

EY Tax Alert

Protocol to India-Mauritius DTAA signed to include Principal Purpose Test

Executive summary

EY Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

This Tax Alert summarizes the amendments to India-Mauritius Double Taxation Avoidance Agreement (DTAA or treaty) vide Protocol signed on 7 March 2024 (2024 Protocol) by India and Mauritius to incorporate the Base Erosion and Profit Shifting (BEPS) related anti-abuse provisions.

The 2024 Protocol proposes to incorporate the minimum standards of anti-abuse provisions, i.e., the Preamble and the Principal Purpose Test (PPT), which will act as a means to deny treaty benefits if one of the principal purposes of the arrangement or transaction is to obtain the DTAA benefit.

The 2024 Protocol will be effective from the date of entry into force, without regard to the date on which the taxes are levied or the taxable years to which taxes relate.

Background

- ▶ The extant India-Mauritius DTAA, which entered into force on 1 April 1983 was amended by way of Protocol signed on 10 May 2016¹ (2016 Protocol), wherein largely the source country taxation rights were enhanced, and Limitation of Benefits (LOB) clause was included apart from the Exchange of Information (EOI) and Assistance in Collection of Taxes related provisions. One of the significant amendments was with regard to provision of taxation rights to source country with respect to capital gains on sale of shares acquired on or after 1 April 2017, while the investments made prior to 1 April 2017 were grandfathered (i.e., only the resident country has exclusive right to tax gains on alienation of shares).
- ▶ The 2016 Protocol did not contain the BEPS related changes and to recollect, Mauritius was a part of list of DTAAs, as notified by India, to be amended through multilateral instrument (MLI), while India was not notified by Mauritius under its list of DTAAs for MLI purposes. Accordingly, India-Mauritius DTAA was not subject to amendment in line with MLI pursuant to BEPS framework.
- ▶ In a subsequent press release dated 10 July 2017, Mauritius announced that for the DTAAs which are not covered by the MLI, Mauritius will discuss bilaterally with the respective treaty partners, including India, in order to implement the BEPS minimum standards.
- ▶ Recently, on 7 March 2024, India and Mauritius signed a protocol to amend the DTAA to better align with the OECD proposals on BEPS.

▶ Principal Purpose Test introduced:

In line with the minimum standard under MLI, the Protocol includes PPT rule, wherein a benefit under the DTAA shall not be granted in respect of an item of income if it is reasonable to conclude that obtaining treaty benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the treaty.

▶ Date of entry into effect:

The 2024 Protocol requires both India and Mauritius to notify each other about completion of the procedures required by their respective laws to implement the provisions of the Protocol. Once the notification has been issued by both the countries, the 2024 Protocol will enter into force on the date of the later of the two notifications. The 2024 Protocol shall also enter into effect on the same day (viz. the date of the later of the two notifications) without regard to the date on which the taxes are levied or the taxable years to which taxes relate.

Details of 2024 Protocol:

▶ Preamble of the DTAA replaced:

- The existing preamble to India-Mauritius DTAA has been replaced to expressly provide that the purposes of tax treaties are not limited to the elimination of double taxation, but also to prevent double non-taxation/reduced taxation including the prevention of inappropriate use of DTAA by residents of third country.
- The phrase “for the encouragement of mutual trade and investment” has been omitted in the revised preamble.

¹ Refer EY Tax Alert “Protocol signed on 10 May 2016 to amend the 1982 India-Mauritius tax treaty” dated 12 May 2016 and EY Tax Alert “Government of India issues notification

on India-Mauritius Protocol coming into force” dated 16 August 2016 in this regard.

Comments

The 2024 Protocol is in furtherance of the commitment of India and Mauritius to further develop their economic relationship and demonstrates their commitment towards combating BEPS. This is a result of bilateral negotiations between India and Mauritius. It may be noted that the 2024 Protocol includes only the minimum standard on anti-abuse provisions, wherein text of preamble has been amended and PPT has been introduced, while various other MLI provisions, such as changes to Permanent Establishment Article, treaty benefit with reference to dual resident entities etc. have not been incorporated.

In terms of its coverage, PPT impacts every treaty benefit, unless the taxpayer is able to demonstrate that benefit is in accordance with object and purpose of the treaty. One of the significant benefits of India-Mauritius DTAA is in respect of shares of Indian companies acquired before 1 April 2017. In this context, the deletion of the phrase "for the encouragement of mutual trade and investment" from the preamble enumerating the object and purpose of the treaty is significant and may suggest a shift in focus towards preventing treaty shopping evasion over aiding commercial relations.

The Protocol will be effective from the date of the later of the notifications^[2] by India and Mauritius about completion of their respective internal process 'without regard to the date on which the taxes are levied or the taxable years to which taxes relate'. Interestingly, a similar language was adopted in the provisions pertaining to Entry into Effect in the 2016 Protocol amending the India-Mauritius DTAA^[3] and the 2016 Protocol amending the India-Japan DTAA^[4], qua the Articles pertaining to EOI and Assistance in Collection of Taxes. Generally, any amendment/addition in such articles are understood to apply not only with respect to transactions undertaken post such change but also in respect transactions undertaken prior to such change.

^[2] If the 2016 Protocol is any guide, completion of such internal procedures takes a few months. Refer EY Tax Alert titled "Government of India issues notification on India-Mauritius Protocol coming into force" dated 16 August 2016 in this regard.

^[3] Refer EY Tax Alert "Protocol signed on 10 May 2016 to amend the 1982 India-Mauritius tax treaty" dated 12 May 2016

^[4] Source: Income Tax Department (incometaxindia.gov.in)

Correspondingly, debate ensued about a potential impact of the 2024 Protocol to past concluded transactions and income streams arising prior to effective date of 2024 Protocol. In this light, the tax authority on 12 April 2024 clarified^[5] that the concerns raised in this regard are premature, as the Protocol is not yet ratified and notified by Government of India (GOI) in exercise of its powers conferred under the Income Tax Laws. Further, it stated that any concerns therein will be addressed as and when the protocol comes into force. While the clarifications are awaited, the taxpayers which may be impacted by the protocol are advised to evaluate such impact and keep track of this significant development.

^[5]Source:
<https://x.com/IncomeTaxIndia/status/1778804751993618707>

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