‘Mauritius Leaks’ and Need for Tax Reforms

The article is based on **Mauritius leaks and need for tax reforms** that was published in The Hindu BusinessLine on 30th August. It talks about the Mauritius Leaks and the need for strengthening tax treaty to avoid tax evasion.

Context

- In July 2019, the **International Consortium of International Journalists** published over 200,000 confidential documents from the offices of Conyers Dill & Pearman, a Bermuda-based law firm that allegedly aids large Western businesses to set up **letterbox companies** in Mauritius aimed at making **tax-motivated investments** in Africa and Asia.
- **The leak** has reignited the debate on **multinational tax avoidance** and how businesses use tax-friendly jurisdictions to channel funds from one country to another in order to minimise their overall corporate tax liability.
- The ‘Mauritius Leaks’ comprise names of some of the most popular brands in India and globally.

Concerns regarding India-Mauritius Tax Treaty

- The **India-Mauritius tax treaty** has been a subject matter of controversy and debate ever since it was signed over 30 years ago.
  - Before 2017, **Article 13(4) of the tax treaty exempted capital gains** arising from sale of shares in an Indian company at the hands of Mauritian residents.
  - And the effective capital gains tax rate in Mauritius was zero percent, which is why a majority of the largest foreign incorporated corporations that invested in India over the last decade did so through Mauritius.
- The **capital gains exemption in the treaty was plugged in 2017 by amending Double Taxation Avoidance Agreement (DTAA) with Mauritius,** paving the way for India to levy capital gains tax involving sale of shares in an Indian company.
- However, till date, **the tax treaty does not contain a general anti-abuse clause** to tackle round tripping of funds or treaty-shopping arrangements.
- While India’s tax treaty with Mauritius contains provisions for **exchange of tax information,** any information requested has to be “foreseeably relevant” for giving effect to the tax treaty or the Income Tax Act.
  - In the absence of extensive, worldwide information-sharing network, wealth is usually not repatriated to India where it belongs, but shifted to new, non-collaborating secrecy jurisdictions.

OECD framework on Base Erosion and Profit Shifting

- As part of the **base erosion and profit shifting (BEPS)** project, the OECD recommended that countries adopt a **principal purpose test** in their tax treaties to deny inappropriate treaty benefits.
  - Under the principal purpose test, the tax authority may deny tax benefits if obtaining a tax benefit was “one of the principal purposes” of a tax arrangement.

- Both India and Mauritius have signed the **OECD's Multilateral Instrument (MLI)** designed to implement some of the BEPS recommendations.
- However, Mauritius has conveniently kept India outside the network of tax treaties that are covered under the MLI by keeping the bilateral treaty with India outside the scope of the multilateral deal.

Renegotiating India-Mauritius Tax Treaty

- It is vital for India to put pressure on Mauritius and **renegotiate its tax treaty to include a principal purpose test** to deny tax arrangements that do not have any genuine commercial substance and are primarily meant to obtain a treaty benefit.
- In the absence of such a provision, Indian courts, who are bound by the principle of ***pacta sunt servanda*** (agreements must be kept), would be hesitant to endorse claims of treaty abuse.
- Some of these arrangements would get captured under the newly incorporated **general anti-avoidance rule (GAAR)** in the Income Tax Act.
    - However, India's domestic GAAR is narrower that the OECD-recommended "principal purpose test" as GAAR uses the "main purpose" test.
    - The safeguards available under the Income Tax Act before invoking GAAR are not available in case of the principal purpose test.

Way Forward: Strengthening India's Tax Administration

- Supplement India's domestic GAAR regime with a mandatory tax disclosure regime for tax advisers such as accounting firms, law firms, banks who assist businesses in aggressive international tax avoidance.
    - Countries such as the United Kingdom, South Africa, Canada, among others, already have in place detailed tax disclosure rules for tax advisers.
- It is necessary for India to mull over a range of policy options to target corporate tax avoidance and allocate separate funds for addressing challenges faced by tax officers in enforcing anti-abuse rules.
- It is important to cooperate under the aegis of the Organisation for Economic Cooperation and Development and the United Nations to develop global jurisprudence to counter base erosion and profit shifting.
- Companies registered in Mauritius are the **largest source of foreign direct investment (FDI) into India,** making it crucial for India to **upgrade its bilateral tax treaty,** adopting the latest international practices that prevent multinational companies from artificially shifting profits to low tax countries.

Drishti Input

"Critically analyse the India-Mauritius Bilateral Tax treaty and its role in avoiding tax evasion and profit shifting by Multinational Corporations in the backdrop of recent Mauritius leaks."

PDF Refernece URL: https://www.drishtiias.com/printpdf/mauritius-leaks-and-need-for-tax-reforms