Indo-Mauritius tax talk: No need to press the panic button

There have been talks in media that the Mauritius government has agreed to restart talks of revising the Double Taxation Avoidance Agreement (DTAA) treaty with India and both the countries are expected to meet soon to discuss the issue, reports CNBC-TV18. Following these reports, stock investments from the latter country are under pressure.

More than 40% of India's total foreign direct investments (FDIs) come in from Mauritius. Siddharth Shah, head of corporate and securities practice at Nishith Desai Associates, said that it is too early to press the panic button. "Mauritius renegotiating tax treaty is not confirmed yet. However, it is wiling to discuss concerns regarding the treaty."

As per the DTAA treaty, a Mauritian company is exempted from tax in India. Of late, the UPA government has been slammed by civil society and opposition for its failure to act against black money and tax evasion.

HP Ranina, Corporate Tax Lawyer, said, “We have to wait and watch whether Mauritius agrees to allow India to tax the capital gains as today the main advantage of going to Mauritius is that the capital gains are not taxable in India even though the shares are situated in India.”

Below is a verbatim transcript of their interview with CNBC-TV18's Udayan Mukherjee and Mitali Mukherjee. Also watch the accompanying video.

Q: What have you heard about this relook in terms of tax treaty between India and Mauritius and what kind of impact it may have in terms of investments coming into India from that country?

Ranina: We have to wait and watch whether Mauritius agrees to allow India to tax the capital gains as today the main advantage of going to Mauritius is that the capital gains are not taxable in India even though the shares are situated in India. So, we have to wait and watch whether Mauritius give in to that. The Indian government is very keen that the capital gain should be made liable to tax in India. The second issue is even if they agree whether it will have prospective effect that is after the treaty is changed or whether it will also cover existing investments that will have to be seen once the agreement is finalised.

Q: Any sense you have of how this thing might be resolved because this has been simmering for a while now and the Indian government’s position is known but any in-between solution that you see being struck here?

Ranina: As I say the only in-between solution which I can see is that even if Mauritius gives in and agrees that the capital gain should be taxed in India, they will insist that it will be done prospectively that is only for those companies which enter into transactions a year after or which registered as resident companies in Mauritius after the treaty is amended. So that could be the only sort of solutions if Mauritius wants to retain whatever investments it already has.

Q: So in such rulings or such decisions, would there be prospective as you are saying with a sunset clause of one year or so within which there could be some adjustments made in holdings from Mauritius?

Ranina: Yes. This is a type of adjustment which could be made and that why there is time which has taken in negotiating this treaty. Mauritius, of course, is also used as a route because it’s more convenient to have multi-jurisdiction investments so possibly Mauritius will still continue to be used even after treaty is amended, not only apart from the fact that there is tax saving is no longer available, but it will still continue to act as a route. However, I think Mauritius wants to save the tax and make it still entitle to exemption that is now what Indian Government is resisting.

Q: The FDI figure is fairly well-known, at 40% of FDI coming in from the Mauritius route, any sense right now of how large the FII exposure coming in from there is into the Indian equity market?

Ranina: I don’t know the exact figure but substantial amount of FII investment is certainly coming in from the Mauritian route. I also want to mention that outgoing FDI is also going through the Mauritian route. So, many Indian companies which are investing outside India, are also using Mauritius as a route for the same reason. So it’s not only for incoming FDI but also for outgoing FDI which is using the Mauritius route.

Q: There is another important clarification that is talked about which is that this tax is not just for companies which are based or domiciled in Mauritius but also money that is routed through Mauritius. That increases the ambit greatly, does it not?

Ranina: Yes, that’s exactly what I am saying, routed through Mauritius for those who want to invest abroad. I would also to say that if the Mauritian treaty is to be revisited then even Cyprus will have to be revisited because Cyprus also has a similar rule where capital gains are not taxable in India though the shares located in India. So, Mauritian is not the only treaty which gives this benefit, even Cyprus gives similar benefit.

Q: Are you aware at this point whether a final decision has been taken on this or is it just a process of dialogue which is started because the reaction in the market is quite extreme today?

Ranina: Yes, there is a dialogue. We don't know whether it's reaching finality but I have no information how soon it will be actually inked.

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Q: You track these issues (tax treaty talks) quite closely. Are you privy to any such decision that has been taken on the Mauritian treaty or is the government close to it?

Shah: I think its something which seems to be creating ripples around, but our sources suggests that yes, Mauritius government is open to discussing about issues arising out of the treaty but renegotiation is not something that has been confirmed, according to our sources, by any of the Mauritian authority. So it is essentially trying to address the concerns that the Indian government may have with regard to the treaty, especially on the round tripping and a lot of those issues which have been coming up on the air. But I think it's not as simple as put about renegotiating the tax treaty because that's not something, in our assessment, that the government is likely to engage in at this point.

Q: Any such decision which comes would probably come with prospective effect and not retrospective effect. So how do you explain the kind of selling that's going on for fear of such a decision coming in the market today?

Shah: It's quite unfortunate in terms of the statements being made and I think somewhere along the line, at least our understanding is, it could possibly lead to unnecessary panic in the market. I think government officials making statements on this. Our understanding is any change in the treaty or renegotiation of a treaty between two states, an exercise which would be extended for months and sometimes years together. So it's not time to press the panic button and second, it's really something in the form and shape in which it is renegotiated. From that perspective, I would say it is premature today to press a panic button on this.

Q: Indications are though that aside from the tax rate itself or looking at any potential capital gains, it's also an information sharing deal that India is seeking to strike. Perhaps prospective, not so much retrospective, but do you think its that information clause as well that it is causing some nervousness because of well-known allegations about round tripping, etc?

Shah: To clarify, India has entered into an exchange of information treaty at least a couple of years back, so it's not something which is new. In fact, the CBDT and the revenue authorities in Mauritius have been collaborating on cases where they suspect round tripping. And to that extent, Mauritius has been extending complete cooperation to the Indian authorities. So it's not a new renegotiation or new negotiation of information sharing. And in fact, Mauritius as we understand have always been forthcoming in terms of sharing data if there is a situation of investigation of round tripping. So it's something which has been in existence for a while under the treaty already.

Q: There is a fear though, that because of the entire civil society movement and the pressure there is right now on black money perhaps India will have to push much harder this time in terms of getting some kind of tax treaty through. Is that what you are picking up, that India is pushing much harder even if Mauritius maybe unwilling, there is some kind of resolution that will have to be sort?

Shah: Yes, in the sense I am sure there is lot of pressure on the government. But one fundamental issue which i think seems being missed out over here is black money and laundering is actually more of an India issue than of course Mauritius itself. Mauritius' treaty, and to that extent in many counts Mauritius KYCs and all of it have been a lot more stringent than many other developed markets around the world. Trying to pass the issue onto Mauritius, I think at first level India needs to probably strengthen their own exchange controls and other issues which can address the round tripping because its an issue for Indian residents tripping their money overseas.... interrupts

Q: Anything specific you are picking up about focusing on capital investments again or investments into the capital market I should say?

Shah: I think it's rather unfortunate in terms of the timing of it and I think in a situation where we are definitely seeing a significant amount of reallocation happening in terms of global investors from India to many other markets where they see more certainty and stability. A move like this could obviously be something which can definitely dampen the inflows and as well in terms of creating an uncertainty in the minds of the international investing community.

I would have obviously expected with all the pressure in terms of building FDI as well as flows into the capital markets. The government could have possibly looked at measures in terms of stabilizing that rather than creating panic on this count. But it's something which is rather difficult to really attribute whether anything concrete on this count has been done and is probably a knee jerk reaction to some unconfirmed reports, you never know.

I think its time for government to possibly introspect and look at it. And again its not Mauritius as a concept, I think round tripping is a larger issue, corruption is a larger issue and attributing it to a treaty or otherwise is something which in many sense shows some amount of immaturity in my view.

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Q: There has been a lot of talks since morning, but the latest is that Marutius has given an in-principle nod to mull review of the tax treaty and dates probably are being set up in July and August. What do you make of that development and how would you expect things to proceed from here?

Shah: I think its obviously a treaty renegotiation. It is a pretty intensive, long drawn exercise, so its difficult at this point to really predict which way the final negotiation will go. These are treaties with mutual benefits, so obviously India will also need to take into account the impact of any renegotiations it would have on outbound investments which may use Mauritius or otherwise.

Again the form of the renegotiation is not clear today, whether it’s really targeted primarily on the capital gains article or is it going to be driven more by information sharing and also whether there would be a limitation of benefit is something which can be negotiated. So I think it’s still too early for us to really say which way the renegotiation would finally go.

Q: Reading comments from the Finance Secretary where he says, "you cannot arbitrarily tax the investments routed from Mauritius". In your assessment what within the tax treaty can get renegotiated?

Shah: I think obviously the article which has been under the fire, so to say, has been the capital gains article and I think that is probably what has been making the news all over. So if the focus is on the renegotiation and if Mauritius were to really look at it, that probably would be the most important piece of the treaty which would undergo renegotiation if it were. And there obviously whether it would be some kind of what they call a limitation of benefit provisions whether that can be negotiated is something whcih needs to be explored.

The second I think that probably where so far the focus has been is to really have information sharing agreement. While there is an arrangement between the two states on sharing of information and cooperation which is already underway. There maybe a more formal information sharing agreement to deal with round tripping. That could be the second point of focus in the whole renegotiation exercise.