CBDT issues press release on Protocol amending the India-Mauritius tax treaty

Background

Today, India and Mauritius has signed a protocol amending the India-Mauritius tax treaty (the tax treaty) at Mauritius. The Central Board of Direct Taxes (CBDT) has issued a press release stating key features of the protocol. The press release is summarised as follows:

Source-based taxation of capital gains on shares

As per the protocol, India gets taxation rights on capital gains arising from the alienation of shares acquired on or after 1 April 2017 in a company resident in India with effect from Financial Year (FY) 2017-18. Simultaneously, protection to investments in shares acquired before 1 April 2017 has also been provided.

In respect of such capital gains arising during the transition period from 1 April 2017 to 31 March 2019, the tax rate will be limited to 50 per cent of the domestic tax rate of India, subject to the fulfillment of the conditions in the Limitation of Benefits (LOB) Article. Taxation in India at a full domestic tax rate will take place from FY 2019-20 onwards.

Limitation of Benefits

The benefit of 50 per cent reduction in tax rate during the transition period from 1 April 2017 to 31 March 2019 shall be subject to LOB Article, whereby a resident of Mauritius (including a shell/conduit company) will not be entitled to benefits of 50 per cent reduction in tax rate, if it fails the main purpose test and bonafide business test.

A resident is deemed to be a shell/conduit company, if its total expenditure on operations in Mauritius is less than INR2.7 million (Mauritian Rupees 1.5 million) in the immediately preceding 12 months.

Source-based taxation of interest income of banks

Interest arising in India to Mauritian resident banks will be subject to withholding tax in India at the rate of 7.5 per cent in respect of debt claims or loans made after 31 March 2017. However, interest income of Mauritian resident banks in respect of debt-claims existing on or before 31 March 2017 shall be exempt from tax in India.

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1 CBDT press release, dated 10 May 2016
Other amendments

The protocol also provides for updating of exchange of information article as per international standard, provision for assistance in collection of taxes, source-based taxation of other income, etc.

Analysis by CBDT

The press release states that the Protocol will tackle the long pending issues of treaty abuse and round tripping of funds attributed to the India-Mauritius treaty, curb revenue loss, prevent double non-taxation, streamline the flow of investment and stimulate the flow of exchange of information between India and Mauritius. It will improve transparency in tax matters and will help curb tax evasion and tax avoidance. At the same time, existing investments, i.e. investments made before 1 April 2017 have been grand-fathered and will not be subject to capital gains taxation in India.

Our comments

The availability of benefit of India-Mauritius tax treaty has always been a matter of contention. The tax treaty was re-negotiated in recent past to incorporate certain changes in current tax treatments in order to prevent treaty abuse and round-tripping of funds.

As per the press release, the protocol has been signed between India and Mauritius incorporating source based taxation of capital gains for shares of an Indian company acquired on or after 1 April 2017. Simultaneously, protection to investments in shares acquired before 1 April 2017 has also been provided. Concessional tax @ 50 per cent is proposed for the transition period from 1 April 2017 to 31 March 2019, subject to the LOB Article. Keeping in line with assurance provided to international investors community, the proposed changes are effected prospectively.

In terms of India's comprehensive economic co-operation agreement with Singapore, residence based capital gains tax treatment together with LOB rules exist. However, such agreed tax treatment is co-terminus with the current residence based capital gain taxation under the India-Mauritius tax treaty. With the amendment to the capital gain article under the India-Mauritius tax treaty, the similar benefit of the India-Singapore tax treaty may also automatically end.

Investors including institutional investors have been given a year in advance to take care of their investments which are routed through Mauritius. This will provide certainty and streamline the flow of investments into India. This step will also address the concern on ease of doing business in India.

Introduction of LOB clause in India-Mauritius tax treaty is in line with the recent trend of including LOB clause in almost all the tax treaties entered by the Indian Government. This is also in line with India's commitment to G20 platform to inch towards implementation of BEPS initiative.
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