The India-Mauritius tax treaty amended

12 May 2016

In brief

The Indian Government has announced the bilateral signature of the Protocol amending the tax treaty between India and Mauritius on 10 May 2016. Although the text of the Protocol has not yet been released, the Government's press release reveals the key features: the introduction of source-based taxation for capital gains on transfer of Indian companies' shares acquired on or after 1 April 2017, source-based taxation of interest income of Mauritian banks, etc.

In detail

India and Mauritius signed the treaty in 1982 and entered into force on 1 April 1983. According to its provisions, India doesn't have the right to tax capital gains of a Mauritius tax resident on sale of shares of Indian companies. This, coupled with the fact that Mauritius doesn't levy a capital gains tax, made Mauritius a favourable jurisdiction for investments in India.

A number of tax disputes have arisen on the issue of availability of treaty benefits as the Indian tax authorities have sought to deny it on the grounds of "treaty shopping". However, the Courts have dismissed these allegations of the tax authorities.

Both Governments have been negotiating a revision of the treaty with the Mauritius Government for a long time and the result is the Protocol signed this May.

Although the Protocol hasn't been released, the press release reveals its key features:

Taxation for capital gains

- In the case of shares in Indian companies acquired prior to 1 April 2017, gains from the transfer of such shares will continue to be exempt from tax in India.
- India will have the right to tax capital gains arising from the sale of shares in an Indian company, if they're acquired on or after 1 April 2017.
- In the case of shares of an Indian company acquired on or after 1 April 2017:

  a) if they're sold after 31 March 2019, the gains will be taxable according to Indian tax laws;

  b) if they're sold before 1 April 2019, the gains would be taxable in India, according to Indian tax laws, but the rate of tax will be equal to 50% of the tax rate for such capital gains. The lower rate would be available to the Mauritius seller subject to satisfying the limitation of benefits conditions set out in the Protocol (as discussed below).

Limitation of benefits

The Protocol has a limitation of benefits clause according to which the benefit of the lower tax rate in capital gains is applicable until 31 March 2019, and is available if a Mauritius tax resident passes a "main purpose test" and a "bona fide business" test. The details of these two tests have not been specified in the Press Release.

The press release also refers to shell/conduit companies. A Mauritius tax resident would be deemed to be a shell or conduit company if its expenditure on operations in Mauritius is less than INR 2.7 million (approx. Mauritian Rupees 1.4 Million) in the preceding 12 months. The consequences of being a shell/conduit company are not set out in the press release.

Other changes

- Interest earned by Mauritius resident banks from debt claims in India will be subject to tax at 7.5% in India. This applies to loans made after 31 March 2017.
- Interest from earlier loans and debt claims remains exempt.
- Source-based taxation for other income has been introduced.
- The Protocol modifies provisions in the treaty relating to Exchange of Information and assistance in tax collection.

PwC Comments

Once the actual Protocol is available, the effect of the above can be evaluated.

The grandfathering of investments made prior to 1 April 2017 is in line with the Indian Government's stated intention of grandfathering past investments.

Going forward, there would be a tax on gains of a Mauritius company on transfer of shares of Indian companies in India.

The press release doesn't mention the impact of the Protocol on the India - Singapore tax treaty. Based on a reading of the language used in the India - Singapore tax treaty it seems that the benefit available under that treaty could be affected.

In this respect, a senior government official has stated that the Indian Government intends to renegotiate the tax treaty with Singapore to bring it on par with the India - Mauritius tax treaty.

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