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Tax Alert

ISSUE 16 | **MAY 2016**

Protocol amending the India-Mauritius tax treaty - impact on Singapore investors

Shift from resident-based taxation to source-based taxation

On 10 May 2016, India and Mauritius signed a protocol amending, inter-alia, the capital gains article under the India-Mauritius tax treaty. The protocol states that the capital gains tax in India on disposal of shares in an Indian company by a Mauritius tax resident would be as follows:

Disposal of shares in an Indian company by Mauritius tax resident	Capital gains tax in India
Shares acquired before 1 April 2017 and disposed anytime	Grandfathered and not taxable in India (subject to fulfilment of existing treaty eligibility criteria)
Shares acquired on or after 1 April 2017 and disposed before 1 April 2019	Taxable in India – tax rate will be limited to 50% of the domestic tax rate of India, subject to fulfilment of the conditions in the Limitation of Benefit (LOB) article. The LOB article provides that benefit of India-Mauritius tax treaty will not be available to a Mauritius tax resident whose a) affairs are arranged with the primary purpose to take advantage of 50% reduction in capital gains tax rate and b) is a shell/conduit company i.e. legal entity with negligible or nil business operations in Mauritius or with no real and continuous business activities carried out in Mauritius. Mauritius tax resident will not be deemed to be shell / conduit company if it is listed on recognised stock exchange of Mauritius or its expenditure on operations in Mauritius is equal to or more than Mauritian Rupees 1.5 million.
Shares acquired on or after 1 April 2017 and disposed on or after 1 April 2019	Taxable in India – at full domestic tax rates

The protocol also provides for the following amendments:

1) Insertion of Service Permanent Establishment (PE) clause – With effect from 1 April 2017, where a Mauritius tax resident furnishes services, including consultancy services, in India, through its employees or other personnel for a period aggregating more than 90 days within any 12 month period, the Mauritius tax resident would constitute a PE in India.
2) Tax on Interest income – With effect from 1 April 2017, Interest arising in India to a Mauritius tax resident will be subject to withholding tax in India at the rate of 7.5% (subject to beneficial ownership test) in respect of debt claims or loans. Further, interest income of Mauritian tax resident banks in respect of debt-claims existing on or before 31 March 2017 shall be exempt from tax in India.

3) Insertion of new Article on 'Fees for Technical Services' – With effect from 1 April 2017, fees for technical services arising in India to a Mauritius tax resident will be subject to withholding tax in India at the rate of 10% (subject to beneficial ownership test and the Mauritius tax resident does not carry on business in India through a PE). In case the amount of fees paid exceed the arm's length price, the excess amount will not be eligible for beneficial rate of 10% under the tax treaty. Further, no 'make available' clause is provided in this article.

4) Source based taxation of 'other income' – With effect from 1 April 2017, other income arising in India to a Mauritius tax resident will now also be subject to tax in India at the domestic tax rates.

5) Updating of exchange of information article as per international standard and provision for assistance in collection of taxes.

These sudden changes, in particular changes to the capital gains article, would adversely impact the foreign direct investment (FDI) flow from Mauritius into India. It was anticipated that the capital gains exemption under the India-Mauritius tax treaty would continue, albeit, with additional substance requirements.

Tax sword on Singapore investors in India

Since the capital gains exemption under the India-Singapore tax treaty is co-terminus with India-Mauritius tax treaty, the above changes could also have implications under the India-Singapore tax treaty. With the amendment to the capital gains article under the India-Mauritius tax treaty, the benefit of residence based capital gains tax treatment under the India-Singapore tax treaty may also end.

It remains to be seen as to whether any grandfathering or concession would be provided for the India – Singapore tax treaty.

Going forward

The FDI coming into India through Singapore has been increasing in the recent years but these changes may cause a dent to such FDI flows. India would continue to require significant FDI and strategic partnerships for its various initiatives namely, Make In India, Digital India etc.

Based on the press statements by senior government officials in India, there would soon be renegotiation of India-Singapore tax treaty between the governments. It is now being hoped that capital gains exemption under the India-Singapore tax treaty can be retained so that Singapore can continue to play a crucial role in India's much needed development.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

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