India-S'pore tax treaty: anomalies need to be dealt with

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THESE are taxing times indeed! The global shift on clamping down on base erosion/profit shifting has the recently amended India-Mauritius tax treaty to add to its list. These amendments have created some anomalies in the India-Singapore tax treaty as well. I will deal with these a little later.

For the last 30 years or so, Mauritius has had a fairy-tale tax treaty with India. It exempted investors from capital gains tax when they invested in shares of Indian companies through Mauritius. Like Singapore, Mauritius does not tax capital gains on the sale of shares. After 1991, when India opened up its economy, Mauritius played a very important role in providing a platform for foreign investment to India.

It allayed the concerns of many investors who feared double taxation and lack of credit availability as a result of a difference in source rules of taxation in India and jurisdictions such as the US. The treaty went through its ups and downs, being challenged in courts in India, but was upheld by the Supreme Court of India in a landmark decision.

When Singapore and India were ready to sign the Comprehensive Economic Cooperation Agreement (CECA) in 2005, they too amended their tax treaty to bring it on a par with what India and Mauritius had, albeit with higher standard of substance to be met in Singapore. This has led to Singapore playing a very critical role in the growth of investments into India. Singapore is indeed a "natural hub" for India and can only benefit with India's projected growth trajectory. In fact Singapore emerged as the largest investor of FDI (foreign direct investment) in India in the recent past. But some anomalies have crept into the India-Singapore tax treaty which need to be dealt with urgently.

The last thing the two countries want is a loss in momentum in their burgeoning economic relationship. The changes to the Mauritius treaty with respect to taxation of capital gains basically give the Indian government the right to tax capital gains in the hands of investors who have invested via Mauritius. The Singapore treaty with India had a "co-terminus" provision which states that if there is such a change in the Mauritius treaty in respect of capital gains, the capital gains provisions of the Singapore treaty would cease to have effect. Simple to many, but an interpretation and implementation nightmare to others!

The changes to the Mauritius treaty are quite clear with sensible provisions relating to grandfathering investments in shares till March 31, 2017. Investors want clarity and they seem to have got that as far as Mauritius is concerned. The lack of a similar grandfathering provision in the Singapore treaty means that no such protection may be available to investments made under the India-Singapore DTAA (double taxation avoidance agreement) for investments in shares prior to March 31, 2017. Hence the urgent need for clarity. What is quite clear is that the intention of India and Singapore was that the two treaties should provide almost equal treatment to investors. The news in India suggests that both countries will be speaking soon to formally amend the treaty. My view on what needs to be done with some urgency:

- Keeping in mind the very critical role Singapore is playing in the development of India, the tax treaty should (like the India-Mauritius pact) have clear grandfathering provisions with respect to all investments made by residents of Singapore in the shares of Indian companies till March 31, 2017, and after that, till March 31, 2019, a rate of tax not exceeding 50 per cent of the applicable capital gains tax in India on gains made prior to March 31, 2019, subject to meeting the limitation of benefits conditions in the Singapore-India treaty. This would then be a mirror to the treaty with Mauritius.
- Mauritius tax residents can now lend money to Indian residents and be subject to a lower withholding tax rate of 7.5 per cent in India. The rate applicable to similar debt investments from Singapore is currently 15 per cent (with a reduced rate of 10 per cent for banks). Singapore is a leading financial centre in the world and will undoubtedly be a centre for debt investments into India as well. Therefore a similar withholding tax rate of 7.5 per cent should be negotiated into the treaty. This will encourage the growth of the debt markets in both India and Singapore. Singapore should also look at its domestic law provisions to ensure that investors investing in debt from Singapore are not put to a greater burden than those investing from Mauritius.

I do hope that the two countries take this on as a matter of urgency and continue building on the strategic partnership they have created.

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