Analysis: India – Mauritius Income Treaty

See treaty text
Type of treaty: Income
Based on the OECD Model Treaty
Signed:August 24, 1982
Entry into force: December 6, 1983
Effective date: July 1, 1983. See Article 28.
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Article 1 Personal Scope

See treaty text
Persons who are residents of one or both States.

Article 2 Taxes Covered

See treaty text
India
The income-tax including any surcharge thereon imposed under the Income Tax Act, 1961 (43 of 1961);
The surtax imposed under the Companies (Profits) Surtax Act, 1964 (7 of 1964)
Mauritius
The income tax.
Mauritius' treaties cover only income tax imposed primarily under the Income Tax Act of 1995, as amended. Social security payments, as well as indirect taxes (such as customs and excise duties on imports, and taxes on consumption or property) are generally not covered by Mauritius' treaties.

Article 3 General Definitions

See treaty text
"India": the territory of India, including the territorial sea and airspace above it and any other maritime zone referred to in the Territorial Waters, continental shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976 (Act No. 80 of 1976), in which India has certain rights and to the extent that these rights can be exercised therein as if such maritime zone is a part of the territory of India;
"Mauritius": all the territories, including all the islands, which in accordance with the laws of Mauritius, constitute the State of Mauritius, including:

- the territorial sea of Mauritius; and

- any area outside the territorial sea of Mauritius which in accordance with international law is designated, under the laws of Mauritius concerning the continental shelf, as an area within which the rights of Mauritius with respect to the sea bed and sub-soil and their natural resources may be exercised.

"A Contracting State" and "the other Contracting State": Mauritius or India, as the context requires;
"Person": an individual, a company and any other entity, corporate or non-corporate, which is treated as a taxable unit under the taxation laws in force in the respective Contracting States;
"National": any individual possessing the nationality of that Contracting State and any legal person, partnership or association deriving its status from the laws in force in that Contracting State;
"Company": any body corporate or any entity which is treated as a company or a body corporate under the taxation laws in force in the respective Contracting States;
"Enterprise of a Contracting State" and "enterprise of the other Contracting State": respectively an industrial, mining, commercial, plantation or agricultural enterprise or similar undertaking carried on by a resident of a Contracting State and an industrial, mining, commercial, plantation or agricultural enterprise or similar undertaking carried on by a resident of the other Contracting State;
"International traffic": transport by a ship or aircraft operated by an enterprise having its place of effective management in a Contracting State, but not when the ship or aircraft is operated by the enterprise solely between places in the other Contracting State;
"Tax": Indian tax or Mauritius tax as the context requires, but does not include any amount payable in respect of any default or omission in relation to the taxes to which the treaty applies or which represents a penalty imposed relating to those taxes;
"Competent authority": in India: the Central Government in the Ministry of Finance (Department of Revenue) or their authorised representative;

in Mauritius: the Commissioner of Income Tax or his authorised representative.

Article 4 Residents

See treaty text

All Mauritian residents and companies are liable to income taxes.

Mauritius

INDIVIDUALS

Individuals resident in Mauritius are taxed on their worldwide income. However, certain specific exemptions from tax are provided under the Income Tax Act.

An individual is treated for tax purposes as being resident in Mauritius in a particular tax year if the individual:

- has his/her domicile in Mauritius, but not if his/her permanent place of abode is outside Mauritius;
- is present in Mauritius in that year for 183 days or more; or
- is present in Mauritius in that year and the 2 preceding years for 270 days or more.

CORPORATIONS

A company is treated under Mauritian income tax law as resident in Mauritius if it is incorporated in Mauritius or has its central management and control in Mauritius. However, a company that has been issued with a Category 2 Global Business Licence (GBL2) under the Financial Services Act 2007 is treated as a non-resident for tax treaty purposes and will therefore not be entitled to any of the benefits provided under the treaty. GBL2 companies are licensed to carry on business only with non-residents and are generally prohibited from carrying on certain listed activities in Mauritius, including:

- banking and financial services
- holding or managing or dealing with a collective investment fund or scheme as a professional functionary
- providing registered office facilities, nominee, directorship, secretarial or other services for corporations; and
- providing trusteeship services as a form of business.

PARTNERSHIPS

A partnership (otherwise referred to as a société) is resident in Mauritius if it has its seat or siège in Mauritius, and also includes a partnership which has at least one associate or associé or gérant resident in Mauritius.

TRUSTS AND ESTATES

A trust is treated as resident in Mauritius if it is administered in Mauritius and a majority of the trustees are resident in Mauritius, or if the settlor of the trust was resident in Mauritius at the time the instrument creating the trust was executed.

Article 5 Permanent Establishment

See treaty text

For a Permanent Establishment to exist:

- There must be a place of business
- Place of business must be fixed
- Business must be conducted through fixed place

In addition to the listed illustrative examples contained in the OECD Model, the treaty also lists:

- a warehouse in relation to a person providing storage facilities for others; AND
- a farm, plantation or other place where agricultural, forestry, plantation or related activities are carried on.

Building sites, construction or assembly projects, and supervisory activities in connection therewith, constitute a permanent establishment if they last more than six months.

The use of facilities solely for the purpose of delivery of goods or merchandise belonging to an enterprise, as well as the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of delivery, may constitute a permanent establishment.
A fixed place of business used for a combination of preparatory or auxiliary activities is not expressly excluded from the concept of a permanent establishment.
Mauritian tax law does not contain a comprehensive definition of the concept of permanent establishment, probably because that concept is not applied for purposes of subjecting to tax the Mauritian-source business profits of a non-resident. For the tests applied in such cases, see the comments below on the business profits article of the treaty.
The treaty therefore provides greater certainty and clarity consistent with the established tax treaty standard on the issue as to when a non-resident will be considered to have a presence in the country sufficient to bring it within the taxing jurisdiction of Mauritius on its business income.

India

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT ("OECD")
GLOBAL FORUM - SUPPLEMENTARY REPORT ON MAURITIUS
The OECD Global Forum on Transparency and Exchange of Information on Tax brought together delegates from 85 countries and 7 international organizations in Cannes, France last week (26 October 2011) to G20 summit. They adopted a progress report on 59 jurisdictions based on completed peer reviews.

Background

In April 2009, the OECD Global Forum on transparency and exchange of information published a progress report on several jurisdictions. Mauritius was included in the list of jurisdictions that have substantially implemented the internationally agreed tax standard, commonly known as the white list. Following this, the OECD conducts peer reviews in two phases, namely phase 1 on legal and regulatory framework; and phase 2 assesses the application of the standards in practice, where it focuses on the effectiveness of Exchange of Information. Mauritius was subjected to a combined review of phases 1 & 2. A progress report was issued on 28 January 2011 which set out recommendations and determinations. In short, the assessors identified some doubts regarding Mauritius ability to exchange information as there was not enough data to
corroborate with the legal framework and the mechanism in place. They concluded that a further review needed to be done, which culminated in the supplementary report issued (26 October 2011).

Supplementary Report

Mauritius has now shown that it has gained experience in exchanging tax information when requested. It is also upgrading its tax treaty network to incorporate paragraph 4 and 5 of the article 26, exchange of information of the OECD model, as well as entering into tax information exchange of information where tax treaty is not in place. The Mauritius Revenue Authority has also set out a procedure manual on exchange of information and now prescribes that any request for exchange of information has to be entertained within a period of 90 days. The supplementary report confirms that progress has been made with
amendments to the law to allow for more transparency, but some more work needs to be done in case of non resident trust and *societes de personne.* In a nutshell, most of the recommendations given in the progress report have now been addressed but the assessors believe that six months is a short time to properly evaluate the mechanism set out in phase 2.

Conclusion

This is welcome news which reinforces the message that Mauritius is accepted by OECD as having the legislation and the mechanism for transparency and exchange of information in tax matters. Note that it is also important to re-emphasize that exchange of information can only be done through the competent tax authorities and fishing expedition is not tolerated. Currently Mauritius has exchange of information article in its tax treaties but which is upgraded to the OECD model through either renegotiation or protocols. It also has tax information exchange Agreements with some countries where tax treaties are not in place.

INDIA – Key judicial cases

The Authority for Advance Rulings ("AAR") in a particular case (detailed below) has held that gains arising from the transfer of shares of an Indian company by a Mauritian resident should not be taxable in India under the India-Mauritius tax treaty ("Treaty"). While rejecting the Indian tax authorities (the "ITA") attempts to disregard the Mauritian entity on grounds of substance, the AAR has made interesting comments on issues such as tax avoidance, beneficial ownership and the validity of treaty shopping. The taxpayer, Ardex Investments Mauritius Limited ("AIML") was incorporated in Mauritius in 1998 and is held by Ardex Holdings U.K. Ltd ("Ardex Holdings"), a UK based company engaged in

the business of manufacturing construction material. AIML is a resident of Mauritius and possesses a tax residency certificate issued by the Mauritian tax authorities. It currently holds 50% of the shareholding in Ardex Endura (India) Pvt. Ltd ("AEIPL"), an Indian company engaged in the business of manufacturing flooring adhesives.
AIML proposes to sell its entire stake in the Indian company to Ardex Beteiligungs GmbH ("ABG"), a German group company, at fair market value. It sought an advance ruling on whether capital gains on the proposed sale would be chargeable to tax in India having regard to the provisions of the Treaty.
The ITA argued that AIML was brought into existence as a façade to make investments in India on behalf of Ardex Holdings UK, just to take advantage of the India-Mauritius Tax Treaty and thereby avoid being taxed under the India-UK tax treaty. It was argued that the assets of AIML comprised only the investment in AEIPL and that AIML did not earn any income in the year prior to the proposed transfer.
The ITA also proposed that the beneficial ownership of the shares of the Indian company vested with Ardex Holdings since the funds for purchase of such shares were sourced from the parent company. It was also alleged that the decision to sell the shares in AEIPL was taken by Ardex Holdings, which AIML followed, being its subsidiary. On this basis, the ITA sought to disregard the corporate veil of the Mauritian entity and bring the transaction to tax. The AAR did not agree with the ITA's submissions. It noted that the shareholding in AEIPL was acquired over a period a period of 10 years and did not come to existence all of a sudden. It also noted that although the formation of AIML was with an eye on the Mauritius Treaty, it cannot be viewed as objectionable treaty-shopping. Relying on the landmark Azadi Bachao Andolan case, the AAR held that there is nothing taboo about treaty shopping. In the Azadi Bachao Andolan case, India's Supreme Court held that treaty shopping is a legitimate exercise of tax planning and taxpayers cannot be denied benefits of the Mauritius Treaty in the absence of express treaty provisions limiting such benefits.
Considering that the shares were held by AIML for a considerable period of time and are proposed to be sold at fair market value, the AAR did not view the arrangement as a tax avoidance scheme. It also did not consider the theory of beneficial ownership to be relevant for deciding whether Ardex Holdings is the holder of the shares of the Indian company. Beneficial ownership is an anti-avoidance tool used in tax treaties aimed at restricting the availability of lower withholding tax rates to persons who exercise real and complete ownership rights over specific streams of income such as dividends, interest, royalty and fees for technical services.

Article 6 Income from Immovable Property

See treaty text

The treaty follows the general rule of providing for the exercise of taxing rights in relation to income from immovable property by the State in which the property is situated.
The treaty goes beyond the OECD Model by extending the scope of application of the principles governing the taxation of immovable property by the State of situs to the income derived from immovable property used for the performance of independent personal services.

Article 7 Business Profits

See treaty text

Distinct and separate enterprise approach
Apportionment of total profits permitted
Same profit attribution method to be used each year.
The treaty adopts the distinct and separate enterprise approach to the taxation of a permanent establishment contained in the OECD Model (2008).
On other issues, the treaty generally follows the OECD Model (2008) provisions in this area.

India

For a non-resident, only that income is subject to tax in India that, inter alia, accrues or arises, or is deemed to accrue or arise in India. (Section 5 of the Act.) In this regard, any income accruing or arising, directly or indirectly, through or from a "business connection" in India to a non-resident, is deemed to accrue or arise in India and hence, such income is taxable in India. (Section 9 of the Act.) The term "business connection" is very wide and what constitutes business connection has been the subject matter of judicial scrutiny in a large number of cases. Business connection may take several forms; it may include carrying on a part of the main business, or activity incidental to the main business of the non-resident through an agent, or it may be a relation between the business of the non-resident and the activity in India, which facilitates or assists the carrying on of that business. (*CIT v. R. D. Aggarwal & Co*. [1965] 56 ITR 20.) However, when the non-resident is entitled to relief under a tax treaty, the provisions of the Act only apply if they are more beneficial to the taxpayer. (Section

90(2) of the Act.) If a non resident entity is reckoned as having a PE in India, only the following business profits can be subject to tax in India:
(i) the income attributable to the PE;
(ii) the income generated from the sale of goods, etc., of the same or similar kind as those sold through the PE; and
(iii) the income from other business activities carried on by the non-resident entity in India of the same or similar kind as those effected through the PE. (Article 7(1) of the DTAA).
Further, the income attributable to the PE will be the income which the PE might be expected to generate if it were dealing at an arm's length basis with the non-resident. (Article 7(2) of the DTAA.)
India's Supreme Court in the case of Morgan Stanley ((*DIT v. Morgan Stanley Co. Inc*., 292 ITR 406 (2007), held that no further income will be attributable to a Service PE (occasioned due to the secondment of employees of an American company to its Indian subsidiary) of an American enterprise if the dealings between the American enterprise and its Indian subsidiary are being conducted at arm's length. However, it also held that the situation would be different if the transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a case, there would be a need to attribute profits to the PE for those functions/risks that have not been considered.
Further, in the judicial cases of Galileo (*Galileo International v. DCIT*, 2007 TIOL-447- ITAT Del.) and Amadeus (*Amadeus Global Travel Distribution v. DCIT*, (2008) 113 TTJ (Delhi) 767), apart from an Equipment PE (on account of computers provided to agents), the foreign companies were held to have an Agency PE in India on a dependent agency theory. Having said so, they were compensating the Indian agent on an arm's length basis. Accordingly, the Delhi Bench of the ITAT held that no further profits would be attributable to the PE in India. While arriving at this conclusion, the ITAT relied on a circular issued by the tax authorities that stated that no further profits of a foreign enterprise are to be taxed in India, where the remuneration of the agent fully represented the value of the profits attributable to the service provided by the agent. (Circular Number 23, dated July 23, 1969, issued by the Central Board of Direct Taxes.) They also relied on a similar judgment of the Bombay High Court rendered in the context of the India - Singapore DTAA. *(SET Satellite (Singapore) Pte Ltd. v. DDIT*, (2008) 110 BOM LR 2726.) Therefore, based on Morgan Stanley's ruling, if the non-resident entity compensates the Indian entity on an arm's length basis adequately reflecting the functions performed and the risks assumed by the Indian entity, it is more likely than not that no income of the non-resident entity will be brought to tax in India, if a PE is occasioned. However, this will depend on the fact pattern of each case. Further, Morgan Stanley, as such, related to a Service PE issue. Additionally, the circular relied on by the Tribunal in the above mentioned cases has since been withdrawn.
In a situation, where the tax authorities seek to calculate the taxable income under the Act and the rules made there under they can resort to either one (1) of the following three (3) methods:
(i) Presumptive method - tax authorities ascertain a reasonable percentage of the turnover;
(ii) Proportionate method - the tax authorities ascertain the profits on the basis of the ratio between global turnover and Indian turnover; and
(iii) If none of the above two (2) methods work, the tax authorities may use such other method as they may “deem fit.” (Rule 10 of the Income Tax Rules, 1962.)

Mauritius

The concept of permanent establishment is not used under Mauritius' tax law for purposes of establishing the source of business income derived by a non-resident from Mauritius. However, where a non-resident who is present in Mauritius sells goods or does so through another person in Mauritius, and the goods are in Mauritius or will be brought into Mauritius for the purpose or in pursuance or consequence of the sale, the non-resident will be deemed to have sold the goods in the course of carrying on a business in Mauritius, whether or not the sale is made within or outside Mauritius. In cases where the non-resident person sells the goods through a person who is present in Mauritius, that person will be deemed to be the non-resident's agent in respect of all the income derived from the business carried on in Mauritius by the non-resident. Consequently, that person becomes liable to income tax on the income, whether or not the non-resident in fact receives the income.
Since treaties generally override domestic law, the effect of the treaty will be to ensure that any tax liability arising for a resident of the other State may only occur in a manner consistent with the treaty provisions.

Article 8 Shipping and Air Transport

See treaty text

Follows the standard OECD Model provision regarding the place of taxation.

No express requirement for taxation of profits relating to boats engaged in inland waterways transport only in the State in which the place of effective management is situated.
The treaty follows the standard OECD Model provision regarding the place of taxation (i.e. only in the State in which the place of effective management of the enterprise is situated).
The treaty also follows the common approach in Mauritius' treaties of omitting the provisions dealing with the tax treatment of profits from inland waterways transport.

Article 9 Associated Enterprises

See treaty text
Usual OECD provisions regarding transfer pricing
Arm's length principle applies in dealings between associated enterprises
The treaty contains no paragraph providing for secondary adjustments
The treaty adopts the standard OECD Model paragraph regarding the application of the arm's length principle to associated enterprises.
However, the treaty omits the second paragraph of the OECD Model, which provides for a secondary adjustment to be made by the other Contracting State following the initial adjustment in accordance with the first paragraph. This means that relief for any double taxation arising as a result of the initial adjustment may have to be obtained in accordance with the mutual agreement procedure.

Article 10 Dividends

See treaty text
Treaty rate: 5% if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends;
15% in all other cases
Domestic rates:
India
Not subject to withholding tax.
Mauritius
Mauritius imposes no tax on dividend payments by Mauritius-resident companies.
In view of the full exemption of dividends from taxation under Mauritius' domestic law, the treaty provisions governing the taxation of cross-border dividends are of little practical relevance for non-residents deriving dividend income from Mauritian-resident companies. The provisions provide relief only for Mauritian residents deriving income from the other State, if such income is taxed at a rate higher than what the treaty permits.

Article 11 Interest

See treaty text
Treaty rate: No limit
Domestic rates:
India
The Authority for Advance Rulings ("AAR") has in a significant ruling re-characterized income in the hands of the investor from capital gains to interest and dividend income thereby denying exemption in respect of capital gains under the India-Mauritius Tax Treaty ("Treaty"). The AAR has disregarded the legal form of the transaction, alleging the transactions to be sham and imputing on the investors the intention to avoid Indian taxes. In this case the AAR dealt with income arising from the sale of shares and Compulsorily Convertible Debentures ("CCDs"). The AAR re-characterized the income arising on such disposition as interest income and not capital gains income on the grounds that a CCD is in the nature of a debt till the time it is converted and any income arising on account of a CCD should be considered interest income, regardless of the fact that the income has arisen on account of sale of such CCD to a party.
Z, the Applicant, and an Indian company V had invested into another Indian company S, which is a wholly owned subsidiary of V and subscribed to equity shares and CCDs issued by S. S is engaged in development of a certain plot of land, which rights were transferred by V to S prior to this investment. Under the investment agreement executed between S, V and Z, the CCDs were mandatorily convertible into equity shares upon the expiry of 72 months from the investment date; additionally, prior to the mandatory conversion date, Z had a put option to sell specific number of equity shares and CCDs to V and V had the call option to purchase the said shares and CCDs from Z.
V exercised the call option and purchased the CCDs from Z in multiple tranches. V approached the tax officer for a nil withholding certificate for the consideration paid to Z for the CCDs as such income, in the opinion of V, was in the nature of capital gains income exempt from tax under Article 13 of the

Treaty. The tax officer however rejected the application and asked V to deposit the withholding tax on this transaction. Z subsequently approached the AAR for a ruling on the issue.
Z contended that the consideration received from V was on account of sale of a capital asset and therefore the amount received over the purchase price was in the nature of capital gains and not interest income. The tax authorities, on the other hand, contended that CCDs are debt instruments carrying a fixed rate of return, and therefore any payments made for such instruments should be treated as interest income.
As a first step, the AAR examined various authorities and case laws to hold that a CCD was in the nature of a debt instrument which continues to so remain till the time the debt is repaid. The AAR also observed that the obligation to repay the principal and an interest component were embedded in the concept of debt and that such payments were not necessarily required to be in the form of debt and could be in the form of cash, as was in this case. The AAR further observed that the definition of 'interest' under the Act and the Treaty to conclude that 'interest' denotes any type of income that become payable on a debenture.
The AAR studied the provisions of the investment agreement which set out the purchase price required to be paid by V to Z for the CCDs, which purchase price was an aggregate of:a) the amount invested by Z, b) a pre-determined rate of return compounded quarterly, which rate varied with the period of investment;c) 10% of the value of the project being developed by S; and d) 8% of the investment amount calculated for a specified period.
The AAR further examined the other provisions of the investment agreement to conclude that while S and V were two separate legal entities, S had no power to exercise any management control over its business and that for all practical purposes V and S were a single entity. The AAR based this conclusion on provisions in the agreement which provided rights to V and Z to nominate directors to the board, right of V and Z with respect to material business decisions of S, consent requirement for S to enter into any related party transaction by S, among other management rights granted to V and Z. Additionally, V was required to share with Z, its financial statement, debt servicing status etc.
In light of such provisions, the AAR observed that on a close reading of the investment agreements, it was apparent that the commitment to repay the debt was on V, the parent of S and not S and therefore, the purchase of CCDs by V from Z should be considered repayment of the debt such that income arising to Z should be treated as interest income.

Mauritius

Interest payments to non-residents are subject to a final withholding tax at the rate of 15% of the gross amount.
It appears to be standard treaty practice for Mauritius to include exemptions for income derived by the State or particular State agencies, where the treaty permits source State taxation of such income. Thus, the treaty incorporates a reciprocal tax exemption for interest income derived by the government or its agencies.
The treaty also exempts from tax interest derived and beneficially owned by any bank resident in the other State, which is carrying on a bona fide banking business.
As in the OECD Model, the treaty adopts the permanent establishment exception to the general treaty principle governing the taxation of interest income. However, it also refers to a fixed base used for the performance of independent personal services as a separate exception to the general principle.

Article 12 Royalties

See treaty text
Treaty rate: 15% maximum
Domestic rates:

India

Subject to a 20% withholding tax.

Mauritius

Royalty payments to non-residents are subject to a final withholding tax at the rate of 15% of the gross amount.
A number of exemptions are provided under the domestic law for royalties paid to non-residents, notably:

- royalties payable by a corporation that holds a Category 1 or Category 2 Global Business Licence;

- royalties payable by a licensed bank where the royalties are paid out of the gross income the bank derives from its banking transactions with non-resident persons and corporations that hold a Global Business Licence; and

- royalties paid by a trust.

In a marked departure from the OECD Model, which confers exclusive taxing rights upon the State of residence of the recipient, this treaty, as does most of Mauritius' treaties, provides for shared taxation between the source and residence States.
The scope of royalties under the treaty is broader than under the OECD Model, in that it covers payments for the use of, or the right to use:
- films or tapes for radio or television broadcasting; and

- industrial, commercial or scientific equipment.

Article 13 Capital Gains

See treaty text
The treaty generally follows the OECD provision on this issue, with a few notable deviations.
The treaty provides additionally for gains on movable property pertaining to a fixed base used for the performance of independent personal services, which is subject to the same principle as gains on movable property that is part of the assets of a permanent establishment. This means taxation by the State in which the enterprise or fixed base is situated.
The treaty adopts the OECD Model provision applicable to gains from the alienation of ships and aircraft but omits reference to boats engaged in inland waterways transport.
Like most of Mauritius' treaties, the treaty does not deal specifically with the issue of the tax treatment of shares whose underlying assets consist mainly of immovable property situated in a Contracting State
Capital gains are not taxed in Mauritius, thus making the provisions of the tax treaty on this issue of less practical relevance for non-residents realizing such gains in Mauritius. As in the case of dividends, the treaty provisions are of greater importance to Mauritian residents realizing taxable gains from the other State.
India
In one case, the AAR ruled that the applicant's scheme for buyback constituted a transaction that was "designed prima facie for avoidance of income-tax". Under Section 245(R) of the Indian Income Tax Act, 1961 ("ITA"), the AAR can refuse to admit an application on certain grounds, such as where the question raised in the application "relates to a transaction or issue which is designed prima facie for the avoidance of income-tax". In this case, the AAR held that the buyback scheme was designed prima facie for avoidance of income-tax and ruled that the income earned by the applicant's Mauritius shareholder from the buyback was taxable in India as dividend and not capital gains, as would have ordinarily been the case.
The applicant ("A Co (India)") was a closely held public company incorporated in India. Its shareholding pattern was as follows: (a) 48.87 % held by A Co (US), a company incorporated in the US, (b) 25.06% held by A Co (Mauritius), a company incorporated in the Mauritius, (c) 27.37% held by A Co (Singapore) , a company incorporated in Singapore and (d) 1.76% held by the general public. In June 2010, A Co (India) proposed a scheme of buy-back of its shares from its existing shareholders. While A Co (US) and A Co (Singapore) declined the buy-back offer, A Co (Mauritius) proposed to accept the same. Accordingly, A Co (India) applied to the AAR to determine whether the income that would arise to A Co (Mauritius) as a result of the buy-back was chargeable to tax in India and whether A Co (India) was required to withhold tax on the consideration to be paid to A Co (Mauritius). A Co (India)'s stand before the AAR was that the income earned by A Co (Mauritius) from the buyback was in the nature of capital gains, which was not taxable in India as per the provisions of Article 13 of the Treaty.
The ITA argued that subsequent to the introduction of Dividend Distribution Tax ("DDT") in 2003, under which there is an additional tax of 15% imposed on dividend distributed by a company, A Co (India) had intentionally not declared dividends to its shareholders in order to avoid payment of DDT and had instead allowed its free reserves to accumulate with the objective of eventually buying back the shares from A Co (Mauritius), a transaction that would not have been taxable in India by virtue of the provisions of the Treaty. The Revenue also pointed out that the other shareholders of A Co India, namely A Co (US) and A Co (Singapore), had not participated in the buyback offer since the income that would have accrued to them would have been taxable in India in their hands. In response, A Co (India) claimed that the decision to not pay dividends was a commercial decision that A Co (India)'s management was free to take and was not done to avoid payment of DDT. Similarly, the decision of A Co (Singapore) and A Co (US) to decline the buyback offer was also a commercial call, which these

companies were free to take. A Co (India) argued that since Section 46A clearly specified that income arising from a buyback was taxable as capital gains, the question of characterizing the buyback consideration paid to A Co (Mauritius) as dividend could not arise.
The AAR accepted the arguments put forth by the ITA. It noted that prior to the introduction of DDT in the year 2003, dividends were being distributed periodically by A Co (India) to its shareholders and there was no reasonable explanation offered by A Co (India) as to why dividends were not declared subsequent to the year 2003 even though A Co (India) was earning profits. The AAR held that the transaction was a colorable device for avoiding payment of tax (i.e. DDT) and the entire arrangement was one designed prima facie for the avoidance of income-tax. It went on to rule that the proposed payment was to be taxable in India as dividend as per paragraph 2 of Article 10 of the Treaty and A Co (India) was liable to withhold tax on the payment to be made to A Co (Mauritius).
In another case, Dynamic India Fund I ("DIF I") a company incorporated in Mauritius, a 100% subsidiary of another Mauritius Company, Dynamic India Fund II ("DIF II') is registered as a Foreign Venture Capital Investor with the Securities and Exchange Board of India and holding a valid Tax Residency Certificate ("TRC") from Mauritius Revenue Authority made investments in shares of Indian Companies with the intention of generating long term capital appreciation. DIF I approached the AAR to seek an advance ruling regarding the taxability of capital gains arising out of the sale of shares of the Indian companies. DIF I holding a valid TRC claimed that the capital gains that may arise out of the sale of shares of the Indian company should be taxable only in Mauritius under paragraph 4 of Article 13 of the DTAA between India and Mauritius ("India-Mauritius DTAA") and capital gains being exempt in Mauritius, the buyer would not be required to withhold any tax on the payments made to DIF I.
According to the Indian tax authorities, the structuring of the investment through Mauritius was a way to evade the capital gains tax earned from the sale of shares of the Indian company as only four out of fifty investors were from Mauritius and hence, the decision in the case of *Azadi Bachao Andolan* should not be accepted. Further, the Revenue argued that the control and management of DIF I was in India making it a tax resident of India as three out of five directors on the Board of Directors of DIF I were from India. In this regard DIF I, asserted that the decisions are taken by the Board of Directors from Mauritius and the control of affairs of DIF I lies in Mauritius.
The AAR held that as capital gains tax arising from the proposed sale of shares of the Indian companies by DIF I would be covered under para 4 of Article 13 of the India-Mauritius DTAA, the same shall be exempt from tax and no tax is required to be withheld. On account of DIF I holding a valid TRC and placing reliance on the decision of the Indian Supreme Court in the *Azadi Bachao Andolan* case, wherein it was held that if the taxpayer had a valid TRC, it would be eligible to treaty benefits under the India-Mauritius DTAA, the AAR ruled that DIF I would be a tax resident of Mauritius and the capital gains arising out of the sale of shares will not be chargeable to tax in India.
The AAR rejected the Revenue's contention of control and management of DIF I being in India on the ground that the majority of directors are non-residents comprising of two local resident directors in Mauritius and all others being non-resident directors. The view of the Revenue that four out of fifty five investors were from Mauritius and that routing the investment by the investors through Mauritius was a scheme to evade tax on the capital gains was also rejected by the AAR. With regard to the controversy of GAAR provisions overriding the DTAAs, the AAR ruled that since GAAR provisions were to come into force from April 1, 2013 currently they have no relevance and can be dealt with by the Revenue only when they come into force.

Article 14 Independent Personal Services

See treaty text

General UN Model provision applies
The treaty retains the separate article on the taxation of income of an individual who provides independent personal services. It is based on the earlier OECD Model version, which was modified in 2000 to assimilate the tax treatment of such income with the treatment of business profits.
The tax treatment of such income is similar to that for business profits (i.e. the attribution of income to the fixed base from which the person performs his activities).
The type of services covered by the provision comprise those listed in both the UN Model and the former OECD Model version, that is, including independent scientific, literary, artistic, educational or teaching activities and the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Article 15 Dependent Personal Services

See treaty text

The general treaty rule applies.
The treaty generally follows the OECD Model. However, it omits reference to the exercise of employment aboard a boat engaged in inland waterways transport.

Article 16 Directors' Fees

See treaty text

The general treaty rule applies. Thus, directors' fees paid by a company resident in one State to a resident of the other State may be taxed in the State of which the company is a resident.
The treaty follows the OECD provision on this issue, which accords the taxing right in relation to directors' fees and other similar payments to the State of which the company paying such fees is a resident. The treaty provision, which is followed in virtually all of Mauritius' treaties so far concluded, is consistent with Mauritius' domestic tax practice, which treats directors' fees as having been derived from a Mauritius source if the paying company is a resident of Mauritius, whether the services are performed in, or from outside, Mauritius.

Article 17 Artistes and Athletes

See treaty text

General rule applies.
If services performed are wholly or mainly supported by public funds, exempt from tax in the source State and taxable in residence State only.
Following the OECD Model provision on this issue, the treaty adopts the exception to the general provisions governing the exercise of taxing rights in relation to business and employment income, where such income is derived by visiting artistes and sportspersons from their activities in the host State. In such cases, it is accepted that the State from which the income is derived (i.e. the host State) is entitled to tax such income without limits.
Furthermore, the host State's taxing right in relation to the income derived by the artiste or sportsperson is not affected by the fact that the income accrues to another person and not directly to the artiste or sportsperson as such. Thus, the income would still be taxable by the host State regardless, for example, of the residence status of such other person. In all of the above cases, it is up to the host State to determine the manner in which to exercise its taxing right.
The government of Mauritius uses its tax treaties as part of the tools for promoting international and cross-cultural exchanges. Thus, in common with most of the treaties it has concluded, this treaty includes an additional provision, which accords exceptional treatment to income derived by visiting artistes and sportsmen from Mauritius where the activities are substantially supported with public funds.

Article 18 Non-Government Pensions and Annuities

See treaty text

Exclusive taxation by the State of residence of the recipient.
Definition of the term “annuity”.
The treaty follows the OECD Model provision governing the taxation of pensions, which is extended to cover annuities. This means that, in principle, exclusive taxing rights in respect of such income is exercisable by the State of which the recipient is a resident, subject to the treaty provision governing government pensions.
Furthermore, the treaty includes a definition of the term “annuity”, as referring to “a stated sum payable periodically at stated times during life or during a specified or ascertainable period of time under an obligation to make the payments in return for adequate and full consideration in money or money's worth.”

Article 19 Governmental Functions

See treaty text

OECD Model provision generally followed.
In accordance with the OECD Model provision on this issue, remuneration for services rendered by an individual to a government, its political subdivision or local authority, as well as pensions paid by, or out of funds created by, such entities, is taxable only by the State to which the services are rendered.
Again, following the OECD Model provision, the treaty provides alternatively for the exclusive taxation of such payments by the other Contracting State if the services are rendered to that other State by an individual who is both a resident and national of that State.
Finally, payments made for services performed by the individual in connection with a business carried on by any of the above entities will not be subject to the principles stated above but may instead be treated in accordance with the other specific treaty provisions, depending on the characterization of

the payments. These provisions include, in particular, those governing wages and salaries, directors' fees, income derived by artistes and sportsmen, and pensions.
Note that the principles governing the treatment of payments for services rendered to a government in a diplomatic or consular capacity supersede the above provisions. Thus, the above provisions generally cover cases which fall outside the rules governing the tax treatment of diplomats and consular agents.

Article 20 Students and Apprentices

See treaty text

General rule applies.
A student or business apprentice who is present solely for the purposes of his education or training is exempt from taxation on the following payments received for the purpose of his maintenance, education or training:

- payments from a foreign source;

- remuneration, not exceeding in any calendar year Rs 15,000 in Indian currency or the equivalent of that amount in Mauritian rupees, derived from an employment exercised in the State which is directly related to his studies and undertaken for the purpose of his maintenance for a duration not exceeding 5 consecutive years from the date of his first arrival in the State.

Article 21 Professors, Teachers and Research Scholars

See treaty text

Exemption on remuneration from teaching or research activities conducted in the host State.
A professor, teacher or research scholar normally resident in one State may visit the other State for a period of up to two years in order to teach or carry on research in a university, college, school or other approved institution.
The remuneration derived from such activities is exempt from taxation in the host State.
To benefit from such tax treatment, the visit must be at the invitation of the government or hosting institution.
However, the treaty provision does not apply if the activity is undertaken primarily for the private benefit of a specific person or persons.

Article 22 Other Income

See treaty text

Taxation only in the State of residence.
The treaty follows the standard OECD Model provision, which assigns exclusive jurisdiction to tax such income to the State of residence.
The treaty also adopts the standard OECD Model provision regarding the exception to the jurisdictional principle stated above, where the income is associated with the activity of a permanent establishment which the resident deriving the income has in the other Contracting State, in which case it is to be treated as taxable in accordance with the treaty provisions governing business profits. Under the treaty, a similar exception exists for income associated with a fixed base from which the resident performs independent personal services. In such a case, the taxation of the income will be governed by the treaty provisions pertaining to income from independent personal services (i.e. Article 14).

Article 23 Methods for Elimination of Double Taxation

See treaty text

India
Credit method; but:
An underlying tax credit will be granted for dividends paid by a Mauritius-resident company to a Indian-resident company with a direct or indirect ownership of at least 10% of the shares of the Mauritian company.
Tax sparing credit
Mauritius
Credit method; but:
An underlying tax credit will be granted for dividends paid by a Indian-resident company to a Mauritian resident company with an ownership of at least 10% of the shares of the Indian company.
Tax sparing credit.
Under Mauritius' domestic tax law, unilateral double taxation relief in the form of an ordinary credit is available for foreign-source income that has been subject to tax abroad. The relief will be granted only where the income is taxable in Mauritius and the foreign tax is of a similar character to Mauritius tax.

The amount of taxable income in respect of which relief is granted is computed without reference to the foreign tax paid nor, in the case of foreign-sourced dividends, the underlying tax paid on the corporate profits out of which the dividend is distributed. However, the credit relief granted will include an underlying tax on the profits out of which the dividend is paid, in cases where the Mauritian resident receiving the income owns directly or indirectly at least 5% of the share capital of the paying company.
While a few of Mauritius' treaties maintain this minimum threshold of 5%, others do not provide specifically for an underlying foreign tax credit, and many others increase this minimum shareholding to 10% mostly in the case of corporate shareholders. In such cases, the unilateral relief mechanism is rendered more favourable than under the treaty.
To ensure that the tax incentives granted to attract non-resident investors for the purposes of economic development inure to the benefit of the investors and not the treasuries of their home countries, it appears to be standard Mauritian tax treaty practice to negotiate tax sparing provisions of a unilateral or reciprocal nature in its treaties with other countries. These provisions treat as paid in Mauritius the tax that is reduced or exempt in Mauritius on the Mauritian-source income derived by the foreign resident. The tax sparing provision enables the foreign resident to claim a credit in the home country for such taxes even if they are not actually paid. It ensures that the investor is the direct beneficiary of the incentive as intended, and not the treasury of its home country, which, depending on the double taxation relief mechanism it applies, may otherwise realize increased revenue collection from the taxes foregone in Mauritius.
In line with this policy, this treaty provides for the reciprocal grant of tax sparing credit in respect of designated taxes foregone in both States.
However, because most tax incentives in Mauritius have been abolished with effect from 1 July 2006, the impact of the tax sparing provision on Mauritian source taxes is not as significant now as it was before.

Article 24 Non-Discrimination

See treaty text

The standard provisions apply
The treaty makes no express provision for stateless persons
The non-discrimination provision applies only to taxes covered by the treaty.
The majority of Mauritius' treaties do not extend the treaty benefits to stateless persons, and this treaty is no exception.
As an additional restriction upon the scope of application of the non-discrimination provision under this treaty, the taxes to which it applies is confined to those covered by the treaty, a position that is followed in most of the treaties concluded by Mauritius

Article 25 Mutual Agreement Procedure

See treaty text

General rules apply
No provision is made for the settlement of unresolved issues through arbitration
The treaty generally follows the OECD Model provision on this issue, except in relation to the settlement of unresolved issues through arbitration, regarding which the treaty omits the Model provision.
Although there is no explicit official statement to this effect, it appears that it is not yet Mauritius' position to negotiate the inclusion of arbitration provisions in its tax treaties. Consequently, virtually none of its existing treaties includes this provision.

Article 26 Exchange of Information

See treaty text

The treaty follows the former OECD standard governing information exchange between Contracting States.
The treaty follows an earlier version of the exchange information article and thus does not conform to the current international standard on information exchange, in particular, in:

- restricting the obligation to exchange information to taxes covered by the treaty;

- not addressing the issue of the supply of information by a requested State even where it does not need such information for its own domestic tax purposes; and

- not including the specific obligation of a requested State to supply information held by banks, financial institutions, nominees, agents or fiduciaries.

However, in pursuance of its commitment to bring its tax treaty standards in line with the current international standard on information exchange, Mauritius has embarked upon the negotiation of amending protocols to existing treaties that still reflect the "old" standard on information exchange. It is thus expected that the provisions governing the exchange of information in this treaty will in due course be amended to achieve conformity with the established international standard.
Mauritius has embarked upon the negotiation of specific tax information exchange agreements containing elaborate mechanisms for information exchange, particularly with countries with which it has not as yet concluded a comprehensive double taxation treaty.

Article 27 Diplomatic and Consular Activities

See treaty text

The treaty follows the standard OECD Model approach toward the treatment of diplomatic and consular staff.
Mauritius has acceded to the Vienna Convention on Diplomatic Relations and the Vienna Convention on Consular Relations, both of which exempt diplomatic agents, as well as consular officers and consular employees and members of their families, from all taxes in the receiving state, subject to certain limited exceptions. Even in the absence of a treaty, Mauritius income tax law exempts from tax the emoluments of a foreigner who holds office in Mauritius as an official of a foreign government and is posted to Mauritius for that purpose.

Article 28 Entry into Force

See treaty text

This Article contains the rules for bringing the treaty into force and giving effect to its provisions.

Article 29 Termination

See treaty text

The treaty remains in force indefinitely until terminated by one of the States, but only after it has been in force for at least five years. The termination procedure requires the State initiating the process to give the other State advance notification in written form through diplomatic channels on or before 30 June in any calendar year.

India - Recommendations

The judicial approach in India has permitted the Indian tax authorities to determine the real owner of the shares in case of colourable transactions. The question now is whether there is effectively a change in the judicial approach when it comes to the application of the treaty benefits and whether Courts are now prone to look at the substance of the transaction and not merely rely on the TRC that was earlier thought to be sufficient.
Over the last few years, media reports suggest that the Government has sought to review the India Mauritius treaty. However, such attempts have not borne fruit yet. India's recently negotiated treaties include a limitation of benefits ("LoB") article to prevent treaty abuse. Any treaty renegotiation can only happen with mutual consent of both contracting states. The Indian Finance Minister had taken the trouble to highlight, as a reaction to the Indian press reports, that any tax treaty negotiation with Mauritius is a sensitive matter for Mauritius and India "cannot take a unilateral decision in this regards since "there are political and diplomatic sensitivities".
So what does this mean for taxpayers? Firstly, taxpayers will need to exercise sufficient prudence on their holding structures that involve the use of beneficial tax treaties and recognize the importance of facts, documentation and conduct in relation to the structures. A focus on these issues will assist in managing the risk of denial of treaty benefits. Taxpayers also have the option to seek an advance ruling on the taxability of a transaction that involves reliance on a beneficial tax treaty. The main benefit of an advance ruling is the upfront certainty it provides and the binding nature of the ruling.
Given the aggressive bent of the Indian tax authorities in India, foreign enterprises which seek to rely on the Treaty may be subjected to a detailed scrutiny. The inquiry is more likely to go beyond the mere existence of a TRC and may require the taxpayer to demonstrate beneficial ownership of the shares sold. Therefore, conceptually, in order to claim the Treaty benefits, the Mauritius entity has to demonstrate satisfactorily to the ITA that it is substantially controlled and managed from Mauritius; and it has been established for sound commercial reason beyond tax considerations.
It will be advisable for the Mauritius entity ("MCo") to obtain the TRC, get it renewed on an annual basis and comply with all the terms prescribed by the Mauritius tax authorities. The reason as to why Mauritius has been chosen as a holding company jurisdiction should be documented with reasons. The reasons could be to include (a) the motive to consolidate the Group's foreign subsidiaries; (b) the formation of a platform for prospective business acquisitions, joint ventures and other opportunities; (c) Mauritius being able to provide a stable political and economic environment; (d) moderate

corporate law/ liberal foreign exchange control regulations; (e) good infrastructure, including reasonable costs for setting up and operating a company, etc.

Other than this, it is extremely important that all corporate rights arising from the shareholding in the Indian company, including the right to appoint directors, voting rights etc, should be exercised by MCo. Further, MCo should be party to shareholders agreement for investment in or for divestment from the Indian company and should exercise all rights arising from such an agreement. All transactions involving MCo (such as remittance for purchase of shares, remittance for dividends, and consideration for sale of shares) should be made through the bank account of MCo. MCo should be involved in discussions and documenting the sale/ purchase transactions and related documents duly authorized by MCo. All expenses relating to the transactions should be incurred by MCo. All critical Board of Directors ("BOD") meetings (especially those where the BOD discusses matters relating to investment/ divestment including in the Indian company) should be held in Mauritius with all the directors of MCo present for the meeting. The minutes of the BOD meeting should demonstrate that active discussions were undertaken before reaching a decision. There should be sufficient documentation to show that MCo has dominion and control over its funds including investments made by its parent company or income / proceeds received from dividends/sale of shares.

To the extent possible, the Indian company should not recognize the ultimate parent company as its investor in the press release, website, interviews, accounting disclosures etc. Likewise, the ultimate parent company should also not represent the Indian company in the press release, website, interviews, accounting disclosures etc. as its direct subsidiary. Further, no company within the Group (other than MCo) should represent the Indian company as its direct subsidiary. There should be no provisions that conflict with the above in the Articles of Association of the Indian company or other legal agreements. The letterheads, visiting cards, stationary, firm signs etc of the Mauritius Company must be kept at its registered office in Mauritius.

GAAR provisions were introduced in the Income Tax Act 1961 to deal with aggressive tax planning. However, the provisions have now been deferred till April 1, 2016. The implementation of GAAR will be in accordance with the guidelines framed by the Central Board of Direct Taxes (the "CBDT"). The CBDT has set up a committee (the "GAAR Committee") to formulate guidelines for implementation of GAAR and to draft a circular to ensure that GAAR is not applied indiscriminately. The GAAR Committee published the first draft guidelines for public comments on June 28, 2012. Subsequent to the release of the draft guidelines, India's Prime Minister has approved the constitution of an expert committee for a more widespread consultation with stakeholders and for greater clarity on the GAAR guidelines. The expert committee has submitted its report ("ECR") to the Indian government on September 1, 2012.

Synopsis of the recommendations in the ECR

Applicability of GAAR

Every case of tax avoidance should not be considered under GAAR unless it is an abusive, artificial and contrived arrangement.

Arm's length dealing test

This test is to be examined in those transactions which are not covered by transfer pricing regulations (including domestic transfer pricing provisions) and where the main purpose of the arrangement is to obtain a tax benefit. In such cases, the tax authority should be able to seek expert opinion from the transfer pricing officer to ascertain whether rights or obligations are the same as ordinarily created by parties acting at arm's length.

Misuse or abuse of provisions of tax law

Where the taxpayer does not follow the law in its spirit or substance or where the arrangement results in consequences which are not intended by the legislation, there is misuse or abuse of the law.

Commercial substance test

The ECR has recommended restoring the definition of 'lacks commercial substance' as present in DTC 2009 and DTC 2010. Amongst others, cases of round tripping or involvement of accommodating parties or arrangements of self cancelling nature etc., are considered to be indicators which lack commercial substance.

Onus of the Tax Authority

The onus to establish conditions for invoking GAAR is on the tax authority.

Deferment of GAAR

Recognizing GAAR to be an extremely advanced instrument of tax administration for which intensive training of tax officers is required, the ECR recommends that GAAR should be deferred for three years on administrative grounds and should be made applicable from tax year 2016-17.

However, the ECR also recommends that an immediate pre-announcement in this regard be made by the Government to be in synchronization with international practice and in order to remove uncertainty in the minds of taxpayers.
In the intervening period and thereafter, concerted training programs are to be initiated for tax officers who deal with cases of international taxation.

Grandfathering of existing investments

Grandfathering of 'arrangements' existing as on the date of introduction of GAAR would confer protection in perpetuity, which is not desirable.
However, all 'investments' (though not arrangements) made by a resident or a non-resident as on the date of commencement of GAAR provisions should be grandfathered so that on exit (sale of such investments), GAAR provisions are not invoked for examination or denial of tax benefit.
In case the Government adheres to implementation of GAAR from tax year 2013-14, the ECR recommends that GAAR should apply only to income received, accruing or arising or deemed to accrue or arise to the taxpayer on or after 1 April 2013 and not to income of the previous years.

Interplay between GAAR and Specific Anti-avoidance Rules (SAAR)

In a case where SAAR is applicable to a particular aspect, GAAR shall not be invoked to look into that aspect.

Treaty override and limitation of benefits (LOB)

In a case where a particular DTAA has inbuilt anti-avoidance provisions in the form of an LOB clause etc. (e.g., Singapore), the ECR has recommended that treaty override should not prevail.
GAAR can be appropriately considered in cases where a DTAA does not have an inbuilt anti-abuse provision.

Circular No. 789 of 2000 with reference to India-Mauritius

The ECR has recommended that in a case where the circular is applicable, GAAR should not be invoked to examine genuineness of the residency of an entity set up in Mauritius.
As needed, the Mauritius DTAA itself should be revisited if the policy so dictates, rather than challenged indirectly through GAAR.

Taxation of capital gains

Based on internationally comparable standards, the ECR has recommended abolishing capital gains tax on transfer of listed securities, whether in nature of capital gains or business income. It has also recommended increasing the rate of securities Transaction Tax, if need be.
Alternatively, the ECR has recommended that until abolition of this tax, the circular accepting TRC issued by Mauritius while granting DTAA benefits may be retained.

Foreign Institutional Investors (FIIs)

Where an FII chooses not to take any benefit under the DTAA and subjects itself to tax in accordance with the domestic law provisions, GAAR provisions may not apply to such FII.
Irrespective of whether or not an FII chooses to take a DTAA benefit, GAAR provisions should not be invoked in the case of a non-resident which has invested directly or indirectly in the FII which has underlying Indian investments. However, such exemption should be available only in respect of investments in listed securities made by an FII in India.

Monetary threshold for application of GAAR

Monetary threshold of INR 3 crore of tax benefit (excluding interest etc.) should be used for applicability of GAAR provisions. 'Tax' may include Dividend Distribution Tax (DDT) or Profit Distribution Tax.

Large Taxpayer Units (LTUs)

LTUs must be made compulsory for a specified class of taxpayers. Considering threshold of tax benefit, there is a high probability that majority of GAAR cases may also fall in this category.

Withholding of taxes

The ECR has recommended that, while processing an application for lower or NIL withholding of tax at source, the tax authority should not invoke GAAR where the taxpayer submits a satisfactory undertaking to pay tax along with interest unless, during the course of assessment proceedings, it is found that GAAR provisions are applicable in relation to the remittance.
However, the tax Authority may invoke GAAR with prior approval of its Commissioner in case the taxpayer does not submit any such satisfactory undertaking.

Approving Panel (AP)

AP should be a permanent body constituting five members, as follows:

- Chairman (who should be a retired judge of the High Court)

• Two members from outside the Government having eminence in the fields of accountancy, economics, business, income tax etc.

• Two members should be Chief Commissioners of Income Tax or one Chief Commissioner and one Commissioner.

The ECR has recommended that, while processing an application for lower or NIL withholding of tax at source, the Tax Authority should not invoke GAAR where the taxpayer submits a satisfactory undertaking to pay tax along with interest unless,
The ECR has taken note of the statutory provision that reference to AP, as also its order, are binding on the tax authority.
The AP may decide the matter by a majority.

Time limits

In case where the Commissioner is not satisfied with the objections of the taxpayer, he must make a reference to the AP within 60 days from receipt of such objections, with a copy to the taxpayer.
In case where the Commissioner is satisfied with the objections of the taxpayers, he must communicate his decision to the tax authority within 60 days from receipt of such objections, with a copy to the taxpayer.
No action can be taken by the Commissioner after a period of six months from the date of receiving reference from the tax authority. In such a case, GAAR cannot be invoked against the taxpayer.

Advance rulings

Administration of the Authority for Advance Rulings should be strengthened so that rulings can be obtained by non-residents, as also residents, within the time frame of six months.

Definition of 'connected person'

The IT Act defines 'connected person' very widely to mean any person who is connected, directly or indirectly, to another person and includes associated person.
The ECR has recommended restricting the definition of 'connected person' only to 'associated person' and 'associated enterprise' which are comprehensively defined under the relevant provisions of the IT Act.

Reporting requirement

The tax audit report may be amended to include reporting by the tax auditor of tax avoidance schemes above a specific threshold of tax benefit of INR 3 crores.

Illustrative cases

The ECR has provided 27 illustrations (with alternative scenarios in some cases) to consider whether GAAR can or cannot be considered as applicable. Certain illustrations also provide basis of reasoning, indicative tainted element test and the details of consequences as may follow. For better understanding of examples, we have, as an Appendix, captured herein a gist of some examples under the following board captions.
Illustrative cases of tax mitigation or negative list where GAAR cannot be invoked.
Tax qualifying amalgamations/demergers as approved by the High Court.
Non-applicability of GAAR in view of SAAR.
Illustrative cases/principles based on which GAAR is proposed to be made applicable.
Cases of misrepresentation of facts or tax evasion which can be dealt with even Independent of GAAR.

Appendix

Illustrations - negative list where GAAR cannot be invoked

Formation of a special purpose vehicle (SPV) by investor entities in various jurisdictions to pool their resources through SPV-incorporated tax favorable jurisdiction ("TFJ") which has ease of operation, lower compliance cost, ease of migration, absence of tax liability etc.
Raising funds through debt, instead of equity, is the commercial judgment of a taxpayer, though the debt is raised from a company in a TFJ outside India
Selection of alternatives to payment of dividend/buyback/issuance of bonus shares, including the point of time of exercise of such choice, though no capital gains tax may be payable in the event of buyback by a shareholder on account of fulfillment of LOB condition of the DTAA.
Where a taxpayer takes advantage of a fiscal incentive by complying with conditions of the Section and by submitting to conditions and economic consequences of the provision in the legislation.
Liquidating Indian company such that assets are distributed to shareholders who, in turn, dispose of assets so received to a third party – this being a permissible selection of one of the most tax efficient manner.

Cases where GAAR will not apply

Merger of overseas holding company (HoldCo) with Indian parent after dividends declared by underlying operating subsidiaries are accumulated at HoldCo level.
Court-approved merger involving merger of profit-making company with loss-making company.
Leveraged acquisition of shares of a company which is eventually merged with the parent and the parent claims interest expenditure in respect of loans utilized for initial share acquisition.

Non-applicability of GAAR in cases where SAAR applies

Cases where Circular No. 789 (relating to TRC) applies for Mauritius or where an LOB provision of the India-Singapore DTAA is satisfied.
In an intra-group service arrangement on cost plus basis amongst large corporate groups, which is subject to transfer pricing.
Cases where a new SEZ unit caters to old contracts and the existing SEZ unit may slowly phase out. This requires evaluation under split/reconstruction condition which is inbuilt in the incentive provision.

Illustration of cases where GAAR is proposed to be made applicable

Routing of investment through a TFJ does not reflect commercial purpose or commercial substance. Presence of office/employees in SPV is of no relevance.
Where buyback offer is made to a group of associated shareholders but the offer to buy back is accepted only by a shareholder entitled to DTAA benefit, it may represent a dubious method. Non-submission to buyback offer by other shareholders may not be for a genuine commercial reason, requiring the arrangement to be examined for ascertaining economic substance and main purpose.
Finalizing loan arrangement from one country and assigning it to another country to avoid withholding on interest leads to abuse of DTAA.
Artificial split of Engineering, Procurement and Construction (EPC) contract where the consideration relating to offshore component is inflated at the cost of onshore component requires reallocation after invocation of GAAR.
Overseas closely-held subsidiary of Indian company (IndCo) (with huge reserves) places deposits with the overseas bank which, in turn, provides loan to IndCo. Also, the conduit bank is not beneficial owner of interest to trigger dividend/deemed dividend taxation.
Interest payment which is based on the rate of return/profit of the borrower may reflect that, in substance, loan is an equity investment. Interest payment requires recharacterisation as dividend, leading to disallowance of expenditure and payment of DDT, though the recipient of interest may still be subjected to tax on interest.
Formation of a partnership in which a company contributes its investment in listed company to the firm at cost price. The firm acts as an SPV to hold investment in the listed company and to dispose of after a year. Avoiding Minimum Alternate Tax (MAT) by the company can be subjected to GAAR by disregarding formation of the firm.
Arrangement by which each employee is given remuneration comprising a mix of shares and salaries such that shares are agreed to be purchased at pre-agreed rates, which gives an opportunity to earn capital gains income to each of the employees, is an arrangement designed to avoid tax on salary. It represents an arrangement which is not for bona fide purposes and is misuse/abuse of tax provisions.

Illustrative cases of misrepresentation of facts or tax evasion which can be dealt with even independent of GAAR

Misrepresentation showing that production of non-SEZ unit is that of SEZ unit.
Misrepresentation of facts and showing on paper that all business operations of an overseas trading subsidiary are outside India though, in reality, the operations are in India.
Misrepresentation of facts which influences the decision of whether or not a permanent establishment exists for an overseas entity in India.

RETROSPECTIVE AMENDMENTS RELATING TO INDIRECT TRANSFER - INDIA

The Government of India made certain far reaching amendments to the Income-tax Act, 1961, addressed to situations where transfers took place exclusively between non-residents—hence indirectly—involving underlying assets in India. Although this amendment was made by the Finance Act 2012, it became effective retrospectively as of 01 April 1962.
Concerns were raised on the wide and retroactive scope of the Indirect Transfer Rules. Reacting to the comments from the financial community, the Ministry of Finance extended the scope of the Expert Committee on GAAR (the "Committee") to include the implications of the applicability of amendments on taxation of transfer where the underlying asset is in India.

Recommendations

The key recommendations of the Committee are as follows:
Retrospective amendments should be avoided, and in case retrospective amendments occur, these should occur in exceptional or rarest of rare cases and with particular objectives of:

(a) Correct apparent mistakes/anomalies in the statute;
(b) Apply to matters that are genuinely clarificatory in nature, i.e. to remove technical defects, particularly in procedure, which have vitiated the substantive law;
(c) To protect the tax base from highly abusive tax planning schemes that have the main purpose of avoiding tax, without economic substance, but not to "expand" the tax based.
No person should be treated as an assessee in default on tax withholding obligation or as a representative assessee of a non-resident in respect of a transfer transaction of shares of a foreign company with an underlying asset in India. This implies that the Indian government can apply the provisions only on the taxpayer who earned capital gains from indirect transfer.
No interest and penalties should be charged on tax demands relating to gains arising on indirect transfers
The taxation of capital gains on indirect transfer should be restricted only to capital gains attributable to assets located in India. Thus capital gains should be taxed on a basis of proportionality between fair market value of the India assets and global assets of the foreign company, as proposed in the DTC Bill 2010.
Where shares or interest in a foreign company or entity derive, directly or indirectly, its value substantially from assets located In India, then the transfer of shares or interest in such company or entity outside India would not be subject to tax in India if:
(a) In case such company or entity is the immediate holding company of the assets situated in India, the voting power or share capital of the transferor along with its associated enterprises in such company or entity is less than 26% of the total voting power or share capital of the company or entity during the preceding 12 months; or
(b) In other cases, the voting power or share capital of the transferor in such company or entity along with its associated enterprises during the preceding 12 months does not exceed such percentage which results in 26% of total voting power or share capital of the immediate holding company of the assets situated in India.
Exemption may be provided to a foreign company which is listed on a recognized stock exchange and its shares are frequently traded therein.
Transfer of shares or interest in a foreign company or entity under intra group restructuring may be exempted from taxation provided that such transfers are not taxable in the jurisdiction where such company is resident. For this purpose, intra group restructuring may be defined as:
(a) Amalgamation or demerger, subject to continuity of at least three fourth ownership; or
(b) Any form of restructuring within the group (associated enterprises) subject to continuity of 100% ownership.
A non-resident will not be subject to tax on indirect transfer of assets situated in India where-
(a) The non-resident investor has made any investment, directly or indirectly, in an FII; or
(b) The investment made by an FII in India represents, directly or indirectly, the underlying assets of investment by a non-resident
Private equity investors would be outside the coverage of taxation of indirect transfer where –
(a) The investment by the non-resident investor in a PE fund is in the form of units which do not result in participation in control and management of the Fund;
(b) The investor along with its associates does not have more than 26% share in total capital or voting power of the company;
(c) The investee company or entity does not have more than 50% assets in India as compared to its global assets;
(d) The investee company is a listed company on a recognized stock exchange and its shares are frequently traded;
(e) The transfer of share or interest in a foreign company or entity results due to a reorganization within the group.
Dividend paid by a foreign company shall not be deemed to accrue or arise in India under section 9(1)(i) of the Income Tax Act 1961
Where capital gains arises to a non-resident on account of transfer of shares or interest in a foreign company and there is a DTAA with the country of residence of the non-resident, then such capital gains shall not be taxable in India, unless-
(a) The DTAA provides a right of taxation of capital gains to India based on its domestic law; or
(b) The DTAA specifically provides right of taxation to India on transfer of shares or interest of foreign company or entity.