

Protocol for amendment of India – Mauritius tax treaty signed

May 12, 2016

In brief

On 10 May, 2016, the Governments of India and Mauritius signed a Protocol for amending the treaty dated 24 August, 1982, between India and Mauritius. The key features of the Protocol are the introduction of source-based taxation for capital gains on the transfer of Indian companies' shares acquired on or after 1 April, 2017, and the source-based taxation of interest income of Mauritian banks, and of fees for technical services.

In detail

The treaty between India and Mauritius was signed in 1982 and was in force from 1 April, 1983. As per the treaty, India does not have the right to tax capital gains arising to a Mauritius tax resident on sale of shares of Indian companies. This, coupled with the fact that Mauritius does not levy a capital gains tax, has made Mauritius a favourable jurisdiction for investing into India.

A number of tax disputes have arisen on the issue of availability of treaty benefits relating to capital gains as the Indian tax authorities have sought to deny the benefits on the grounds of 'treaty shopping'. However, the Courts have mostly not accepted the contentions of the tax authorities.

The Indian Government has been negotiating a revision of the treaty with the Mauritius government for a long time. The Protocol is a result of the negotiations.

The following are the provisions of the Protocol, as seen from the perspective of the taxability in India of the income of a resident of Mauritius:

Taxation of capital gains

- In the case of shares in Indian companies acquired prior to 1 April, 2017, gains arising to a Mauritius resident on the transfer of such shares will continue to be exempt from tax in India, regardless of when the shares are transferred. In other words, gains from the transfer of shares acquired before 1 April, 2017 will not be taxable in India even if the shares are transferred on or after 31 March, 2017.
- India will have the right to tax capital gains arising from the sale of shares in an Indian company, if such shares have been acquired on or after 1 April, 2017.
- As per the current provisions of the treaty, gains arising to a Mauritius

resident from the alienation of immovable property, of movable property associated with a permanent establishment, and of ships and aircrafts operated in international traffic and associated movable property, can already be taxed in India in certain cases.

- Gains arising to a resident of Mauritius from the alienation of any other property can be taxed only in Mauritius.

Lower capital gains tax rate

- There is a lower tax rate applicable to shares acquired on or after 1 April, 2017, if such shares are sold before 1 April, 2019. In such cases, the gains would be taxable in India as per the Indian tax laws, but the rate of tax will be equal to 50% of the applicable tax rate for such capital gains.
- The benefit of the lower tax rate on capital gains would be available to a Mauritius

tax resident ('the alienator') only if ;

- (a) The affairs of the alienator are not arranged with the primary purpose of taking advantage of the benefit of the lower rate;
 - (b) The alienator passes a 'main purpose' test and a 'bona fide business' test; and
 - (c) The alienator is not a shell/ conduit company.
- Companies not having a *bona fide* business activity are treated as if their affairs were arranged with the primary purpose of taking advantage of the benefit of the lower rate.
 - A shell/ conduit company means any entity with negligible or nil business operations, or with no real and continuous business activities carried in Mauritius
 - A Mauritius resident company whose expenditure on operations is less than Mauritian Rupees 1.5 million during the period of 12 months preceding the date the gains arise is deemed to be a shell/ conduit company.
 - However, a Mauritius resident company shall be deemed not to be a shell/ conduit company, if:
 - (a) it is listed on a recognised stock exchange in Mauritius; or
 - (b) its expenditure on operations in Mauritius is equal to or more than Mauritian Rupees 1.5 million during the period of 12 months preceding the date the gains arise
 - In the case of shares in an Indian company acquired on or after 1 April, 2017, and transferred on or after 1 April,

2019, the gains arising on the transfer will be taxed as per Indian tax laws without any concession.

Interest income

- Interest arising in India and paid to a resident of Mauritius may be taxed in India, but the tax cannot exceed 7.5% of the gross amount of interest if the beneficial owner of the interest is a resident of Mauritius.

It may be noted that earlier, there was no limit in most cases on the Indian tax which could be levied on the interest arising in India and paid to a resident of Mauritius (other than a bank).

- The earlier exemption for interest income of a bank resident in Mauritius carrying on *bona fide* banking business continues in respect of interest arising from debt claims existing on 31 March, 2017.

Other changes

- The Protocol has introduced a provision relating to taxation of fees for technical services, largely on similar lines as in various other treaties entered into by India.
- Fees for technical services arising in India and paid to a resident of Mauritius may be taxed in India, but the tax cannot exceed 10% of the gross amount of fees for technical services if the beneficial owner of the fees for technical services is a resident of Mauritius
- As per the treaty, income not expressly dealt with by any other provision of the treaty is taxable in the country of residence of the recipient of income. The Protocol has amended the treaty to provide that such income may also be taxed in the country in which the income arises. In other words, any income arising in

India to a Mauritius resident would be subject to tax in India, unless it is expressly dealt with by a specific provision of the treaty.

- The Protocol has widened the scope of the term permanent establishment to include the activity of furnishing of services, including consultancy services. Such activities would constitute a permanent establishment if the activities continue for a project (or two or more related projects) for a period aggregating to more than 90 days within any 12-month period.
- The Protocol modifies the existing provisions in the treaty relating to Exchange of Information and assistance in tax collection.

Effective date

- The Protocol will come into force once both the Governments, i.e. Government of India and Government of Mauritius, have notified to each other that the procedures required by their respective laws for the bringing into force of the Protocol have been completed.
- Once the Protocol is so notified, it will apply from assessment year 2018-19 for all purposes except for the provisions relating to exchange of information and tax collection, which provisions will come into effect immediately.

The takeaways

- Going forward, there would be a tax on capital gains arising to a Mauritius company on the transfer of shares companies' resident in India.
- It should be noted that gains arising on transfer of shares of companies that are not resident in India should

continue to be not taxable in India. Similarly, gains from alienation of debt instruments should also continue to be not taxable in India.

- Based on the Protocol, the India-Singapore treaty should be affected to the extent that it provides that capital gains may be taxed only in the country of residence, since the relevant provisions have been linked to the continuation of the corresponding provisions of the India Mauritius treaty. In this respect, a senior official of the Government of India has stated that the Indian government intends to renegotiate the treaty with Singapore to bring it on par

with the India-Mauritius treaty.

- Earlier Mauritius was not a preferred jurisdiction for making loans or debt investments as compared to other countries, except to the extent of loans from a Mauritius resident bank. The change in the tax rate to 7.5% on interest income should provide Mauritius a competitive edge over other countries.
- Going forward, fees for technical services arising in India earned by a Mauritius resident should ordinarily be taxable in India, but the rate should not exceed 10% if

certain conditions are satisfied.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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