

*Carolyn*

One of the  
RSM team



## Newsflash

**India - Mauritius enhance efforts to Combat Tax avoidance through Potential Treaty Amendments**

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### India - Mauritius enhance efforts to Combat Tax avoidance through Potential Treaty Amendments

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#### 1.0 Background

- 1.1 The Double Taxation Avoidance Agreement ('DTAA' or 'tax treaty') between India and Mauritius was signed on 24 August 1982 with an aim of encouragement of mutual trade and investment. The treaty benefits included but were not limited to lower tax rates on dividend income and exempted capital gains tax on Indian securities transfers for Mauritius residents.
- 1.2 After India's economic liberalization in 1991, Mauritius became a preferred destination for foreign investments directed towards India owing to the favourable capital gains and dividend tax regime provided under the India-Mauritius treaty. Over the years, investments made via Mauritius have been under the radar of tax authorities and access to treaty has been challenged in numerous cases. In most cases, treaty benefit has been allowed by the Courts\* if Mauritius entity has been issued a valid tax residency certificate by Mauritian authorities.
- 1.3 In order to address potential tax avoidance issues, both the Government of India and the Government of Mauritius amended the India-Mauritius tax treaty by signing a Protocol on May 10, 2016. This Protocol introduced source-based taxation for capital gains on the transfer of shares of Indian companies acquired post March 31, 2017, subject to Limitation of Benefits (LOB).
- 1.4 India adopted the Multilateral Convention to implement tax treaty measures to prevent Base Erosion and Profit Shifting (BEPS). India opted to amend its Double Taxation Avoidance Agreements (DTAAs) through the Multilateral Instrument (MLI)<sup>‡</sup>, including Mauritius in its list for potential revisions. In contrast, Mauritius did not notify its tax treaty with India for the purpose of MLI. Consequently, the India-Mauritius DTAA remained unchanged, unaffected by MLI amendments designed to align with the BEPS framework.
- 1.5 Subsequently, Mauritius announced in a Press release on 10 July 2017, that it would initiate bilateral discussions with its treaty partners, including India, to implement the BEPS minimum standards for DTAAs not covered by the MLI.
- 1.6 Recently, the Mauritius Cabinet approved the signing of a protocol on 23 February 2024, to amend the tax treaty with India, aligning it with the BEPS framework. Following that, on 7 March 2024, India and Mauritius formally signed a Protocol amending the India-Mauritius tax treaty.

#### 2.0 Amendments to the Treaty vide Protocol dated 7 March 2024

- 2.1 The Protocol includes the following amendments:

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\* CBDT Circular No. 789 dated 13.04.2000 upheld by the Supreme Court in case of UOI vs. Azadi Bachao Andolan [2003] 263 ITR 706 (SC) supported by Press Release dated 01.03.2013.

‡ The Multilateral Instrument (MLI) was introduced as part of the OECD's Base Erosion and Profit Shifting (BEPS) project, which included 15 Action Plans. Action Plan 15 deals with Multilateral Convention ('MLI') to implement tax treaty related measures to prevent BEPS. India and Mauritius are signatories to MLI.

- (a) replacing the Preamble of the tax treaty,
- (b) inserting a new Article 27B regarding limitations on entitlement to treaty benefits in accordance with the Principal Purposes Test ('PPT') under Article 7 of the MLI for Prevention of Treaty Abuse, and
- (c) date of entry into effect for the Amended Treaty provisions

A brief discussion of the aforementioned potential amendments are as under:

## **2.2 Article 1 - Preamble of the DTAA replaced.**

Treaty's existing Preamble has been revised by omitting the phrase "for the encouragement of mutual trade and investment" and replacing it by "without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the Convention for the indirect benefit of residents of third jurisdictions)".

## **2.3 Article 2 - Insertion of a new Article 27B regarding limitations on entitlement to treaty benefits in accordance with the PPT under Article 7 of the MLI for prevention of treaty abuse.**

Under the newly inserted Article 27B, the grant of benefit under the Convention may be withheld in respect of any item of income if it is reasonably concluded that obtaining the benefit is one of the principal purposes of the arrangement or transaction that resulted directly/ 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 would be allowed.

## **2.4 Article 3 - Date of entry into effect.**

India and Mauritius will inform each other upon completing the necessary procedures as per their respective local laws to enact the Protocol. The Protocol shall come into effect on the later of such dates of these notifications. Additionally, the provisions of the Protocol shall apply from the date it enters into force, regardless of the date taxes are imposed or the taxable years to which the taxes pertain.

## **3.0 Our Comments**

- 3.1 With the above amendment, the Indian Mauritius treaty has been aligned with the proposals of OECD and BEPS minimum standards. The amendment marks a shift from promoting bilateral investment flows to deterring tax evasion, with a focus on preventing non-taxation or reduced taxation through tax avoidance strategies. The inclusion of the PPT in the agreement empowers tax authorities to deny treaty benefits if the one of the principal purposes of a transaction was to obtain a tax benefit.
- 3.2 These amendments emphasize the countries' commitment to combat tax avoidance and ensure transparency in cross-border transactions. It is believed that these amendments are intended to discourage tax avoidance, but there are still some areas of ambiguity, particularly regarding the applicability of the new rules.
- 3.3 The Protocol aims to prevent tax evasion by ensuring that treaty benefits are only granted for

transactions with a genuine purpose. However, the application of the PPT to grandfathered investments remains unclear, necessitating explicit guidance from the Central Board of Direct Taxes ('CBDT').

- 3.4 As the Article 3 of the Protocol provides for effect of the Protocol from the date the Protocol enters into force, regardless of when the taxes are imposed or the tax years they pertain to, it is unclear if the Protocol may also have a retrospective effect, unlike previous amendments, which could impact investments made before 1 April 2017 which are otherwise subject to grandfathering benefit.
- 3.5 It is worth mentioning that the CBDT issued a message on X (Twitter) on 12 April 2024, addressing concerns regarding the treaty amendment, possibly to alleviate investor apprehensions. It was also clarified that the Protocol is pending ratification and assured that any queries would be addressed as needed.

For further information please contact:

RSM Astute Consulting Pvt. Ltd.

8th Floor, Bakhtawar, 229, Nariman Point, Mumbai - 400021.

T: (91-22) 6108 5555/ 6121 4444

F: (91-22) 6108 5556/ 2287 5771

E: [emails@rsmindia.in](mailto:emails@rsmindia.in)

W: [www.rsmindia.in](http://www.rsmindia.in)

Offices: Mumbai, New Delhi - NCR, Chennai, Kolkata, Bengaluru, Surat, Hyderabad, Ahmedabad, Pune, Gandhidham, Jaipur and Vijayanagar.



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This Newsflash summarizes on the potential amendments in India-Mauritius tax treaty. It may be noted that nothing contained in this newsflash should be regarded as our opinion and facts of each case will need to be analyzed to ascertain applicability or otherwise of the said judgement and appropriate professional advice should be sought for applicability of legal provisions based on specific facts. We are not responsible for any liability arising from any statements or errors contained in this newsflash.

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