Tax benefits to be slashed as India, Mauritius ink new deal

With these changes in place, it is clear that the government intends to dissuade tax planning or tax avoidance activities and wants the investments to come to India through home countries directly, experts added.

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The DTAA, which allowed the lower of the tax rates among the signatory countries to prevail, meant nil tax capital tax liability for investors, as the African nation kept the rate zero. (Image: Freepik)

The tax benefits for investors based out of Mauritius in India are set to be reduced substantially further, with the two countries signing a protocol to amend the convention encompassing the bilateral Double Taxation Avoidance Agreement (DTAA). The agreement signed by the two sides on March 7 at Port Louis – FE has seen a copy of it – is the first of its kind for New Delhi.

It will for all practical purposes, result in denial of tax reliefs for assorted incomes –dividend, royalty, technical free etc. , to investors and traders from the island nation. Indian HNIs who take the island route for tax avoidance will also be impacted.

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Tax experts also said that once the amendments take effect – both countries will have to notify them in due course – the benefit of nil capital gains tax for investments from Mauritius made before April 1, 2017 too could come under the scanner, as the amendments “seemed to have retrospective effect.” A 2016 amendment to the DTAA, it may be recalled, had ended the virtual zero capital gains tax benefit for Mauritius investors, by making gains from sale of shares purchased after April 1, 2017 taxable at India’s rates.

The DTAA, which allowed the lower of the tax rates among the signatory countries to prevail, meant nil tax capital tax liability for investors, as the African nation kept the rate zero.

The latest protocol is in compliance with the OECD-anchored plan to reinforce anti-abuse provisions, under the so-called base erosion and profit sharing (BEPS) framework. The India-Mauritius tax treaty would now acquire the status of a “covered tax agreement under the BEPS Multilateral Instrument.

Essentially, a principal-purpose test (PPT) would be prerequisite for the tax benefits to be granted.

The PPT will enure that tax reliefs will be denied if “it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that treaty benefit is one of the principal purposes of the party seeking to rely on the relevant double tax treaty.”

According to sources, Mauritius is the first country with which India has amended its DTAA’s ‘preamble’ to avoid creating opportunities for “non-taxation” or “reduced taxation” through means of tax evasion or avoidance for taxpayers.

Experts called the move a “paradigm shift” in the applicability of the treaty provisions.

The taxation rate of a dividend income in India under the Income-Tax Act 1961 is in the range of 20% plus applicable surcharge and cess (effective rate as high as over 42% for HNIs) , but the same income for shareholders from Mauritius can be subject to withholding tax of only 5% if the Mauritius investor entity being the beneficial owner holds directly at least 10% of the capital of the Indian company.

Such benefits of a lower tax can be denied under the PPT if it can be reasonably concluded by the tax authority that obtaining this lower tax benefit was one of the “principal purposes” of this arrangement.

“With the inclusion of PPT, the invoking of treaty provisions to transactions, which were designed to benefit from grandfathering provisions (regarding capital gains tax) now also comes under scanner since the protocol seems to have a retrospective effect, unlike the amendments which were undertaken in 2016,” said Saurrav Sood, Practice Leader – International Tax, SW India

Yeeshu Sehgal, Head of Tax Market, AKM Global, says that the new norms can lead to a surge in litigation as investors from Mauritius will be required to substantiate the “commercial rationale” behind their transactions now, demonstrating that the primary objective was not to take treaty benefits.

On the benefit to Indian tax authorities, Dhruv Sanghavi, Co-head International Tax at Nishith Desai Associates says that PPT gives India a potent tool to deny treaty benefits in cases of aggressive tax planning. “That could be seen as a 'benefit' in a sense of the term. However, given the aggressive stance that the tax authorities tend to adopt, it may potentially raise more issues than it may create solutions," he said.

With these changes in place, it is clear that the government intends to dissuade tax planning or tax avoidance activities and wants the investments to come to India through home countries directly, experts added.

The latest protocol was signed by Nandini Singla, High Commissioner of India to Mauritius, and Dharam Dev Manraj, Financial Secretary, Mauritius. In February, Mauritius Cabinet had approved the plan.

The DTAA has been major attraction for investors: Cumulative FDI equity inflows from Mauritius to India between April 2000–September 2023 amounted to $167 billion, or 25% of total FDI inflows into India in this period. The 2016 amendment hasn't dented Mauritius' share in India's FDI inflows.

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