

## **NOTE ON THE INDIA-MAURITIUS TREATY**

In March 2000, Indian tax authorities served notices on several Mauritius-based Foreign Institutional Investors (“FIIs”) for payment of tax on capital gains and dividend on the ground that the FIIs did not have any effective management in Mauritius. This raised a hue and cry among the FIIs, a majority of whom were large international investment and stock broking houses. To remedy this, India’s Central Board of Direct Taxes (“CBDT”) issued a Circular No. 789 dated April 13, 2000 (the “2000 Circular”), among other things, to clarify the following:

- (a) Where a Certificate of Residence was issued by the Mauritius authorities, such a certificate would constitute sufficient evidence of residential status and beneficial ownership under the Double Taxation Avoidance Convention between India and Mauritius (“DTAC”); and
- (b) The test of residence mentioned above would also apply in respect of income from capital gains on sale of shares and could be used to allow FIIs benefits of the DTAC.

The 2000 Circular was challenged in a writ petition filed in the Delhi High Court. The petitioner, Shri Shiva Kant Jha, alleged that since Mauritius was a tax haven, treaty shoppers from western countries were using Mauritius to invest in India, thus avoiding payment of tax.

The Delhi High Court allowed the writ petition and quashed the 2000 Circular.

The judgment of the Delhi High Court in the writ petition was appealed in the Supreme Court. The Supreme Court overruled the judgment of the Delhi High Court and upheld the validity of the 2000 Circular.

Therefore, FIIs and foreign companies investing in India via Mauritius have been able to avail of the benefits of the DTAC as the Certificate of Residence issued by the Mauritius tax authorities is accepted by the Indian tax authorities as constituting sufficient evidence of residence in Mauritius.

However, the CBDT has issued another circular dated February 10, 2003, which specifies that if the effective management of a Mauritius-registered fund is in India, the fund is liable to be taxed in India even though it is registered and

resident in Mauritius. To determine the place of effective management, the place at which important decisions of the fund are taken have to be taken into consideration. Therefore, Mauritius-registered FIIs and companies whose effective management is in India will not be entitled to the benefits of the DTAC and of the Supreme Court's ruling on the 2000 Circular.

It is believed that the Finance Minister may, in the budget, propose amendments to the Income Tax Act, to water down the benefits of the 2000 Circular and the Supreme Court's ruling thereon. The amendments may specify the residence criteria in a foreign country in order to avail of treaty benefits and may stress on need to have substance or "effective management" in such foreign country, as opposed to merely a certificate of residence.

With respect to private equity funds, there is some talk of bringing to tax in India carried interest earned by fund managers, although they may not have a direct nexus to the fund and may only render advisory services.