

1. 'Mauritius Leaks' and Need for Tax Reforms

Context:

- ▶▶ In July 2019, the International Consortium of International Journalists published over 200,000 confidential documents from the offices of Conyers Dill & Pearman, a Bermuda-based law firm that allegedly aids large Western businesses to set up letterbox companies in Mauritius aimed at making tax-motivated investments in Africa and Asia.
- ▶▶ The leak has reignited the debate on multinational tax avoidance and how businesses use tax-friendly jurisdictions to channel funds from one country to another in order to minimise their overall corporate tax liability.
- ▶▶ The 'Mauritius Leaks' comprise names of some of the most popular brands in India and globally.

What is BEPS?

- ▶▶ Base erosion and profit shifting refers to the phenomenon where companies shift their profits to other tax jurisdictions, which usually have lower rates, thereby eroding the tax base in India.

Treaty Shopping:

- ▶▶ In Treaty shopping, a resident of a third country invests by taking advantage of a fiscal treaty between India and another contracting state.
- ▶▶ This has greatly contributed in encouraging FDI in the country but has been a medium of tax evasion. The Supreme Court has also noted in the Azadi Bachao Andolan case that treaty shopping opportunities could be an additional factor to attract such investments.
- ▶▶ The roots of the Treaty shopping are in the inconsistencies among international tax regimes. If there is a dissimilarity of tax systems, it can lead to distortion of investment flows.
- ▶▶ The underlying principle of bilateral tax treaties, i.e. the principle of reciprocity is impeded when a third-country resident derives benefits from a treaty intended to serve only the interests of residents of the two treaty partners.

Round Tripping:

- ▶▶ In India Round Tripping, money is routed back into the country by local investors through tax havens like Mauritius.

- ▶▶ We all know that India receives maximum FDI inflows through the Mauritius Route. During the 2000-2010 period Mauritius pumped in \$47.24 billion into the country constituting 43 per cent of the total FDI inflow.
- ▶▶ Our government suspects that it is losing, revenue due to the Round Tripping. India and Mauritius have signed the double tax avoidance agreement (DTAA).
- ▶▶ But India has signed the same treaty with many other countries as well. Then, why we suffering loss from Mauritius investments.

Concerns regarding India-Mauritius Tax Treaty:

- ▶▶ The India-Mauritius tax treaty has been a subject matter of controversy and debate ever since it was signed over 30 years ago.
- ▶▶ Before 2017, Article 13(4) of the tax treaty exempted capital gains arising from sale of shares in an Indian company at the hands of Mauritian residents.
- ▶▶ And the effective capital gains tax rate in Mauritius was zero percent, which is why a majority of the largest foreign incorporated corporations that invested in India over the last decade did so through Mauritius.
- ▶▶ The capital gains exemption in the treaty was plugged in 2017 by amending Double Taxation Avoidance Agreement (DTAA) with Mauritius, paving the way for India to levy capital gains tax involving sale of shares in an Indian company.
- ▶▶ However, till date, the tax treaty does not contain a general anti-abuse clause to tackle round tripping of funds or treaty-shopping arrangements.
- ▶▶ While India's tax treaty with Mauritius contains provisions for exchange of tax information, any information requested has to be "foreseeably relevant" for giving effect to the tax treaty or the Income Tax Act.
- ▶▶ In the absence of extensive, worldwide information-sharing network, wealth is usually not repatriated to India where it belongs, but shifted to new, non-collaborating secrecy jurisdictions.

About the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting:

- ▶▶ The Convention is an outcome of the OECD / G20 BEPS Project to tackle base erosion and profit shifting through tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.
- ▶▶ The Convention implements two minimum standards relating to prevention of treaty abuse and dispute resolution through Mutual Agreement Procedure.

- ▶▶ The Convention will not function in the same way as an Amending Protocol to a single existing treaty, which would directly amend the text of the Covered Tax Agreements. Instead, it will be applied alongside existing tax treaties, modifying their application in order to implement the BEPS measures.
- ▶▶ The Convention ensures consistency and certainty in the implementation of the BEPS Project in a multilateral context. The Convention also provides flexibility to exclude a specific tax treaty and to opt out of provisions or parts of provisions through making of reservations.
- ▶▶ A list of Covered Tax Agreements as well as a list of reservations and options chosen by a country are required to be made at the time of signature or when depositing the instrument of ratification.

OECD framework on Base Erosion and Profit Shifting:

- ▶▶ As part of the base erosion and profit shifting (BEPS) project, the OECD recommended that countries adopt a principal purpose test in their tax treaties to deny inappropriate treaty benefits.
- ▶▶ Under the principal purpose test, the tax authority may deny tax benefits if obtaining a tax benefit was “one of the principal purposes” of a tax arrangement.
- ▶▶ Both India and Mauritius have signed the OECD’s Multilateral Instrument (MLI) designed to implement some of the BEPS recommendations.
- ▶▶ However, Mauritius has conveniently kept India outside the network of tax treaties that are covered under the MLI by keeping the bilateral treaty with India outside the scope of the multilateral deal.

Renegotiating India-Mauritius Tax Treaty:

- ▶▶ It is vital for India to put pressure on Mauritius and renegotiate its tax treaty to include a principal purpose test to deny tax arrangements that do not have any genuine commercial substance and are primarily meant to obtain a treaty benefit.
- ▶▶ In the absence of such a provision, Indian courts, who are bound by the principle of pacta sunt servanda (agreements must be kept), would be hesitant to endorse claims of treaty abuse.
- ▶▶ Some of these arrangements would get captured under the newly incorporated general anti-avoidance rule (GAAR) in the Income Tax Act.
- ▶▶ However, India’s domestic GAAR is narrower than the OECD-recommended “principal purpose test” as GAAR uses the “main purpose” test.
- ▶▶ The safeguards available under the Income Tax Act before invoking GAAR are not available in case of the principal purpose test.

Way Forward:

Strengthening India's Tax Administration:

- ▶▶ Supplement India's domestic GAAR regime with a mandatory tax disclosure regime for tax advisers such as accounting firms, law firms, banks who assist businesses in aggressive international tax avoidance.
- ▶▶ Countries such as the United Kingdom, South Africa, Canada, among others, already have in place detailed tax disclosure rules for tax advisers.
- ▶▶ It is necessary for India to mull over a range of policy options to target corporate tax avoidance and allocate separate funds for addressing challenges faced by tax officers in enforcing anti-abuse rules.
- ▶▶ It is important to cooperate under the aegis of the Organisation for Economic Cooperation and Development and the United Nations to develop global jurisprudence to counter base erosion and profit shifting.
- ▶▶ Companies registered in Mauritius are the largest source of foreign direct investment (FDI) into India, making it crucial for India to upgrade its bilateral tax treaty, adopting the latest international practices that prevent multinational companies from artificially shifting profits to low tax countries.

