AN ANALYSIS OF THE ISSUES PERTAINING TO THE AMENDMENT OF INDIA-MAURITIUS TAX TREATY

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Introduction

The last three decades have witnessed a rather polished tax treaty between India and Mauritius. Investors were exempted from being taxed, provided they did so in share of Indian companies through Mauritius. Therefore it played a pivotal function in bringing foreign investment to India[2].

It allayed the concerns of many investors who feared double taxation and lack of credit availability as a result of a difference in source rules of taxation in India and jurisdictions such as the US. The treaty went through its ups and downs, being challenged in courts in India, but was upheld by the Supreme Court of India in a landmark decision.

The logic behind the amendment

The Government of India has taken up several initiatives for inhibiting the increasing issue of money laundering and tax avoidance. According to statements released by the Indian Finance Ministry, the pact would take care of issues of exploitation of the treaty and round tripping 'lazy Susans' that are often associated to the India-Mauritius treaty. Further, it aims to restrict revenue loss, prohibit double non-taxation, consolidate the flow of investment and also trigger the interchange of knowledge between the two countries. It is also anticipated to reduce unpredictability in the market, by possibly intimidating non serious investors.

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[2] Baistrocchi, Eduardo A. "The use and interpretation of tax treaties in the emerging world: theory and implications." *British Tax Review* 4 (2008).

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India signed the protocol amending the Double Taxation Avoidance Agreement (DTAA) with Mauritius, giving India the right to tax capital gains arising from sale or transfer of shares of an Indian company acquired by a Mauritian tax resident, it proposes to exempt investments made until March 31, 2017, from such taxation.

The government also said that shares acquired between April 1, 2017 and March 31, 2019 will attract capital gains tax at a 50% discount on the domestic tax rate — i.e., at 7.5% for listed equities and 20% for unlisted ones. The full tax impact of the protocol will fall on investments beginning April 1, 2019, when capital gains will attract tax at the full domestic rates of 15% and 40%.

In a span of 15 years, in the period between April 2000 and December 2015, Mauritius accounted for $ 93.66 billion i.e. 33.7% of the total foreign direct investment of $ 278 billion. It is estimated that there would be an effect of curbing the flow of investments by imposition of capital gains tax on the acquisition of shares of Indian companies after March 31, 2017[3].

Impacts of this amendment

Source based taxation approach will certainly have an effect on the impact foreign investment from Mauritius into India. Investments will now have to factor in the Indian capital gains tax.

The amendment will bear a brunt on prospective investments transmitted through Mauritius. Investments which will be made between the period of the amended provision and April 2017 may be seen as having been entered into mainly for the purpose of seeking the benefit under the Tax Treaty. There is an indication that suggests the possibility a window of investment that will be responsible for inviting investment into India because of the exemption from capital gains tax[4].

[3] http://forbesindia.com/blog/economy-policy/india-mauritius-tax-treaty-an-end-and-a-new-beginning/ last accessed on June 25, 2016.

[4] http://www.economictimes.indiatimes.com/topic/India-Mauritius-tax-treaty last accessed on June 25, 2016.

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Organisations in the Mauritius, primarily incorporated for attracting investments will be liable to tax at general domestic rates in the country. It is expected that Mauritius may be at a position of advantage from the disbursement due to attaining LOB conditions. The existing LOB conditions may however, the LOB conditions may not be entirely applicable from April 2019 onwards. Therefore, this would in turn bring about the formation of entities in Mauritius. This amendment will thus have a significant effect on venture capital funds and the like, through Mauritius.

Certain issues for consideration

The amendment appears to have left intact the taxation of indirect transfers. It will be debatable as to whether a transaction of indirect transfers prior to April 1, 2017 will now be drained under the Mauritian Tax Treaty based on the benefits secured to the Mauritian resident company without seeking to look through the antecedent transaction of the indirect transfer[5].

Overseas investors use convertible instruments for the purpose of investing into Indian companies. Convertible instruments when so converted post the given date of April 1, 2017, the question remains whether it can be said that they are taxed in India because of the same. There is a need to analyse whether there is any advantage from the newly introduced Rule 8AA of the Income-tax Rules, 1962. This encompasses provisions that state that the duration of holding must involve the period for which debenture is held prior to conversion for ascertaining the date of acquisition of shares.

It is indicated that the India-Singapore DTAA is proposed to be re-negotiated to similarly reflect the Tax Treaty changes. It would be interesting to examine the changes, considering that Singapore already has LOB conditions in place for the restriction of .

Conclusion

[5] http://economictimes.indiatimes.com/markets/expert-view/who-gains-who-loses-in-new-tax-pact-with-mauritius-will-fiis-run-away/articleshow/52216039.cms last accessed on June 27, 2016.

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There will be a significant decline in the litigation due to the Mauritian Tax Treaty. These amendments have brought in much more lucidity to the existing provisions thereby boosting confidence in investment related decisions. From this viewpoint, this amendment is indeed a much required one.

In order to bring the tax treaty between India and Mauritius at par with the Comprehensive Economic Cooperation Agreement (CECA), Singapore and India amended the tax treaty. This gave way to placing Singapore playing a critical component in the rise of investments into India. Post this amendment, India now has the authority to tax the capital gains in hands of investors through Mauritius[6]. The Singapore treaty with India had a "co-terminus" provision which states that if there is such a change in the Mauritius treaty in respect of capital gains, the capital gains provisions of the Singapore treaty would cease to have effect.

The amendments made in the Mauritius treaty are very apparent, with reasonable provisions relating to the insertion of grandfathering clauses for investments in shares till March 31, 2017[7]. Investors want clarity and they seem to have got that as far as Mauritius is concerned. The lack of a similar grandfathering provision in the Singapore treaty means that no such protection may be available to investments made under the India-Singapore DTAA (double taxation avoidance agreement) for investments in shares prior to March 31, 2017.

There is an immediate need for clarification. It is quite apparent that the objective of India and Singapore was that the treaties must deal in an almost equal method with the investors. Press releases in our country propose that both these nations might formally work out amendment of the treaty.

I believe that an urgent emphasis needs to be given to the tax treaty, since Singapore plays an important function in the economic development of our country. It must be given certain

[6] http://www.mondaq.com/india/x/492096/Capital+Gains+Tax/IndiaMauritius+Tax+Treaty+AmendedCapital+Gains+Tax+Exemption+Withdrawn last accessed on June 29,2016.
[7] www.incometaxindia.gov.in/Pages/international-taxation/dtaa.aspx last accessed on June 29,2016.

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special privileges, like the India-Mauritius pact with regard to such investments made by residents of Singapore in the shares of Indian companies till March 31, 2017.

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