THE END OF THE NEGOTIATION: PROTOCOL TO INDIA-MAURITIUS TAX TREATY FINALLY RELEASED

Authors
Anurag Jain
Parul Jain

Tags
Capital Gains
Exchange of Information
India
Mauritius
Tax Treaties

Anurag Jain and Parul Jain are partners in the Corporate Tax Practice of BMR & Associates LLP, where they advise a number of Fortune 500 multinationals and private equity and venture capital firms with respect to investments in India.

The Mauritius government has released the text of a protocol seeking to amend the India-Mauritius tax treaty (the "Protocol" and "Mauritius Tax Treaty," respectively). While a press release[1] issued by the Indian government on May 10, 2016 details some of the key amendments,[2] the Protocol itself provides for significant additional amendments, which are addressed in this article. The Protocol will come into force once each governments has notified the other that it has completed the procedures required by its respective laws.

ARTICLE 1 – SERVICE P.E. CLAUSE

Article 1 of the Protocol amends Article 5 of the Mauritius Tax Treaty. Article 5 provides that only business profits attributable to a Permanent Establishment ("P.E.") located in the other contracting state can be taxed by that other state. The amendment pursuant to the Protocol provides that services furnished through employees or other personnel would also constitute a P.E. in the source state of the enterprise rendering services, where activities of that nature continue (for the same or connected project) for an aggregate of more than 90 days within any 12-month period.

This is commonly referred to as a service P.E. clause. A service P.E. clause is not included in the O.E.C.D. Model Tax Convention on Income and on Capital (the "O.E.C.D. Model Treaty"). However, it is expressly promoted by the U.N. Model Double Taxation Convention (the "U.N. Model Treaty"). The service P.E. caluse was included in a number of tax treaties concluded by India, including the treaties with the U.S., the U.K., and Singapore. While some of India's tax treaties (*e.g.*, the foregoing treaties) specifically carve out certain technical services from the service P.E. clause, no such exception was provided under the Protocol. In that sense, the service P.E. clause added to the Mauritius Tax Treaty is similar to the service P.E. clause included in tax treaties by India with Iceland, Georgia, Mexico, and Nepal.

With increasing mobility of employees in multinational organizations, the service P.E. clause has been a matter of dispute in a number of cases where employees are sent on secondment or deputation.

It is important to note that the language added in the Protocol does not explicitly limit the application of the service P.E. clause to services provided "within a contracting state." The potential implication is that the source state could assert the existence

---

1 See "India-Mauritius Tax Treaty Re-negotiated – Indian Government Issues Press Release," *BMR Edge*, 5.2 (2016).

2 *E.g.*, the amendment to the source-based taxation of capital gains on disposition of shares, including the transitional benefits and the applicability of the Limitation of Benefits ("L.O.B.") article.

of a service P.E., even if services are rendered entirely outside that state, if they are performed by the relevant employees or personnel and meet the time threshold.

In 2008, the O.E.C.D. added paragraphs 42.11 to 42.48 to the commentary on Article 5 of the O.E.C.D. Model Treaty. These paragraphs discuss the taxation of services performed in the territory of a contracting state and provide that these services will not be taxed in that state if they are not attributable to a P.E. situated therein. Simultaneously, India expressed its position that it reserves a right to treat an enterprise as having a service P.E. without specifically including the words "within a contracting state." Hence, this omission seems to be in line with the position taken by India on the O.E.C.D. commentary and could even expose taxpayers without any physical presence to net income taxation in the source state and the resultant challenges.

ARTICLE 2 – TREATMENT OF INTEREST INCOME

Article 2 of the Protocol amends Article 11 of the Mauritius Tax Treaty, pertaining to taxability of interest income. The relevant changes are summarized below:[3]

Existing Provisions	Amended Provisions
• Interest arising in India and paid to a Mauritius resident could be taxed in India, according to its domestic tax law, without any ceiling on the tax rate. • Interest derived and beneficially owned by a Mauritius bank that carries on a *bona fide* banking business is exempt from tax in India.	• Interest arising in India and paid to a Mauritius resident can be taxed in India, according to its domestic tax law. However, if the Mauritius-resident payee is the beneficial owner of the interest, Indian tax shall not exceed 7.5% of the gross interest. • The exemption available to Mauritius banks is only available with respect to loans outstanding on or before March 31, 2017.

Limiting the tax rate applicable in the state of source, and the requirement that interest be "beneficially owned" by a resident of the other state, is in line with O.E.C.D. Model Treaty and the U.N. Model Treaty. Further, most tax treaties entered into by India provide similar benefits.

Under the current Mauritius Tax Treaty, interest income on instruments such as mandatory convertible debentures, non-convertible debentures, or loans issued by a Mauritius entity to a resident of India is subject to tax, with no limitation, at 40% in many cases, and a beneficial rate of 20% or 5%, in specific cases. Therefore, this amendment is certainly a welcome change, which provides the Mauritius Tax Treaty an edge above other treaties to which India is a party. This includes the treaties with Singapore, Cyprus, and the U.S., where the applicable tax is limited to 10% or 15%, as the case may be.

---

[3] The current Mauritius Tax Treaty (and the amended version pursuant to the Protocol) includes corresponding provisions for interest arising in Mauritius and paid to an Indian resident. However, for the sake of simplicity, this table refers to interest arising in India and paid to a Mauritius resident.

ARTICLE 3 – FEES FOR TECHNICAL SERVICES

While Article 12 of the Mauritius Tax Treaty provides for the treatment of royalties, unlike many other treaties to which India is a party, the Mauritius Tax Treaty did not include a provision discussing the tax treatment of Fees for Technical Services ("F.T.S."). Article 3 of the Protocol amends the Mauritius Tax Treaty and adds a new article, 12A, which provides for the tax treatment of F.T.S. Generally, Article 12A provides the following:

- Both the country of residence and the country of source have the right to tax F.T.S.
- The rate of tax in the source country is limited to 10% of the gross amount of the F.T.S., if the beneficial owner of the payment is a resident of the other contracting state.
- The definition of F.T.S. generally covers consideration paid for managerial, technical, or consultancy services, including the provision of services of technical or other personnel.

"In the event that income is paid with respect to managerial, technical, or consultancy services rendered by a Mauritius entity for a period of less than 90 days, the income would be taxed pursuant to the provisions of Article 12A."

The provisions of Article 12A are similar to the F.T.S. article included in other treaties to which India is a party. It is pertinent to note that neither the O.E.C.D. Model Treaty nor the U.N. Model Treaty provide a separate article discussing the treatment of F.T.S. In the absence of a separate article dealing with F.T.S., such income would typically not be taxed in the source state, unless the payee has a P.E. in that state. Pursuant to this change, F.T.S. income paid by an Indian resident to a resident of Mauritius would now be subject to tax in India.

Note that Article 12A does not include "make available" criteria in the definition of "included services," as is found in the treaties between India and the U.S., the U.K., and Singapore. This effectively expands the scope of taxable F.T.S. income to be on par with domestic Indian tax law.

To summarize, in the event that income is paid with respect to managerial, technical, or consultancy services rendered by a Mauritius entity for a period of less than 90 days, the income would be taxed pursuant to the provisions of Article 12A. Income arising from the rendering of all types of services for a period exceeding 90 days would be taxable under Article 7 of the Mauritius Tax Treaty, provided the services are for the same or connected projects.

ARTICLES 4 AND 8 – CAPITAL GAINS TAX EXEMPTION AND THE L.O.B. CLAUSE

With respect to the sale of shares of an Indian company by a Mauritius resident, Article 4 of the Protocol makes the following changes to Article 13 (Capital Gains) of the Mauritius Tax Treaty, effective as of April 1, 2017:

- Gains from the transfer of shares of a company resident in India, which are acquired on or after April 1, 2017, would be subject to tax in India.
- However, the tax rate applicable to gains arising from a sale of shares acquired after April 1, 2017 and sold between April 1, 2017 and March 31, 2019

shall not exceed 50% of the domestic tax rate otherwise applicable to such gains (see also below relating to Article 8 of the Protocol).

Article 8 of the Protocol adds new Article 27A (Limitation on Benefits) to the Mauritius Tax Treaty. The L.O.B. provision limits the availability of benefits under the Mauritius Tax Treaty to avoid treaty shopping and prevent conduit companies from obtaining benefits. The addition of this clause affects the transitional reduction of tax with respect to capital gains.

The new L.O.B. provision includes the following stipulations:

- An entity shall not be entitled to the benefits of the Mauritius Tax Treaty (including the newly inserted concessional capital gains taxation) if the entity's affairs are arranged in the country of residence primarily for the purpose of taking advantage of treaty benefits. This would include entities not having *bona fide* business activities.

- A shell or conduit company shall not be entitled to benefits under the Mauritius Tax Treaty. An entity will be treated as a shell or conduit company if, in the immediately preceding 12 months, it did not incur expenditures on operations in its country of residence of at least 1,500,000 Mauritian rupees or 2,700,000 Indian rupees, as the case may be. However, an entity is deemed not to be a shell or conduit company if it is listed on a recognized stock exchange in its country of residence.

According to Article 9 of the Protocol, Article 8 will be effective in India, for fiscal years beginning on or after April 1 of the year following the date on which the Protocol enters into force. In Mauritius, it will be effective for fiscal years beginning on or after July 1 of the same year. Article 4 of the Protocol (Capital Gains) shall be effective for assessment year 2018-19 and any subsequent assessment years.

The articles dealing with taxation of capital gains arising on sale of shares of an Indian company are in line with what has been stated in theMay 10, 2016 i press release.[4]

There are some open questions regarding the potential interplay between the General Anti-Avoidance Rule ("G.A.A.R.") and tax treaties, as well as the grandfathering of certain treaty benefits with regard to shares acquired after April 1, 2017 as a result of conversion of other instruments. Additionally, it seems that an indirect transfer of shares of a foreign (non-Indian) company whose value is derived substantially from Indian assets may not be subject to tax in India despite the changes made in the Protocol.

ARTICLE 5 – SOURCE RULE FOR TAXATION OF OTHER INCOME

Article 5 of the Protocol amends Article 22 (Other Income) of the Mauritius Tax Treaty to enable taxation in the source country of any "other income" arising in the country.

---

4 For a detailed analysis, see "India-Mauritius Tax Treaty Re-negotiated – Indian Government Issues Press Release."

According to Article 9 of the Protocol, Article 5 will be effective in India for fiscal years beginning on or after April 1 of the year following the date on which the Protocol enters into force. In Mauritius, it will be effective for fiscal years beginning on or after July 1 of the same year.

The amendment to Article 22 changes the rule for taxation of other income, and specifically ushers in "source-based" taxation. This seems to be an all-encompassing provision, which removes a preexisting safe harbor from Indian taxation for all other income derived in India by a Mauritius resident and vice-versa.

ARTICLE 6 – EXCHANGE OF INFORMATION

Article 26 (Exchange of Information) has been replaced to expand its scope. Significant provisions included in the new Article 26 vis-à-vis the existing exchange of information ("E.O.I") provisions are described below:

- In addition to the taxes covered under the treaty, the scope of E.O.I. has been enhanced to include "taxes of every kind and description," insofar as these taxes are not contrary to the provisions of the tax treaty.
- The information exchanged must no longer be "necessary," but it will be sufficient for the information to be "foreseeably relevant" for the purpose of carrying out the provisions of the tax treaty or the enforcement of a domestic law concerning tax.
- Information or documents received under the tax treaty, can also be shared with authorities or persons having "oversight" over the assessment, collection, and enforcement of taxes or prosecution with respect to these taxes or appeals thereof. Information so disclosed can also be used for "other" purposes if permitted by the laws of both states and authorized by the disclosing state. The provision enabling disclosure of information to the person to whom it relates has been deleted.
- The requested state cannot deny collection or disclosure of information on the ground that it does not need such information for its own tax purposes. Further, a requested state cannot decline to supply information solely because the information is held by a bank, other financial institution, nominee, or person acting in an agency or a fiduciary capacity; or because it relates to ownership interests in a person.

Efforts to increase tax transparency and E.O.I. have been gaining global momentum recently. Both Mauritius and India have been actively participating in global forums for E.O.I., are participating in the O.E.C.D.'s Common Reporting Standard ("C.R.S."), and are complying with the U.S. Foreign Account Tax Compliance Act ("F.A.T.C.A.").

Currently, Article 26 of the Mauritius Tax Treaty is being significantly revamped to widen the scope of E.O.I. and bring it on par with the provisions of the O.E.C.D. Model Treaty.

Further, information can also be disclosed to oversight bodies. Oversight bodies include authorities that supervise tax administration and enforcement authorities, as part of the general administration of the government. Neither having a purpose of carrying out the provisions of the tax treaty nor applicability of taxes covered in the tax treaty is a prerequisite for E.O.I. Instead, the Protocol states that E.O.I. shall not be restricted by Article 1 and 2 of the Mauritius Tax Treaty. This has the following potential ramifications:

- Information regarding an individual may be sought from a country, irrespective of whether the person is a resident of the requested country.
- E.O.I. may not be limited to taxpayer-specific information. Countries may also exchange other sensitive information related to tax administration and compliance improvement, *e.g.*, risk analysis techniques or tax avoidance or evasion schemes.

Moreover, under the existing E.O.I. provision, "persons with respect to whom the information or document relates" are specifically entitled to receive the information and documents that are obtained under Article 27. Under the new Article 27, such persons are not expressly mentioned. However, pursuant to the commentary to the O.E.C.D. Model Treaty, information obtained under this article may also be shared with the taxpayer, his/her proxy, or a witness deposed because such person is connected with the assessment or collection of taxes. It will be interesting to see how the Indian Revenue Authorities deal with information they obtain, either by sharing the information with taxpayers under the new Article 27 or refraining from doing so.

ARTICLE 7 – ASSISTANCE IN COLLECTION OF TAXES

In line with the O.E.C.D. Model Treaty and the U.N. Model Treaty, Article 26A (Assistance in the Collection of Taxes) has been added to the Mauritius Tax Treaty. Some of the notable features of the provision are as follows:

- Both countries shall lend assistance to each other in the collection of "revenue claims" arising out of any taxes.
- The term revenue claims refers to the amount owed with respect to taxes of every kind and description (including interest, administrative penalties, and costs of collection or conservancy related to such taxes), insofar as this taxation is not contrary to the provisions of the tax treaty or any other instrument signed by both countries.
- Both countries will be obliged to accept and collect revenue claims of the other country and take measures for conservancy, subject to the fulfillment of certain conditions.
- Revenue claims accepted by a country shall not be subject to time limits or accorded any priority applicable to a revenue claim under the laws of that country or accorded any priority applicable in the other country. No proceedings with respect to the existence, validity, or the amount of a revenue claim can be brought before the courts in the country accepting the revenue claim.

In an era of globalization, traditional approaches towards assistance in the collection of taxes have changed. This change was to some extent influenced by the development of electronic commerce and the concerns about the ability to collect V.A.T. (Value Added Tax) on such activities. The 1998 O.E.C.D. report *Harmful Tax*

Competition: an Emerging Global Issue also highlighted concerns about increased tax evasion, if one country will not enforce the revenue claims of another country. The report thus recommended that:

> Countries be encouraged to review the current rules applying to the enforcement of tax claims of other countries and that the Committee on Fiscal Affairs pursue its work in this area with a view to drafting provisions that could be included in tax conventions for that purpose.

As a result of these concerns, the O.E.C.D. Council approved the inclusion of a new Article 27 on assistance in tax collection in the 2003 update of the O.E.C.D. Model Treaty. The new Article 26A is in *pari materia* with Article 27 of the O.E.C.D. Model, and thus, it may help the Indian government to recover tax dues from willful defaulters. India has also inserted a similar provision for assistance in collection of taxes in recent tax treaties with Sri Lanka, Fiji, Bhutan, Albania, Croatia, Latvia, Malta, Romania, and Indonesia. Further, the tax treaties with the U.K. and Poland have been amended to insert an article of this nature.

"This is a landmark move by the Modi-led government, which finally claims victory over long-drawn treaty negotiations that have lasted several years."

Both India and Mauritius have also signed the Convention on Mutual Administrative Assistance in Tax Matters. Moreover, similar to the new Article 26, assistance in collection of taxes is not restricted by Article 1 and 2 of the tax treaty.

CONCLUSION

This is a landmark move by the Modi-led government, which finally claims victory over long-drawn treaty negotiations that have lasted several years. Taking a myopic view, as a result of the Protocol and the additional tax cost for Mauritian investors, Mauritius may lose its sheen as a preferred jurisdiction for investments into India. However, a broader view reveals that foreign investors are likely to welcome the certainty of the new tax regime and the lack of retroactive taxing provisions with respect to capital gains, as evidenced by the grandfathering rules.

The Indian government has been wise to grandfather investments made before April 1, 2017 and to align this date with the proposed introduction of G.A.A.R. Albeit, the interplay of the L.O.B. clause and G.A.A.R. is still unclear. The addition of two-year transitional provisions with respect to the taxation of capital gains is another welcome step. Other major changes provided in the Protocol are in line with the O.E.C.D. Model Treaty and with recent tax treaties entered into by India. This, therefore, makes the existing Mauritius Tax Treaty more robust while re-emphasizing the importance of Mauritius as a source of investments into India.

The only loose thread seems to be the fate of the capital gains exemption under the India-Singapore tax treaty (the "Singapore Tax Treaty"). From media reports, it appears that the Indian government may soon initiate negotiations with its Singaporese counterparts. With Singapore overtaking Mauritius as the largest source of foreign direct investment in 2015,[5] the Indian government would be well-advised to bilaterally negotiate the Singapore Tax Treaty well in time, in order to provide a level playing field for investments made from Singapore and those made from Mauritius.

---

5 Department of Industrial Policy & Promotion, "Fact Sheet on Fact Sheet on Foreign Direct Investment (FDI), from April, 2000 to December, 2015."

Disclaimer: *This newsletter has been prepared for informational purposes only and is not intended to constitute advertising or solicitation and should not be relied upon, used, or taken as legal advice. Reading these materials does not create an attorney-client relationship.*