India announces fundamental changes to the India-Mauritius double tax treaty

Global Tax News

23 MAY 2016

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The Government of India announced in a press release dated May 10, 2016 that Mauritius and India have signed a protocol amending the agreement for avoidance of double taxation with Mauritius.

The text of the protocol is yet to be released, as is the official written announcement from the Government of Mauritius.

Pursuant to the press release, the key announcements highlighted in the protocol are as follows:

- **Shares in Indian companies acquired on or after 1 April 1, 2017**: disposal of such shares will now be subject to tax in India. This change shifts the residence based test for capital gains under the Mauritius-India double tax treaty (DTAA) to a source-based test.
- **Shares in Indian companies acquired before April 1, 2017**: such shares will continue to benefit from the current capital gains exemption in Article 13(4) of the Mauritius-India DTAA.
- **Shares acquired on or after April 1, 2017 but disposed of before March 31, 2019**: limited transitional provisions will be applicable. Disposal of such shares will be subject to a reduced tax rate of 50 percent of the domestic rate in India. The application of the reduced rate is however subject to a Limitation of Benefits clause (LOB).
- Under the LOB clause, the reduced tax rate during the transitory period will be available if a Mauritius resident company passes the main purpose and bona fide business test and has total expenditure on operations in Mauritius of at least Rs1.5 million (approximately US$40,000) in the 12 months preceding the disposal.
- **Shares acquired on or after 1 April 2017 and disposed of after March 31, 2019**: gains on the disposal of such shares will be subject to tax in India at the prevailing tax rate.
- **Interest arising in India on loans made after March 31, 2017:** Such interest derived by Mauritian resident banks will be subject to withholding tax at the rate of 7.5 percent.

Commentary

- Mauritius has for a long time been the main vehicle for Foreign Direct Investment (FDI) into India. Mauritius accounted for 34 percent of foreign direct investments in the country between 2000 and 2015 (source: Department of Industrial Policy and Promotion – India). With the capital gains exemption no longer being available for shares acquired after 1 April 2017, questions will be raised on whether Mauritius will continue to be used as a vehicle for investments in India. The transitory provisions offer temporary comfort as they are limited both in scope and time.
- The protocol will have a knock-on effect on the Singapore-India DTAA because article 6 of the protocol to that

treaty specifies that the benefits available under it only apply so long as the equivalent benefits apply under the Mauritius-India DTAA.

- Subject to the text of the protocol, the above changes should only be applicable to the disposal of shares in India companies. Arguably, investments made through instruments other than shares such as debt-like instruments or derivative contracts may still benefit from the capital gains exemption under the Mauritius-India double tax treaty.

Conclusion

The signature of this protocol is likely to have significant impact on inbound investment in India and raise major concerns among stakeholders across the global business industry. The text of the protocol is eagerly awaited for more clarity over the precise scope of transactions which will be affected.

Find out more about this development by contacting Marc Hein or Johanne Hague of Jurisconsult Chambers, Port Louis, Mauritius. Jurisconsult is a member of DLA Piper Africa Group, an alliance of leading independent law firms working together in association with DLA Piper, both internationally and across Africa.