Client Update

India Shuts Down Mauritius Route: Time to Rethink Investment Structures

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On May 10, 2016, the Indian government issued a press release announcing the signing of a protocol (the "Protocol") to amend the India-Mauritius tax treaty.[1] As a result of these amendments, Mauritius tax residents will no longer be exempt from Indian capital gains tax on sales of shares of Indian resident companies that are acquired on or after April 1, 2017.

KEY AMENDMENTS

The press release highlights the following key amendments of the Protocol:

- End of Exemption from Indian Capital Gains Tax. Prior to the amendment, a tax resident of Mauritius was eligible for an exemption from capital gains tax in India on a sale of shares of an Indian resident company. The Protocol amends the India-Mauritius tax treaty so that gain from such a sale will be subject to tax in India at the applicable Indian tax rates on capital gains.
- Grandfathered Transactions. Shares acquired prior to April 1, 2017 are grandfathered and will not be affected by the Protocol. Accordingly, investors can continue to invest in shares of Indian resident companies through properly structured Mauritius holding companies until April 1, 2017 and be exempt from Indian capital gains tax. As long as the shares are acquired before April 1, 2017, the exemption from capital gains tax is available regardless of when such shares are disposed of.
- Two-Year Transition Period. The Protocol provides for limited relief from full Indian capital gains taxation for a two-year transition period. Investments by Mauritius tax residents that are made on or after April 1, 2017 and that are sold prior to April 1, 2019 will benefit from a 50% reduction

[1] Available at: http://pib.nic.in/newsite/PrintRelease.aspx?relid=145185.

in the applicable Indian tax rate if a so-called "limitation of benefits" ("LOB") article, discussed below, is satisfied.

- Limitation of Benefits (LOB) Provision. The LOB provision will be met if a Mauritius resident (i) is not a shell or conduit company and (ii) satisfies the "main purpose" and "bona fide business" tests. A resident will be deemed to be a shell/conduit company if its total expenditure on operations in Mauritius is less than Rs. 2,700,000 (approximately 40,000 US dollars) in the immediately preceding 12 months. The press release does not provide details on what constitutes "main purpose" or "bona fide business." The LOB provision apparently is not relevant to the sale of shares in a grandfathered investment.

IMPACT ON INDIA-SINGAPORE TAX TREATY

Under the India-Singapore tax treaty, the exemption from Indian capital gains tax for tax residents of Singapore remains in force only as long as the India-Mauritius tax treaty includes an analogous provision. Accordingly, under the terms of the India-Singapore tax treaty, the exemption from Indian capital gains tax for Singapore tax residents is expected to become unavailable as a result of the Protocol. It is unclear, however, when and how the change will become effective. For example, it is not known whether the change will take immediate effect or if investments made prior to April 1, 2017 will be grandfathered, and whether there will be any transition period to provide relief from full Indian capital gains taxation. It is expected that the India-Singapore tax treaty will be renegotiated.

WHERE NEXT?

By phasing in the application of the Protocol, investors will have some time to consider alternative investment structures into India. In particular, investments structured through the Netherlands may be considered as the tax treaty with India provides for an exemption from Indian capital gains tax on sales by Dutch tax residents of shares of Indian resident companies. However, given the Indian government's stated commitment to adhere to the OECD's Action Plan on Base Erosion and Profit Shifting ("BEPS"), which is designed to address treaty abuse and double non-taxation, it is possible that it will seek to renegotiate the tax treaty with the Netherlands, which does not include an LOB provision. In addition, from April 1, 2017, any investment structure will need to be analyzed in light of India's "general anti-avoidance rules" ("GAAR"), which will come into effect as of such date and are expected to give the Indian government considerable discretion to disregard or recharacterize "impermissible tax avoidance arrangements."

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