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Mauritius tax treaty leaves out derivatives

Text of the agreement is silent on derivatives, which account for a large share of equity trading; analysts say debentures may be exempt as well

Photo: Mint

Derivatives are exempt from capital gains tax under the revised India-Mauritius tax treaty, revenue secretary Hasmukh Adhia has confirmed.

The text of the agreement is silent on this. Analysts and experts also confirm that the amended treaty doesn't cover derivatives. They add that it also doesn't cover debentures. *Mint* couldn't immediately confirm that.

That is significant because derivatives account for 90% of all equity trading in India and there's no reason to assume that the proportion is any different for foreign portfolio investors (FPIs) trading in India.

This will reduce the sting of the revised tax treaty which now taxes capital gains.

Rajesh Gandhi, partner at Deloitte Haskins & Sells Llp, said the full text of the protocol specifies that only capital gains arising from transfer of shares will be taxed. “This means that portfolio investors using the futures and options route will not be subject to capital gains tax,” he said.

Sameer Gupta, tax leader for financial services, EY, said in a note that the capital gains tax exemption was being phased out only with respect to shares of an Indian resident company.

“This suggests that investments by Mauritius tax residents in other Indian securities viz exchange traded derivatives, convertible/non-convertible debentures shall continue to remain exempt in India even after 1 April 2017, subject to the General Anti-Avoidance Rules (GAAR). This position with respect to other securities is prevalent in other treaties as well that India has,” he said.

This also means Mauritius remains a preferred destination for FPIs and other investors seeking to play the Indian market. “A clarification to this effect that derivatives and debentures may not be taxed as capital gains would spell a comeback for Mauritius as a jurisdiction through which investments are routed in India. For FPIs, futures and options is a core product and for private equity funds, corporate bonds contribute for the bulk of investments,” said Richie Sancheti, head, funds practice, Nishith Desai Associates.

Fine print

The fine print of the treaty, which was released by the Mauritius government on Thursday, also reveals that even fees for engineering and technical expertise provided by personnel of a foreign company to an Indian company will now be taxed in India at 10%, subject to certain stipulations.

The agreement also proposes that the tax on interest income earned by Mauritian companies will be capped at 7.5%, thus making the terms more favourable for such companies as compared with other countries.

Earlier this week, India and Mauritius agreed to amend the more-than-three-decade-old tax treaty to plug loopholes to prevent round-tripping of funds and tax evasion.

This also gave India the right to tax capital gains on investments coming in from Singapore, since the terms of the Mauritius and Singapore treaty are linked to each other.

India has got the right to tax capital gains arising from sale of shares of Indian resident companies from 1 April 2017, as per the new terms of the treaty.

So far, capital gains from such transactions could only be taxed by Mauritius. Since the tax rate was close to zero in Mauritius, it became an attractive destination for routing of investments by foreign investors. Around 50% of foreign direct investment into India comes from Mauritius and Singapore, as per data available with the government. Also, as per data available with National Securities Depository Ltd, almost 31% of the total assets under custody of FPIs is with investors from Mauritius and Singapore.

Two days after announcing the changes in the treaty that are likely to impact private equity and venture capital investors as well as FPIs, the Indian finance ministry sought to allay concerns of FPIs. “Met FPIs with (revenue secretary Hasmukh Adhia) for an intense discussion on tax concerns such as GAAR, tax treaties’ implications, etc,” minister of state for finance Jayant Sinha tweeted.

Sunil Jain, partner at J. Sagar Associates, a law firm, said the Indian government had closed the Mauritius route for investors looking to benefit from the capital gains clause as well as those who provided technical services to Indian companies without paying any taxes in India.

“The treaty has introduced a clause on permanent establishment for services wherein if a personnel of a company provides services for more than 90 days within a year to an Indian company, it will constitute permanent establishment, thus giving India the right to tax such services,” he said.

Jayshree P. Upadhyay and Ami Shah in Mumbai contributed to this story.