Is the India Mauritius Tax Treaty out of the Treaty Shopping List?

A battle against tax treaty abuse

Cross-border transactions have gained momentum across geographies.

Multinational enterprises (MNEs) are aggressively carving out ways and means to execute business operations in manner that yields maximum rewards.

On one hand, the local tax laws are drafted such that they aim at extracting maximum tax revenue for the respective country, while on the other hand, the provisions of the treaty provide a cushion to the taxpayer(s), undue advantage of which is leveraged by the taxpayers – a concept known as "Treaty-Shopping".

What is Treaty Shopping?

When persons who are resident of a third country, attempt to take benefit of a Tax Treaty between two other countries, it can be construed as a case of Treaty Shopping.

To counterTreaty Shopping, OECD vide its Base Erosion and Profit Shifting Action ('BEPS') Plan 6 contains a three-branched approach to address Treaty Shopping issue:-

i. Contracting countries entering into Tax Treaty have no intention to create opportunities for Treaty Shopping;

ii. Specific Anti-Abuse provisions of LOB rule based on the Limitation-on-benefits ('LOB') provisions based on the legal nature, ownership in, and general activities of, residents of contracting countries;

iii. Even general anti-abuse rule based on the Principal Purpose(s) of transactions, known as Principal Purpose Test (PPT) to address issues of tax benefit of Treaty provisions which are not on ordinary course.

PPT – A subjective and strict watchman

LOB

The LOB clause finds its place in various treaties to ensure only genuine residents, who have a substantive economic presence in their home country, can claim benefits under the Treaty. It helps prevent Treaty exploitation by entities with no real economic connection to the concerned contracting states.

PPT

PPT plugs arrangement(s) where availing benefit of the respective tax treaty is 'one' of the principle purposes and obtaining benefit would be contrary to the object and spirit of the Tax Treaty.

Comparison

It is pertinent to draw attention towards a comparison between the LOB measure and the PPT measure as flowing from the above discussion. Clearly, it may seem to the naked eye upon reading of the measures that there is no major distinction between the two anti-abuse provisions. However, upon analysis it surfaces that following are the key differences between the two:

Simplified LOB	PPT
Specific anti-avoidance measure	General mechanism to address treaty abuse
Analysis of the taxpayers' business activities in the state in which the taxpayer is a resident	Assess whether one of the principal purposes of a particular transaction or arrangement is to obtain tax treaty benefit
Limits obtaining treaty benefits to those taxpayers, that in addition to being resident, satisfy number of objective tests	No specific tests, denial of treaty benefits based on a reasonable conclusion with regard to facts of the case/ transaction.

India Mauritius - The Tax Treaty Saga

Historical Setup

To look back, the India-Mauritius Tax Treaty was entered into force on April 1, 1983. Thereafter, vide Protocol signed May 10, 2016, Article 27A was inserted in the Tax Treaty amongst other amendments, providing taxation rights to source country as regards capital gains owing to sale of shares acquired on or after April 1, 2017.

Recent Developments

On March 7, 2024, a Protocol was signed amending the India-Mauritius Tax-Treaty. It was during the three-day State Visit to Mauritius by Hon'ble President of India, where four agreements were exchanged, one of which was "Protocol to amend the India-Mauritius Double Tax Avoidance Agreement (DTAA) to make it compliant with Base Erosion and Profit Shifting (BEPS) Minimum Standards".

At a glance, the following are the amendments that are sought to be made in the India-Mauritius Tax Treaty vide the aforementioned Protocol:

i. Preamble to the Treaty has been replaced
ii. Addition of Article 27B – Entitlement to Benefits

Further, this Protocol shall come into force on later of the dates when both India and Mauritius notify each other the completion of the legal procedures. It shall have effect from such date indifferent as to the date of levy of taxes or taxable years to which the taxes relate.

Preamble

First and foremost, it is of great importance that as part of the Protocol, the preamble of the treaty has been amended and has witnessed a dramatic departure from the erstwhile idea of avoiding double taxation and encouraging mutual trade and investment to the revised endeavour of warding-off double non-taxation/reduced taxation including the prevention of inappropriate use of treaties by residents of third country.

Article 27B – Entitlement to Benefits

The man of the hour, "Article 27B – Entitlement to Benefits" is intended to be inserted after Article 27A, in line with MLI provisions brought about by the OECD. At this juncture, it would be beneficial to dissect and analyse the aforementioned tightly worded Article 27B.

For starters, Article 27B is a non-obstante clause which empowers the article with an overriding effect over other provisions of the treaty itself. This also makes it worth noting that in addition to others, even those arrangements that pass LOB rule may now be under the lenses of PPT rule. Hence, as one would understand that PPT rule goes above the facts and legalities of the arrangements.

"benefit" – The term "benefit" may be understood to incorporate all tax reductions, exemptions, deferrals and refunds surfacing from the tax treaty.

"reasonable to conclude, having regard to all relevant facts and circumstances" - Only a reasonable satisfaction of the tax authorities is required to invoke this provision.

"one of the purpose" - Furthermore, to widen the ambit of the rule, even if one of the purpose of the transaction/ arrangement was to obtain benefit under the treaty, the taxpayers may be denied any treaty benefits arising therein.

Protocol – Prospective/ Retrospective?

It is understood that third leg of the Protocol talks about the date from which the provisions of the Protocol shall have effect. The wordings contained therein create ambiguity on whether or not the protocol would have retrospective effect. A formal notification clarifying the above position would be a welcome move, It is highly likely that the cards might not fall in taxpayers' favour, and the Protocol amendment may be applicable retrospectively. If this happens, it may result in a storm of litigation..

Protocol overrides grandfathering of Investments?

Another gripping question is whether the benefit of grandfathering would continue to stay for the grandfathered investment(s). Possible situations that may arise are:

a) Where the investments made prior to April 1, 2017 continue to stay protected under the grandfathering provisions, no matter when the income is accrued?

b) Where the investments made prior to April 1, 2017, there may be a case where any income accrues/ exit is made prior to the date of effect of the Protocol stand exempt and only the income accruing/ exits made on or after the date of effect of Protocol are subject to PPT?

c) All investments are subject to PPT.

Possibility of adopting the third view is highly likely as the proposed article starts with a non-obstante clause. Such a strict approach, i.e. to bring all investments under scrutiny, may narrow down the scope of protection for older investments, potentially affecting long-term investors.

PPT vs GAAR – An Interplay?

The Indian Income-tax laws provide a framework to plug tax avoidance arrangements through General Anti Avoidance Rules ('GAAR'). With the introduction of PPT, it would be safe to say that PPT is broader in scope than the General Anti-Avoidance Rules ('GAAR') under the India Income-tax laws.

GAAR provisions deal with arrangements wherein the 'main purpose' is to seek tax benefit, whereas PPT rule applies where if availing treaty benefit was one of the principal purposes.

Further, the GAAR provisions provide a threshold for its applicability i.e. arrangements where the tax benefit for all parties in aggregate exceeds INR three crores. Whereas, no threshold is prescribed under the PPT provisions.

Wherein case a transaction falls within the ambit of GAAR provisions, resort to PPT would be fruitless. On the contrary, if a transaction falls within the ambit of PPT provisions, resort to GAAR provisions might prove beneficial.

Protocol Amending the India – Mauritius tax treaty – A Boon or Bane?

India and Mauritius are both signatories to Multilateral Instrument ('MLI') but the bilateral tax treaty between the two countries was not subject to amendment under MLI in accordance with the BEPS framework because even though the treaty with Mauritius was a part of India's Covered Tax Agreement ('CTA') list, to be amended through MLI, India was not notified by Mauritius under its CTA. Accordingly, India-Mauritius treaty was not subject to any such amendment. It is interesting to note that India has modified its tax treaties for implementation of PPT in accordance with MLI with Treaty partner countries which have notified treaty with India as a CTA For eg, the tax treaties with Singapore, UK include PPT rule already.

Mauritius companies with the sole purpose of taking the advantages of the India – Mauritius Tax Treaty are now under the purview of a strict PPT and may be held liable if unable to prove otherwise.

Indian payers withholding tax while making payments to Mauritius entities need to be wary of introduction of PPT rule as they may now face exposure of lower tax withholding repercussions, unless evidenced by adequate supporting documentation.

Tax authorities in India are likely to look beyond TRC (tax residency certificate by Mauritius tax authorities) and may challenge the ability to deny the benefit of India-Mauritius tax treaty if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the treaty benefits was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly such tax benefit.

Additionally, Mauritius is the country from where maximum FDI flows into the country. The Protocol amendment may impair such investment flow.

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