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# PROTOCOL AMENDING THE INDIA - MAURITIUS TAX TREATY

## 1. INTRODUCTION

On May 10, 2016, India and Mauritius signed the protocol (the "**Amendment Protocol**") amending the Treaty for Avoidance of Double Taxation and Prevention of Fiscal Evasion dated August 26, 1982 (the "**Treaty**").

The Amendment Protocol intends to tackle issues of treaty abuse, round tripping of funds and curb revenue loss. The key change that will raise investor's eyebrows is the imposition of a capital gains tax on the sale of shares by a Mauritian company holding shares in an Indian company.

Please note that investments made prior to April 1, 2017 are not subject to the amendments made pursuant to the Amendment Protocol.

## 2. AMENDMENTS

We set out below a brief overview of the key amendments made to the Treaty by the Amendment Protocol.

### 2.1. Definition of 'Permanent Establishment'

The definition of a '*permanent establishment*' in relation to a business has been amended to include the provision of services by an enterprise through employees for a period of more than 90 (ninety) days in a period of 12 (twelve) months.

This inclusion will give the Indian government the power to tax the profits of a Mauritius based business providing services through employees who are present in India for a period of more than 90 (ninety) days (which need not run concurrently) in a period of 12 (twelve) months.

### 2.2. Tax on Interest

Presently, the Treaty provides an exemption on taxation of interest derived by the following Mauritian entities in India:

- A Government or local authority;
- An agency created or organised by the Government;
- A bank carrying on a bona fide business activity which is resident in Mauritius.

The Amendment Protocol also specifically provides that interest derived by a non-exempted Mauritian resident from India can only be taxed at a rate not exceeding 7.5% (seven point five per cent).

Further, the Amendment Protocol removes the exemption provided to resident Mauritian banks carrying out *bona fide* business activity. However, the exemption under the Treaty will continue in relation to any interest arising from a claim or debt existing on or before March 31, 2017.

The exemptions provided to Government or local authorities (and agencies created or organised by the Government) in relation to the taxation of interest continue.

2.3. Tax on Fees for Technical Services

The Amendment Protocol provides for taxation by India of any fees for technical services arising in India and paid to a Mauritian business. Mauritius would also be able to tax the fees for technical services received by the Mauritius business. The tax that may be levied by India in such a case is capped at 10% (ten per cent).

However, if the Mauritian business has a *permanent establishment* in India, or the Mauritian resident performs the service in a personal capacity and has a fixed base in India, then Mauritius will not be able to tax the fee for technical services. In these circumstances, the provisions of Article 7 (*Business Profits*) and Article 14 (*Independent Personal Services*) of the Treaty as relevant would apply.

2.4. Tax on Capital Gains

A key change under the Amendment Protocol is that gains from any sale of shares of an Indian company by a Mauritian resident holder will be subject to tax in India (subject to a cap as set out below). Such tax can be levied only on the sale of shares that are acquired on or after April 1, 2017.

The Amendment Protocol provides that the tax on capital gains will be capped at 50% (fifty per cent) of the applicable tax rate in India during the period between April 1, 2017 and March 31, 2019. This is subject to the *Limitation of Benefits* provision (discussed below).

2.5. Tax on Other Income

The Amendment Protocol has also introduced a specific provision to the effect that any item of income of a Mauritian resident not dealt with in the Treaty may also be taxed in India if it arises in India.

2.6. Exchange of Information

The provisions on the exchange of information between India and Mauritius under the Treaty have been made much more expansive. In addition, affirmative obligations to gather information and disclose it have been added.

Of particular significance is the obligation to disclose information, regardless of whether the information is held by a bank or other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

## 2.7. Assistance in the Collection of Taxes

The Amendment Protocol adds an entirely new section with respect to assistance by Mauritius to India for the collection of taxes, which are due and payable to India from a Mauritian resident.

Whilst this provision cannot compel Mauritius to act against Mauritian Law, it does allow India to utilize the Mauritian revenue collection machinery to collect tax from a Mauritian resident.

The provisions also seek to provide an exemption, on an accepted revenue claim, from any time limit under Mauritian law for the collection of taxes.

## 2.8. Limitation of Benefits

A major change brought in by the Amendment Protocol is the introduction of a *Limitation of Benefits* provision. The *Limitation of Benefits* provision denies the benefit of capital gains (arising in the period between April 1, 2017 and March 31, 2019) being taxed at 50% (fifty per cent) of the applicable tax rate in India, to the following entities:

- A Mauritian resident whose affairs are arranged with the primary purpose of taking advantage of this benefit.
    - An entity not having *bona fide* business activities will be covered by this provision.
- A shell or conduit company.
    - A shell or conduit company has been defined as an entity having negligible or no business operations or with no real and continuous business activities being carried out in Mauritius.
    - A Mauritius company shall be deemed to be a shell or conduit company if its expenses on operations in Mauritius are less than Mauritius Rs. 1,500,000 (Mauritius Rupees one million five hundred thousand) or INR 2,700,000 (Indian Rupees two million seven hundred thousand) in the 12 (twelve) month period immediately preceding the date when the gains arise.
    - A listed company shall not be considered to be a shell or conduit company.

In these circumstances, the capital gains of the Mauritian entity will be taxed at the full applicable rate of tax in India.

In this context, it should be noted that the corresponding provisions in the India – Singapore Treaty defines a shell or conduit company as one that has an operating expenditure of less than the equivalent of INR 5,000,000 in the 24 (twenty four) month period preceding the date when the gains arise.

## INDUSLAW VIEW

The Amendment Protocol makes many notable changes, which are the topic of discussion both in the media and amongst professionals with a cross border focus and involved or familiar with India – Mauritian structures.

Key amongst these are the *Limitation of Benefits* provision, the source-based taxation for capital gains on the transfer of shares of an Indian company by a Mauritius based shareholder, the expansion of the definition of '*permanent establishment*' to include a '*service PE*' and the provisions with respect to exchange of information and assistance in the collection of taxes.

The case law in India which led to a settled position that treaty benefits would be available based on a tax residency certificate seems set to change or evolve in a new direction. The changes with respect to *Limitation of Benefits* also seem likely to reopen debates about substance and operations, which seemed to have been settled. However, the *Limitation of Benefits* provisions will only apply to capital gains tax between April 1, 2017 and March 31, 2019.

The tax on capital gains provisions apply to the "*alienation of shares*", which seems to indicate that it will apply only to the transfer of equity shares and preference shares (the latter whether fully, partially, or non-convertible).

However, these provisions should not apply to debentures, unless those debentures are convertible into shares, and a conversion event has occurred resulting in the Mauritian transferor transferring shares and not the debentures.

Similarly, these provisions should not apply to the transfer derivatives, p-notes and other similar instruments, as long as no event has occurred under such instruments which lead to the Mauritian transferor transferring shares.

The breadth of the provisions with respect to the exchange of information and assistance in the collection of taxes seem to reflect developments that are currently topical in the Indian media. The Government has publicly declared a campaign against corruption and black money and the widening of the exchange of information provisions certainly seems to coincide with the aim of clamping down on tax evasion.

The international secondment of employees will also have to be keenly scrutinized from an international tax perspective. The express provision with respect to a "*service PE"* brings this issue, already a hot button topic and the subject of interesting case law, into more focus.

Historically, Mauritius has been a preferred country to route investments into India due to the provisions of the Treaty, but will the changes brought in by the Amendment Protocol push investments through other routes? In this context, it is interesting to note that the India - Singapore Treaty provides for *residency-based* taxation for capital gains unlike the Amendment Protocol. However, the India - Singapore Treaty specifically provides that capital gains on the transfer of shares will be in force as long as the Mauritius Treaty provides for residence-based taxation in relation to the transfer of shares.

It remains to be seen as to whether the India - Singapore Treaty will be amended to bring in the concept of *source-based* taxation for capital gains and add assistance obligations in relation to collection provisions as seen in the Amendment Protocol.

In summary, the Amendment Protocol, juxtaposed with changes in Indian law on the treatment of trusts and *pass through* benefits (from an investment standpoint), raises the question as to whether the *preeminent* place of Mauritius in India's tax treaty landscape will continue.

It is clear that Mauritian structures for future investments will now need to be carefully assessed. Investors, who do not have feet on the ground in India or make infrequent investments in the country, may now consider the cost of compliance and structuring an Indian investment through Mauritius to be higher than other jurisdictions.

Whether, therefore, there will be a dip in the volume of investments into India through Mauritius remains to be seen. The Amendment Protocol does grandfather the application of tax on investments until a certain date, which might avoid an immediate dip in investments through the Mauritian route. At this time, as we continue to comb through the fine print, we perceive that the Amendment Protocol may prompt a change in India investment structures.

Over the years the media has speculated several times about the change to the India – Mauritius Treaty. The speculation is over, the changes are here, and certainly herald an interesting time.

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