Panel on DTAA with Mauritius spots tax ambiguity

By *Sachin Dave* & *Sugata Ghosh*, ET Bureau | Jul 25, 2016, 12.54 AM IST

The main mandate of the committee is to find out the problem areas in the treaty and suggest changes required to address investor concerns.

MUMBAI: Mergers, conversion of securities and ADRs, and offering of bonus stocks are among the problem areas spotted by a team examining India's revised tax treaty with Mauritius. The committee — comprising officials of Sebi, Central Board of Direct Taxes, HSBC and Franklin Templeton — has in its first meeting this month discussed the problem areas in the new tax protocol which states that there is no capital gains tax on equity bought prior to April 1, 2017.

The panel has accepted that there is tax ambiguity related to quasi-debt instruments like a compulsorily convertible security purchased before April 1, 2017 but converted and sold after that date. Similarly, it is unclear as to what will be the tax impact on an investor who buys stocks of company A before April 2017, receives shares of company B to which company A is merged after April 2017, and then books capital gains by selling the shares of B, say in 2018; while technically the investor received shares of B after the cut-off date, it was part of a share exchange scheme and by virtue of the holding in company A. What if an investor deposits securities such as ADR and GDR (purchased before April 2017) with the custodian bank to obtain shares after the cut-off date and sells the stocks in 2019? Will capital gains from sale of shares (converted from ADR) be taxed? Also, what if the capital gains tax on sale of bonus shares issued post April 2017 against stocks which were bought before the cut-off date?

"We have to take a reasonable position in line with best international practices. Investors entering into transactions prior to April 1, 2016 did it based on their understanding of law at that point of time.

Just because there was a merger later, or a security was not a pure stock but was scheduled to be converted later, one should not take a rigid stand to tax investors. It's the same with partly-paid shares where the full payment takes place April 2017," said one of the committee members. "We will give our recommendations to the finance ministry by September, following which the CBDT would come out with the circular," he said. The committee was set up after the then junior finance minister Jayant Sinha, along with finance secretary Hasmukh Adhia, discussed the revised Mauritius treaty with foreign portfolio investors in a conference call organised by Goldman Sachs on May 19.

The main mandate of the committee is to find out the problem areas in the treaty and suggest changes required to address investor concerns.

"Investments are made by funds in target companies on the basis of the capital terms requirements of the investee company and could take the form initially of non-equity; for instance convertible debt or convertible preference shares. In keeping with the investor sentiments, the grandfathering provisions should thus provide protection to non-equity investments that convert to equity post April 1, 2017 as that would then truly protect 'investments' as of March 31, 2017," said Sameer Gupta, partner and tax leader- financial services, EY.

India renegotiated the double taxation avoidance agreement (DTAA) with Mauritius. Under the original pact with Mauritius, short-term capital gains were not taxed in India if the investments were made from the island nation.

As per the earlier DTAA, an investor could choose where he wanted to pay tax — in India or Mauritius. Many conveniently chose Mauritius as that country charged no tax. As per the renegotiated agreement, short-term capital gains tax will be levied in India at half the rate prevailing during the transition period of two years from April 1, 2017 and the full rate thereafter.

Industry trackers feel that the government and CBDT must clear the fog on these ambiguities to minimise litigation. For instance, the Capital Markets Tax Committee, a Hong Kong-based body of FPIs and private equity investors believe that the government should spell out the conditions that offshore investors have to fulfill to avoid being pulled up under the General Anti-Avoidance Rules which kick off from

April 1, 2017. Under GAAR, offshore investors can come under the glare of the Indian tax office if the latter believes that such investors lack substance.

"One aspect which the committee should consider suggesting is stating that the tax residency certificate issued by Mauritius tax authorities shall be regarded as sufficient evidence to treat the Mauritius resident as beneficial owner for the purposes of concessional rate of tax under the treaty on interest, royalty and fees for technical services. It would provide much needed clarity and mitigate future litigation on this issue," said Bhavin Shah, financial service tax leader, PwC India.