Grant Thornton

#GTBharat
SHAPING VIBRANT INDIA

India-Mauritius Tax Treaty

impact of new protocol

The India-Mauritius tax treaty has been the subject of myriad litigations primarily associated with treaty shopping. The recent amendment of this treaty through a protocol dated 7 March 2024 (2024 protocol) has once again brought this issue into focus. What are the key changes and their impact on existing and new investments in India through Mauritius?

Change in the preamble

Earlier preamble

"The Government of the Republic of India and the Government of Mauritius, desiring to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains and for the encouragement of mutual trade and investment ...."

New preamble

"The Government of the Republic of India and the Government of Mauritius, intending to eliminate double taxation with respect to the 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 residents of third jurisdictions) ...."

Impact

The preamble to a tax treaty sets out its object and purpose. Hence, any change to the preamble reflects intent of the governments in the application of the provisions. Accordingly, removing the words "for the encouragement of mutual trade and investment" and replacing it with the words "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 residents of third jurisdictions)" clearly demonstrates the new approach.

The Supreme Court had earlier, in the case of **UOI v. Azadi Bachao Andolan**[1], observed that developing countries may allow treaty shopping to encourage capital and technology inflows for promoting other non-tax benefits to their economy. The principles of this decision may no longer apply with the change in the preamble and courts would now examine and interpret transactions differently.

1 [2003] (132 Taxman 373) (SC)

Introduction of principal purpose test (PPT)

A new Article[2] introducing the PPT has been added. It provides that benefit under the India-Mauritius tax treaty would not be available in respect of an item of income, if it is reasonable to conclude that obtaining tax benefit under the said tax treaty was one of the principal purposes of the transaction.

Impact

In cases where the principal purpose, or one of the principal purposes of structuring the transaction, was availing the tax treaty benefit, the tax treaty protection could now be declined.

The 2024 protocol introduces two of the minimum standards required as a part of the Base Erosion and Profit Shifting (BEPS) project:

- The tax treaty is not intended to create opportunities for non-taxation/reduced taxation through tax avoidance and treaty shopping, and
- The tax treaty should contain an anti-avoidance measure, either a PPT or a detailed limitation of benefit (LOB) clause.

India and Mauritius are required to notify each other regarding the completion of procedures in their respective jurisdictions for bringing the 2024 protocol into force. The protocol shall have effect from the date of the later of the two notifications **without regard to the date on which the taxes are levied or the taxable years to which taxes relate.**

Grant Thornton Bharat's point of view

Will these changes impact foreign direct investment (FDI) inflows?

Cumulative FDI equity inflows from Mauritius to India during the period April 2000-December 2023 amounted to USD 170.918 billion, which represents 26% of total FDI inflows over that period. In FY 2022-23 alone, FDI equity inflows from Mauritius amounted to USD 6.13 billion and for FY 2023-24 (from April 2023 – December 2023), the inflow was USD 7.04 billion[3], making it the second largest source of FDI into India for both financial years after Singapore.

In March 2024, Mauritius-based funds were the fourth largest investor by geography after the United States (41.7%), Singapore (7.64%) and Luxembourg (7.15%).

The introduction of the PPT will mean that foreign investors based in Mauritius would now need to establish a commercial rationale or a justification for being a resident of Mauritius. This is likely to negatively impact FDI flows through the Mauritius route.

Are these changes retrospective?

The 2024 protocol [4] stipulates that "the provisions of this protocol shall have effect from the date of entry into force of the protocol, **without regard to the date on which the taxes are levied or the taxable years to which the taxes relate."**

Taxpayers are concerned that this article provides an avenue to the Revenue authorities to apply the PPT provisions on a retrospective basis. The Revenue authorities could possibly argue that even though the transactions pertain to a period before the date on which the 2024 protocol came into force, the PPT provisions could now be used to ascertain whether a taxpayer is entitled to treaty protection. Such an interpretation would amount to a retrospective amendment to the India-Mauritius tax treaty.

There is also a concern that this change will impact the grandfathering benefit for capital gains prior to 1 April 2017, available under the India-Mauritius tax treaty.

In our view, such an interpretation would be unwarranted since a tax treaty preamble is not a machinery provision. The preamble is in effect the very soul or essence of a tax treaty and the provisions of the tax treaty take colour from its preamble. Further, it is a well-established rule that treaties are interpreted *ut res magis valeat quam pereat*, i.e., to make it workable rather than redundant.

---

2 Article 27B

3 https://www.dpiit.gov.in/sites/default/files/Fact%20Sheet%20December%202023_1.pdf

4 Article 3

The change to the preamble of a tax treaty is hence a substantive and fundamental change to the scheme of the tax treaty and is inherently incapable of retrospective application. Therefore, one should look at the preamble as on the date on which the investment was made and not what exists on the date of divestment. As long as the benefit in question can be said to be in accordance with the preamble in force at the relevant time, it would be covered by the exception clause set out in the PPT.

The Central Board of Direct Taxes (CBDT) has also clarified that protocol is yet to be notified, and hence, the apprehensions about its retrospective application are premature. It is expected that the CBDT will provide suitable clarifications to address this concern of taxpayers shortly.

How will these changes impact transactions in the interim period before the CBDT clarification?

Due to the ambiguities arising from the wordings of the 2024 protocol, buyers may be advised to mitigate their risk by deducting taxes at source. At a practical level, it appears that in the interim period, payers may become cautious and apply the withholding tax rates under domestic tax law without giving effect to the India-Mauritius tax treaty benefits.

Indemnity clauses in mergers and acquisition schemes may also need to factor this aspect. One will need to see how the insurance products deal with these changes. As per some reports, withholding tax insurance products may now become costly in view of the uncertainties involved.

What will be the implications on beneficial ownership test after introduction of the PPT in the India-Mauritius tax treaty?

The Revenue's case against Mauritius structures, so far, has mainly been based on examining possible tax avoidance motives of the taxpayer. The question of beneficial ownership by the Mauritian entity comes up in litigation very often despite the fact that there is no specific beneficial ownership requirement in the Article relating to capital gains[5] of the India-Mauritius tax treaty. Existence of such requirement cannot be inferred or assumed, this principle was established by the Mumbai Tribunal in the case of **Blackstone FP Capital Partners Mauritius V Ltd v. DCIT[6].**

The PPT is much wider in scope than the beneficial ownership test, and therefore, the controversy on beneficial ownership may now not be very relevant, for transactions that are examined under this Article[7] of the India-Mauritius tax treaty.

What are the key differences between the India-Singapore tax treaty and the India-Mauritius tax treaty after the 2024 protocol?

Both the treaties contain capital gain exemptions for Indian company shares acquired before 1 April 2017 and the preamble of both the treaties are also now similarly worded.

The PPT now exists in both the tax treaties. The India-Singapore tax treaty is a covered tax agreement (CTA) and the PPT in the India-Singapore tax treaty has been introduced by the multilateral instrument (MLI). The provisions of the MLI are applicable to the India-Singapore tax treaty for taxes levied with respect to taxable periods beginning on or after 1 April 2020.

The India-Mauritius tax treaty is not a CTA, and as of now, the amended protocol hints at retrospective implication. Hence, currently, there seems to be more clarity for taxpayers with respect to the India-Singapore tax treaty.

5 Article 13

6 [2022] (138 taxmann.com 328) (Mumbai - Trib.)

7 Article 13

What would be the interplay between the General Anti-Avoidance Rule (GAAR) codified in the Indian domestic law and the PPT contained in the India-Mauritius tax treaty?

The PPT clause in the India-Mauritius tax treaty seems to be broader in scope than the GAAR provisions under the Act.

The GAAR applies only if the 'main purpose' of the arrangement is to obtain a tax benefit or, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, even if the main purpose of the whole agreement is not to obtain a tax benefit.

The GAAR also contains some safeguards, that is to say that GAAR can only be invoked if the tested arrangement:

- Creates rights, or obligations, which are not ordinarily created between persons dealing at an arm's length;
- Results, directly or indirectly, in the misuse, or abuse, of the provisions of the Act;
- Lacks commercial substance or is deemed to lack commercial substance, in whole or in part; or
- Is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for *bona fide* purposes.

On the other hand, the PPT may apply even if obtaining a benefit of the India-Mauritius tax treaty was one of the principal purposes of the transaction. In addition, the GAAR would be applicable if the tax benefit is INR 3 crore or more. There is no such threshold for the PPT to apply. Finally, under the GAAR, grandfathering benefit is available in respect of transfer of investments made before 1 April 2017.

Consequently, taxpayers may need to evaluate the facts of their case and analyse if it is better to follow the domestic law provisions instead of tax treaty provisions.

Will these changes make IFSC GIFT city more lucrative?

Under the provisions of the Act, specific tax exemptions/deductions have been provided that could be availed by funds/units set-up in IFSC GIFT City and their non-resident investors, subject to satisfying certain prescribed conditions.

Given that these benefits are codified in the provisions of the Act itself, IFSC GIFT city may become a preferred jurisdiction in many cases, as it provides more tax certainty as compared to treaty protection, wherein as of now, there may be some uncertainties involved.

For more details, please contact

Riaz Thingna

Partner, Tax, Grant Thornton Bharat
E: riaz.thingna@in.gt.com

Connect with us on

@Grant-Thornton-Bharat-LLP
@GrantThorntonBharat
@Grantthornton_bharat
@GrantThorntonIN
@GrantThorntonBharatLLP
GTBharat@in.gt.com

© 2024 Grant Thornton Bharat LLP. All rights reserved.

"Grant Thornton Bharat" means Grant Thornton Advisory Private Limited, a member firm of Grant Thornton International Limited (UK) in India, and those legal entities which are its related parties as defined by the Companies Act, 2013, including Grant Thornton Bharat LLP.

Grant Thornton Bharat LLP, formerly Grant Thornton India LLP, is registered with limited liability with identity number AAA-7677 and has its registered office at L-41 Connaught Circus, New Delhi, 110001.

References to Grant Thornton are to Grant Thornton International Ltd. (Grant Thornton International) or its member firms. Grant Thornton International and the member firms are not a worldwide partnership. Services are delivered independently by the member firms.