-Mauritius DTAA continue to provide the benefit.
Now that these provisions under the India-Mauritius DTAA have been amended, a concern that arises is that while the Protocol in the Mauritius DTAA contains a grandfathering provision which protects investments made before April 01, 2017, it may not be possible to extend such protection to investments made under the India-Singapore DTAA.

As stated above, the Cyprus route is not a preferred option but the Dutch route is still open and we would not be surprised to see FDI from The Netherlands increasing sharply in times to come.