India, Mauritius amend double taxation avoidance agreement

A PARADIGM SHIFT. Focus on preventing tax evasion over promoting investment flows

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New Delhi

The amendment of the Double Taxation Avoidance Agreement (DTAA) by India and Mauritius signals a paradigm shift from promoting bilateral investment flows to preventing tax evasion.

A Principal Purpose Test (PPT) has been incorporated into the agreement under which the tax administration can deny the tax treaty benefit if the principal purpose of the action undertaken by the taxpayer was to obtain a benefit.

KEY TERMS

- A Principal Purpose Test (PPT) has been incorporated in the agreement
- To apply PPT, a new article has been added to the treaty
- There is a change in the preamble where the expression 'encouragement of mutual trade and investment' has been removed
- Both countries intending to eliminate double taxation

PROTOCOL DETAILS

The protocol amending the treaty was signed on March 7 and now the details of the signed protocol are out in public. There is change in the preamble where the expression 'encouragement of mutual trade and investment' has been removed. It has been said that both countries intending to eliminate double taxation with respect to taxes covered by this convention without 'creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in this convention for the indirect benefit of third jurisdiction).'

Explaining this, Saurrav Sood, Practice Leader at SW India, said the amendment aims to exclude encouragement of mutual trade and investment and include the intention of not providing treaty benefit that creates a situation of reduced taxation or non-taxation. "This is a paradigm shift in the applicability of the treaty provisions to situations that otherwise were the basis of deciding in favour of the taxpayer in the judgment of Azadi Bachao Andolan by the Supreme Court," he said.

To apply PPT, a new article has been added to the treaty which says 'a benefit under this convention shall not be granted in respect of an item of income if it is reasonable to conclude that obtaining that benefit was one of the principal purposes.'

Explaining this provision, Rakesh Nangia, Chairman of Nangia Andersen India said that such a provision aims to curtail tax avoidance by ensuring that treaty benefits are only granted for transactions with a bona fide purpose.

However, the application of the PPT to grandfathered investments remains ambiguous, highlighting the need for explicit guidance from the CBDT.

"The omission of the phrase 'for the encouragement of mutual trade and investment' from the treaty's preamble suggests a shift in focus towards preventing tax evasion over promoting bilateral investment flows. This development underscores India's commitment to international tax co-operation standards while raising critical considerations for investors leveraging the India-Mauritius corridor," he said.

PREFERRED CHANNEL

The treaty was first signed on August 24, 1982 and amended on May 10, 2016. Mauritius was initially the preferred channel for foreign portfolio and foreign direct investors due to the tax advantage that accrued due to the DTAA between two countries.

The agreement laid down that capital gains tax had to be paid in the country where the foreign investor was based. Since the rate of capital gains tax in Mauritius was zero, investors from this country paid no capital gains tax.

However, the situation changed in 2016 when it was decided that in case of shares purchased after April 1, 2017, capital gains arising from an investment in an Indian company will be taxed in India.

With the double tax avoidance treaty with Singapore being linked to the agreement with Mauritius, investments from Singapore have also been brought into the Indian tax net.

SIGN PROTOCOL AMENDING DTAA

India, Mauritius revise tax treaty, aim to plug evasion

ENS ECONOMIC BUREAU
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INDIA HAS signed a protocol amending the Double Taxation Avoidance Agreement (DTAA) with Mauritius to plug treaty abuse for tax evasion or avoidance. The amended pact has included what is called the Principal Purpose Test (PPT), which essentially lays out the condition that the tax benefits under the treaty will not be applicable if it is established that obtaining that duty benefit was the principal purpose of any transaction or arrangement.

In the amended protocol, Article 27B has been introduced in the treaty defining the 'entitlement to benefits'. The PPT will deny treaty benefits, such as the reduction of withholding tax on interest royalties and dividends, where it is established that obtaining that treaty benefit is one of the principal purposes for the party engaged in the transaction.

The amendment to the India-Mauritius treaty was signed on March 7 at Port Louis and was made public Wednesday. Mauritius has been a preferred jurisdiction for investments in India due to the non-taxability of capital gains from the sale of shares in Indian companies until 2016. The treaty was last amended in May 2016 allowing the right to tax capital gains arising from sale or transfer of shares of an Indian company acquired by a Mauritian tax resident and exempting investments made until March 31, 2017 from such taxation.

This recent amendment, however, does not clarify if the past investments will be grandfathered. The Ministry of Finance is yet to issue a clarification on the same.

THE PRINCIPAL PURPOSE TEST

■ The amended pact has included what is called the Principal Purpose Test, which essentially lays out the condition that the tax benefits under the treaty will not be applicable if it is established that obtaining that duty benefit was the principal purpose of any transaction or arrangement

The DTAA was a major reason for a large number of foreign portfolio investors (FPI) and foreign entities to route their investments in India through Mauritius. Mauritius remains India's fourth largest source of FPI investments, after the US, Singapore, and Luxembourg. FPI investment from Mauritius stood at Rs 4.19 lakh crore at the end of March 2024, which is 6 per cent of the total FPI investment of Rs 69.54 lakh crore in India. FPI investment from Mauritius had stood at Rs 3.25 lakh crore, out of total FPI investment of Rs 48.71 lakh crore at the end of March 2023.

The two nations have now also amended the preamble of the treaty to incorporate the thrust on tax avoidance and evasion. The earlier objective of 'mutual trade and investment' has now been replaced with an intent to "eliminate double taxation" without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance including through "treaty shopping arrangements" aimed at obtaining relief provided under this treaty for the indirect benefit of residents of third jurisdictions.

"After this change now, any Indian inbound or outbound cross-border structuring of investment routed through Mauritius should factor in the BEPS MLI (Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting) impact, especially if the structuring involves availing of tax treaty benefits (in India or Mauritius). Also, this amendment applies to all incomes such as capital gains, dividends, fee for technical services, etc," Yeeshu Sehgal, Head of Tax Market, AKM Global said.

While this amendment aims to curb tax treaty abuse and minimise avenues for tax avoidance or mitigation by integrating PPT into the said treaty, it may result in a rise in litigation. "...there may be 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. It remains to be seen whether this amendment will extend to grandfathered investments. It is noteworthy that ongoing litigation pertaining to beneficial ownership and substance concerning Indian investments is already prevalent," Sehgal said.

Tax experts also said that any guidance issued by the Indian government will be required to understand the full impact of these changes on investments and tax planning strategies.

"...the application of the PPT to grandfathered investments remains ambiguous, highlighting the need for explicit guidance from the CBDT. Furthermore, the omission of the phrase "for the encouragement of mutual trade and investment" in the treaty's preamble suggests a shift in focus towards preventing tax evasion over promoting bilateral investment flows," Rakesh Nangia, Chairman, Nangia Andersen India said.

The recent amendment reflects India's intent to align with global efforts against treaty abuse, particularly under the BEPS framework. Though India is yet to make any announcements regarding Pillar Two amendments in its domestic tax laws, tax experts said it is anticipated that developments may be announced in the budget in July 2024 after elections, experts said.

In October 2021, over 135 jurisdictions agreed to implement a minimum tax regime for multinationals under 'Pillar Two'. Following this, in December 2021, Organisation for Economic Co-operation and Development (OECD) released the Pillar Two model rules — Global Anti-Base Erosion (GloBE) rules — which will introduce a global minimum corporate tax rate set at 15 per cent. The minimum tax is proposed to apply to MNEs with revenue above €750 million and is estimated to generate around $150 billion in additional global tax revenues annually. The Pillar Two also provides for a co-ordinated system of taxation of a top-up tax on profits arising in a jurisdiction whenever the effective tax rate, on a jurisdictional basis, is below the minimum rate of 15 per cent.

India-Mauritius sharpen focus on tax avoidance with amended treaty

Experts say more clarity needed with regard to applicability of DTAA provisions

Surabhi

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The amendments to the double taxation avoidance agreement between India and Mauritius are aimed at dissuading tax avoidance, believe experts, but note that there remain some areas of ambiguity, especially with regards to its applicability.

"The recent Protocol to the India-Mauritius DTAA, which incorporates the Principal Purpose Test (PPT), represents a move by India to align with global efforts against treaty abuse, particularly under the BEPS Action 6 framework. The introduction of the PPT aims to curtail tax avoidance by ensuring that treaty benefits are only granted for transactions with a bona fide purpose," said Rakesh Nangia, Chairman, Nangia Andersen India.

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Furthermore, the omission of the phrase "for the encouragement of mutual trade and investment" in the treaty's preamble suggests a shift in focus towards preventing tax evasion over promoting bilateral investment flows. This development underscores India's commitment to international tax cooperation standards while raising critical considerations for investors leveraging the India-Mauritius corridor.

He, however, noted that the application of the PPT to grandfathered investments remains ambiguous, highlighting the need for explicit guidance from the Central Board of Direct Taxes.

"Given the potential implications for investors, it's essential to monitor for any official announcements or clarifications from the CBDT on this matter. Tax professionals and investors will need to carefully analyze the amended DTAA's text and any guidance issued by the Indian government to understand the full impact of these changes on their investments and tax planning strategies," he said.