

Tax Hotline

December 15, 2004

INDIA WANTS TO REWORK TAX TREATY WITH MAURITIUS

The Indian Finance Minister, while replying to questions in the Parliament, said on Friday that India is likely to revisit the double taxation avoidance agreement (DTAA) with Mauritius and bring it in line with the model treaty developed by the finance ministry.

While the India-Mauritius DTAA provides for periodic review, it does not provide for reopening treaty negotiations. Since the Indian Government is keen on renegotiating the DTAA, it has indicated that Mauritius should be convinced for re-negotiating as otherwise India could give the benefit given under the India- Mauritius DTAA to countries such as Singapore and other Asean countries with which it is negotiating comprehensive economic cooperation agreements.

India would like to have three major changes in this DTAA to improve tax collection from companies coming through Mauritius:

1. Shift from residence based to source based taxation, particularly in relation to capital gains tax
2. Introduce "Limitation of Benefit" article to check treaty shopping.
3. Rework the rates of withholding tax

The Finance Minister has also stated that India's DTAA's with Malta, Zambia, Qatar and Cyprus are also proposed to be reworked. Interestingly, some of these DTAA's also have residence based taxation.

The aim of the exercise is, of course, to curb the tax avoidance by entities otherwise taxable in India escaping through the Mauritius route. In this context, **the ruling by the Supreme Court ("SC") in the case of *Azadi Bachao Andolan vs. Union of India and Others*** is of relevance, where the SC upheld a circular issued by the Central Board of Direct Taxes, which clarified that the certificate of residence issued by the Mauritius tax authorities was sufficient for determining residence for the purposes of availing the treaty benefit. The curative petition against this decision has been dismissed by the SC.

In view of **the recent ruling of the AAR that the income derived by a foreign institutional investor ("FI")**, on trading in securities is business income and is not taxable in India in absence of a permanent establishment in India, it is debatable whether the proposed changes in the DTAA treaty would render any substantial benefit to the Indian exchequer. It is to be noted that FIs are a major source of flow of foreign investments into India.

While many tax treaties entered into by India provide for periodic review, they require the consent of the other country to renegotiate the treaty. Treaty negotiation is a very lengthy process and India would need to take a long term view and think strategically prior to embarking on treaty re-negotiation.

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