

# Tax Hotline

November 11, 2008

## "MAURITIUS IS OKAY" SAYS FIPB

After rejecting Foreign Direct Investment ("FDI") proposals from Mauritius for several months on the grounds of "treaty shopping" by following the Department of Revenue's ("DoR") reservations, the Foreign Investment Promotion Board ("FIPB") has finally laid to rest the controversy by rejecting the argument of treaty shopping, put forth strongly by the DoR for rejecting such FDI proposals.

This departure of the FIPB from the reservations cast by the DoR is evident from the clearance of a number of FDI proposals from Mauritius at its meeting held on October 24, 2008.<sup>1</sup>

The concept of 'treaty shopping' involves a case wherein a resident of a third country seeks to obtain the benefit of a double tax agreement between two other countries by interposing a company or other entity in one of the treaty countries.

Despite the fact that FDI from Mauritius accounts for nearly 43% of the total FDI into India<sup>2</sup>, FIPB, in the recent past, had rejected several of such investment proposals on the grounds of treaty shopping and other similar objections as were being advocated by the DoR.

The arguments put forth by the DoR were contradictory to the 'circular' issued by the Government of India, which clearly states that any company which has obtained a Mauritian certificate of residence would be entitled to the benefits of the India-Mauritius Double Taxation Avoidance Agreement ("Treaty").<sup>3</sup> The Supreme Court of India has also upheld the sanctity of the Treaty and the validity of investments made by companies resident in Mauritius into India.<sup>4</sup> Further, it also observed that there was no provision within the Treaty which excluded a third-country resident from setting up intermediate vehicles for availing Treaty benefits. The FIPB has rightly pointed out that the tax department can investigate such issues from a tax angle. This is a step in the right direction which clearly demonstrates that regulatory approvals for investment into India are separate from taxation issues. While FIPB may decide whether to permit investment into India based on the foreign investment policy, tax issues should not affect such decisions, and should be left open for the tax department to investigate into and litigate.

In a market already battered by turbulence and uncertainty, the new stance taken by the FIPB should provide significant relief to the India-focused investing community.

- Vivek Mimani & Parul Jain

1. <http://finmin.nic.in/fipbweb/downloadfile.asp?FileName=cases31102008.pdf>
2. [http://www.dipp.nic.in/fdi\\_statistics/india\\_fdi\\_July2008.pdf](http://www.dipp.nic.in/fdi_statistics/india_fdi_July2008.pdf)
3. Circular No. 789 dated April 13, 2000.
4. Union of India v. Azadi Bachao Andolan [2003] 132 Taxman 373/263 ITR 706 (SC). The following words of the Supreme Court are relevant: "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."

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