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DOUBLE TAXATION AVOIDANCE TREATY AMENDED

BACKGROUND

As per the existing India - Mauritius Double Taxation Avoidance Treaty ("**India-Mauritius Treaty**"), capital gains derived by a Mauritius resident through sale of shares of an Indian company has been subject to capital gains tax only in Mauritius and not in India. Given the fact that the rate of capital gains tax in Mauritius is barely marginal, it encouraged global investors including foreign portfolio investors (FPI) and foreign entities to route their investments in India through Mauritius. This discrimination between the local investors (who are liable to pay capital gains tax) and overseas investors coming through Mauritius (who were exempt from such taxation) deprived the Indian Government of significant tax revenues.

In order to curb revenue loss, the Government of India and the Government of Mauritius have signed a Protocol on May 10, 2016, the brief overview of which has been provided below.

KEY AMENDMENTS OF PROTOCOL:

Source-based taxation of capital gains on shares:

Period	Capital Gains Tax
Investments made until March 31, 2017	Exempted
Sale or transfer of shares of an Indian company acquired by a Mauritian tax resident on or after 1st April, 2017	Taxable in India at discounted rate
Between transition period of April 1, 2017 to March 31, 2019	50% discount on the domestic tax rate subject to Limitation of Benefits.
Investments beginning April, 2019	Full domestic rates will apply

Limitation of Benefits:

- The reduced tax rate during the transition period shall not be available if a resident of Mauritius (including a shell/conduit company) "fails the main purpose test and the bonafide test.
- A resident shall be deemed to be a shell/conduit company, if its total expenditure on operations in Mauritius is less than Rs. 2,700,000 (Mauritius Rupees 1,500,000) in the immediately preceding months".

- This would ensure that the beneficial tax treatment shall be available only to Mauritius residents who have a substantial (and not merely formal) presence in that jurisdiction.

Source-based taxation of interest income of banks:

Interest income arising in India to Mauritian resident banks will be subject to withholding tax in India

Period	Tax Rate
In respect of debt claims or loans made after 31st March, 2017	7.5%
In respect of debt-claims existing on or before 31st March, 2017	Exempt from tax in India

ARA LAW View

The Protocol has addressed the issue of round tripping of funds thereby preventing double non - taxation and streamlining the flow of investment between India and Mauritius. However, the protocol shall impact all the prospective investments with effect from April 1, 2017. There are discussions going round in the industry in parallel that Netherlands may emerge as an alternative investment hub for global investors including FPIs as the India - Netherlands DTAA provides that in case a company based in Netherlands holds less than 110% equity in an Indian entity, it would not attract capital gains on the sale of those shares to residents or non-residents. Even if it were to own more than 10% equity in an Indian company, the India - Netherland treaty allows it to sell the shares to a non-resident without attracting tax. Now that that benefit under the Mauritius Treaty is falling away, it will automatically bring to an end the benefits under the Singapore Treaty. However, it is not clear whether the Singapore Treaty benefits would terminate at once, and that too without prospective effect. These issues will surely be the subject matter of great debate and interpretation in the days and weeks to come.

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