

Govt weighs scrapping TRC rule for Mauritius Investors

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Rattled by its defeat in a \$2.2-billion tax dispute with Britain's Vodafone Group, the government is examining the possibility of scrapping a rule that makes it incumbent upon India's tax authority to recognise so-called the tax residency certificates (TRCs) issued by the Mauritius tax office. The TRC is considered to be proof that an investor is a resident of Mauritius and thus entitled not to pay capital gains tax under the Indo-Mauritius tax treaty.

The option to withdrawing the TRC rule, which has been in place since April 2000, was discussed at a meeting convened by finance minister Pranab Mukherjee on Friday to consider the larger implications of the Vodafone verdict. However, a final decision will come after wider consultations as such a move could increase uncertainty and impact FDI and FII flows in a gloomy economic environment, said a person with knowledge of the development.

Close to 50% of foreign institutional investment or purchase of Indian stocks and bonds and 40% of foreign direct investment comes through Mauritius. The SC ruled that the Indian government could not tax Vodafone's purchase of Hutchinson's stake in its mobile telephony joint venture in India with Essar as the deal was done through a holding company registered in the Cayman.

The ruling also upheld the rights of a non-resident investor to invest through the Mauritius route, provided the transaction is genuine though one of the judges said the authorities were not barred from investigating tax fraud. "An Indian company can invest in a tax haven and create a whollyowned subsidiary in Mauritius and obtain a TRC to invest in India.

Large amounts can be routed through India using TRC as a defence, but once it is established that such investment is black money or capital that is hidden, then the TRC can be ignored," said Justice Radhakrishnan in a separate ruling that concurred with the main judgement but made some additional.

"TRC is just one form of documentary evidence of tax residency. It is not the requirement of the treaty. The fundamental position should not change even if the circular is withdrawn. The SC has permitted look through for sham structures. With or without the circular, that would still be possible.

Withdrawal of circular though will raise some concern among investors as each structure may be looked at on a case by case basis," said Shefali Goradia, Partner, BMR Advisors.

The rule was issued by way of a circular in 2000 and its validity has been upheld by the Supreme Court in a decision known as the Azadi Bachao case. The government issued the circular after some assessing officers sought to deny the benefits of the Indo Mauritius tax treaty to some Mauritius resident companies, saying that their beneficial ownership was outside Mauritius and the purpose of investing in India was to escape tax.

In the recent past, India has been pushing for a review of the Indo-Mauritius tax treaty to curb treaty shopping, a practice in which residents of a third country take advantage of a beneficial tax treaty between two countries to lower their tax liability.



If India's stance is accepted a "limitation of benefit clause" will be inserted into the treaty that will enable only genuine residents of both countries to enjoy the benefits. However, Mauritius is not willing to budge, resulting in the Indian tax authorities to look at options such as withdrawing the TRC.

India has been issuing TRCs for a decade now. The Supreme Court's ruling in the Vodafone case said a genuine corporate structure set up for purely commercial purposes and for genuine investment should be recognised. However it also said that legislative measures to plug loopholes are in order.

