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CBDT issues press release towards protocol for amendment of the Double Taxation Avoidance Agreement between India and Mauritius

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The Central Board of Direct Taxes ('CBDT'), has issued a press release dated May 10, 2016, towards Protocol for amendment of the Convention, for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains, between India and Mauritius ("India Mauritius DTAA").

Background

Under the bilateral agreement existing between the two nations, capital gains from sale of shares can be taxed only in the place where the alienator (holder of the shares) is resident. Consequently, capital gains on sale of Indian shares by Mauritius entities are taxable only in Mauritius as per the DTAA, and as Mauritius generally does not levy capital gains tax, there is no capital gains tax on such transactions - this lead to structuring of investments into India through Mauritius (to avail the benefit of double non-taxation on exit) and also round-tripping of funds to India from Mauritius. India has been attempting to renegotiate the DTAA between India and Mauritius for many years.

Press Release

Source-based taxation of capital gains on shares

- With this Protocol, India gets taxation rights on capital gains arising from alienation of shares **acquired on or after April 1, 2017** in a company which is resident in India. Further, protection to investments in shares acquired before April 1, 2017 has also been provided.
- In respect of such capital gains arising during the transition period from April 1, 2017 to March 31, 2019, the tax rate will be limited to 50% 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 full domestic tax rate will be applicable for capital gains arising from April 1, 2019 onwards.

LOB

- The benefit of 50% reduction in tax rate during the transition period from April 1, 2017 to March 31, 2019 shall be subject to LOB Article, whereby a resident of Mauritius (including a shell / conduit company) will not be entitled to benefit of 50% reduction in tax rate, if it fails the main purpose test and bonafide business test.
- A resident would be deemed to be a shell/ conduit company, if its total expenditure on operations in Mauritius is less than Rs. 2,700,000 (Mauritian Rupees 1,500,000) 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% in respect of debt claims or loans made after March 31, 2017. Similar to capital gains tax exemption till March 31, 2017, interest income of Mauritian resident banks in respect of debt-claims existing on or before March 31, 2017 shall be exempt from tax in India.

Strengthening Exchange of Information

- The Protocol also provides for updation of Exchange of Information Article as per international standard, provision for assistance in collection of taxes, source-based taxation of other income, amongst other changes.

The CBDT has clarified that the Protocol is intended to tackle long pending issues of treaty abuse and round tripping of funds attributed to the India Mauritius DTAA, 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.

Comments

While we are still waiting for the final Protocol to be notified (only the press release is available at this stage), it is clear that India has attempted to address long standing issues of treaty abuse and round tripping of funds. One big positive is that there will be no retroactive impact as investments made prior to April 1, 2017 have been 'grandfathered' – this is in line with the Government's commitment to have a stable and predictable taxation regime (even provisions like general anti-avoidance rules have been made applicable only prospectively from April 1, 2017).

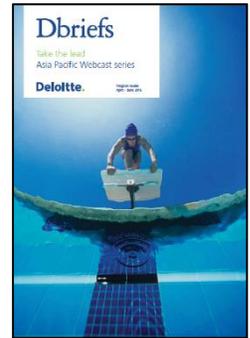
This amendment would have ramifications, for investments into India from Singapore, as the benefits of residence-based taxation of capital gains, on sale of shares under the India Singapore DTAA, are linked to the India Mauritius DTAA.

All in all, the amendment is in line with India's commitment to the base erosion and profit shifting ('BEPS') initiative and strong intent to curb the menace of double non-taxation. One would have to examine the fine print in the final protocol (once it is released), especially since certain terms such as 'main purpose test', 'bonafide business test', etc., have not been defined in the press release, to assess the full impact of this amendment.

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Contacts

Ahmedabad

19th Floor, Shapath –V
S.G.Highway
Ahmedabad-380015
Gujarat-India
Tel: + 91 (079) 66827300
Fax: + 91 (079) 66827400

Bangalore

Deloitte Centre, Anchorage II,
100/2, Richmond Road,
Bangalore 560 025.
Tel: +91 (080) 6627 6000
Fax: +91 (080) 6627 6010

Chennai

No.52, Venkatanarayana Road,
7th Floor, ASV N Ramana Tower,
T-Nagar,
Chennai 600 017.
Tel: +91 (044) 6688 5000
Fax: +91 (044) 6688 5050

Coimbatore

Shanmugha Manram
41, Race Course,
Coimbatore
Tamil Nadu - 641018
Tel: + 91 (0422) 439 2801
Fax: +91 (0422) 222 3615

Delhi/Gurgaon

Building 10,
Tower B, 7th Floor,
DLF Cyber City,
Gurgaon 122 002
Tel : +91 (0124) 679 2000
Fax : + 91 (0124) 679 2012

Hyderabad

1-8-384 and 385, 3rd Floor,
Gowra Grand S.P.Road,
Begumpet,
Secunderabad – 500 003.
Tel: +91 (040) 6603 2600
Fax: +91 (040) 6603 2714

Kolkata

Bengal Intelligent Park Building Alpha,
1st floor, Block EP and GP Sector V,
Salt Lake Electronics Complex,
Kolkata - 700 091.
Tel : + 91 (033) 6612 1000
Fax : + 91 (033) 6612 1001

Mumbai

Indiabulls Finance Centre,
Tower 3, 28th Floor,
Elphinstone Mill Compound,
Senapati Bapat Marg, Elphinstone (W),
Mumbai – 400013
Tel: + 91 (022) 6185 4000
Fax: + 91 (022) 6185 4101

Pune

106, B-Wing, 7th Floor,
ICC Trade Tower,
Senapati Bapat Road,
Pune – 411 016.
Tel: + 91 (020) 6624 4600
Fax: +91 (020) 6624 4605

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