K C Mehta & Co LLP
Chartered Accountants

kcm NETWORK

kcm Flash

International Tax

April 24, 2024

Navigating Turbulent Waters - India-Mauritius Protocol Amendment sets sail against tax evasion

Snapshot

India and Mauritius have signed a Protocol for amending DTAA with a view to prevent tax evasion and avoidance. The revised Preamble inter alia aims at barring opportunities for non-taxation or reduced taxation through abusive practices like treaty shopping. Principal Purpose Test (PPT) provision has been introduced via Article 27B (Entitlement to Benefits) to deny treaty benefits if obtaining them was **one of the** principal purposes of any arrangement or transaction. These amendments and the language therein are in line with the Multilateral Instruments (MLI) measures introduced by OECD. Furthermore, a notification is required by both states to inform each other upon completing Protocol implementation procedures. It also provides that the Protocol shall be effective from the date of entry into force (i.e., later of the date when both the countries have notified each other).

Background

India and Mauritius signed a Protocol to amend the India-Mauritius DTAA on March 7, 2024, at Port Louis (capital of Mauritius).

The amendments include a revamped Preamble emphasizing on elimination of double taxation without non-taxation or reduced taxation through abusive arrangements and the introduction of a PPT provision to deny treaty benefits in certain cases. Further, a notification is required by both the countries for bringing the Protocol into force. The Protocol will be effective from the date of entry into force without regard to the date on which the taxes are levied or the taxable years to which the taxes relate. The Protocol is being viewed as a step to promote fair and equitable taxation while preventing misuse of treaty benefits.

Salient Features of Protocol

Preamble Amendment for addressing Treaty Shopping:

The revised Preamble specifically intends to eliminate double taxation **without creating opportunities for non-taxation or reduced taxation** through tax evasion or avoidance (including through **treaty-shopping arrangements aimed at obtaining reliefs provided in DTAA** for the indirect benefits of residents of third jurisdictions).

(*Treaty shopping is a practice where taxpayers exploit tax treaties by routing investments through intermediary jurisdictions to benefit from favorable tax provisions.*)

Introduction of Principal Purpose Test:

A new article, Article 27B (Entitlement to Benefits) is proposed to be added to the DTAA, whereby a benefit under DTAA is

denied in respect of an item of income if it is reasonable to conclude that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit. The benefit shall not be denied if it is established that granting that benefit would be in accordance with the object and purpose of the relevant provisions of DTAA.

Notification required by both the states to enforce the Protocol:

Each state (i.e., both India and Mauritius) should notify the other regarding completion of the procedures required by its law for bringing into force the said Protocol. The Protocol shall enter into force on the date of the later of these notifications.

Effective from date of entry into force:

The provisions of the Protocol shall have effect from the date of entry into force of the Protocol without regard to the date on which the taxes are levied or the taxable years to which the taxes relate.

KCM Comments

Efforts are being made by both Mauritian as well as Indian government towards enhancing transparency and curbing tax evasion and avoidance practices. These amendments, aimed at preventing abuse of the treaty for purposes such as treaty shopping and ensuring that its benefits are aligned with the intended objectives, reflect a collaborative effort by both countries to strengthen their tax treaty framework.

As a member of G20 and an active participant of the Base Erosion and Profit Shifting (BEPS) project, India has been committed to the BEPS outcome. BEPS Action Plan 6 addresses treaty shopping through treaty provisions and provides for a minimum standard that members of the BEPS Inclusive Framework have agreed to implement. It provides for three methods for addressing treaty shopping:

- PPT + simplified or a detailed limitation of benefits (LOB) rule; or
- the PPT alone; or
- Detailed LOB rule together with rules to address conduit arrangements.

(*LOB is a provision that restricts the benefits of a favorable tax treaty to eligible taxpayers*)

Article 6 of the MLI, titled "Purpose of a Covered Tax Agreement", replicates the Preamble language of the OECD Model Tax Convention. Article 7 of the MLI, titled "Prevention of Treaty Abuse", also replicates Article 29 of the Model Tax Convention concerning "Entitlement to Benefits". Both Article 6 and Article 7, taken together, fall under the scope of one of the minimum standards as documented in the Action Plan 6 Final Report entitled "Preventing the Granting of Tax Benefits in Inappropriate Circumstance".

The extant India-Mauritius DTAA was not in compliance with the above framework. This was a much-needed step from Indian exchequer viewpoint since major chunk of investment in India flows through Mauritius and the fact that Mauritius had not notified India-Mauritius DTAA under MLI, the substantive conditions under PPT were not applicable to the said DTAA thereby giving space for exploiting treaty provisions in undesired circumstances. The existing limitation of benefit clause under India-Mauritius DTAA was made applicable only to capital gains tax arising in the predetermined period. Though an attempt had been made by virtue of 2016 amendment to shift residence-based taxation to source-based taxation, still there was room for treaty misuse since domestic tax laws of Mauritius and existing provisions of DTAA are more favorable in certain aspects. Hence many companies were establishing SPVs / investment vehicles in Mauritius for routing investments. The amended Protocol would empower the tax authorities to adopt a "look through" approach

whereby the authorities may look beyond the TRC and deny treaty benefits if "one" of the principal purposes is to obtain treaty benefits. Hence, commercial rationale would need to be substantiated going forward and since the same would be a subjective exercise, there is a high possibility of surge in litigation. This is a paradigm shift in the applicability of the treaty provisions since in the judgement of Azadi Bachao Andolan [2003] 132 Taxman 373 (SC), the Supreme Court emphasized on the fact that provisions of DTAA would supersede the provisions of the Income Tax Act ('Act') even if the same are inconsistent with the provisions of the Act and in relation to treaty shopping the Court observed that "*There are many principles in fiscal economy which, though at first blush might appear to be evil, are tolerated in a developing economy, in the interest of long term development. Deficit financing, for example, is one; treaty shopping, in our view, is another. Despite the sound and fury of the respondents over the so called 'abuse' of 'treaty shopping', perhaps, it may have been intended at the time when Indo-Mauritius DTAC was entered into. Whether it should continue, and, if so, for how long, is a matter which is best left to the discretion of the executive as it is dependent upon several economic and political considerations. This Court cannot judge the legality of treaty shopping merely because one section of thought considers it improper. A holistic view has to be taken to adjudge what is perhaps regarded in contemporary thinking as a necessary evil in a developing economy.*" The proposed Protocol amendment suggests that the time has come when the government aims to put an end to treaty shopping. Time and again Indian judiciary has debated on the topic as to whether TRC is conclusive evidence for entitlement to treaty benefits or whether the 'look through' approach can be adopted in determining taxability under DTAAs. Hon'ble Supreme Court has recently admitted an SLP against the Delhi High Court judgement in the case of Blackstone Capital Partners (Singapore) VI FDI Three Pte. Ltd [2024] 158 taxmann.com 261 (SC), wherein High Court had held that TRC was sufficient evidence to claim treaty eligibility. The Protocol is a step in the direction of addressing loopholes and bolstering anti-abuse provisions to promote fairness, transparency, and cooperation in the realm of international taxation.

The Supreme Court in the case of Nestle SA [TS-616-SC-2023] held that a notification under section 90 of the Act is necessary and a mandatory condition to give effect to a DTAA, or any Protocol changing its terms that has the effect of altering the existing provisions of law. In line with the Apex Court's ruling, the Protocol will have to be notified under section 90 of the Act for giving effect to the same.

Another important facet of this Protocol which has created a buzz in the economy is the suggestive retroactive effect of the said Protocol since it has been specified that the Protocol shall come into force from the date of entry into force and no regard shall be made to the date on which the taxes are levied or the year to which the tax pertains. This statement has created confusion regarding the investments made in India which exist on the date of entry into force of the Protocol. Whether the said investments shall be affected by the said Protocol since the investments made before the date of entry into force have not been grandfathered as was done in the case of capital gains. If the said investments are assessed by the tax authorities in the light of the aforesaid Protocol, there might be undue hardship on the investors and the investors may be bombarded with insurmountable litigation challenges. It might be possible to contend that one of the objectives of the extant DTAA provisions was to encourage mutual trade and investment and hence the original investment was made in line with

the object and purpose of the DTAA. This interpretation would also be in line with Article 31 of the Vienna Convention which provided that a treaty should be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. It is worthwhile to note that the Preamble of a tax treaty often provides valuable insights into the objectives and intentions of the contracting states and hence investments made in line with the object and purpose of the erstwhile language of Preamble existing when the investment was made should be entitled to the benefits of tax treaty. However, with the shift of objective from enhancing mutual trade to preventing treaty abuse, the intent of the DTAA has undergone a change and hence how the courts interpret the provisions will have to be seen.

There is also a possibility that the said amendment will play an important role in reducing future litigation since the countries worldwide are making intentions clear by coherently working in the area of curbing treaty shopping and unethical tax practices. Hence, going forward we may see a decline in restructuring exercises aimed at tax avoidance. The IT department in a social media post have stated that the Protocol is yet to be notified under section 90 of the Act and any queries shall be addressed when the Protocol will come into force. Time will tell if the situation calms down, or if the law merely adds layers of complexity.

India – Mauritius DTAA has always been an area of interest for tax enthusiasts. With this new development and the buzz around the same, it would be exciting to witness how these turbulent waters are pacified.

This document is prepared exclusively for the benefit and use of member firms of KCM Network and their clients. This should not be used as a substitute for professional advice. Reasonable care has been taken for ensuring the accuracy and the authenticity of the contents of this alert. However, we do not take any responsibility for any error or omission contained therein on any account. It is recommended that the readers should take professional advice before acting on the same.

For further analysis and discussion, you may please reach out to us.

Locations

Ahmedabad
Arpit Jain
Level 11, Tower B,
Ratnaakar Nine Square,
Vastrapur,
Ahmedabad - 380 015
Phone: + 91 79 4910 2200
arpit.jain@kcmehta.com

Bengaluru
Dhaval Trivedi
4/1, Rudra Chambers, First Floor, 4th Main, B/W 8th & 9th Cross Road, Malleshwaram,
Bengaluru - 560 003
Phone: +91 99983 24622
dhaval.trivedi@kcmehta.com

Mumbai
Bhadresh Vyas
315, The Summit Business Bay,
Nr. WEH Metro Station,
Gundavali, Andheri East,
Mumbai – 400 069
Phone: +91 22 2612 5834
bhadresh.vyas@kcmehta.com

Vadodara
Milin Mehta
Meghdhanush,
Race Course,
Vadodara - 390 007
Phone: +91 265 2440 400
milin.mehta@kcmehta.com