FPIs in Mauritius to face greater scrutiny after tax treaty revision

Legal experts divided on whether grandfathering will be available for investments before April 2017

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Khushboo Tiwari | Mumbai

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Foreign portfolio investors (FPIs) from Mauritius may face higher scrutiny after the amendment in the India-Mauritius tax treaty introduced a principle purpose test (PPT) to prevent treaty abuse by taxpayers.

The Mauritius government had in February decided to amend the double taxation avoidance agreement (DTAA) with India to align with the Organisation for Economic Co-operation and Development's proposal on base erosion and profit shifting.

Although the agreement between India and Mauritius was signed on March 7, the protocol of the amendment was made public for the first time on Wednesday, said legal experts.

The norms are yet to be notified by the Indian government, after which they will take effect.

Under PPT, taxpayers will be able to avail of the benefits under the agreement only when they can establish that the benefit is in accordance with the relevant provisions, including 'substance' requirements.

Substance refers to the basic requirements mandated for the fund on employees, offices, turnover, expenses, etc., to operate in a specific country.

"Even if one of the principal reasons for choosing Mauritius is tax benefit, then treaty benefit can be denied... Some taxpayers could therefore find it difficult to argue that of all the reasons why they chose Mauritius, obtaining a tax advantage was not one of them," said Rajesh Gandhi, a partner at Deloitte.

"Circular 789, which has been upheld by the Supreme Court, conclusively sets out that a tax residency certificate is adequate proof of tax residency to claim benefits under the India-Mauritius tax treaty. However, the introduction of PPT may now imply the necessity for a closer scrutiny of the commercial substance and rationale while claiming relief under the treaty," said Arijit Ghosh, member, international tax at Nishith Desai Associates.

According to data from the National Securities Depository, Mauritius ranks fourth in the list of countries with the highest assets under custody (AUC) in India after the US, Singapore, and Luxembourg.

The total AUC for Mauritius is Rs 4.18 trillion, and the total number of FPIs registered in the jurisdiction is over 600.

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However, legal experts are divided on whether investments and capital gains before 2017 will be grandfathered or given exemption from tax implications after the new amendment.

"Unlike the grandfathering of pre-2017 investments under General Anti-Avoidance Rule, the protocol does not contain any such exemption, and therefore past investments can be scrutinised subject to tax reassessment conditions," said Gandhi.

"The PPT clause itself also includes an exception to the rule for when the benefit is in line with the objects and purposes, and to this extent, treaty benefits should continue to apply for grandfathered shares," said Ghosh.

Rubal Bansal Maini, partner, Luthra and Luthra Law Offices India, also shares the same opinion.

"The benefits that may have been derived from any item of income under the said DTAA may now be given to the taxpayers when they fulfil the PPT. The amendment vide the protocol dated March 7, 2024, will not apply to the capital gains on shares acquired before the grandfathering period, i.e., April 2017," she said.

Industry experts are of the opinion that wider scrutiny of FPIs may push for migration or registration in the International Financial Services Centre (GIFT IFSC) in India.

"In view of the increased tax scrutiny, coupled with the fact that global tax policies are getting more stringent by the day on tax avoidance, FPIs are expanding their presence in the Gujarat International Finance Tec-City to benefit from lower costs and mitigate operational challenges in infamous jurisdictions like Singapore and Mauritius as the IFSCs are loaded with beneficial tax treatments," said S R Patnaik, partner, Cyril Amarchand Mangaldas.

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