

Volume 6 Issue 2 July 2018  
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# Kathmandu School of Law Review

ISSN 2091-2110

Volume 5

Issue 2

November 2017

**FOREWORD BY EDITOR-IN CHIEF**

*Prof. (Dr.) Yubaraj Sangroula*

**FEATURE ARTICLE**

Emergence of Principle of Sic Utere Tuo Ut Alienum Non-Laedes in Environmental Law and Its Endorsement by International and National Courts: An Assessment

*T.R. Subramanya and Shuvro Prosun Sarker*

**ARTICLES**

The Problem of Rohingya Refugees in Bangladesh: A Critical Analysis

*Nour Mohammad*

Round Tripping and Treaty Shopping: Controversies in Bilateral Agreements & Remedies Forward-The Double Taxation Avoidance Agreement (DTAA) between Mauritius and India and the Dilemma

*Rajendra Prasad Gumpth, Anupam Jha and Samperchand Pudaruth*

Hindu Kush Himalayan Ecosystem as a Common Concern of Humankind: Imperative for Better Regional Jurisprudence

*Debasis Poddar*

Citizens of an Enemy State: The Enemy Alien Disability Rule in the Constitution of Nepal

*Prakat Khatri and Kundan Raj Sharma*

Protection of Traditional Knowledge: Emerging Issue of Intellectual Property Law

*Madhu Soodan Poudyal*

Status of Differently-abled Persons in Work Place: A Study of Courts inside Kathmandu Valley

*Anupa Aryal*

Conflict of Laws: Jurisdiction of the Court and Choice of Law in Cross-Border Matrimonial Suit in India

*Indrani Kundu*

Judicial Activism in Regulating 'Human Rights Violations' by Police Authorities in India

*Sandeepa Bhat B.*

An Appraisal of Tourism Law: Eclectic in Nature

*Narayan Prasad Giri*

Right to Education and Employment: A Step Towards Empowering Transgender Community

*Naresh Kumar Vats and Megha Purohit*

The Rise of Digital Era: A Changing Scenario of E-governance in Nepal

*Ojaswi K.C. and Roshani Regmi*

The Extra-Territorial Applicability of the Principle of Non-Refoulement and Its Interception with Human Rights Law

*Shishir Lamichhane*

'A Right to Water' in International Human Rights Law: Flow from Implicit to Explicit Right

*Swechhya Sangroula*

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Kathmandu School of Law Review

Volume 5, Issue 2, November 2017  
ISSN 2091-2110



KSL



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# Round Tripping and Treaty Shopping: Controversies in Bilateral Agreements & Remedies Forward - *The Double Taxation Avoidance Agreement (DTAA) between Mauritius and India and the Dilemma Forward*

Rajendra Parsad Gunpath\*, Anupam Jha\*\* and Sameerchand Pudaruth\*\*\*

## Abstract

*In a contextualized approach, the authors have revisited the DTAA<sup>1</sup> between Mauritius and India to reflect to what extent Round Tripping and Treaty Shopping have an impact in the bilateral agreement between India and Mauritius. The DTAA between India and Mauritius<sup>2</sup> was signed in August 1982, and the spirit of the bilateral agreement and the negotiations, which were carried out afterwards successively, were to provide exemptions from shareholders as who have already been taxed in Mauritius should not be taxed further. However, exemptions from capital gains tax in Mauritius would also mean that tax evasion soon becomes the center of recent negotiations between the two countries with serious concerns over tax abuses, round tripping and treaty shopping. Nevertheless, although Mauritius is considered a tax haven, there are still very strong ties between the two countries both historically and financially with mutual economic and financial support in a win-win situation. Indeed, Mauritius contributes to nearly 34% of total Foreign Direct Investment (FDI) flow into India becoming one of the largest contributors of FDI into India, competing directly with other countries like Singapore. However, it was felt by the Indian Government that there are strong abuses against tax evasion in Mauritius in addition to black money and money-laundering, and consequently India had to tread in deep waters to amend its DTAA to prevent round tripping and consequently treaty shopping.*

## Introduction

The rationale of this study is to show that round tripping transits large amount of money from one country to another through unofficial channels and is invested back into the same country from outside to avail of tax benefits under the provisions of the DTAA as inspired under the Organization for Economic Co-Existence and Development-Model Convention coupled with existing legislations (*Income Tax Act, 1961*) and Guiding Rules (such as for example the International

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<sup>1</sup> The Double Taxation Avoidance Agreement between Mauritius and foreign countries especially India in a network of 33 tax treaties where neither capital gains nor withholding taxes are levied and the Integrated Resort Scheme projects-*infra* just to name a few are also very promising.

<sup>2</sup> Actually, Mauritius ranks 32<sup>nd</sup> among 175 countries and second in Africa, after South Africa, and ease for doing business (World Bank's "007 Doing Business Survey, 2007) after various economic reforms, business facilitation, investment opportunities and incentives.

Chambers of Commerce, Paris doc. No 180/267 of 25<sup>th</sup> July 1987)<sup>3</sup>. And the bilateral agreement, which dated back to 1983, between India and Mauritius is the best model to illustrate this phenomenon of round tripping and treaty shopping. Round tripping and treaty shopping are funds of foreign Indian investors through the small island of Mauritius back to their homeland in the form of foreign investment. However, round tripping encourages tax evasion as well as money laundering as they inflate volume and revenues but in reality add no profit. Thus, the Indian government suspected loss in revenue due to round tripping even though Mauritius is contributing up to 34 percent to the Indian's FDI, representing some 400 million dollars annually. 10% of inflows into India between 2004 and 2009 were attributed to round tripping, long term evil strategy that is used for tax evasion as well as money laundering (Figures 1 and 2).

Finally, the Central Board of Direct Taxes (CBDT) investigated, *inter alia*, tax evasion, round tripping and treaty shopping and proposed that Indian domestic companies, which are often labeled as 'offshore companies' and which are well settled in Mauritius or Singapore, in routing their investments through Mauritius having to pay capital gains tax<sup>4</sup> as well. However, some provisions of the capital gains tax provisions need amendments and the CBDT is pressing for same with a view to readjust loss in revenues in India with the introduction of the General Anti-Avoidance Rules (GAAR), which could probably limit this. In fact, GARR empowers tax officials to deny tax benefits on transactions or arrangements that do not reflect any commercial purpose other than tax avoidance. Whatsoever, Mauritius has been a favourite round tripping and treaty shopping destination for much of the black money generated in India<sup>5</sup> (including a large proportion of the slush funds stashed away by some of the country's most powerful politicians and industrialists). However, the Indian Supreme Court quashed the Delhi High Court's judgment where the judges found that treaty shopping was illegal on the ground that the judiciary is not the law making body but the law interpreting body as there has been no explicit mention about treaty shopping being illegal in any law of the land and neither is it stated in the DTAA or any bilateral agreement between the two nations. Despite the fact that FDI has been beneficial to business in Mauritius, the aim of this paper is to enlighten the main issues behind this controversial bilateral agreement and stress on that why it must be renegotiated, the culprit being round tripping and treaty shopping, with Mauritius

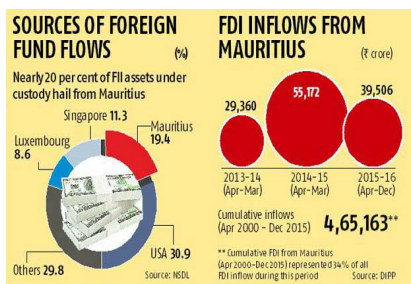
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<sup>3</sup> Foreign Direct Investment is the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. This series shows net outflows of investment from the reporting economy to the rest of the world and is divided by GDP available at [www.indexmundi.com/facts/mauritius/foreign-direct](http://www.indexmundi.com/facts/mauritius/foreign-direct) accessed on 24 January 2017.

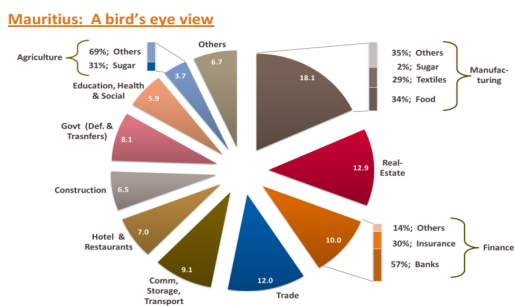
<sup>4</sup> *Financial Services Development Act 2001*: It defines a qualified global business as a corporation holding either a Category 1 Global Business License or a Category 2 Global Business License. Global Business License 1 companies are companies which are liable to corporate tax at 15% only but may claim foreign tax credit on foreign income with their tax reduced to 3 %. They invest in Mauritius with Mauritius' treaty partners. Global Business License 2 Companies are exempt from corporate tax but are not entitled to treaty benefits.

<sup>5</sup> *Ram Jethmalani & Others v Union of India & Ors.* (2011) 8 SCC 1.

with the introduction of the Indian Direct Tax Code, a Tax Residence Certificate and the Guidelines on General Anti-Avoidance Rules (GARR).



(Figure 1)



(Figure 2)

Source: Subramanian, ‘Mauritius investors to be taxed from Apr 2017’ *Business Standard*, New Delhi, 2016, available at [www.business-standard.com](http://www.business-standard.com), accessed on 27 January 2017.

### Research Methodology

In this contextualized paper, the authors have relied principally on secondary data (Central Statistics of Mauritius is the official source of information emanating from the Mauritian Government) and have given their explanations, suggestions and recommendations on Round Tripping and Treaty Shopping explaining to what extent tax havens may contribute to Foreign Direct Investment in India. However, it is true that there are, *inter alia*, tax evasions, treaty abuses, corruption or money laundering which pushed the Indian Government to amend its DTAA with Mauritius.

### Research Problem

One of the major problems of this study is to explore why are tax havens a necessary evil in international financing despite round tripping and treaty shopping and why the Indian Government became powerless to the DTAA with Mauritius or Singapore? Round tripping is the ferrying out of money of India into another country to avoid tax and short-term capital gains (sale of shares held less than 12 months) which attracts a 15% short-term capital gains tax in fact.

However, the amendment to the DTAA between the two countries raised sensitive issues though the two countries have very strong socio-political ties with mutual respect in terms of religion and culture. Over and above, the Indian government has financially supported the small island nation making it a well-developed and efficient financial services hub and business Centre with generation then promotion of business friendly legislative and regulatory environment. As a result, the burgeoning growth of the investment funds makes a record with more than 650 funds registered so far with the Financial Services Commission in Mauritius. Presently, Mauritius combines the traditional advantages of being an offshore financial center having no capital gains tax<sup>6</sup>, and being a liberal exchange

<sup>6</sup> The Non-Citizen (Property Restriction) Act 1975 (Act 22 of 1975) was passed and one of its aims and objective was to categorize Global Business License I and Global Business License 2. Under this Act, non-citizen investor may acquire property in Mauritius with the prior approval of the Prime Minister. However, the Banking Act 2004 has merged the two

regime- allowing free repatriation of profits with the distinct advantage of being a treaty based jurisdiction. It makes having: a wide network of tax treaties, abundant professional service providers at relatively low cost, economic and political stability and an educated and multilingual workforce since majority of the population are of Indian descent and origin.

With a Circular- No. 682 dated 30.3. 1994 issued by the Central Board of Direct Taxes (CBDT)- about exercise of its powers under section 90 of the Income Tax Act, the Government of India clarified that capital gains of any resident of Mauritius by alienation of shares of an Indian company shall be taxable only in Mauritius according to Mauritius taxation laws and will not be liable to tax in India. Consequently, a large number of Foreign Institutional Investors (FIIs), who were Indian residents in Mauritius started to invest large amounts of capital in shares of Indian companies with the expectation of making large profits by the sale of such shares without being subjected to tax in India. This year, when funds are routed through Mauritius or Singapore eventually, negotiations are initiated in order to amend the DTAA between the two nations by adding a protocol to create a level-playing field for both the domestic investors and foreign investors. Mauritius has also imposed stringent KYC requirements and sharing of banking information, in compliance with international norms, of 90 cases of suspected tax evasion and financial malpractice over the past three years.

Firstly, sovereign domestic tax policy may account for this and secondly, though certain Indian residents were round-tripping their funds into India through Mauritius, parties to the DTAA like another international bilateral contracts were bound by the principle of *pacta sunt servanda* and the Indian Supreme Court were quick to dismiss unfounded claims of treaty abuse and rightly did so. As an illustration, since the *Azadi Bachao Andolan* case<sup>7</sup> to the *Vodafone* case<sup>8</sup> (although in Vodafone the Court stood firm on tax fraud) and more recently in *Servo BPO*<sup>9</sup>, the Indian judges categorically ruled that anti-abuse provisions cannot be read into the provisions of the treaty and that it is for Parliament, as a matter of separation of powers, to take adequate legislative measures to plug loopholes that encourages treaty shopping. It is clear that a set of glaring loopholes have been left wide open in India's laws and legislations that enables racketeers and other tax abusers to use the Mauritian route for a range of the most nefarious activities and the manipulation of India's corrupt stock exchanges.

Under the India-Mauritius DTAA, India does not have a right to tax gains derived by a resident of Mauritius from the sale or disposal or shares of an Indian company. In the same length, Mauritian resident selling shares of an Indian company can take the benefit of the India-Mauritius tax treaty and do not be

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business sector such that the same banking license now applies to both sectors. Now, all Integrated Resort Scheme (IRS) must be approved by the Board of Investment (BOI) and whose powers are regulated under the Board of Investment Act 2000 (Act 24 of 2000) to issue investment certificates as per the Health Development Certificate Act 1992 generating a turnover of more than Rs 3 million to the country.

<sup>7</sup> *Supreme Court of India v Azadi Bachao Andolan* 2003 263 ITR 706 (SC)

<sup>8</sup> *Vodafone* case (2012) 6 SCC 613.

<sup>9</sup> *Servo BPO Pvt. Ltd v Authority for Advance Rulings* (Civil Writ Petition No. 11037 of 2014 (O&M)).

liable to India capital gains tax, especially a tax haven like Mauritius with its zero-rate tax policy. Consequently, a zero-rate tax policy encourages tax evasion; and tax havens intentionally disturbs inflows and outflows investments. Nevertheless, gross foreign investments reached a record of \$ 55.5 billion in the year upto March 2016, according to brokerage Religare Capital Markets. Anyway, if there should be no DTAA in the Indian-Mauritian bilateral agreements then Indian firms would keep other options open to target other tax havens like Delaware or Cayman Islands eventually.

Ultimately, tax havens like Mauritius prove to be a more cost-effective offshore jurisdiction from non-U.S. investors as that most Indians' would probably continue to domicile their funds and management companies in Mauritius.

Countries have different legislations, especially on tax. If there is no Capital Gain Tax in Mauritius with low income tax on foreign investors, then the problem arises under the DTAA as tax goes deductible in India at source on the gross dividend paid out at the rate of 5% or 15% depending upon the extent of shareholding of the Mauritius resident. As a result, doubts have been raised regarding the taxation of dividends in the hands of investors from Mauritius. Therefore, despite the DTAA between the two countries, the Indian Supreme Court, in the matter of *Azadi Bachao Andolan*<sup>10</sup>, went on to say that "it is therefore, not possible for us to accept the contentions so strenuously urged on behalf of the respondents that avoidance of double taxation can arise only when tax is actually paid in one of the Contracting States". India has lost over \$ 600 million a year in revenue on account of this benefit under the tax treaty.

At this stage it is important to disclose some of the reasons why the DTAA between Mauritius and India is so contested and to judge consequently whether there is a need to renegotiate the DTAA in the interest for both countries? As a result, the Indian Finance Bill 2012 foresees details on a certificate of resident though this document is not a sufficient condition for availing benefits of the DTAA and under the Direct Tax Code. The Guidelines on General Anti-Avoidance Rules or GARR would be a useful instrument to monitor tax avoidance.

For instance, out of the USD 8.99 billion, which have been invested in India, some USD 4.5 billion have transited through Mauritius, allowing foreign investors to benefit from the DTAA. Though it is suspected that there are apprehensions of black money, treaty shopping (a national or a resident of a third country interposes a company or other entity in a Member State party to the agreement without being a party to the agreement), round tripping (that is countries are not party to the DTAA but are enjoying capital gains tax exemption to those coming through Mauritius) and some investors are *mala fide*. In Mauritius, with a view to respond to fraud, the legislator has reacted promptly with the passing of the Anti-Money Laundering (Miscellaneous Provisions) Act<sup>11</sup> and the Prevention of Corruption Act which sets up the Independent Commission Against Corruption in 2002. The Mauritian legislator has also passed the Financial Intelligence and Anti-Money Laundering Act, which establishes the Financial Intelligence Unit.

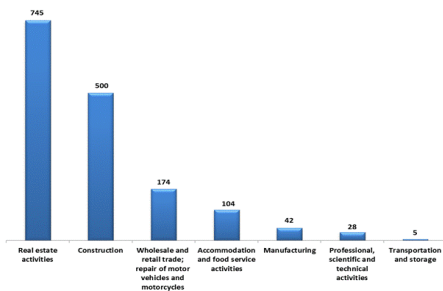
<sup>10</sup> *Azadi Bachao Andolan* (n 7).

<sup>11</sup> *Anti-Money Laundering (Miscellaneous Provisions) Act* 2003 (Act No. 34 of 2003)

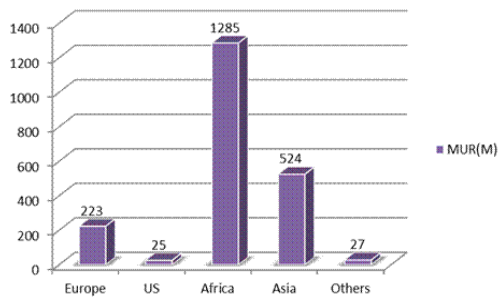
In India, it is also worth mentioning that the Delhi High Court's decision in the *Azadi Bachao Andolan*<sup>12</sup> held that "there was no rule that treaty benefits are denied in cases of treaty shopping". In fact, some tax inspectors were trying to deny that the relevant treaty benefits and it was unfair to do so. In the same line, the Finance (Miscellaneous Provisions) Act<sup>13</sup> came into force recently, on the 18<sup>th</sup> July 2008, bringing some major amendments to the Registration Duty Act by imposing duties on any document witnessing a transaction, other than a transfer of an immoveable property or a moveable property in Mauritius, between a non-citizen and a company holding a Global Business License under the Financial Services Act 2007. In fact, in the past, it used to be a requirement to have a document registered for its admissibility before a court of law but this requirement has now been abolished. It is also in this spirit that the Non-Citizen (Property Restriction) Act 1975 and later the Investment Promotion Act 2000 came into force with a view to promote business in Mauritius. The following legislations are very often resorted to conduct the above transactions in Mauritius: Land (Duties and Taxes) Act, Land Acquisition Act, Landlord and Tenant Act, Morcellement Act, Pas Géométriques Act, Planning and Development Act, Registration Act, State Land (Alienation) Act and the State Land Act.

### Overview of the Literature Review

FDI also promotes the use of more advanced technologies by domestic firms through capital accumulation in the domestic country<sup>14</sup>



(Figure 3)



(Figure 4)

**Source:** Luiz de Mello, "The effectiveness of education and health spending among Brazilian" *Economics Department Working Paper* No. 793 (2009).

Mauritius has very huge investment opportunities (seafood and exploitation of deep-sea water for oil). However, in terms of FDI, the DTAA between India and Mauritius has been and still remains the most beneficial of all treaties that India has had and that Mauritius (Figures 3 and 4) has been able to obtain a niche in

<sup>12</sup> Ibid.

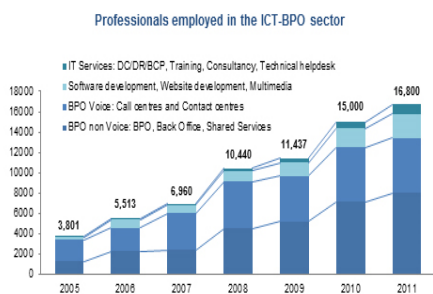
<sup>13</sup> *Finance (Miscellaneous Provisions) Act 2008* (Act No. 18 of 2008).

<sup>14</sup> Luiz de Mello, "The Effectiveness of Education and Health Spending among Brazilian" *Economics Department Working Paper* No. 793, 2009.

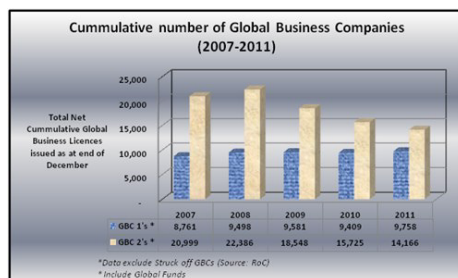
terms of FDI in India, being the largest source for nearly 10 years,<sup>15</sup> According to Arvin Boolell, Minister of Foreign Affairs of Mauritius:

It has been an excellent mechanism for economic cooperation. It is recalled that since 2000, 35.18 billion USD have been routed through Mauritius making Mauritius the main contributor of FDI to India. Today, India is the No.1 recipient of funds through its diaspora. Most of these bilateral investments are routed through Mauritius.

In spite of the Euro-zone crisis, Mauritius has an economic growth of nearly 4% which is a clear representation of the growth potential the country has.<sup>16</sup> It helps to increase domestic markets competition, create job opportunities and enhance business and economic growth.<sup>17</sup>



(Figure 5)



(Figure 6)

**Source:** Anthony E Scaperlanda et al, 'The Determinants of U.S. Direct Investment in the E.E.C', *American Economic Review*, vol 59, issue 4, pp. 558-568.

Actually, Mauritius ranks 32<sup>nd</sup> among 175 countries and second in Africa, after South Africa, and eases for doing business (World Bank's "007 Doing Business Survey, 2007)<sup>18</sup> after various economic reforms, business facilitation, investment opportunities and incentives. By transferring knowledge, FDI will increase the existing stock of knowledge in the host country through labor training, transfer of skills, and the transfer of new managerial and organizational practice. FDI will also promote the use of more advanced technologies by domestic firms through capital accumulation in the domestic country.<sup>19</sup> Some researchers on elasticity and capital (Lucas, 1993) found that the FDI inflows are more elastic with respect to cost of capital than wages and also more elastic with respect to aggregate demand in exports than domestic demand. Indeed, determinants of FDI inflows to transition economies like some countries in the central Europe for example are country risk, labor cost, host markets size and gravity factors during the period

<sup>15</sup> J. Harper, 'The Mauritius-India Double Tax Treaty without Tears', available at <http://www.mondaq.com> accessed on 27 January 2017.

<sup>16</sup> B. Bheemul-Sooreea, 'Mauritius as a Success Story for Foreign Direct Investment: What Strategy and Policy Lessons Can Emerging Markets Learn?', *Journal of International Business Research*, vol. 11, No. 2, 2012, pp. 322-340.

<sup>17</sup> Noorbakshi *et al*, 'Human Capital and FDI Inflows to Developing Countries: New Empirical Evidence', *World Development*, vol. 29, issue 9, 2001, p. 1593.

<sup>18</sup> World Bank, '007 Doing Business Survey', 2007, available at <http://www.doingbusiness.org/> accessed on 27 January 2017.

<sup>19</sup> De Mello (n 14).



1994 to 1998.<sup>20</sup> Scaperlanda and Mauer pointed out that FDI contributes positively to the market size (Figures 5 and 6).<sup>21</sup> Major determinants of FDI flows are market size, openness of the economy, infrastructure, macroeconomic stability such as inflation, wages, human capital, natural resources just to name a few but it was also demonstrated that some determinants such as infrastructure and inflation are both positively related while the wage rate is negatively associated to FDI flows.<sup>22</sup> These determinants are also important factors influencing the FDI flows in South Asian countries principally.<sup>23</sup> Some authors found that there is a positive and significant relationship between market size and FDI flows<sup>24</sup> though FDI seems to be more determined by wealth effects rather than market size effects<sup>25</sup> and may even be insignificant on FDI flow.<sup>26</sup> There are also conflicting views concerning labor cost and FDI. Some authors affirmed that the FDI and labor cost are closely associated whereas other authors declared that labor cost and FDI are negatively related since a higher labor-cost would result in a higher cost of production and in turn reduced FDI inflows.<sup>27</sup> Whether trade openness is a positive and significant determinant of FDI has also been studied and has been found to have a positive impact on FDI. Similarly, the development of higher educational institutions could turn Mauritius into a 'knowledge hub' of the Indian Ocean attracting high-value-added foreign investment by increasing the visibility of the country regionally (such as student fairs on the African country) and internationally, provided there are infrastructures facilities such as electricity, water, transportation, telecommunications as they contribute positively to FDI.<sup>28</sup> Some studies have been carried out and it has been found that market size and growth are important determinants of FDI.<sup>29</sup>

### Impact of Round Tripping and Treaty Shopping

Round tripping is not prohibited under Indian laws as of now but it deregulates financial transactions with loss in revenue especially from capital gains tax. Nevertheless, tax havens overlooked to curb round tripping and treaty shopping as it may whisk away potential investors. As an illustration, Singapore and Mauritius alone accounted for about 51% of FDI inflows representing \$ 72 billion between 2011 and 2015, and only as of March 2016, these tax havens accounted for 28% (\$ 80.1 billion) and 44% (\$22.3 billion) of outstanding foreign Portfolio

<sup>20</sup> J.E. Duran, *Los determinantes de la iedenospaises de America Latina y el Caribe: suimpactosobre el comercio y la integracion regional*, ECLAC, Mimeo, 1999.

<sup>21</sup> Anthony E Scaperlanda et al, 'The Determinants of U.S. Direct Investment in the E.E.C', *American Economic Review*, vol 59, issue 4, pp. 558-568.

<sup>22</sup> Luis Nunes, 'Determinants of FDI in Latin America', *Documentos de Trabajo/Working Papers*, No. 2006-252.

<sup>23</sup> PravakarSahoo, 'Foreign Direct Investment in South Asia: Policy, Trends, Impact and Determinants', *ADB Institute Discussion Paper* No. 56, November 2006.

<sup>24</sup> Nunes (n 22).

<sup>25</sup> Helga Kristjansdottir, 'Determinants of foreign direct investment in Iceland' *Department of Economics University of Copenhagen*, 2005.

<sup>26</sup> E. Asiedu, 'On the Determinants of Foreign Direct Investment to Developing Countries: Is Africa Different?' *World Development*, vol. 30 (1), pp. 107-118.

<sup>27</sup> Nunes (n 22).

<sup>28</sup> Asiedu (n 26).

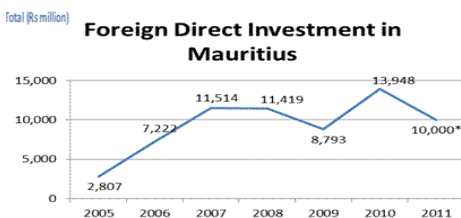
<sup>29</sup> Dawn Holland, 'Foreign Direct Investment and Enterprise Restructuring in Central Europe', *Economics of Transition*, vol. 8, issue 2, pp. 477-504.

Investment (FPI) in equities and bonds respectively. Together, they account for 49% of cumulative FDI inflows into India.

In treaty shopping, a resident of a third country, which is not a treaty member between the DTAA between India and Mauritius, also takes advantage of the fiscal treaty encouraging FDI flows in India but it has been a medium of tax evasion. In the *Azadi Bachao Andolan case*, the Indian Supreme Court also observed that treaty shopping opportunities could also be an additional factor to attract such investments. Nevertheless, the roots of a treaty shopping are in the inconsistencies among international tax regimes and if there is a dissimilarity of tax systems then it could also lead to distortion of investment flows. Treaty shopping may be controlled by introduction of a Limitation of Benefit Clause (LOB) and other clauses which limit the benefits to the residents of the two countries only. The LOB has been very beneficial pursuant to a Protocol in 2005 where India provided for capital gains tax exemption to a Singapore resident, who sells shares of an Indian company. However, in parallel to the transaction, the LOB deters treaty abuse because the Singapore resident will not be entitled to capital gains tax exemption if its affairs are primarily designed to take advantage of capital gains exemption.

### Facts and Findings

Very rapidly as Indian investors showed interest and arrived massively, Indian offshore companies kept mushrooming on the small island nation pushing the Mauritian economy upwards. From the year 2000 to 2009, the largest source of FDI in India came from Mauritius with an astonishing 44% of total flows (Figures 7 and 8).



(Figure 7)



(Figure 8)

Source: [www.unctad.org](http://www.unctad.org)

Mauritius, according to a recent publication of CNUCED, has attracted USD 273 million of FDI in 2011 against USD 430 million in 2010. However, the DTAA between India and Mauritius is also criticized for various reasons as there are alleged abuses and fraud by some Indian investors including round tripping and treaty shopping. It is therefore important to understand why the DTAA between Mauritius and India faces so many attacks when it brings so much income to the Indian government? Surprisingly enough, countries like France (Rs 3.3 billion), South Africa (Rs 2.2 billion) and UK (Rs 1.7 billion), and not India, are investing massively in Mauritius. The Emirates (Rs 369 million) and the USA (Rs 230 million) are lagging behind rather. China is investing up to Rs 280 million.

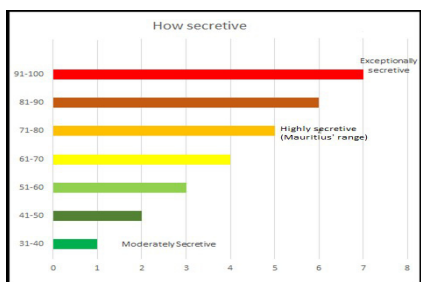
Countries which are benefitting from Mauritian FDI are Mozambique (Rs 670 million), India (Rs 632 million), Madagascar (Rs 188 million) and Thailand (Rs 165 million).

### Recommendations

With a view to become a favorite destination of foreign investors and to revitalize Asia's third-largest economy, India will start imposing capital gains tax on investments routed through Mauritius starting from next year, after the two countries agreed to amend a three-decade old treaty. Negotiation started in 1996, making the change possible in the wake of Base Erosion Profit Shifting (BEPS) framework agreed to by countries including India to eradicate round tripping and treaty shopping. To compensate revenue losses, funds routed through Mauritius interested in India will have to weigh paying capital gains taxes that could range from zero to as much as 20% versus the expense of setting up a new structure.

- India may impose a 10% tax on capital gains arising in Mauritius to compensate losses as there is no capital gains tax in Mauritius.
- To control and administer treaty shopping and round tripping then offenders to be brought before a court of law are must.
- In no way shall the DTAA between India and Mauritius be amended such that its provisions that are more beneficial to the tax payer would prevail. They must be beneficial to both countries and that any issue must be dealt amicably.
- Other DTAA, which have high business potential, with other countries must be exploited.
- The GARR must be expressed in clear and precise terms. GARR should not provoke uncertainties.
- The Direct Tax Code Bill is a very controversial piece of legislation therefore its entry into force would have a serious impact on investment, trade; and global business sector in Mauritius and investment in India may not be as attractive as it was before.
- For the past 10 years, Mauritius has been the largest source of FDI into India representing 44% of India's total FDI and the success story is largely due to the DTAA between the two countries. Should it be amended, it might not be the main route of investments in India in the future.
- It is a must to encourage and promote Indian offshore companies to settle in Mauritius under Global Business License Company I as they pay tax, create job opportunities and even encourage tourists to live in a green and healthy Mauritius.

In addition, India, by next year, will toughen the criteria under which offshore funds can claim tax benefits abroad as a key priority for Prime Minister Narendra Modi's government. In this endeavor, the OECD's BEPS Project contains specific and clear recommendations on how the amended DTAA may minimize treaty abuse and, henceforth, prevent loss of revenues in India. Further, as per the 2016 survey, Mauritius is in the spotlight for being a tax haven again as the island economy was pinpointed as the least transparent country in Sub-Saharan Africa on the financial secrecy index (FSI).



(Figure 9)

The amendments in Article 13 will phase out the capital gains tax exemptions as under:

Particulars	Tax Consequences in India under DTAA
Investment in shares till August 30, 2010	Investments made till August 30, 2010 will be grandfathered under General Anti-Avoidance Agreement Rules ("GAAR"), which overrides tax treaties and will come into effect from financial year 2017-18 onwards.
Investments in shares between August 30, 2010 till March 31, 2017	Capital gains exemptions will continue for shares acquired before April 1, 2017, irrespective of their date of transfer.
Concessional tax rate from April 1, 2017 to March 31, 2019	Investments made after August 30, 2010 will be subject to GAAR. Capital gains from shares (acquired after April 1, 2017) transferred before March 31, 2019, will be taxed at 50 percent of the domestic tax rate of India subject to fulfilling the conditions stipulated in the 'Limitation of Benefits' ("LOB") clause. The concessional tax rate will also be subject to GAAR.
Transfer of shares (acquired after April 1, 2017) after March 31, 2019	Taxable in India at full domestic tax rate

(Figure 10)

Source: www.financialsecrecyindex.com

To compensate revenue losses in India, although Mauritius is one of the largest contributors of FDI in India with a share of investment as huge as 44%, a protocol was signed between India and Mauritius to amend the provisions of the DTAA between the countries with an impact of future investments. For some experts, the protocol and its amendments (Figures 9 and 10) will increase investments reducing tax evasion. Indeed, there will be a transition period from April 1, 2017 to March 30, 2019, during which the capital gains will be taxed at half the domestic rate. The protocol tackles, *inter alia*, the long pending issues of treaty shopping and round tripping of funds attributed to the DTAA, curbs revenue loss, prevents double non-taxation, streamlines the flow of investment and stimulates the flow of exchange of information between the two nations such that the DTAA may, henceforth, exercise its functions properly to stimulate the flow of exchange of information properly as per international norms.

- The Protocol amends Article 13 of the DTAA with effect from April 2017 by inserting two new paragraphs: paragraph 3A, which provides that gains from the alienation of shares acquired on or after April 1, 2017, in a company, which is resident of a contracting State, may be taxed in that State; and paragraph 3B, which provides that the rate of tax on capital gains arising between April 1, 2017 and March 31, 2019 shall not exceed 50 percent of the tax rate applicable on such gains in the State in which the target company is situated.
- The protocol also adds a new Article 27A on limitation of benefits. According to the Article, the benefit of new paragraph 3B of the treaty (reduced tax rate) shall be denied in cases where the affairs are seen to be arranged with the 'primary purpose' of taking advantage of the said paragraph. Article 27A further adds in its clause 2 that a shell or a conduit company posing as a resident of either of contracting State shall not be entitled to the benefits of paragraph 3 B.

The press release as produced herein states clearly the controversies and implications between the bilateral agreement between India and Mauritius and go on to say that:

Protocol for amendment of the Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income

and capital gains between India and Mauritius was signed by both countries on 10th May, 2016 at Port Louis, Mauritius.

The key features of the Protocol are as under:

- i. Source-based taxation of capital gains on shares: With this Protocol, India gets taxation rights on capital gains arising from alienation of shares acquired on or after 1st April, 2017 in a company resident in India with effect from financial year 2017-18, while simultaneously protection to investments in shares acquired before 1st April, 2017 has also been provided. Further, in respect of such capital gains arising during the transition period from 1st April, 2017 to 31st March, 2019, the tax rate will be limited to 50% of the domestic tax rate of India, subject to the fulfilment of the conditions in the Limitation of Benefits Article. Taxation in India at full domestic tax rate will take place from financial year 2019-20 onwards.
- ii. Limitation of Benefits (LOB): The benefit of 50% reduction in tax rate during the transition period from 1st April, 2017 to 31st March, 2019 shall be subject to LOB Article, whereby a resident of Mauritius (including a shell / conduit company) will not be entitled to benefits of 50% reduction in tax rate, if it fails the main purpose test and bonafide business test. A resident is deemed to be a shell/ conduit company if its total expenditure on operations in Mauritius is less than Rs. 2,700,000 (Mauritian Rupees 1,500,000) in the immediately preceding 12 months.
- iii. Source-based taxation of interest income of banks: Interest arising in India to Mauritian resident will be subject to withholding tax in India at the rate of 7.5% in respect of debt claims or loans made after 31<sup>st</sup> March, 2017. However, interest income of Mauritian resident banks in respect of debt-claims existing on or before 31<sup>st</sup> March, 2017 shall be exempt from tax in India.
- iv. The Protocol also provides for updating of Exchange of Information Article as per international standard provision for assistance in collection of taxes, source-based taxation of other income, amongst other changes.

Under the amended DTAA, only those Mauritius-based companies that have a total expenditure of more than Rs 27 lakh in the preceding 12 months will be able to benefit from the tax treaty. Therefore, it is expected to improve transparency in tax evasion, treaty shopping and round tripping with a view to curb tax evasion and tax avoidance. Nevertheless, there shall be a smooth transition to the new tax regime such that capital gains will be taxed at 50% of the domestic tax rate in India during the period April, 2017 to March 31, 2019 provided the concession of 50% reduction in tax rate during transition period will not be available if an entity fails the main purpose test and *bona fide* business test. At the same time, existing investments that is investment made before 1.4.2017 have been grandfathered and will not be subjected to capital gains tax in India.

The treaty amendment of DTAA with Mauritius brings about certainty taxation matters for foreign investors. Therefore, it reinforces India's commitment to

OECD-BEPS (Base Erosion and Profit Sharing) to settle in the long run and long term financial stability, predictability and fairness of the tax system.

### **Conclusion**

The DTAA between India and Mauritius has boosted the economy of Mauritius and is a very precious engine for FDI. It must be dealt with caution whenever there are amendments to be implemented. FDI penetrating India via Mauritius is largely attributed to the DTAA. The financial sector contributes 11.6% to the Gross Domestic Product and a large number of management companies have been set up and most of them are Indian offshore companies. More than 2000 people are employed in these offshore companies creating job opportunities for fresh graduates in Mauritius. If the DTAA is amended and in case the GARR, which is still uncertain for the Mauritian authorities, is prejudicial to the economy of Mauritius then other DTAA's must be exploited as other prospects may be open with Africa and even China as well. China is a country with high business, commercial and financial potential and Mauritius may also look in this direction. Mauritius has also strong links with China and Mauritius already has an Investment Promotion and Protection Agreement with this country. Over and above all, Mauritius may explore other venues such as Islamic Banking, another emerging sector in Mauritius, and tighten its relations with the United States (the African Growth and Opportunity Act (AGOA) between US and Mauritius has been very promising up to now) afterwards.