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Direct Tax Alert

April 12, 2024

India signs a protocol to align the India-Mauritius tax treaty with BEPS standards

Background

- In order to tackle Base Erosion and Profit Shifting ('BEPS') practices and to improve coherence of international tax rules, 140[1] countries finalized BEPS action plans at the forum of Organization for Economic Co-operation and Development ('OECD')/G20 Inclusive Framework.
- Action Plan 15 deals with Multilateral Convention ('MLI') to implement tax treaty related measures to prevent BEPS. India and Mauritius are signatories to MLI. However, Mauritius has not notified India-Mauritius tax treaty ('the treaty') as a Covered Tax Agreement ('CTA') and therefore, MLI does not apply to the India-Mauritius tax treaty.
- On February 23, 2024, Mauritius cabinet agreed to the signing of a protocol to amend the tax treaty between India and Mauritius in order to comply with the BEPS minimum standards.
- On March 7, 2024, India and Mauritius signed the protocol amending the India-Mauritius tax treaty[1].

Amendments in the protocol

- The protocol seeks to replace the preamble of the tax treaty. It states that the intention of both the countries is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. It also clarifies the intention to eliminate double taxation without creating opportunities through treaty-shopping arrangements aimed at obtaining reliefs provided in the tax treaty for the indirect benefit of residents of third jurisdictions. This seems to be in line with Article 6 –

[1] https://www.mea.gov.in/TreatyDetail.htm?4377

Purpose of a Covered Tax Agreement of the MLI.

- The protocol seeks to insert new Article 27B in the India-Mauritius tax treaty on limitation on entitlement to the treaty benefits in line with Principal Purposes Test ('PPT') under Article 7 – Prevention of Treaty Abuse of the MLI.
- The tax treaty benefits shall be denied if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was ***one of the principal purposes*** of any arrangement or transaction that resulted directly or indirectly in that benefit. However, if such tax treaty benefit is in accordance with the ***object and purpose*** of the relevant provisions of the tax treaty, then the benefit shall be allowed.
- India and Mauritius shall notify each other upon completion of the procedures required by their respective local laws for bringing the protocol into force. The protocol shall enter into force on the date of later of these notifications.
- The provisions of the protocol shall have effect from the date of entry into force of the protocol, without regard to the date on which taxes are levied or taxable years to which the taxes relate.

Dhruva Comments

- Mauritius has been one of the most preferred destinations for investment into India due to the benefit provided by the tax treaty between the two countries. This changed in 2016[2], when capital gains arising from an investment made in an Indian company after April 1, 2017, was made subject to tax in India. However, the investments made before April 1, 2017, were grandfathered.
- The existing preamble to the India-Mauritius tax treaty captured the intention of the treaty to avoid double taxation, prevent fiscal evasion with respect to taxes on income and capital gains and encourage mutual trade and investment.
- The revised preamble now explicitly captures the intention of the tax treaty to avoid double taxation without creating opportunities for double/reduced non-taxation through tax evasion. This amendment is in line with the BEPS standards. However, it is important to note that the protocol removes '*encouragement of mutual trade and investment*' as an intent and purpose of the tax treaty.
- The Supreme Court in the case of *UOI* v. *Azadi Bachao Andolan*[3], after referring to the preamble of India-Mauritius tax treaty, observed that the developing countries allow treaty shopping to encourage capital and technology inflows. However, the loss of tax revenues could be insignificant compared to the other non-tax benefits to the economy.
- This protocol undoubtedly advances the India-Mauritius tax treaty parallel to CTAs of MLI (including India- Singapore tax treaty) so far as principal purpose test is concerned. It is stated that the protocol shall have effect from the entry into force irrespective of date on which taxes are levied or taxable year to which the taxes relate.
- The newly introduced protocol raises an interesting question i.e. whether Article 27B (*pari materia* to PPT of MLI) will be applicable on grandfathered investments sold after the date of amendment especially considering the amendment in preamble of the tax treaty. A clarification from the Central Board of Direct Taxes is very much welcome to avoid unnecessary litigation.

[2] Vide Protocol signed on May 10, 2016

[3] [2003] 263 ITR 706 (SC)

- It is also important to note that the new PPT clause under Article 27B is broader in scope than the General Anti-Avoidance Rules (‘GAAR’) made under the Income-Tax Act, 1961 as the GAAR applies only if the ‘main purpose’ of the arrangement is to obtain a tax benefit, whereas the PPT may apply if obtaining a benefit of the tax treaty was one of the principal purposes. Further, the GAAR provides threshold for its applicability which is absent in PPT.
- Separately, one needs to be also mindful of introduction of PPT while withholding tax on payments made to Mauritius entities (such as dividend, interest, etc.). The deductor may prefer to obtain a lower TDS certificate rather than undertaking exposure of lower withholding consequences.

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