THE MAURITIUS ROUTE: THE INDIAN RESPONSE

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INTRODUCTION

India has a wide network of double taxation avoidance agreements, of which the most famous, or infamous, is the one with Mauritius. India's tax treaty with Mauritius ("Treaty") was signed at Port Louis on August 24, 1982 and has been effective since April 1, 1983 and July 1, 1983, in India and Mauritius, respectively[1]. The Treaty was amended pursuant to a protocol ("Protocol") signed on May 10, 2016[2].

37.5 million Indian Rupees ("INR"), which grew phenomenally to 30,933 million INR by 2000.[5] FDI inflows for the period between April 2000 and September 2016 reveal that Mauritius has been the largest contributor of FDI, accounting for 5,194,995 million INR, representing 32.81% of the total inflows into India.[6] The Supreme Court of India ("SC") remarked in 2012 that the investment from Foreign Institutional Investors ("FII") was about 4,500,000 million INR, 700,000 million INR of which was from Mauritius.[7] The trading relationship is somewhat reciprocal as India has been the largest exporter of goods and services to Mauritius since 2007,[8] and the International Monetary Fund noted in 2013 that the end of the Treaty would have significant ramifications for the economy of Mauritius.[9]

So, how did this come about? India opened its doors to foreign investment only in 1991, which was when Mauritius was emerging as a banking offshore jurisdiction.[10] In this phase of simultaneous liberalisation, investors appear to have discovered the tax arbitrage opportunities available under the Treaty.[11] The critical tax arbitrage opportunity related to capital gains arising from sale of shares contained in Article 13(4).[12]

Article 13(4) is couched as a residuary provision. Paragraphs 1, 2, and 3 of Article 13 discuss the allocation of taxation rights on gains from alienation of immovable property, movable property forming part of a permanent establishment/fixed base, and ships and aircrafts operating in international traffic and related movable property, respectively.[13] Unlike paragraphs 1, 2, and 3, paragraph 4 does not account for situs as a factor.[14]

amendment would not affect the Mauritius Route.[45] Eventually, the provision never saw the light of the day.

It is apparent now that the intention of the CBDT and the executive was to claim the right to tax. However, backlash from Mauritian authorities and internal hesitation in singling out Mauritius resulted in the Mauritius Route being closely guarded. The legislative amendments were also stalled because of market pressure.

II. TREATMENT OF THE MAURITIUS ROUTE BY THE INDIAN JUDICIAL AND QUASI-JUDICIAL AUTHORITIES: 1983 TILL NOW

This Part looks at how the Indian judicial and quasi-judicial authorities dealt with the Mauritius Route, by analysing some key judgments and rulings.

As the Mauritius Route began to be used only in the early 1990s, the litigation started shortly thereafter. The Mauritius Route came under the scrutiny of the judicial as well as quasi-

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In E*Trade Mauritius Ltd. v. DIT International Taxation, the AAR held that the TRC would at least constitute presumptive evidence of beneficial ownership of shares and gains therefrom, even if not conclusive evidence.[79] The AAR observed that the double non-taxation under the Treaty was odd, and had been inevitable because of the peculiar provision in the Treaty, the CBDT circular,

The SC clarified that while a limitation of benefit cannot be read into a tax treaty, a TRC may be assailed in case of a colorable device, tax fraud, or when a resident uses an entity for round tripping or any other illegal activities.[78]

In Serco BPO Private Ltd. v. Authority for Advance Rulings[79] the High Court of Punjab and Haryana said that refusal to accept the validity of a TRC would be contrary to the Treaty and "constitute an erosion of the faith and trust between States."[80] If the entitlement to benefits under the Treaty was subject to actual payment of taxes in Mauritius, it would result in an unintended fluid and fluctuating position.[81] TRC was also upheld by the AAR in In re Shinesei I Investment Ltd.[82]

A perusal of the rulings and precedents reveals that the Mauritius Route has been subject to much litigation over the years. The AAR's first set of rulings were faced with the difficult task of deciding the legality and legitimacy of the Mauritius Route; albeit prima facie. As has been pointed out, even before Circular 2 was issued, there was a change in the AAR's approach in tackling issues of perceived tax avoidance. The SC's validation of Circular 2 and the Mauritius Route did not prevent some AAR rulings to depart from a seemingly settled position. The SC's upholding of Circular 2 and the Mauritius Route, while based on the reluctance to rewrite a treaty, openly acknowledges the non-tax factors that play out in treaty negotiations.

III. THE P

prevalent in the source state[86] on the fulfilment of conditions stipulated in a limitation of benefit clause set out in Article 27A ("LOB"), as explained later. Article 13(4) still leaves taxing rights of any property, other than that mentioned in paragraphs 1, 2, 3, and 3A, with the residence state.[87]

A. Analysing the Protocol and the LOB

The Protocol confines itself to shares, continuing the trend of Circular 1 and Circular 2. "Shares" is not defined in the Treaty. Article 10(4) defines dividends as income from shares or other rights, and juxtaposes it from debt-claims, participating in profits, and other corporate rights subject to same tax treatment as shares.[88] The meaning attributed to shares would thus depend on the Indian domestic law, unless context suggests otherwise.[89] The Companies Act of 2013 defines a "share" as a share in the share capital, including stock.[90] Hence, the Protocol does not disturb the allocation of taxing rights in respect of other fiscal instruments like debentures, hybrid instruments such as compulsory convertible debentures, futures and options contracts,[91] alienation of interests in limited liability partnerships,[92] and participatory notes.[93]

It is germane to peruse the Indian domestic law on capital gains taxation with respect to shares to see if the issue of double taxation existing in the

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the entity is listed on a recognised stock exchange in one of the Contracting States.[103]

In the event that the beneficial ownership of a Mauritian entity is not held in Mauritius, the revenue officers may argue that the primary purpose is to gain tax arbitrage, and thus seek disallowance of the concessional rate. Taking cue from past decisions, companies will have to demonstrate strong commercial reasons to tip the balance in their favour. Coming to the shell/conduit company test, which is a mix of objective and subjective factors, companies may attempt to meet the former (expenditure threshold or listing requirement) to avoid further scrutiny. How fool proof is the test then?

The language and tests in the LOB is reminiscent of a limitation clause that was incorporated in the India-Singapore tax treaty in 2005. In 2005, the India-Singapore tax treaty was amended to assign the right to tax capital gains to the resident jurisdiction.[104] However, companies had to fulfill conditions under a limitation clause.[105] Hence, while the limitation clause in the India-Singapore treaty applied so that a company could claim to be taxed in the resident jurisdiction, the LOB conditions help a company to enjoy a concessional rate of taxation in the source state. Considering that the context and purpose of the two limitation clauses are different, one wonders if the language of the LOB was inspired from the limitation clause in the India-Singapore tax treaty and the propriety of the same.

Significantly, this amendment was to be in force only until the Treaty provided for resident jurisdiction for capital gains on shares.[106] Consequently, the India-Singapore tax treaty has now been amended.[107]

transactions may be looked through, amongst other actions.[110] How does this affect the Treaty and the Protocol? GAAR applies even if it is less beneficial to an "assessee",[111] thus operating as a unilateral treaty override. The effect of GAAR on the Treaty and the Protocol has to bAy o Poc ae-8n-, -0.0A 84 Te6

taken such position.[118] Hence, the minimum standards set out in the MLI do not apply to the Treaty.

CONCLUSION

The Mauritius Route provides an interesting case study for a taxation and migration analysis. When the migration of entities to Mauritius for tax arbitrage opportunities was discovered, one may have anticipated that the Treaty would be amended to plug the loophole causing the double non-taxation opportunity. However, the Indian response demonstrates why this was not to be. At the heart of the Indian response is the belief of the SC, the Indian executive, and the CBDT that the Treaty has played a pivotal role for the Indian economy, trade, foreign investment, and bilateral relations.

The Mauritius Route brought to the forefront the tussle between the revenue officers on the one hand, and the Indian executive and CBDT on the other hand. As has been highlighted, the executive and CBDT began their dialogue with an