India-Mauritius Amend Tax Treaty: Foreign Investments To Come Under Close Scrutiny

The tax department can now question investments made via Mauritius where the main purpose of the investment is to obtain treaty benefit.

Varun Gakhar

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Investments coming into India via Mauritius will now face closer scrutiny as the Indian government and the Mauritian government have inked a pact to amend the double taxation avoidance agreement between the two nations.

As per the amending protocol, benefits of the India-Mauritius tax treaty will not be available to a taxpayer routing investments through Mauritius if it can be reasonably concluded that availing of these benefits is one of the principal purposes of the party seeking to rely on the tax treaty.

This is known as the 'principal purpose test'.

The intention is to avoid creating opportunities for non-taxation or reduced taxation, particularly through treaty shopping arrangements aimed at obtaining treaty benefits for residents of third jurisdictions.

The introduction of the principal purpose test brings the Mauritius-India tax treaty in line with the BEPS minimum standard. The test is designed to deny treaty benefits in cases of aggressive tax planning arrangements, which are against the object and purpose of a given tax treaty provision, said Dhruv Janssen-Sanghavi, leader at Nishith Desai Associates.

The difficulty with this provision is that it imposes a low burden of proof on the tax authorities before they can deny treaty benefits, but puts a very high burden on the taxpayers to prove that their arrangement is kosher, he said.

The settled position that seems to have emerged over the years in the context of the India-Mauritius tax treaty is that the existence of a valid tax residency certificate, or TRC, is substantive to availing of treaty benefits, said Rahul Charkha, partner at Economic Laws Practice.

However, with the introduction of this new provision, global investors and funds will have to be vigilant, scrutinizing the substance and business rationales behind multi-tier structures and cross-border transactions, he said.

The amendment does not clarify whether or not past investments will receive grandfathering.

It appears that the grandfathering benefit may not be available since the principal purpose test provision has been introduced as a non-obstante clause of the treaty, and therefore, it shall prevail over other provisions of the treaty, including the grandfathering provision, SR Patnaik, partner at Cyril Amarchand Mangaldas, told NDTV Profit.

In addition, the date of applicability of this provision has been ambiguously worded in the protocol.

On the one hand, the protocol stipulates that the provision will take effect as soon as both countries ratify it under their respective laws.

However, it also specifies that it will take effect regardless of the date of the taxes' levies or the taxable years to which they apply.

If this provision is said to have retrospective effect, it may significantly impact a number of cases that are pending at various levels, ranging from assessment levels to the apex court, wherein the tax department denied the tax treaty benefits to the Mauritius-based investors, Patnaik said.

Patnaik said that the CBDT should put out an official clarification with regard to its applicability.

It is pertinent to note that the 1982-signed India-Mauritius tax treaty underwent an amendment in 2016.

The 2016 amendment was brought in because Mauritius did not levy a capital gains tax on the sale of shares in an Indian company, which made it a favourable destination for treaty shopping. After the amendment came into force, capital gains arising out of the sale of shares were made taxable in India.

Since 2016, FDI inflows from Mauritius have dropped from USD 15.72 bn in FY17 to USD 6.13 bn in FY23.

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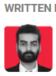

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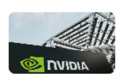

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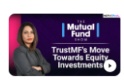

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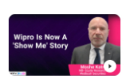

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