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The Mauritius Route: The Indian Response

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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]

The Preamble of the Treaty provides that one of its objectives is to encourage "*mutual trade and investment*."[3] The Treaty has served as the backbone for a major part of the foreign direct investment ("FDI")[4] into India. To be more precise, in 1993 the FDI inflow from Mauritius was estimated at

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1. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes of Income and Capital Gains art. 28, India-Mauritius, Aug. 24, 1982, Notification No. G.S.R. 920(E) (June, 12, 1983) [hereinafter I-M Treaty] (available for download at http://www.aseanbriefing.com/userfiles/resources-pdfs/India/DTA/Asia_DTA_Mauritius_India.pdf).

2. Protocol Amending the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, India-Mauritius, May 10, 2016, Notification No. S.O. 2680(E) (Aug. 10, 2016) [hereinafter Protocol], http://www.incometaxindia.gov.in/communications/notification/notification682016.pdf [https://perma.cc/QKJ7-SN58].

3. I-M Treaty, *supra* note 1, at pmbl. This language is missing in some other treaties such as the tax treaty between India and UAE, which outlines its purposes as being "for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital." *See* Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital, India-U.A.E., Nov. 18, 1993, Notification No. G.S.R. 710(E) (Nov. 18, 1993).

4. The Indian government categorizes inward foreign investment into different classes: foreign direct investment and foreign institutional investment. Investors opting for the former are considered to create a "*lasting interest*" in nonresident enterprises whereas the latter typically make short-term investments in the secondary capital markets. *See* DEP'T OF INDUS. POLICY & PROMOTION, MINISTRY OF COMMERCE & INDUS., CONSOLIDATED FDI POLICY CIRCULAR OF 2016, at 4 (2016) (India).

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 non-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] Article 13(4) allocates gains derived by a resident from alienation of the remaining properties (other

5. THIRTEENTH LOK SABHA, 1 JOINT COMMITTEE ON STOCK MARKET SCAM AND MATTERS RELATING THERETO 299 (2002) (India) [hereinafter JOINT COMM. ON STOCK MARKET].

6. DEP'T OF INDUS. POLICY & PROMOTION, MINISTRY OF COMMERCE & INDUS., GOV'T OF INDIA, QUARTERLY FACT SHEET ON FOREIGN DIRECT INVESTMENT (FDI) FROM APRIL, 2000 TO SEPTEMBER, 2016, at 5 (2016) http://dipp.nic.in/sites/default/files/FDI_FactSheet_April_Sep_2016.pdf [https://perma.cc/4T5R-KHCC].

7. Vodafone Int'l Holdings B.V. v. Union of India, (2012) 6 SCC 613, 729 (India).

8. MINISTRY OF EXTERNAL AFFAIRS, INDIA – MAURITIUS RELATIONS 3 (2016) (India), https://www.mea.gov.in/Portal/ForeignRelation/Mauritius_08_01_2016.pdf [https://perma.cc/GQR3-FL8L].

9. IMF, *Mauritius: Article IV Consultation*, Country Report No. 13/97, at 8, 28 (Apr. 2013).

10. Suzanne Gujadhur Bell, *The India Mauritius Special Relationship*, OFFSHORE INVESTMENT, Jan. 2005, at 24, 24.

11. Urmila Barnymandhub Boolell, *Indo-Mauritius Doubts Dispelled*, INT'L TAX REV., Nov. 1996, at 26, 26.

12. Prabu Natarajan, *India Budget Outlines Incentives*, INT'L TAX REV., Apr. 1997, at 9, 9 ("Mauritius residents do not pay any capital gains tax in India on the disposition of shares of Indian companies.").

13. I-M Treaty, *supra* note 1, at art. 13(1)–(3).

14. Serco BPO Private Ltd. v. Auth. for Advance Rulings, (2015) Civil Writ Petition No. 11037 of 2014, ¶ 46 (Punjab and Haryana HC) (on file with author).

than those mentioned in paragraphs 1, 2, and 3) to the resident jurisdiction.[15] Paragraph 5 defines the concept of alienation.[16]

Pursuant to Article 13(4), only the resident jurisdiction taxes capital gains from alienation of shares.[17] In respect of the foreign investment coming into India from Mauritius, any capital gains on the alienation of shares was taxable only in Mauritius. The domestic tax law of Mauritius exempted capital gains from the sale of shares.[18] Hence, gains from the alienation of shares held by Mauritius entities in Indian companies were not taxed in either India or Mauritius. This led to the migration of a number of entities to Mauritius, as is evidence by the FDI figures, and the emergence of the so-called Mauritius Route.

The Mauritian authors have argued that the factors which led to the prominence of the Mauritius Route were not those under the Treaty, but those offered by Mauritius, such as superior service standards, labour workforce, proximity to India, historic and cultural ties,[19] political stability, legal checks against expropriation, and a lack of foreign exchange constraints.[20]

Considering that the double non-taxation opportunity under Article 13(4) of the Treaty has played a role with respect to the inflow of foreign investment,[21] this Paper looks at the Mauritius Route as a case study for understanding the link between taxation and migration. The modest attempt of this Paper is to examine the Indian tax law response to the migration of entities to Mauritius by assessing the role of the major actors—the executive, legislative, judicial and quasi-judicial authorities, the tax authorities, and the revenue officers—between 1983 and April 2017.

15. I-M Treaty, *supra* note 1, at art. 13(4). "Gains derived by a resident of a Contracting State from the alienation of any property other than those mentioned in paragraphs 1, 2 and 3 of this Article shall be taxable only in that State." *Id.*

16. *Id.* at art. 13(5).

17. *Id.* at art. 13(4).

18. The Income Tax Act of 1995 exempts "[g]ains or profits derived from the sale of units or of securities [quoted on the Official List or on such Stock Exchanges or other exchanges and capital markets as may be approved by the Minister]." The Income Tax Act, 1995, part IV, ¶ 1 (Mauritius).

19. Bell, *supra* note 10, at 25.

20. Urmila Barnymandhub Boolell, *Mauritius Offers Access to India*, INT'L TAX REV., Mar. 1996, at 47, 47.

21. *See* Vodafone Int'l Holdings B.V. v. Union of India, (2012) 6 SCC 613, 729 (India) (showing that in 2012, the investment in India from FII was about 4,500,000 million INR, 700,000 million INR of which was from Mauritius). Despite academics not having reached a consensus on whether tax treaties lead to increased FDI, it is worth noting that the SC firmly believes that India received increased FDI and FII as a result of the Mauritius Route and not directly from investors based in Mauritius. For an overview of the different studies and views on the issue, see VERONIKA DAURER, 44 TAX TREATIES AND DEVELOPING COUNTRIES: SERIES ON INTERNATIONAL TAXATION 42–47 (2013).

I. THE MAURITIUS ROUTE: ROLE OF THE EXECUTIVE, CBDT, AND LEGISLATURE FROM 1983 TO 2016

The Mauritius Route sparked the ire of the Indian revenue officers, as the entities availing the benefits of Article 13(4) were not beneficially owned from Mauritius. In response, the Central Board of Direct Taxes ("CBDT") wrote to the Mauritius government claiming that such entities should be taxed in India.[22] The Mauritius authorities responded that though the beneficiaries of the funds investing into India were residents of third countries, the investments were made in the Indian capital markets in conformity with prevalent norms and regulations.[23] The authorities also highlighted that the investments would not have been made in a risky jurisdiction such as India but for the Treaty.[24]

The CBDT issued a circular ("Circular 1") shortly thereafter, in March 1994. Circular 1 affirmed that as per Article 13(4), capital gains from alienation of shares arising in the hands of Mauritius residents would only be taxed according to the domestic law of Mauritius.[25] Circular 1, which is a reiteration of the language of Article 13(4), appears to have been issued to reassure investors and the Mauritius government, alike.

Pursuant to further talks, a joint working group was constituted in 1995 to renegotiate the Treaty.[26] The Indian delegation proposed the insertion of a limitation clause,[27] which was rejected by Mauritius.[28]

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22. JOINT COMM. ON STOCK MARKET, *supra* note 5, at 300.

23. *Id.*

24. *Id.* (explaining how India has a higher cost of investment due to its "high risk" investment market).

25. CBDT Circular No. 682, Clarification Regarding Agreement for Avoidance of Double Taxation with Mauritius (Mar. 30, 1994) (India), http://www.incometaxindia.gov.in/Communications/Circular/910110000000000444.htm [https://perma.cc/KAN6-Q882].

> 3. Paragraph 4 deals with taxation of capital gains arising from the alienation of any property other than those mentioned in the preceding paragraphs and gives the right of taxation of capital gains only to that State of which the person deriving the capital gains is a resident. In terms of paragraph 4, capital gains derived by a resident of Mauritius by alienation of shares of companies shall be taxable only in Mauritius according to Mauritius tax law. Therefore, any resident of Mauritius deriving income from alienation of shares of Indian companies will be liable to capital gains tax only in Mauritius as per Mauritius tax law and will not have any capital gains tax liability in India.

Id.

26. JOINT COMM. ON STOCK MARKET, *supra* note 5, at 301–02.

27.
> If, in accordance with the provisions of this Agreement, the right of India to tax income is limited and according to Mauritius tax laws the income is regarded as income from foreign sources and therefore exempted from Mauritius tax, India may tax such income as if this Agreement did not exist.

Id. at 184.

28. *Id.* at 185.

In 2000, the revenue officers denied the benefit of Article 13(4) of the Treaty to some FIIs who were beneficially owned outside India and Mauritius.[29] This resulted in the exit of some FIIs.[30] The CBDT issued a circular ("Circular 2") in April 2000. Circular 2 stated that FIIs and other investment funds operating from Mauritius are incorporated there and thus liable to tax there.[31] Such entities are residents of Mauritius; once they have a residence certificate ("TRC") issued by the Mauritian authorities, that would constitute *sufficient proof* for demonstrating, (i) beneficial ownership and residence for the concessional rate for dividend income under Article 10 and (ii) residence for capital gains under Article 13(4).[32]

By stating that a TRC would be sufficient proof, any further enquiry by the revenue officers about the Mauritian entity including its beneficial ownership/control was sought to be shut out. Thus, there was no longer any silence in the law; Circular 2 clarified that beneficial ownership was irrelevant, thereby legalizing and legitimizing behaviour which may have hitherto been labelled as tax avoidance.

In the early 2000s, there was a massive stock market scam in India.[33] A Joint Parliamentary Committee, set up to investigate the scam, cautioned against the misuse of the Mauritius Route.[34] However, it noted that the Indian government had made consistent efforts to renegotiate the Treaty.[35] Failure to renegotiate

29. Union of India v. Azadi Bachao Andolan, (2003) 10 SCC 1, 19 (India).

30. *Id.*

31. CBDT Circular No. 789, Clarification Regarding Taxation of Income from Dividends and Capital Gains Under the Indo-Mauritius Double Tax Avoidance Convention (DTAC) (Apr. 13, 2000) (India), http://www.incometaxindia.gov.in/Communications/Circular/910110000000000483.htm [https://perma.cc/49P5-ZMH3].

32. *Id.* (emphasis added).

> 1. The provisions of the Indo-Mauritius DTAC of 1983 apply to 'residents' of both India and Mauritius. Article 4 of the DTAC defines a resident of one State to mean "any person who, under the laws of that State is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of a similar nature." Foreign Institutional Investors and other investment funds, etc., which are operating from Mauritius are invariably incorporated in that country. These entities are 'liable to tax' under the Mauritius Tax law and are, therefore, to be considered as residents of Mauritius in accordance with the DTAC.
>
> 2. . . . It is hereby clarified that wherever a Certificate of Residence is issued by the Mauritian Authorities, such Certificate will constitute sufficient evidence for accepting the status of residence as well as beneficial ownership for applying the DTAC accordingly.
>
> 3. The test of residence mentioned above would also apply in respect of income from capital gains on sale of shares. Accordingly, FIIs, etc., which are resident in Mauritius would not be taxable in India on income from capital gains arising in India on sale of shares as per paragraph 4 of article 13.

Id.

33. JOINT COMM. ON STOCK MARKET, *supra* note 5, at 1–2.

34. *Id.* at 181.

35. *Id.* at 182–84.

was attributed to the "*special relationship*"[36] shared with Mauritius, and the fact that Mauritius could not be singled out because similar provisions existed in treaties with other countries signed by India.[37]

In 2008, the Indian government proposed moving from a residence to a source-based jurisdiction for Article 13(4).[38] The Mauritian counterparts refused.[39] In 2012, the Indian government announced the introduction of a General Anti-Avoidance Rule ("GAAR"), to be effective in assessment year 2013-2014.[40] This was later deferred,[41] which may have nudged Mauritius to cooperate in subsequent negotiations.[42] In 2013, Mauritius was willing to submit to a limitation of benefit clause but insisted on keeping Article 13(4) intact.[43] This did not find favour with the Indian government.

There was an attempt to amend the Income-Tax Act of 1961 ("Act") through the Finance Bill of 2013 to stipulate that a TRC was necessary but not sufficient proof for claiming benefits under a treaty.[44] However, an uproar from the market led the then Finance Minister to issue a clarification that the proposed

36. *Id.* at 308. While the report does not elaborate on the special relationship, the two countries share historic and cultural ties apart from their trade and investment ties. *See* FED. RESEARCH DIV., LIBRARY OF CONG., INDIAN OCEAN: FIVE ISLAND COUNTRIES 100–02, 133–34 (Helen Chapin Metz ed., 3rd ed. 1995); Bell, *supra* note 10, at 24–25 (emphasis added).

37. JOINT COMM. ON STOCK MARKET, *supra* note 5, at 308.

38. *India and Mauritius Fall Out over Double Tax Treaty*, INT'L TAX REV. (Mar. 18, 2008), http://www.internationaltaxreview.com/Article/2613987/India-and-Mauritius-fall-out-over-double-tax-treaty.html [https://perma.cc/2Q9Y-NYCV].

39. *See id.* Although Mauritius did not consent to the Indian government's proposal, it "offered to concede ground by allowing the Indian tax authority to conduct direct tax investigations in the jurisdiction." *Id.*

40. *Presentation of Union Budget for 2012-13 Before the Joint Sitting of the Lok Sabha and the Rajya Sabha*, ¶ 154 (Mar. 16, 2012) (India) (statement of Pranab Mukherjee, Minister of Finance), http://indiabudget.nic.in/ub2012-13/bs/bs.pdf [https://perma.cc/6QK2-49PX]; Memorandum on the Indian Finance Bill, 2012, at 28–29 (Apr. 1, 2012), http://indiabudget.nic.in/ub2012-13/mem/mem1.pdf [https://perma.cc/4M22-KPKV].

41. *Pranab Amends GAAR Proposals: Here Are the Key Takeaways*, BUS. TODAY (May 7, 2012) (India), http://www.businesstoday.in/current/policy/gaar-pranab-mukherjee-amends-rules-investment-avoid-tax/story/24635.html [https://perma.cc/PJ4E-L9RD].

42. *See* Matthew Gilleard, *Mauritius Finally Agrees to Rework Tax Treaty with India*, INT'L TAX REV. (July 10, 2012), http://www.internationaltaxreview.com/Article/3058443/Mauritius-finally-agrees-to-rework-tax-treaty-with-India.html [https://perma.cc/WV8N-UCWS].

43. Matthew Gilleard, *Mauritius Still Keen to Act on India Treaty and Change Image*, INT'L TAX REV. (July 9, 2013), http://www.internationaltaxreview.com/Article/3229016/Mauritius-still-keen-to-act-on-India-treaty-and-change-image.html [https://perma.cc/8ART-NTXE].

44. The Finance Bill, 2013, Bill No. 18, Lok Sabha, Feb. 28, 2013, § 21 (India) (proposing amendment to § 90 of the Income-Tax Act) ("The certificate of being a resident in a country outside India or specified territory outside India, as the case may be, referred to in sub-section (4), shall be necessary but not a sufficient condition for claiming any relief under the agreement referred to therein.").

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-judicial authorities. The earliest rulings came from the Authority for Advanced Rulings ("AAR"),[46] a quasi-judicial authority set up to answer queries relating to the tax liability of nonresidents. Notably, the AAR could refuse an application if the transaction or issue was designed *prima facie* for tax avoidance.[47]

A. *Mauritius Route: The Early AAR Decisions*

In re Advance Ruling No. P. 9 of 1995[48] was one of the first queries posed on the Mauritius Route. It pertained to two Mauritian companies seeking to ascertain whether they could avail themselves of the benefits provided under Articles 10 and 13(4), as and when they earned dividends and capital gains.[49] The AAR rejected the applications stating that the transaction was designed *prima facie* for tax avoidance, as the beneficial owner was located in the United Kingdom.[50] Had the beneficial owner invested directly into India, it would have

45. Press Release, Press Info. Bureau, Finance Ministry Issues Clarification Regarding Tax Residency Certificate (TRC) (Mar. 1, 2013) (India) (on file with author).

46. The AAR is a quasi-judicial authority that was set up under the Finance Act, 1993 to help non-residents assess their income tax liability and plan tax affairs well in advance. The tribunal comprises a Chairman (a retired Judge of the Supreme Court) and two members, one officer each from the Indian Revenue and Legal Services. A ruling given by the AAR binds the applicant and the tax authorities in respect of the specific transaction. *See* Finance Act, 1993, No. 38, Acts of Parliament, 1993, § 31 (India) (adding §§ 245N–245V, which established the AAR, to the Income-Tax Act of 1961); Income-Tax Act (as amended by Finance Act, 2008), 1961, No. 43, Acts of Parliament, 1961, §§ 245O, 245R, 245S (India).

47. Income-Tax Act, § 245 R(2)(c).

48. (1996) 220 ITR 377 (A.A.R. decided Dec. 22, 1995).

49. *Id.* at 379–80, 382.

50. *Id.* at 390.

paid tax on capital gains both in India and the U.K. under the India-U.K. treaty, unlike under Article 13(4) of the Treaty.[51]

In *In re Advance Ruling P. No. 10 of 1996*,[52] an American company was setting up a fund, one tranche of which was to invest in India, for which an investment company and an investment manager were incorporated in Mauritius.[53] Despite the applicant's admission of the tax advantage, the AAR brushed it aside.[54] The AAR felt the strongest point in favour of the applicant was that investments could not be made directly by multiple investors on account of the restrictions in the Indian law.[55] The AAR also accepted the reasoning that the companies were incorporated in Mauritius because it was a low-cost financial services centre.[56]

This ruling was hailed as pragmatic because the transaction was considered to be based on strong commercial reasons.[57] It is worth noting that both orders were given by the same Chairman because the difference in approach is quite stark; in the former order, the AAR's impression of a tax arbitrage motive was sufficient to make out a case for tax avoidance while in the latter that seemed less relevant. While there were convincing reasons to show that there was a need to invest through a single entity, the choice of Mauritius was justified merely on objective factors. In later applications as well, the question relating to tax avoidance was tackled on similar lines.[58]

The same Chairman made an additional point in *TVM Ltd. v Commissioner of Income-Tax*; the eligibility of the applicant to enjoy relief under the Treaty is contingent on having paid taxes in Mauritius.[59]

B. Legality of Circular 2

This and other circumstances outlined in the earlier section may have prompted issuance of Circular 2. The next set of landmark cases surrounded the legality of Circular 2.

In *Union of India v. Azadi Bachao Andolan*, the SC upheld the legal validity of Circular 2.[60] Strictly speaking, Article 13(4) never required control or

51. *Id.* at 391.
52. (1996) 224 ITR 473 (A.A.R. decided Aug. 14, 1996).
53. *Id.* at 482–83.
54. *Id.* at 507. "[O]ne would certainly be too naive if one were to believe that self interest and tax considerations did not enter the picture." *Id.* at 508.
55. *Id.* at 510.
56. *Id.* at 507.
57. Roy Rohatgi, *Authority Aids India's Global Image*, INT'L TAX REV., June 1997, at 35, 39.
58. TVM Ltd. v. Comm'r of Income-Tax (1997) 237 ITR 230, 247–48 (A.A.R. Mar. 18, 1997); DLJMB Mauritius Investment Co. v. Comm'r of Income-Tax, (1997) 228 ITR 268, 277 (A.A.R. July 16, 1997).
59. *See* (1997) 237 ITR 230, 249 (A.A.R.).
60. (2003) 10 SCC 1, 64 (India).

beneficial ownership of the shares to be within India or Mauritius. Thus, the officers used the analysis of *TVM Ltd. v Commissioner of Income-Tax*,[61] and they argued that as the entities were not paying taxes in Mauritius they were nonresidents and thus disentitled from availing the Treaty.[62] The SC held that the Union Government is empowered to issue circulars for implementation of a treaty, and such circulars would prevail over the domestic law in case of any inconsistency.[63] The SC remarked that for all the fury of the revenue officers, treaty shopping and abuse "*may have been intended*."[64] If the benefits of the Treaty were to be denied to nationals of a third State, a limitation of benefits clause should have been included. The judges reasoned that treaties are negotiated with various factors in mind and represent a set of compromises, and developing countries often permit treaty shopping to incentivize "*scarce foreign capital or technology*."[65]

C. Application of Azadi Bachao

Azadi Bachao only laid down the law and thus, it is germane to examine how this was applied in subsequent precedents.

In *In re Dynamic India Fund I*,[66] despite the applicant's Mauritius TRC, the revenue officers argued for denial of benefits under Article 13(4) on account of the entity being controlled from India.[67] The AAR observed that there was no evidence to prove that the control was exercised from India, and on account of the TRC, Article 13(4) benefit was available.[68]

However, in a later application, the AAR observed that the revenue officers failed to rebut the presumption of tax residency created by the TRC.[69] Thus, it appeared that TRC was no longer considered as conclusive proof of tax residency.

61. *TVM Ltd.*, (1997) 237 ITR at 249.

62. *Azadi Bachao Andolan*, (2003) 10 SCC at 38.

63. *Id.* at 27. *But cf.*, Income-Tax Act (as amended by Finance Act, 2008), 1961, No. 43, Acts of Parliament, 1961, § 90(2) (India) (establishing that, when a nonresident whose home country has a tax agreement with India, the provisions of the 1961 Act apply "to the extent they are more beneficial").

64. *Azadi Bachao Andolan*, (2003) 10 SCC at 54 (emphasis added).

65. *Id.* at 53–54.

66. A.A.R. No. 1016 of 2010 (July 18, 2012), http://aarrulings.in/it-rulings/uploads/pdf/1342683890_dynamic.pdf [https://perma.cc/QL7A-GSGD].

67. *Id.* ¶¶ 5, 8.

68. *Id.* ¶¶ 8, 12.

69. *In re* SmithKline Beecham Port Louis Ltd., A.A.R. No. 1004 of 2010, ¶¶ 8, 9 (Aug. 16, 2012), http://aarrulings.in/it-rulings/uploads/pdf/1345628438_aar-1004-smithkline.pdf [https://perma.cc/K8NN-HHPR]; *see e.g.*, Aayush Kumar & Varun Natarajan, *Indo-Mauritius DTAA: The Way Forward*, 41 INTERTAX 693, 694–95 (2013); Mihir Naniwadekar, *Recent AAR Rulings on the 'Mauritius Route*,*'* INDIACORPLAW (Aug. 23, 2012), http://indiacorplaw.blogspot.in/2012/08/recent-aar-rulings-on-mauritius-route.html [https://perma.cc/8APH-Z2EJ].

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.[70] 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, and the law laid down in *Azadi Bachao*.[71] Even while doubting the logic of using TRC to infer beneficial ownership, the AAR opined that the presumption created by the TRC had not been rebutted on facts.[72] The revenue authorities appealed this decision, putting issues of beneficial ownership back on the table.[73]

The Bombay High Court in *Aditya Birla Nuvo Ltd. v. Deputy Director of Income Tax* distinguished *Azadi Bachao* because, there, the investing entity was U.S.-owned—not Mauritius.[74] The TRC from the Mauritius authorities was thus, irrelevant.

Hence, within a decade of the *Azadi Bachao* ruling, the ratio had been distinguished, followed, and narrowed down.[75] Revenue officers continued to seek denial of Article 13(4) by urging issues of beneficial ownership and control. This occasioned the SC to reaffirm the validity of the Mauritius Route in *Vodafone International Holdings BV v. Union of India*.[76] The Court reiterates the inextricable link between the Mauritius Route and foreign investment, as can be seen from the following quote:

> *No presumption can be drawn that the Union of India or the Tax Department is unaware that the quantum of both FDI and FII do not originate from Mauritius but from other global investors situate outside Mauritius. . . . If the Union of India and Tax Department insist that the investment would directly come from Mauritius and Mauritius alone then the Indo-Mauritius treaty would be dead letter.*[77]

70. A.A.R. No. 826 of 2009, ¶ 10 (March 22, 2010), http://aarrulings.in/it-rulings/uploads/pdf/1269340941_etrade.pdf [https://perma.cc/YD5C-5U3Q].

71. *Id.* ¶ 14.

72. *See id.* ¶¶ 6.5, 10, 12, 14. The applicant was a Mauritian company and its holding company was in the United States. *Id.* ¶ 1.1. Though the parent company had funded the share purchase, played a key role in negotiating the share sale, and was the end recipient of the sale consideration, it was held that the evidence did not rebut the presumption created by the TRC. *Id.* ¶ 12.

73. M. Padmakshan, *Taxman Moves High Court Against Authority for Advance Ruling's Order on E*Trade Mauritius*, ECON. TIMES, (Aug. 9, 2013) (India), http://economictimes.indiatimes.com/news/economy/policy/taxman-moves-high-court-against-authority-for-advance-rulings-order-on-etrade-mauritius/articleshow/21718530.cms [https://perma.cc/WMV4-CGMA].

74. (2012) 342 ITR 308, ¶¶ 4–19, 46–47 (2011) (Bombay HC).

75. *See In re* Ardex Investments Mauritius Ltd. No. 886 of 2010, ¶ 6 (A.A.R. Nov. 14, 2011), http://aarrulings.in/it-rulings/uploads/pdf/1321368205_ruling-ardex.pdf [https://perma.cc/WE43-GTKL].

76. (2012) 6 SCC 613, 727 (India).

77. *Id.* (emphasis added in part).

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 PROTOCOL: UNDERSTANDING THE SCOPE AND IMPACT

The Protocol was signed between India and Mauritius on May 10, 2016.[83] It amended a few articles of the Treaty, including Article 13.[84] The analysis here only examines the amendments relating to capital gains taxation arising from alienation of shares.

The Treaty has been amended to incorporate two new paragraphs in Article 13. In effect, the right to tax capital gains from alienation of shares acquired on or after April 1, 2017 is vested with the source jurisdiction.[85] Capital gains on shares acquired on or after April 1, 2017 and derived between then and March 31, 2019 may avail the benefit of a concessional rate—50% of the tax rate

78. *Id.* at 728–29.

79. (2015) Civil Writ Petition No. 11307 of 2014 (Punjab and Haryana HC) (on file with author).

80. *Id.* ¶ 30 (emphasis added).

81. *Id.* ¶ 40.

82. A.A.R. No. 1017 of 2010, ¶ 7 (Aug. 10, 2016), http://aarrulings.in/it-rulings/uploads/pdf/1473270870_aar-1017-shinsei-ruling.pdf [https://perma.cc/7PBR-SMYS].

83. Protocol, *supra* note 2.

84. *Id.* at art. 4 (amending Article 13 of the I-M Treaty).

85. *Id.* (inserting paragraph (3A) into Article 13: "Gains from the alienation of shares acquired on or after 1st April 2017 in a company which is resident of a Contracting State may be taxed in that State.").

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 non-taxation existing in the erstwhile regime has been resolved.

86. *Id.* (inserting paragraph (3B) into Article 13: "However, the tax rate on the gains referred to in paragraph 3A of this Article and arising during the period beginning on 1st April, 2017 and ending on 31st March, 2019 shall not exceed 50% of the tax rate applicable on such gains in the State of residence of the company whose shares are being alienated.").

87. *Id.* (replacing the existing paragraph 4 of Article 13 with the following: "Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 3A shall be taxable only in the Contracting State of which the alienator is a resident.").

88. I-M Treaty, *supra* note 1, at art. 10(4) ("The term 'dividends' as used in this Article means income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the Contracting State of which the company making the distribution is a resident.").

89. *Id.* at art. 3(2) ("In the application of the provisions of this Convention by a Contracting State, any term not defined therein shall, unless the context otherwise requires have the meaning which it has under the laws in force of that Contracting State relating to the areas which are the subject of this Convention.").

90. Companies Act, 2013, No. 18, Acts of Parliament, 2013, § 2(84) (India).

91. Linesh Lalwani, Ashish Sodhani & Rajesh Simhan, *India Mauritius Tax Treaty Renegotiated*, NISHITH DESAI ASSOCS.: TAX HOTLINE (May 11, 2016), http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/india-overhauls-tax-treaty-with-mauritius-india-and-mauritius-sign-protocol-for-amendment-of-dtaa.html?no_cache=1&cHash=b4f74d914ce62cff5000a5029b488625 [https://perma.cc/3FE3-MR75].

92. Dhruv Sanghavi, *'Company' and 'Shares' Under the 2016 India-Mauritius Protocol and the U.N. Model Treaty*, 83 TAX NOTES INT'L 509, 509 (2016).

93. Editorial, *Mauritius No Longer India's Treasure Island*, ECON. & POL. WKLY., May 14, 2016, at 8, 8 (India).

The Act draws a distinction between long-term and short-term gains.[94] Interestingly, India has liberalized its domestic regime on capital gains taxes on shares in the past decade.[95] The Finance Act of 2004 introduced a Securities Transaction Tax ("STT"),[96] which levies a 0.1% tax on the purchase and sale of equity shares on the purchaser and seller where *inter alia* the transaction is entered into on a recognised stock exchange.[97] In turn, (a) long-term gains from sale of equity shares are exempt from tax if the transfer was effected after October 1, 2004 and STT had been paid thereon,[98] and (b) short-term gains from sale of equity shares are taxed at a flat rate of 15% if the transfer was effected after October 1, 2004 and STT had been paid.[99]

Hence, despite the reallocation of taxing rights transactions, long-term capital gains from listed equity shares will still enjoy a double non-taxation status. The Final Report on BEPS Action Plan 6 on the issue of treaty abuse seeks to clarify that tax treaties are not intended to create opportunities for double non-taxation.[100] Will the revenue officers continue to raise issues of abuse on account of the limited double non-taxation?

The LOB is not a treaty-wide clause, being restricted solely to capital gains, and will only be in force for two years. The conditions contained in the LOB state that the entity should not be (a) arranged with the primary purpose of taking advantage of the particular provision or (b) a shell /conduit company.[101] An entity fulfilling the former criterion appears to also satisfy the bona fide business activities test. A shell/conduit company is defined as an entity "with negligible or nil business operations or with no real and continuous business activities carried out in [the] Contracting State."[102] An entity is deemed to be not a "shell/conduit company" if (a) in the immediately preceding twelve month period its expenditure on operations is equal or more than 2.7 million INR or (b)

94. *See* Income-Tax Act (as amended by Finance Act, 2008), 1961, No. 43, Acts of Parliament, 1961, §§ 2(29A), 2(29B), 2(42A), 2(42B) (India). A capital asset is ordinarily termed to be long-term if it has been held for a period of at least thirty-six months prior to transfer. *See id.* at § 2(42A) (defining a "short-term capital asset" as a capital asset held for not more than thirty-six months). However, this period is modified to twelve months in the instance of listed shares and twenty-four months in the instance of unlisted equity shares. *Id.*

95. Prashant Prakash, Jaya Kumari Pandey & Abhishek K. Chintu, *Revisiting Capital Gains Tax on Securities in India*, ECON. & POL. WKLY., May 14, 2016, at 47, 47.

96. Finance (No. 2) Act, 2004, No. 23, Acts of Parliament, 2004, §§ 97(13), 98, 99(c) (India).

97. *Id.* § 98.

98. Income-Tax Act, § 10(38).

99. *Id.* § 111A.

100. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], OECD/G20 BASE EROSION AND PROFIT SHARING PROJECT: PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES, ACTION 6 – 2015 FINAL REPORT, at 91–93 (2015).

101. Protocol, *supra* note 2, at art. 8 (adding Article 27A into the I-M Treaty).

102. *Id.*

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]

B. Treaty and GAAR Interplay

GAAR is coming into force with effect from April 1, 2017,[108] which coincides with the commencement of the Protocol. GAAR targets impermissible avoidance arrangements.[109] If a transaction is classified as impermissible, the arrangement may be disregarded, income may be re-characterized, and

103. *Id.*

104. Protocol Amending the Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Taxes on Income, India-Sing., art. 6, June 29, 2005, Notification No. S.O. 1022(E) (July 18, 2005).

105. *Id.* at art. 3.

106. *Id.* at art. 6.

107. Press Release, Press Info. Bureau, Ministry of Fin., India and Singapore Sign a Third Protocol for Amending the Double Taxation Avoidance Agreement (DTAA) (Dec. 30, 2016) (India), http://pib.nic.in/newsite/PrintRelease.aspx?relid=156015 [https://perma.cc/3X4S-RVZ6].

108. Income-Tax Act (as amended by Finance Act, 2008), 1961, No. 43, Acts of Parliament, 1961, § 95(2) (India).

109. *Id.* § 96(1). Described as arrangements, the main purpose of which, is to obtain a tax benefit and that: (a) are not on an arms-length basis; (b) result in misuse or abuse of the Act; (c) lack commercial substance; or (d) are not bona fide. *Id.*

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 be understood in two phases: (i) April 1, 2017 to March 31, 2019 when the LOB will be in effect and (ii) April 1, 2019 onwards when the LOB ceases to exist.

In the first phase one has to examine whether LOB and GAAR would apply simultaneously. The CBDT has clarified that "[*i*]*f a case of avoidance is sufficiently addressed by LOB in the treaty, there shall not be an occasion to invoke GAAR*."[112] Technically, revenue officers may still claim that abuse is not "*sufficiently addressed*" through the LOB and that GAAR should apply as well.[113] For example, in the case of capital gains on listed equity shares which still enjoy double non-exemption, revenue officers may invoke this window of opportunity.

In the second phase, Article 13 along with remaining provisions of the Treaty would be subject to the greater scrutiny under GAAR. The CBDT has assured that GAAR will be invoked rarely and uniformly and not merely because a tax-neutral jurisdiction has been chosen.[114] However, it is still early days to say how this would play out for the Mauritius Route.

A significant move ahead in the domain of tax treaties is the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("MLI"), which has been signed by India.[115] Each signatory can choose which of its treaty partners is to be covered under the MLI.[116] While India intended to bring the Treaty within the ambit of MLI,[117] Mauritius has not

110. *Id.* § 98(1).

111. *Id.* § 90(2A).

112. CBDT Circular No.7 of 2017, Clarifications on Implementation of GAAR Provisions Under the Income Tax Act, 1961 (Jan. 27, 2017) (India) (emphasis added), http://www.incometaxindia.gov.in/communications/circular/circular7_2017.pdf [https://perma.cc/3FCN-V7N5].

113. Sriram Govind, *New India GAAR Circular Aims for Clarity but Remains Unsatisfactory*, MULTINATIONAL TAX & TRANSFER PRICING NEWS (Jan. 30, 2017), http://mnetax.com/new-india-gaar-circular-aims-clarity-remains-unsatisfactory-19320 [https://perma.cc/NF4F-7ZQ7].

114. Press Release, CBDT, Dep't of Rev., Ministry of Fin., Sub: Clarifications on Implementation of GAAR Provisions Under the Income Tax Act, 1961 (Jan. 27, 2017) (India) (on file with author).

115. Sriram Govind, *India's Multilateral Instrument Choices: A Quick Run-Through*, MULTINATIONAL TAX & TRANSFER PRICING NEWS (June 12, 2017), https://mnetax.com/indias-multilateral-instrument-choices-quick-run-21718 [https://perma.cc/3NFA-6V8C].

116. *Id.*

117. *India: Status of List Reservations and Notifications at the Time of Signature*, OECD, http://www.oecd.org/tax/treaties/beps-mli-position-india.pdf [https://perma.cc/B6ZT-C8MQ] (showing India including the Treaty with Mauritius as part of the agreements to be covered by the MLI).

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 aim to claim the taxing rights but eventually changed their stance in the wake of the non-tax factors.

Circular 2 of CBDT legalized and legitimized the Mauritius Route so much so that later, when there was a proposal to amend the Act regarding the sufficiency of the TRC, it could not be passed. Despite the Mauritius Route receiving affirmation from the highest court it has been the subject of much litigation perhaps because the revenue officers were not convinced of the legitimacy of Article 13(4).

The Protocol has its own shortcomings and one has yet to see how the Indian experience will be shaped in light of the GAAR. In light of the developments relating to the MLI, if any changes are to be made to the Treaty it would only have to be through bilateral negotiations between India and Mauritius. Given how closely the bilateral relations have been guarded, this may mean a long wait before any further breakthrough.

118. *Mauritius: Status of List Reservations and Notifications at the Time of Signature*, OECD, http://www.oecd.org/tax/treaties/beps-mli-position-mauritius.pdf [https://perma.cc/6YBS-4LF7] (showing Mauritius *not* including the Treaty with India as part of the agreements to be covered by the MLI).