



news flash

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INDIA-MAURITIUS TAX TREATY – THE AMENDING PROTOCOL AND WHAT LIES IN THE FINE PRINT

Background

Historically, Mauritius was a preferred jurisdiction from where India has received substantial foreign direct investment (“**FDI**”). A cumulative FDI worth USD 158 billion has come from Mauritius to India in the two decades 2000 - 2022 (27% of total FDI inflows into India), thanks largely to the Double Taxation Avoidance Convention (“**DTAC**”).

However, after the amending protocol in 2016, FDI inflows from Mauritius have dropped from USD 15.72 bn in 2016-17 to USD 6.13 bn in 2022-23, with Mauritius becoming India’s third largest source of FDI¹.

What was the amendment in 2016?

The DTAC was amended by a protocol signed in 2016 (“**2016 Protocol**”) which *inter-alia* gave India the right to tax capital gains in India on sale of shares of an Indian company held through a Mauritius entity beginning 1 April 2017. The 2016 Protocol protected the investments in shares acquired before 1 April 2017, i.e. the investments made before April 2017 were grandfathered.

The benefit of grandfathering provisions which provide for capital gains on investments made through Mauritius prior to 1 April 2017 to be taxed only in Mauritius has seen a spate of litigation in the recent past, with challenges being raised by the revenue on the ‘beneficial ownership’ of these Mauritius entities² and the sanctity of the TRC issued by the Mauritius tax authorities. There have been judicial precedents where generally the sanctity of TRC and Circular 789 dated 13 April 2000 (which stated that a TRC

issued by authorities will be accepted to determine tax residency) has been upheld, however, it is still a litigious issue³.

What has changed now?

On 7 March 2024, India and Mauritius signed a Protocol (“**2024 Protocol**”) once again amending the DTAC signed between India and Mauritius. The key amendments, keeping in line with the minimum BEPS standard, are as follows:

1. **Preamble** – the amended preamble provides that the intention of the tax treaty is to avoid double taxation without creating opportunities of non-taxation or reduced taxation through tax evasion / tax avoidance.
2. **Introduction of the Principal Purpose Test (“PPT”)** – the PPT condition (in line with MLI) would have to be satisfied for availing the beneficial provisions of the DTAC.
3. **Entry into effect** – the 2024 Protocol will be effective once it is notified by India and Mauritius respectively and will come into force from the date of later of the two notifications.

The devil is in the details - what are the ambiguities?

Though the draft text of the 2024 Protocol, which was signed, was made available on public domain on 11 April 2024, there are certain details / points which are not clear. While the Indian tax authority, on 12 April 2024, clarified⁴ that the concerns raised by taxpayers will be addressed as and when the 2024 Protocol comes into force, there is no clarity yet on the timelines for the notifications by the respective countries.

Some of the points which, in our view, need further clarity are as follows:

1. **Clarity on applicability of the 2024 Protocol** – whether the amended provisions can be applied retrospectively in relation to income earned in past years that are still open to assessments or will it only be applied prospectively.
2. **Impact on the grandfathered investments** – will the exemptions to past investments grandfathered, which is already a litigious topic, see further increased investigation on the eligibility for beneficial exemption provisions, which can be denied by the tax authorities if one of the ‘principal purposes’ of the transaction/arrangement is to obtain a tax benefit.
3. **Interplay between the domestic general anti avoidance regulations (“GAAR”) and PPT** – with the different thresholds for applicability of GAAR and PPT, how will they be used by the tax authorities after the 2024 Protocol comes into effect.

The wait and watch

While the stakeholders wait and watch on the notification and clarifications / guidance which may be issued by the tax authorities going forward, it has become imperative to evaluate the existing structures to evaluate the benefits, if any, which are proposed to be availed by them in future after the 2024 Protocol comes into force and assess the impact of PPT on eligibility of availing such benefits.

With the conspicuous omission of the phrase "for the encouragement of mutual trade and investment" in the treaty's preamble, the industry sentiments perceive a probable shift in focus towards preventing tax evasion over promoting bilateral investment flows, and only time will tell how the 2024 Protocol and its impact on current and future structures unfolds and whether it is interpreted to be effective retrospectively.

1. https://fsi.mea.gov.in/Portal/ForeignRelation/Mauritius_2023.pdf
2. Blackstone FP Capital Partners Mauritius V Ltd. v. Deputy Commissioner of Income-tax, International Taxation [2022] 138 taxmann.com 328 (Mumbai - Trib.)
3. Norwest Venture Partners X-Mauritius v. Deputy Commissioner of Income-tax, Circle IT [2024] 160 taxmann.com 632 (Delhi - Trib.); Superb Mind Holding Ltd. v. ACIT (International Taxation) [2024] 160 taxmann.com 470 (Delhi - Trib.); Bid Services Division (Mauritius) Ltd. v. Authority for Advance Ruling (Income-tax) [2023] 148 taxmann.com 215 (Bombay); Accion Africa-Asia Investment Company v. ACIT [2024] 161 taxmann.com 582 (Delhi - Trib.); Leapfrog Financial Inclusion India (II) Ltd.v. ACIT [2023] 155 taxmann.com 166 (Delhi - Trib.)
4. Source: <https://twitter.com/IncomeTaxIndia/status/1778804751993618707>

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