



## Protocol amending the India-Mauritius Double Taxation Avoidance Agreement (DTAA)

*The more than decade-long negotiations between India and Mauritius over the existing bilateral tax treaty have now come to an end following the signing of a Protocol by both states on 10<sup>th</sup> May 2016.*

### Background

The India-Mauritius DTAA was executed by the two Contracting States on 24<sup>th</sup> August 1982 and entered into force in Mauritius on 1<sup>st</sup> July 1983. A protocol (the “Protocol”) amending the DTAA was signed by both states on 10<sup>th</sup> May 2016 ahead of the implementation of the Indian General Anti-Avoidance Rules on 1<sup>st</sup> April 2017. The Protocol is yet to be ratified by both Contracting States and has not yet come into effect.

The key change brought about by the Protocol is the amendment to Article 13 “Capital Gains” whereby the taxing rights on capital gains (CG) will lie with India as from 1<sup>st</sup> April 2017. Presently, CG on the disposal of shares of an Indian company held by a company resident in Mauritius are only taxable in the residence country i.e. in Mauritius where there is no CG tax.

A phase-wise approach has been proposed for the shift from the residence-based taxation to the source-based taxation, through the implementation of (i) a grandfathering provision for investments acquired prior to 1<sup>st</sup> April 2017 and (ii) a 2-year transition period from 1<sup>st</sup> April 2017 to 31<sup>st</sup> March 2019 when Mauritian companies will benefit from a reduced tax rate on CG subject to meeting the conditions of a newly introduced “Limitation of Benefits” clause.

The other salient change was made to Article 11 of the DTAA with the introduction of withholding tax of 7.5% on the interest arising on debt claims/loans made by Mauritian resident banks to Indian companies after 31<sup>st</sup> March 2017.

### Main Highlights of the Protocol

#### Article 4 – Taxation of capital gains on shares

##### Taxing Rights

Article 13 of the current DTAA will be amended such that as from **1<sup>st</sup> April 2017**, CG arising from disposal of shares of Indian companies will be taxable in India (source-based taxation).

##### Grandfathering provision

Investments acquired in India before **1<sup>st</sup> April 2017** will be unaffected by the Protocol and will be subject to the provisions prevailing under the current DTAA. In other words, capital gains arising on such investments will be taxed in the investors’ country of residence i.e. Mauritius where there is no capital gains tax.



## Transition Period

During the period **1<sup>st</sup> April 2017 to 31<sup>st</sup> March 2019**, any CG generated on the sales of investments acquired after **1<sup>st</sup> April 2017**, will benefit from 50% tax reduction on the Indian domestic tax rate (Reduced Tax Rate), subject to the fulfillment of the conditions of the Limitation of Benefits (LOB) article (see below).

As from **1<sup>st</sup> April 2019**, full domestic Indian tax rate will apply.

Capital Gains tax rates currently applicable in India are tabled below:

Shares	Gains	Market	Investment in shares acquired before 1 April 2017	During Transition Period Capital Gains on investments acquired after 1 April 2017 (50% of domestic rate subject to LOB)	Post Transition Period Capital Gains on investments acquired after 1 April 2017	
Listed	Short Market	On Market	Grandfathered	8.11%	16.22%	
		Off Market		For FPI – 16.22% For Non-FPI – 21.63%	For FPI – 32.45% For Non-FPI – 43.26%	
	Long Market (if shares sold after 12 months)	On Market		Exempt under domestic law subject to Securities Transaction Tax		
		Off Market		5.41%	10.82%	
Unlisted	Short Term			For FPI – 16.22% For Non-FPI – 21.63%	For FPI – 32.45% For Non-FPI – 43.26%	
	Long Term (if shares sold after 24 months)			N/a	10.82%	

## Limitation of Benefits(LOB)

During the transition period, a Mauritian resident will benefit from the Reduced Tax Rate provided that:

- It satisfies the main purpose and bona fide business test; and
- It is not a shell/conduit company

A Mauritian company will be deemed **not** to be a shell/conduit company provided that:

- It is listed on a recognized stock exchange in Mauritius\*; or
- It has incurred local operating expenses of not less than INR 2.7m / Mauritian Rupees 1.5m (circa USD 43k) in the immediately preceding period of 12 months from the date the gains arise.

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## Article 2 - Source-based taxation of interest income

According to the Article 2 of the Protocol, withholding tax not exceeding 7.5% will be introduced on interest arising in India. This implies that any interest arising in India and payable to Mauritian residents, which is currently taxed at domestic rates in the source country, will now benefit from a capped reduced rate.

Interest arising on debt claims or loans contracted with Mauritian resident banks, currently exempted from withholding tax under the current DTAA, will now be taxed at 7.5% as from 1<sup>st</sup> April 2017. Any interest arising on debt claims or loans contracted with Mauritian resident banks prior to **31<sup>st</sup> March 2017** will remain exempted from tax in India.

## Other Updates:

Protocol	India-Mauritius DTAA	Salient Changes
Article 1	Article 5 – Permanent Establishment	Definition of Permanent Establishment (PE) has been extended to include: “(j) the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only where activities of that nature continue (for the same or connected project) for a period or periods aggregating more than 90 days within any 12-month period.”
Article 2	Article 11 – Interest	As detailed above.
Article 3	Article 2	New article inserted in DTAA. It relates to the introduction of withholding tax of 10% on fees for Technical Services.  Technical Services performed through PE will be exempted.
Article 4	Article 13 – Capital Gains	As detailed above.
Article 5	Article 22 – Other Income	Other income arising in the other Contracting state and not covered under the DTAA may also be taxed in the other State.  Under the current DTAA, other such income is taxed in the country of residence.
Article 6	Article 26 – Exchange of Information or Document	Article 26 has been amended in lines with the prevailing international standards.
Article 7	Article 26A – Assistance in the Collection of Taxes	New article inserted in DTAA. It relates to mutual assistance to be provided by contracting states in relation to the collection of revenue claims.



Protocol	India-Mauritius DTAA	Salient Changes
Article 9	This Article provides guidance on the entry into force of the Articles of the Protocol.	<p><u>Articles 1,2,3,5 and 8:</u></p> <p>(a) in the case of India, in respect of income derived in any fiscal year beginning on or after 1 April next following the date on which the Protocol enters into force;            (b) in the case of Mauritius, in respect of income derived in any fiscal year beginning on or after 1 July next following the date on which the Protocol enters into force.</p> <p><u>Article 4:</u>            Effective in both Contracting States for assessment year 2018-19 and subsequent assessment years.</p> <p>The Protocol will enter into force once it has been ratified by both Contracting States.</p>

## Other Observations

### Protocol v/s General Anti-Avoidance Rules (GAAR)

The GAAR is an anti-abuse provision and will be implemented on 1<sup>st</sup> April 2017. The GAAR will be invoked in cases where tax treaties are misconstrued and misused for gaining tax benefit unduly. In such instance, the provisions of a DTAA would not be available to a taxpayer.

A comparison of the Protocol and GAAR has been tabled below:

	Protocol	GAAR
Grandfathering provisions for existing investments	<b>Yes:</b> All investments acquired before 1 <sup>st</sup> April 2017 will be unaffected by Protocol. Capital gains arising on the disposal of shares held in Indian companies will be taxed in the investors' country of residence i.e. in Mauritius where there is no capital gains tax	<b>Yes:</b> All investments existing as at the date of the commencement of the GAAR will be grandfathered and GAAR provisions will not be invoked for examination or denial of tax profits.  This was confirmed by Minister of Finance, Arun Jaitley in his budget last year.
Taxing Rights on Capital Gains	<b>No:</b> As from 1 <sup>st</sup> April 2017, taxing rights on Capital Gains will be transferred to India. A reduced tax rate will be applied on Capital Gains subject to the fulfillment of the conditions of the Limitations of Benefits clause.	<b>Yes:</b> Mauritius would retain the taxing rights on Capital Gains subject to the Bona Fide Business and Main Purpose test.  In addition, there is a sharing of taxing rights subject to a Limitation of Benefits article.

## Impact on the India-Singapore DTAA

Article 6 of the protocol dated 18 July 2005 amending the India-Singapore DTAA provides that the provision relating to capital gains tax is co-terminus with the akin provision in the India-Mauritius DTA.

Therefore, the amendments brought to Article 13 of the India-Mauritius DTAA will nullify the CG clause in the India-Singapore protocol. Capital gains arising to Singapore residents from the sale of shares of an Indian Company will be treated under the original India-Singapore DTAA dated 24<sup>th</sup> January 1994.

## Concluding Remarks

The signing of the Protocol will indubitably dispel doubts and speculations regarding uncertainties that hovered over the India-Mauritius DTAA for the past years. Whilst the grandfathering provision is a welcome move and will protect all investments made prior to 1<sup>st</sup> April 2017, the Protocol is likely to have a significant impact on inbound investments in India. Investors are therefore strongly recommended to seek expert advice on their existing structures to assess the need for any restructuring.

Also, it appears that investments made through hybrid instruments or instruments other than shares will still be eligible to claim residence-based taxation as the Protocol only makes reference to the taxing rights on “shares”.

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