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Beyond Borders: Navigating the Intricacies of India-Mauritius Double Tax Avoidance Agreement and Its Impact on Trade and Investment

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The evolution of international taxation has indeed spurred mechanisms such as Double Taxation Avoidance Agreements (DTAAs) to address the challenges of double taxation in cross-border transactions. Among these agreements, the 1982 India-Mauritius DTAA stands out as a significant milestone, facilitating substantial cross-border investment opportunities between the two nations. However, the implementation of such agreements has not been without its challenges. Concerns have emerged regarding treaty abuse, particularly as investors from third-party nations have sometimes exploited the advantageous provisions of the India-Mauritius DTAA to their benefit. Mauritius's appeal as a jurisdiction for strategic tax planning is underscored by its attractive attributes, including its low domestic tax rate and absence of capital gains tax. This preference, combined with the advantageous provisions of the India-Mauritius DTAA, has heightened the need for measures to address potential abuses and uphold the integrity of the tax system. In response to these challenges, initiatives such as the Base Erosion and Profit Shifting (BEPS) program have been developed to combat practices like treaty shopping and tax misuse. Furthermore, India has taken proactive steps to safeguard its tax interests by integrating measures such as the Principal Purpose Test (PPT) and the Limitation on Benefits clause into its tax treaties. These measures aim to mitigate the risk of treaty abuse and ensure that tax treaties serve their intended purpose of fostering legitimate cross-border economic activities while preventing undue tax avoidance practices. Through these efforts, India aims to strike a delicate balance between promoting international investment and safeguarding its tax base, thereby contributing to a fair and transparent global tax framework.

Keywords: *treaty shopping, limitation of benefits, principle purpose test, tax avoidance.*

INTRODUCTION

The international landscape of taxation has witnessed significant transformations in response to the complexities arising from cross-border economic activities. One pivotal development in this realm is the establishment of bilateral agreements between countries aimed at mitigating the challenges posed by the taxation of the same income in multiple jurisdictions. This introductory section provides a comprehensive exploration of the historical background of DTAAs, a detailed overview of the India-Mauritius DTAA, and an in-depth examination of the definition and concept of treaty shopping.

BACKGROUND OF DOUBLE TAXATION AVOIDANCE AGREEMENTS (DTAAS)

The roots of Double Taxation Avoidance Agreements can be traced back to the early 1920's. Despite the effects of globalisation, the concepts and institutions set by the League of Nations in the 1920s continue to be reflected in the contemporary international tax treaty system. These ideas were formulated in a global economy where communication was slow and trade was limited to material goods. Measures to prevent double taxation were called for during the interwar period due to the double taxation of cross-border income coming through the crossover of parent jurisdiction and residing jurisdiction. On behalf of businesses, the International Chamber of Commerce (ICC) stated that action to avoid double taxation is urgently needed. In order to avoid double taxation, the League of Nations created the very first model tax treaty in 1928. This model served as the basis for contemporary tax treaties, the UN Model, and the OECD Model from 2010. The League of Nations did not anticipate that the model tax convention it created in 1928 would remain essentially the same and grow into a vast network of bilateral tax treaties. It favoured a system of multilateral tax treaties, with some bilateral tax treaties serving as an intermediary, transitional approach.[1]

[1] Michael Kobetsky, *International Taxation of Permanent Establishments: Principles and Policy* (CUP 2011) 106–151

The fundamental problem that DTAAs sought to address was the potential for an individual or a company to be taxed on the same income in both the country of residence and the country where the income was generated. This double taxation not only discouraged international investments but also posed challenges to businesses operating on a global scale. In response to these challenges, countries began negotiating and entering into DTAAs to allocate taxing rights and prevent the adverse effects of double taxation. These agreements serve as legal frameworks to provide clarity on the jurisdiction of taxation and establish rules for resolving potential conflicts. The overarching goal is to create a conducive environment for international trade and investment by eliminating or reducing instances of double taxation.

Over time, the network of DTAAs has expanded globally, reflecting the recognition of their significance in fostering economic cooperation and ensuring a fair and predictable tax environment for businesses and individuals engaged in cross-border activities. The historical background of DTAAs underscores their evolution as essential tools in the realm of international taxation, facilitating economic growth and fostering cooperation between sovereign states.

OVERVIEW OF INDIA-MAURITIUS DTAA

Against this backdrop of the broader historical context, the India-Mauritius Double Taxation Avoidance Agreement emerges as a noteworthy case study. Concluded in 1982, this agreement holds particular significance due to its impact on the flow of investments between the two nations.

The India-Mauritius DTAA, like many other bilateral tax treaties, outlines the principles governing the taxation of income arising in one contracting state and received by residents of the other. One of the distinctive features of this treaty is its treatment of capital gains, particularly those arising from the sale of shares. Historically, Mauritius provided a favorable tax regime, making it an attractive jurisdiction for Indian businesses to route their investments, especially in sectors such as real estate and capital markets. The agreement played a crucial role in facilitating cross-border investments and trade between India and Mauritius. However, over time, concerns began to emerge about the potential misuse of the treaty. Investors from third

countries, not directly involved in economic activities in Mauritius, started exploiting the favorable terms of the India-Mauritius DTAA. This practice, commonly known as 'Treaty shopping' raised questions about the legitimacy and economic substance of investments routed through Mauritius.

DEFINITION AND CONCEPT OF TREATY SHOPPING

According to Vogel. K. Klaus, 'Tax planning involves the application of both domestic tax laws and conventions against double taxation. The reason for this is the legal openings resulting from tax treaties. Many transactions are made in an attempt to obtain the benefits of a treaty that, in the absence of the taxpayer's residency in a contracting state, would not apply to him or her. These agreements are now referred to as treaty shopping.'[2]

The concept of treaty shopping[3][4] challenges the fundamental principles underpinning DTAAs, as it introduces a layer of complexity and potential abuse. Investors engaging in treaty shopping may establish entities in an intermediary jurisdiction with the primary purpose of gaining access to more favorable tax treatment, exploiting gaps or ambiguities in the language of the tax treaty. This practice raises concerns about the erosion of the tax base of both the source and residence countries and calls into question the intended purpose and benefits of the bilateral agreement. Understanding treaty shopping involves a nuanced exploration of the motives, methods, and consequences of such practices. Motives may range from legitimate tax planning to outright abuse, and methods may involve complex corporate structures designed to meet the technical requirements of the tax treaty while circumventing its underlying principles. Consequences, both economic and legal, extend beyond the immediate parties involved, impacting the tax revenues of the countries party to the treaty and influencing the broader dynamics of international taxation.

In the case of the India-Mauritius DTAA, the concept of treaty shopping became a focal point of debate and policy considerations as Indian authorities sought to address the challenges posed

[2] Ekkehart Reimer and Alexander Rust, *Klaus Vogel on Double Taxation Conventions* (5th edn, Wolters Kluwer)
[3] *Crown Forest Industries Ltd. v Supreme Court of Canada* [1995] 2 SCR 802
[4] *Azadi Bachao Andoaln v Union of India* (2002) 256 ITR 563 (Del)

by the misuse of the treaty. This paper seeks to unravel the complexities surrounding treaty shopping within the context of the India-Mauritius DTAA, examining its historical evolution, legal intricacies, practical implications, and potential policy responses.

POPULARITY OF THE MAURITIAN ROUTE

In the landscape of international investments, the Mauritius route has emerged as a pivotal channel for directing capital into India. This popularity can be attributed to a multifaceted combination of commercial and tax-related advantages. Among these, the India-Mauritius Double Tax Avoidance Treaty stands as a cornerstone, providing unique benefits to investors for over three decades. This article delves into the various factors that have propelled Mauritius into the limelight as a preferred route for foreign investments in India.

INDIA-MAURITIUS DOUBLE TAX AVOIDANCE TREATY

The pivotal factor behind the prominence of the Mauritius route is undoubtedly the Double Tax Avoidance Treaty (DTAC) signed between India and Mauritius in 1982. For more than 30 years, this treaty provided unparalleled advantages until its amendment in 2016. The modus operandi of the Mauritius route, as established by the DTAC, granted absolute protection to Mauritian residents from Indian capital gains tax.[5]

Technicalities of the Mauritian Route: The operational methodology of the Mauritius Route is intricately tied to the India-Mauritius Double Tax Avoidance Treaty (DTAC), a bilateral agreement inked in 1982 that afforded comprehensive protection to Mauritian residents from taxes on capital gains emanating from India.[6] This treaty allocated the taxing rights exclusively to the Residence state, meaning that India, as the Source state, had no claims on capital gains. Article 13(4) of the DTAC stipulates that in the event of selling shares in an Indian company, the

[5] 'Investment routed from Mauritius to India for tax benefits: WTO' *Business Line* (03 June 2015) <https://economictimes.indiatimes.com/news/politics-and-nation/investment-routed-from-mauritius-to-india-for-tax-benefits-wto/articleshow/47531260.cms?from=mdr> accessed 20 February 2024

[6] 'Double Taxation Agreement between India and Mauritius 1983' (*Asean Briefing*, 12 June 1983) <http://www.aseanbriefing.com/userfiles/resources-pdfs/India/DTA/Asia_DTA_Mauritius_India.pdf> accessed 20 February 2024

seller would not be subjected to Indian capital gains tax. The systematic approach under this modus operandi involves an investor initially establishing an intermediary firm in Mauritius. Subsequently, the investor channels capital to this Mauritian entity, which then becomes the conduit for investment in India. Notably, this strategic process shields the investor from Indian capital gains tax, thanks to the protective measures enshrined in the DTAC.

For investors hailing from non-treaty countries, the procedural framework involves initially transferring funds to Mauritius. Through this financial manoeuvre, they assume the identity of a Mauritian resident, thereby gaining access to the advantageous provisions of the DTAC. Following this, the investor proceeds to direct investments from Mauritius to India, capitalizing on the protective shield against capital gains taxation provided by the treaty. This intricate methodology not only facilitates tax efficiency but also underscores the importance of understanding the nuanced mechanisms governing cross-border investments through the Mauritius Route.

Treaty Shopping:[7] The practice commonly referred to as treaty shopping constitutes a significant phenomenon in international finance. This strategy involves routing cross-border capital and investments through a third country, primarily to capitalize on the advantageous terms stipulated in treaties specific to that jurisdiction. At the heart of treaty shopping is the establishment of shell companies, entities devoid of genuine business or economic activities, serving solely as instruments for financial and legal operations under the control of their owner or controller.

Given the unique benefit of exemption from capital gains tax on investments in India afforded exclusively to residents of Mauritius, investors from other nations adopt a distinctive approach. They engage in treaty shopping by first creating a shell company in Mauritius, assuming the legal identity of a Mauritian resident. Remarkably, this enables even non-Mauritian investors to own a company with a Mauritian identity at minimal additional cost. This Mauritian-registered

[7] Adrienne Klasa, 'Round-tripping: how tiny Mauritius became India's main investor' *Financial Times* (30 October 2018) <https://www.ft.com/content/b2a35d1e-c597-11e8-86b4-bfd556565bb2> accessed 20 February 2024

entity becomes the conduit for routing investments to India, thereby availing itself of the preferential treatment accorded to Mauritian companies under the tax treaty.[8]

Crucially, the tax treaty does not draw a distinction between a company genuinely operating in Mauritius and one established solely to exploit tax benefits. This lack of differentiation allows investors to establish a Mauritian entity for a relatively modest investment, paving the way for the diversion of funds into Indian stocks and shares. By doing so, investors can strategically evade the burden of paying capital gains taxes, both in India and Mauritius. This intricate manoeuvre exemplifies the strategic use of legal frameworks to optimize financial outcomes, emphasizing the need for a nuanced understanding of treaty shopping practices in the realm of international investment.

DOMESTIC TAX FRAMEWORK IN MAURITIUS

In addition to the benefits derived from the advantageous tax treaty, Mauritius boasted an exceptionally low domestic tax rate, further solidifying its appeal as a premier destination for tax planning. The fiscal landscape in Mauritius was characterized by a distinct advantage – the absence of taxes on capital gains, coupled with the exemption of any withholding tax on dividends or interest generated by Global Business Companies (GBC) engaged in global investments within Mauritius. This favourable domestic tax framework played a pivotal role in positioning Mauritius as a leading hub for strategic tax planning initiatives. Investors and businesses leveraging the Global Business Companies structure in Mauritius were particularly advantaged by the absence of capital gains tax. Furthermore, the exemption from withholding taxes on dividends and interest from global investments added another layer of attractiveness for those seeking tax-efficient jurisdictions for their financial activities.[9]

By offering this combination of a tax-friendly environment and a proactive approach to fostering global investments, Mauritius not only became a preferred choice for international businesses

[8] Article 27A of Agreement for Avoidable of Double Taxation and Prevention of Fiscal Evasion with Mauritius
[9] 'Holding Regimes (2018): Mauritius compared to other jurisdictions' (*Biz Week*, 30 March 2018) <http://bizweek.mu/fr/info/holding-regimes-2018-mauritiu s-compared-other-jurisdictions> accessed 20 February 2024

but also underscored the importance of a comprehensive understanding of domestic tax regulations in shaping investment decisions. This convergence of factors propelled Mauritius to the forefront of global tax planning destinations, making it a jurisdiction of choice for those seeking optimal fiscal efficiency in their financial endeavours.

THE PRESENCE AND IMPACT OF GLOBAL BUSINESS COMPANIES (GBC) IN MAURITIUS

Mauritius strategically positioned itself as a hub for global business activities by launching its global business sector and facilitating the establishment of Global Business Companies (GBC). This development positioned Mauritius as a preferred destination for structuring investments, especially in emerging markets such as India. The structure of GBCs in Mauritius played a pivotal role in shaping the financial landscape, offering distinct advantages that contributed to its prominence until 2018. The Financial Services Commission of Mauritius issued two categories of Global Business Licenses, distinguishing between GBC1 and GBC2.[10] GBC1 entities were considered tax residents of Mauritius, granting them eligibility to access the benefits of Mauritius' extensive network of tax treaties. On the other hand, GBC2 entities were not treated as tax residents of Mauritius and were consequently ineligible to avail themselves of the advantages offered by Mauritius' network of tax treaties. Importantly, GBC2 entities were exempt from taxation in Mauritius.[11]

Within Mauritius, the corporate tax rate stood at 15%, a factor that significantly influenced the tax landscape for GBCs. Mauritius, by combining the attributes of an offshore jurisdiction with the absence of capital gain taxes, no withholding taxes, confidentiality provisions, and facilitation of easy repatriation of profits and capital, successfully solidified its position as a major player in the offshore financial sector. These factors collectively contributed to Mauritius becoming an attractive and strategic choice for international businesses and investors seeking to optimize their financial operations within a tax-efficient and confidential environment. This

[10] Mauritian Budget 2018 harmonises the fiscal regime in Mauritius' (*International Proximity*, 15 June 2018) <https://www.internationalproximity.com/2018/06/15/mauritian-budget-2018/> accessed 20 February 2024

[11] Ministry of Finance and Economic Development, 'Budget Speech 2018-19, Mauritius' (*Budget*) <http://budget.mof.govmu.org/budget2018-19/2018_19budgetspeech.pdf> accessed 20 February 2024

underscores the critical role that the presence and policies surrounding Global Business Companies played in shaping Mauritius as a key player in the global financial arena.[12]

HISTORICAL TIES WITH INDIA AND THE IMPACT OF THE INDIAN DIASPORA IN MAURITIUS

Mauritius benefits significantly from its profound historical and cultural ties with India, laying the groundwork for an exceptionally strong bond between the two nations. This historical association has fostered a close relationship that extends beyond diplomatic and economic considerations. An integral aspect contributing to this connection is the substantial presence of the Indian Diaspora within the Mauritian population, constituting approximately 68% of the total. The Indian Diaspora in Mauritius is not merely a demographic statistic but a dynamic and politically influential community. The community has played a pivotal role in shaping the socio-political landscape of Mauritius, leveraging its numerical strength to exert political influence. This influence has further strengthened the ties between Mauritius and India, creating a diplomatic and strategic alliance that goes beyond conventional international relations.

India's affinity towards Mauritius is notably manifested through its consideration of the Indian Diaspora's interests. This is exemplified by the special provisions accorded to Mauritius in the Double Tax Avoidance Treaty (DTAC). The preferential treatment granted in the DTAC reflects India's acknowledgement of the historical ties and the influential presence of the Indian Diaspora in Mauritius. In essence, the historical relations with India, coupled with the impactful role of the Indian Diaspora in Mauritius, form a formidable foundation for the close association between the two nations. This association goes beyond conventional diplomatic ties, encompassing shared cultural values and a recognition of the political influence wielded by the Indian Diaspora. Understanding this historical context is crucial for comprehending the

[12] Paddy Carter, 'Why do Development Finance Institutions use offshore financial centres?' (*Overseas Development Institute*, 31 October 2017) <https://www.odi.org/publications/10967-why-do-development-finance-institutions-use-offshore-financial-centres> accessed 20 February 2024

nuanced factors contributing to Mauritius' advantageous position, especially in the context of diplomatic agreements such as the DTAC.[13]

COMPARATIVE ADVANTAGES POSITIONING MAURITIUS ON THE GLOBAL STAGE

Mauritius stands out on the global map due to its distinctive set of comparative advantages, making it an enticing destination for capital raising and financial services. These advantages are multifaceted, encompassing strategic geographical positioning, a business-friendly framework, cultural diversity, seamless connectivity, and an open orientation to the international community. Collectively, these factors have propelled Mauritius to be recognized as an attractive and world-class international centre, facilitating the flow of capital and financial services across continents. The strategic geographical location of Mauritius plays a pivotal role in its appeal. Positioned at the crossroads of Asia, Europe, the USA, and Africa, Mauritius serves as a central hub for facilitating international transactions. Its business-constructive framework further enhances its attractiveness, providing a conducive environment for investors seeking optimal conditions for financial activities. This framework encompasses regulatory measures, tax structures, and legal provisions that collectively contribute to the ease of doing business in Mauritius.

Moreover, the ethnic diversity of Mauritius adds another layer of appeal, creating a melting pot of cultures that fosters a cosmopolitan atmosphere. This diversity not only enriches the social fabric of the nation but also makes it a welcoming and inclusive environment for international investors and businesses. Connectivity emerges as a key factor, as Mauritius serves as a bridge connecting major global regions. Its accessibility and well-established infrastructure facilitate the smooth movement of capital and financial services, positioning the nation as a central player in the global financial landscape. The openness of Mauritius to the rest of the world further cements its status as an international centre of choice. This openness translates into a welcoming

[13] 'India-Mauritius Bilateral Brief' (*High Commission of India - Mauritius*) <https://hcimauritius.gov.in/pages?id=9avme&subid=yb8md&nextid=RdG7d> accessed 20 February 2024

stance toward global investments and collaborations, fostering a conducive environment for international business ventures.

BEPS ACTION PLAN 6 AND ITS IMPACT ON THE INDIA-MAURITIUS DOUBLE TAXATION AVOIDANCE AGREEMENT (DTAA)

In the realm of international taxation, the Base Erosion and Profit Shifting (BEPS) initiative, spearheaded by the Organisation for Economic Co-operation and Development (OECD), represents a monumental effort to address tax avoidance strategies that exploit gaps and mismatches in tax rules. BEPS Action Plan 6 specifically focuses on preventing the abuse of tax treaties, and its implications for the India-Mauritius Double Taxation Avoidance Agreement are profound. This article delves into the intricacies of BEPS Action Plan 6, its objectives, and how it has influenced the landscape of cross-border taxation, particularly in the context of the India-Mauritius DTAA.

BEPS ACTION PLAN 6: AN OVERVIEW[14]

Background and Context: BEPS, a phenomenon characterized by multinational enterprises shifting profits to low or no-tax jurisdictions, prompted the OECD to launch the BEPS project in 2013. Action Plan 6 of the BEPS initiative specifically addresses treaty abuse, acknowledging that taxpayers were engaging in treaty shopping – exploiting gaps in tax treaty rules to inappropriately obtain benefits intended for genuine economic activities.

Objectives of Action Plan 6: BEPS Action Plan 6 sets out to prevent the granting of treaty benefits in inappropriate circumstances. It provides recommendations to countries on designing and implementing rules to tackle treaty abuse. The overarching goal is to ensure that tax treaties are not misused to artificially reduce taxes and that benefits are granted based on the genuine economic activities of the taxpayers involved.[15]

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[14] Prevention of Tax Treaty Abuse, action 6
[15] *Ibid*

PRINCIPAL COMPONENTS OF ACTION PLAN 6

Action Plan 6 includes three principal components:

Introduction of a Minimum Standard: Countries are required to include a minimum standard in their tax treaties to counter treaty shopping. This minimum standard comprises two components: a) a 'Principal purpose test' (PPT) that allows a country to deny treaty benefits if obtaining these benefits was one of the principal purposes of any arrangement or transaction, and b) 'Simplified limitation on benefits' (LOB) provision that offers specific rules to grant treaty benefits based on the genuine activities of the taxpayer.

Treaty-Related Measures: Countries are encouraged to develop additional measures, either in the form of treaties or domestic law, to complement the minimum standard. These measures could include a more detailed LOB provision, a detailed PPT, or other rules to prevent treaty abuse.

Implementation and Monitoring: A peer review process ensures the effective implementation of the minimum standard. The reviews evaluate whether countries have successfully incorporated the minimum standard into their tax treaties and if the minimum standard is applied in a manner consistent with the objectives of preventing treaty abuse.[16]

IMPACT ON THE INDIA-MAURITIUS DTAA

Treaty Shopping and BEPS Concerns: As cross-border transactions evolved, concerns about treaty shopping, and investors routing their investments through Mauritius to benefit from the favorable tax terms of the India-Mauritius DTAA intensified. BEPS Action Plan 6 directly addresses these concerns by advocating for measures that prevent the abuse of tax treaties, aiming to ensure that benefits are granted only when there is a genuine economic connection between the taxpayer and the jurisdiction providing the benefits.

[16] *Ibid*

Principal Purpose Test (PPT) and Limitation on Benefits (LOB) Provision:[17] In line with BEPS Action Plan 6, countries, including India, have started incorporating the minimum standard into their tax treaties. The principal purpose test (PPT) has become a pivotal component of these changes. The PPT allows a country to deny treaty benefits if obtaining these benefits is one of the principal purposes of any arrangement or transaction. This directly targets arrangements that lack economic substance and are primarily designed for obtaining tax benefits.

Additionally, the limitation on benefits (LOB) provision, as suggested by BEPS Action Plan 6, has gained prominence. A well-crafted LOB provision helps ensure that treaty benefits are granted to entities that have a substantial connection to the contracting state and are engaged in bona fide economic activities.

Amendments to the India-Mauritius DTAA: In response to BEPS concerns and the evolving international tax landscape, India took significant steps to amend the India-Mauritius DTAA. The amendment, effective from April 1, 2017, marked a paradigm shift in the taxation of capital gains. It introduced a source-based taxation regime for capital gains arising from the alienation of shares, diluting the historical benefit that exempted Mauritius-based entities from capital gains tax in India.

The amendment incorporated elements of the BEPS Action Plan 6, aligning the India-Mauritius DTAA with international standards for preventing treaty abuse. The principal purpose test (PPT) became a crucial determinant in granting treaty benefits, ensuring that benefits are not extended when the principal purpose of an arrangement is to obtain tax advantages.[18]

Challenges and Implications for Investors: While aligning the India-Mauritius DTAA with BEPS Action Plan 6 addresses concerns related to treaty abuse, it introduces challenges for investors. The changes in the taxation of capital gains impacted investment structures that relied on the

[17] Smarak Swain, 'Can PPT-LOB Clause Plug the Loopholes Inherent in PCC Entities?' (*Kluwer International Tax Blog*, 29 May 2019) <https://kluwertaxblog.com/2019/05/29/can-ppt-lob-clause-plug-the-loopholes-inherent-in-pcc-entities/> accessed 20 February 2024

[18] B.K.Pandey, 'Amendment of India Mauritius DTAA and its Impact on Foreign Investment in India' (2019) 8(2S3) International Journal of Recent Technology and Engineering <https://www.ijrte.org/wp-content/uploads/papers/v8i2S3/B12670782S319.pdf> accessed 20 February 2024

historical tax advantages of the Mauritius route. Investors had to reassess their strategies, and businesses faced the need to restructure their operations to comply with the amended treaty provisions.[19]

EVALUATING THE IMPACT[20]

Opportunities for a Level Playing Field: The alignment of the India-Mauritius DTAA with BEPS Action Plan 6 presents opportunities for a more equitable and transparent international tax environment. By curbing treaty shopping and ensuring that treaty benefits are granted based on genuine economic activities, the amended DTAA contributes to a level playing field for businesses operating in India. This is in line with the broader global efforts to foster fair and responsible tax practices.

Enhanced Tax Revenue and Fiscal Policy Flexibility: From India's perspective, the amendments offer the potential for enhanced tax revenues. By taxing capital gains at the source, India retains a greater share of the tax base, contributing to fiscal sustainability and the ability to implement robust public policies. The amendments provide the government with increased flexibility to design and implement fiscal policies that align with national priorities, fostering economic growth, and addressing social challenges.

Investor Confidence and Regulatory Clarity: While the amendments present challenges for investors, they also contribute to a more predictable and transparent regulatory environment. Clarity in tax regulations is instrumental in building investor confidence. The revised DTAA provides a clear framework for investors to navigate, reducing uncertainties associated with the previous tax regime. This, in turn, supports a more stable investment climate.

JUDICIAL PRECEDENTS

Navigating Indirect Transfers: Legal Response to Vodafone: The landscape of Indian taxation underwent a significant transformation in response to the landmark decision by the Apex Court

[19] *Ibid*
[20] *Ibid*

in the Vodafone case[21]. This ruling established a precedent wherein the sale of shares by a non-resident company, even if holding Indian assets indirectly, was deemed exempt from capital gains tax in India. This verdict posed a challenge, prompting legislative action and the introduction of indirect transfer provisions in the Income Tax Act (ITA). In the aftermath of the Vodafone decision, the Indian government sought to address the perceived loophole that allowed non-resident entities to circumvent capital gains tax on indirect transfers. To rectify this, section 9 of the ITA underwent crucial amendments in 2012, which were applied retrospectively from 1962. These amendments aimed to bring indirect transfers of Indian shares by non-residents within the ambit of taxation in India.

The crux of the amendment lies in the taxation of gains derived by non-residents through the transfer of shares in a non-resident company. The pivotal criterion for the applicability of this tax was if the shares, whether directly or indirectly, derived more than 50% of their value from assets located in India. This provision was strategically crafted to ensure that gains arising from the disposal of shares, even if held indirectly through a non-resident entity, would now be subject to taxation in India. The introduction of these provisions marked a legislative response to the Vodafone judgment, closing the perceived loophole and reinforcing the government's ability to tax gains derived from the transfer of shares with underlying Indian assets. By doing so, the amendments aimed to align the tax framework with the economic substance of transactions, ensuring that indirect transfers did not escape the purview of Indian taxation.

Tax Avoidance via Mauritius: Historical Perspectives and Legal Evolution: Historically, investors have leveraged the Mauritius route for investments in India to exploit advantageous tax provisions embedded in both Mauritian domestic law and the Double Taxation Avoidance Agreement (DTAA) with India. Until April 1, 2017, this route provided a unique benefit, Mauritian companies could sell shares in Indian entities, realize capital gains, and distribute them to shareholders without incurring income tax in either India or Mauritius. The Apex

[21] *Vodafone International v Union of India* (2012) 1 SCR 573

Court's recognition of the Mauritius route in the UOI v Azadi Bachao Andolan[22] case added credence to its legitimacy as a treaty conduit for South Asia and South Africa.

The term 'Suitable Treaty Conduit' as used by the Apex Court, underscores the historical context of the DTAA. Enacted in 1983, Article 13 of the DTAA delineated the taxation of capital gains, stipulating that India lacked the authority to tax capital gains arising from the alienation of shares by a Mauritian resident. This provision, often referred to as the 'Residuary clause' formed the basis for Circular No. 682 (1994)[23], wherein the Central Board of Direct Taxes clarified that capital gains for Mauritian residents were solely taxable in Mauritius. However, the Revenue's scrutiny of gains from Mauritian entities selling shares in Indian companies prompted a response. Circular No. 789 (2000)[24] reiterated the stance of Circular No. 682, emphasizing that a valid Certificate of Residence from Mauritian authorities was sufficient for treaty benefits. This clarification faced legal challenges but was ultimately validated by the Apex Court, solidifying the Mauritius route as a legitimate practice.

The Apex Court's recognition of treaty shopping, allowing entities to strategically choose jurisdictions for tax benefits, further fortified the Mauritius route. This acknowledgment highlighted the economic rationale behind developing countries permitting treaty shopping to attract capital and technology inflows. The landscape evolved in 2012 with the Vodafone case, where the Apex Court asserted that even under the Income Tax Act (ITA), indirect transfers of Indian shares were not taxable. This decision aligned with international practices, recognizing the common strategy of foreign investors using intermediary entities, like Mauritius-based companies, for tax and business advantages.

Despite amendments in 2012 introducing indirect transfer provisions to the ITA, the Mauritius route remained unaffected due to Article 13(4) of the DTAA. The introduction of the General

[22] *UOI v Azadi Bachao Andolan* (2003) 263 ITR 706

[23] 'Clarification regarding agreement for avoidance of double taxation with Mauritius' (*Income Tax India*) <https://incometaxindia.gov.in/Communications/Circular/910110000000000444.htm#:~:text=Circular%20No,%2C%20dated%2030%2D3%2D1994&text=1.,on%206%2D12%2D1983>

[24] Wherever the 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 DTAC accordingly

Anti-Avoidance Rule (GAAR) in 2017 empowered Revenue to label certain transactions as impermissible avoidance arrangements.[25] Simultaneously, the DTAA underwent changes, taxing gains from direct transfers of Indian shares acquired after April 1, 2017. Notably, the Indian Government, cognizant of indirect transfer provisions, refrained from renegotiating the DTAA. The absence of amendments regarding indirect transfers in the context of Mauritius signifies continuity in this strategic avenue for investors. Support for this perspective can be drawn from the Andhra Pradesh High Court's decision in Sanofi Pasteur Holding SA v Department of Revenue[26], emphasizing the applicability of the residuary clause in similar India-France agreements.

ANALYSIS OF THE LEGAL PRECEDENCE

According to my inference, the Authority for Advance Rulings (AAR) exhibited justification in abstaining from the application of the initial two restraints stipulated in the first proviso to section 245R(2) of the Income Tax Act (ITA). However, it appears that the AAR may have rushed its decision on the matter of tax avoidance. Our contention is grounded in the perception that the AAR prematurely delved into the merits of the case at the admission stage, deviating from the prescribed procedural norms and raising concerns about the potential influence of such premature decisions on the subsequent assessment of tax avoidance.

Specifically, the AAR asserted that the residuary clause (4) of Article 13 of the Tax Treaty, pertaining to capital gains taxation, was inapplicable to cases involving the indirect transfer of shares. Consequently, the AAR deemed a transaction involving the indirect transfer of shares, as in the present case, taxable in India. However, if the AAR adhered to this interpretation, it logically follows that there was no basis for alleging tax avoidance by the Mauritian entities. This rationale aligns with the perspective articulated by Justice O. Chinnappa Reddy in McDowell and Co. Ltd. v Commercial Tax Officer[27], highlighting that tax avoidance involves circumventing tax obligations within the bounds of the law. Thus, if the Mauritian entities were

[25] 'Clarifications on implementation of GAAR Provisions under Income Tax Act 1961' (*Income Tax India*) <https://incometaxindia.gov.in/communications/circular/circular7_2017.pdf> accessed 20 February 2024

[26] *Sanofi Pasteur Holding SA v Department of Revenue* (2013) 354 ITR 316

[27] *McDowell and Co. Ltd. v Commercial Tax Officer* AIR 1986 SC 649

legitimately taxable in India for the gains derived from selling their stake in the Singaporean entity holding Indian shares, the inquiry into whether the transaction was designed to avoid Indian taxes appears redundant. Moreover, I that the AAR's ruling on the merits contradicts the dictum of the Andhra Pradesh High Court in Sanofi. Additionally, the AAR's assertion that gains from the indirect transfer of Indian shares were taxable post-amendment in 2017, while gains from direct transfers were exempt before the amendment, is questioned.

Regarding the issue of tax avoidance, the AAR seemingly disregarded the Supreme Court's decision in Azadi Bachao, where the court acknowledged that, in the absence of a limitation on benefits clause in the Tax Treaty, residents of countries other than India and Mauritius could legitimately avail themselves of the treaty's benefits. This acceptance by the Apex Court raises questions about the ethical considerations surrounding the Revenue's contentions that influenced the AAR's adverse observations on tax avoidance. Furthermore, there lies fault with the AAR for imposing conditions not prescribed in the Tax Treaty, particularly in relation to the concept of beneficial ownership. This concept, elucidated in detail by the AAR, is not explicitly mentioned in Article 13 of the Tax Treaty and is deemed irrelevant in the absence of a direct reference. The AAR's reliance on such unprescribed conditions is considered a misstep in its decision-making process. Additionally, the AAR's observation on the parameters for checking tax avoidance, as established in Vodafone, is critiqued for its apparent oversight. The AAR's limitation of its analysis to the Mauritian leg of the holding structure, rather than applying parameters to the entire structure as per the Supreme Court's approach, is deemed a hasty decision. This oversight becomes more apparent when considering that the absence of direct investment or business operations in India was acknowledged, making any conclusion about the arrangement being pre-ordained for tax avoidance contradictory.

In summary, my assessment contends that the AAR's oversight of critical aspects, including the temporal context of the investment structuring and the application of prescribed conditions, renders its conclusions on tax avoidance erroneous and susceptible to judicial scrutiny. The AAR, designed to provide finality, may have veered off course by entertaining frivolous issues and overlooking crucial facets of the case. The ruling's apparent irrationality, especially in

neglecting the historical context of the investment, positions it for potential overruling on grounds of fundamental flaws in reasoning.[28]

RECOMMENDATIONS AND FUTURE PROSPECTS

From my personal perspective, the revelation that the Indo-Mauritius tax treaty is causing a substantial annual tax loss of over Rs 2,000 crore[29] is a matter of significant concern. As a Finance Ministry official rightly points out, this loss is primarily attributed to the exemption of capital gains from taxation in Mauritius. The agreement, which stipulates that capital gains from the sale of shares will be taxed only in the country of residence of the investor, creates a scenario where a Mauritius-based investor is exempt from paying capital gains tax in both India and Mauritius. This exemption has evidently become a channel for potential tax evasion, resulting in considerable revenue leakage for the Indian government. The Finance Ministry's acknowledgment of tax losses extending to non-securities sectors further underscores the magnitude of the issue. The situation is exacerbated by the existence of loopholes in the 'exchange of information' clause, leaving India vulnerable to the discretion of Mauritian authorities when seeking information related to tax avoidance.

The decision to review the Double Taxation Avoidance Agreement (DTAA) with Mauritius is a prudent step in addressing these concerns. Minister of State for Finance S S Palanimanickam's commitment to preventing tax evasion and enhancing the exchange of information reflects the government's proactive stance. The mention of hawala transactions and treaty shopping as additional reasons for the review signifies a comprehensive approach to address potential avenues of financial impropriety. The official's observation that money routed through Mauritius may involve kickbacks or illicit transfers abroad through under-invoicing of exports or over-invoicing of imports highlights the urgency of addressing these issues. The

[28] Deepak Chopra and Priya Tandon, 'Mauritius Mayhem: To eat the humble pie?' (*AZB Partners*, 05 January 2021) <https://www.azbpartners.com/bank/mauritius-mayhem-to-eat-the-humble-pie/> accessed 20 February 2024

[29] 'INDIA LOSING RS 2,000 CR A YR ON DTAA WITH MAURITIUS' (*Taxmann*) <https://www.taxmann.com/datafolder/news/News7862.htm> accessed 20 February 2024

attractiveness of Mauritius as an investment route due to treaty shopping further emphasizes the need for a careful re-evaluation of the existing treaty terms.

The call for strengthening the 'exchange of information' provision is well-founded. The current subjective nature of the clause under the Indo-Mauritius DTAA, where information deemed 'necessary' for carrying out the provisions of the convention will be shared, indeed leaves room for interpretation and manipulation. The suggested alignment with the Organisation for Economic Cooperation and Development's standard, which mandates sharing information that is 'foreseeably relevant,' is a step toward greater transparency and effectiveness in combating tax evasion. While acknowledging that tax considerations are pivotal in business decisions, experts' opinions about the long-term impact on investment flows into India are reassuring. The growing Indian economy is likely to continue attracting business and investments, mitigating potential concerns arising from the reworking of the DTAA with Mauritius.

In conclusion, the need for a thorough review of the Indo-Mauritius tax treaty is evident, not only to safeguard tax revenues but also to ensure a fair and transparent system that fosters legitimate cross-border investments and prevents illicit financial activities. The government's commitment to addressing these issues is a positive signal for the future integrity of India's financial ecosystem.

CONCLUSION

The analysis of legal precedents regarding the Authority for Advance Rulings (AAR) offers valuable insights into the complexities surrounding tax avoidance within the framework of the Indo-Mauritius tax treaty. While the AAR's decision to abstain from certain restrictions outlined in the Income Tax Act demonstrates a judicious approach, concerns linger regarding the expeditious manner in which it delved into the intricacies of tax avoidance. This expediency seems to have led to a departure from prescribed procedural norms, prompting questions about its potential ramifications on subsequent tax assessments. Moreover, discrepancies in the AAR's interpretation of tax treaty clauses, particularly regarding the applicability of the residuary

clause of Article 13 to indirect share transfers, raise doubts about the consistency and coherence of its rulings.

The recommendations for a thorough review of the Double Taxation Avoidance Agreement (DTAA) between India and Mauritius are not only timely but also reflective of a proactive stance towards addressing potential loopholes and shortcomings in the existing treaty framework. The acknowledgement of significant tax losses underscores the urgency of reforming treaty provisions to curb tax evasion effectively. Strengthening the 'exchange of information' clause to align with international standards is a crucial step towards enhancing transparency and cooperation in combating financial malpractice.

However, amidst these deliberations, it's essential to consider the broader implications of reworking the DTAA. While initial concerns may arise about the potential impact on investment flows into India, experts opine that the country's robust economic fundamentals will continue to attract foreign investments, thereby mitigating any short-term disruptions. Moreover, the proposed revisions aim not only to safeguard tax revenues but also to foster a fair and transparent tax regime that encourages legitimate cross-border investments while deterring illicit financial activities.

In conclusion, the call for a comprehensive review of the Indo-Mauritius tax treaty reflects the government's commitment to ensuring the integrity and efficacy of India's tax system. By addressing existing loopholes and enhancing cooperation in combating tax evasion, India endeavors to create a conducive environment for sustainable economic growth and development.