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Mauritius ousting India from purview of MLI and maintaining status quo of recently amended Indo-Mauritius DTAA – Implications for India

Introduction

- The base erosion and profit shifting ('BEPS') Project led by the Organisation for Economic Co-operation and Development ('OECD') recognized the widespread use of aggressive international tax planning being resorted by taxpayers for artificially shifting the profits to non/low tax jurisdictions, which resulted in loss of tax revenue in jurisdictions where substantive economic activities giving rise to such profits were undertaken. Accordingly, a need was felt to introduce and implement, inter alia, tax treaty-related measures to address the issue of treaty abuse, artificial avoidance of permanent establishment status etc.

- One of the outcomes of the BEPS Project is the Multilateral Instrument ('the MLI')[1]. The MLI is a convention signed by various countries, which would modify the existing bilateral tax treaties of the countries which are signatory to the MLI. Basically, the MLI allows jurisdictions to import recommendations from BEPS Project, including inter alia, minimum standards to prevent treaty abuse and treaty shopping into their existing bilateral tax treaties, thereby, saving the respective countries from the herculean and time consuming task of entering into negotiations with other countries for amending the existing bilateral tax Treaties. The MLI has to be read alongside the existing tax treaties, and the same would have the effect of modifying the existing bilateral Treaty in order to bring it in line with the BEPS recommendations.

- The MLI contains certain provisions for prevention of treaty abuse (discussed infra) prescribed by the BEPS Final Report, to be adopted by respective countries. Except for these mandatory minimum standards, which needs to be adopted by each country, the MLI provides flexibility for countries to include or exclude other provisions through opt-in and opt-out mechanisms.

1 The draft of MLI can be accessed at http://www.oecd.org/tax/beps/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm

Applicability and framework of the MLI

- The provisions of MLI would apply to those countries which are signatory to the MLI and have ratified/approved the MLI in accordance with their domestic laws. The MLI would come into effect after expiry of three calendar months from the date on which five instruments of ratification have been deposited with the Secretary-General of the Organisation for Economic Co-operation and Development ('Depositary').For a country which is ratifying the MLI thereafter, the MLI would come into force after expiry of three calendar months therefrom.

- Upon coming into effect, the MLI would not *ipso facto* apply to all the existing bi-lateral tax Treaties signed by a signatory country, but the same would only apply to those Treaties which have been notified by a country as a covered tax agreement ('CTA') to be modified by the MLI. If both the parties to a bilateral tax Treaty have listed that Treaty as a CTA, then only the MLI would be applicable to such tax Treaty.

- Once an existing tax Treaty with a country has been notified as CTA by both the parties to such treaties, then, also all the provisions contained in the MLI would not automatically apply to such Treaty. Each party has a right to make a reservation stating that a particular provision of MLI would not apply in respect of a particular CTA. Where one of the parties reserves the right for a provision of the MLI not to apply to a CTA, such provision of the MLI will not apply to the CTA, irrespective of whether or not the other party to that treaty has made a similar reservation.

- At the time of signing of the MLI by a country, such country is required to file with the Depositary, a provisional list of the tax treaties which are to be notified as CTA and list of reservations with respect to the provisions of MLI that are not to apply to all or some of the CTAs listed therein or are to be applied with certain modifications, subject to revision at the time of ratification.

- Therefore, a tax treaty entered between two countries would only be modified by MLI, if both parties to the treaty have notified the said treaty as CTA under the MLI, and only to the extent the said provisions of the MLI are adopted by both the parties. In this regard, OECD has also launched a preliminary (beta) version of the MLI Matching Database for comments and suggestions from the public. The said Database makes projections on how the MLI modifies a specific tax treaty covered by the MLI by matching information from signatories' MLI Positions.

- On June 7, 2017, 68 countries around the world, including India signed the MLI to implement tax treaty-related measures to prevent BEPS. Although, India has included tax Treaty signed with Mauritius in the list of covered tax agreements, however, it is pertinent to note that Mauritius, which signed the MLI on 6th July, 2017[2], has not

2 OECD's press release of Mauritius signing the MLI can be accessed at http://www.oecd.org/ctp/treaties/mauritius-signs-the-multilateral-beps-convention-to-tackle-tax-avoidance-by-multinational-enterprises.htm

included the tax Treaty entered with India under the list of covered tax agreements for the purpose of implementation of MLI.

Background of Indo–Mauritius DTAA and recent amendment thereto

- Until signing of the Protocol to Indo-Mauritius Double Tax Avoidance Agreement ('DTAA') on 10.05.2016, Mauritius was a preferred jurisdiction for investing in India as capital gains arising to a Mauritian tax resident from sale of movable property (not forming part of PE, if any) situated in India was not taxable in India and considering that there was no capital gains tax under domestic tax laws of Mauritius, such gains were completely out of tax net.[3] India raised the said issue with Mauritius pressing for an amendment in the bilateral Treaty between the two countries and held negotiations from time to time, without much progress being made in this regard.

- It was only last year that India and Mauritius signed Protocol to the DTAA to withdraw the capital gains tax exemption available on sale of shares in the source State, under the Treaty, albeit in phases. In terms of the said Protocol, India was vested with the right to tax capital gains arising from alienation of shares of an Indian resident company acquired on or after April 1, 2017. Investments made prior to 01.04.2017 were "grand-fathered" and were not to be subject to capital gains tax in India. For gains arising from investment made after 01.04.2017 but transferred before 31.03.2019, the tax rate was limited to half of the rate prescribed under the domestic law in India, subject to satisfaction of conditions stated in the LOB Article; otherwise, benefit of the said concessional rate is prescribed not to be available.

Brief description of anti-Treaty abuse provisions incorporated in MLI

- The MLI has incorporated various anti-Treaty abuse related measures identified, as part of the final BEPS Action Plan/project, for:

  i. neutralizing the effects of hybrid mismatch arrangements;

  ii. preventing the granting of Treaty benefits in inappropriate circumstances i.e. Treaty abuse;

  iii. preventing the artificial avoidance of permanent establishment status;

  iv. making dispute resolution mechanism more effective;

- The anti-abuse provisions for prevention of Treaty abuse contained under Article 7 of MLI includes the following measures:

3 Refer, Article 13(4) of India Mauritius Tax Treaty

- **Principal purpose test ('PPT') Rule:** This is a general anti-abuse rule whereby treaty benefit is sought to be denied in respect of a transaction or arrangement if one of the principal purposes of undertaking such transaction or arrangement is to obtain the said treaty benefit, unless it is established that granting of said benefit was in accordance with the object and purpose of the relevant treaty provision(s).The aforesaid provision is a minimum mandatory standard specified under BEPS.

- **Simplified Limitation of Benefits ('SLOB') provisions:** This is a specific anti-abuse rule which limits the availability of treaty relief to only certain defined tax residents that meet certain criteria based on their legal nature, ownership, business activities etc., that would have otherwise been available under the Bilateral treaty. The person meeting the aforesaid criteria would constitute a "qualified person" under article 7(9) of the MLI. Parties to the MLI have an option to apply the SLOB provision as a supplement to the PPT Rule; however, SLOB provision would apply to a CTA only when both the parties to that CTA have opted for the same.

- **Detailed Limitation of Benefits ('DLOB') provisions:** The parties have the option to reserve the right for PPT under MLI not to apply to their CTAs if the parties intend to adopt a DLOB provision in combination with either PPT or SLOB to address conduit financing structures or a PPT thereby ensuring that the BEPS minimum standards are met. The countries which opt for DLOB provision shall endeavor to reach a mutually satisfactory solution which meets the minimum standard though bilateral negotiations.

A country has a choice to adopt either (i) PPT Rule only or; (ii) PPT alongwith SLOB/ DLOB provisions or; (iii) DLOB provisions

Position of India and Mauritius as regards anti-Treaty abuse provisions under MLI

- While India has notified its bi-lateral tax treaty with Mauritius as a CTA under the MLI, however, Mauritius has not notified its tax treaty with India as a CTA under the MLI.

- In its provisional notification, India has opted for the PPT Rule with SLOB provisions across all its Treaties notified as CTA. Mauritius, in its provisional notification, has opted for the PPT Rule alone as an interim measure; however, Mauritius intends to adopt a limitation of benefit provision in replacement of the PPT Rule, through bilateral negotiations.

VA Comments

- In order to obtain benefit from exemption of capital gains tax under the India –Mauritius tax Treaty, investment(s) were routed into India through shell/conduit companies located in Mauritius; such transaction lacked commercial/business substance and were used for the purpose of evasion of tax. To curb the prevalent abuse of the tax Treaty, the bi-lateral treaty was amended and anti-abuse measures were included in the tax treaty, with investments made in shares prior to 01.04.2017 being grand fathered.

- Since both the countries have adopted the PPT rule under MLI for combating treaty abuse, had Mauritius notified its treaty with India as a CTA, then it could have jeopardized the protection granted to investments made before 01.04.2017 which were grand fathered under the India-Mauritius tax Treaty as amended in 2016. However, since Mauritius has not included Treaty with India as a CTA under MLI, therefore, the provisions of MLI shall not apply to any transaction entered between tax residents of India and Mauritius. Therefore, India's existing tax Treaty with Mauritius (as amended in 2016) would remain unaffected and grand fathered investments would continue to enjoy protection envisaged in the Protocol.

- Since Mauritius is committed to the BEPS Project, India and Mauritius would both have to conduct bilateral negotiations to adopt the minimum standards included in the BEPS recommendations in their existing DTAA. The outcomes of the bilateral negotiations would be highly anticipated.

For any details and clarifications, please feel free to write to:

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