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MAURITIUS TRADE ROUTE MARRED?

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Introduction

In a complete disregard to the decision of the Supreme Court of India (**"SC"**) in Union of India vs. Azadi Bachao Andolan, *(2003) 263 ITR 706, 263 ITR 706 (SC),* which had permitted the Mauritian companies having tax residency certificates to benefit from the India-Mauritius tax treaty, *Circular No. 789, dated 13-4-2000,* the recent decision of the Bombay High Court (**"HC"**) in E Trade Mauritius Limited vs. ADIT & Ors, *WP. No. 2134 of 2008,* seriously impacts the Mauritius route.

Factual Matrix

E Trade Mauritius Ltd. (**"E Trade"**), a wholly owned subsidiary of E Trade Financial Corporation based in Mauritius sold its stake in IL & FS Investmart, an Indian company to Mauritius based HSBC Violet Investments (**"HSBC"**). To authorize payment of consideration by HSBC without any withholding of tax in this sale, E Trade sought to obtain a certificate from the Indian tax authorities under section 197 of the Income Tax Act, 1961 (which provides for the certificate to get benefits of reduced rates/no rates). The tax authority refused this certificate, and, in response to the refusal E Trade filed a writ petition before the HC challenging this decision.

The HC directed E Trade to file a revision application before the Director of Income Tax (**"DIT"**) and accordingly disposed the writ petition. Pending the decision of the DIT, HSBC was also directed to deposit a sum of INR 245 million which would be withheld from the consideration paid to E Trade. The HC further stated that the DIT shall also issue an appropriate order regarding the disposal of the amount deposited. Pursuant to the HC's order, the DIT, in its revisional decision refused to grant the certificate regarding withholding of tax by HSBC. Aggrieved E trade again appealed to the HC. The HC, giving effect to the decision of the revisional authority, in its order, dated March 23, 2009 directed for the release of INR 243.1 million after deducting the tax at source from the deposited amount to the government and the refund of the balance amount to E Trade.

Our observation

The HC has not gone into the merits of the case and its order give effect to the decision of the revisional authority. The said order is solely in relation to the issue of withholding tax and there is no ruling on the issue of chargeability of the capital gains to tax in India. At this stage, it cannot be said that there has been any concrete determination of taxability of the consideration received by E Trade in India. DIT's decision was

based on the premise that E Trade held the shares of the Indian company on behalf of E Trade US and as such, would not be entitled to the benefits of the India-Mauritius tax treaty.

The Indo-Mauritius tax treaty provides that capital gains arising in India from the sale of securities can only be taxed in Mauritius thereby leading to zero taxation as there is no capital gains tax in Mauritius. The SC, in the Azadi Bachao Andolan case, had highlighted the role of such treaties in fostering inflows of foreign exchange and capital into India. The current decision of the HC has the potential to disrupt the Mauritius trade route.

In our opinion any change in the tax treaty or questions of treaty abuse have to be addressed at a policy level between the governments of two nations by making necessary amendments. As E Trade is entitled to challenge the revisional order of the DIT before the HC in writ, pending any change in the existing treaty or revision of the current judgment, the SC judgment will continue to prevail, but foreign investors will need to be cautious about the potential tax benefits of investing through Mauritius.

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