CLIENT MEMO

INDIA'S SUPREME COURT VALIDATED THE USE OF MAURITIUS TREATY FOR INBOUND INVESTMENT

The Indian Supreme Court ruled in 2003 that capital gains realised by foreign investors on their investments in India which are held through Mauritius companies will be exempt from Indian tax by virtue of the provisions of the India-Mauritius Treaty ("the Treaty"). This memorandum provides clients with background to the decision which continues to be an important element in planning for investment in India.

Most Foreign Direct Investment ("FDI") into India is routed through Mauritius holding companies.The reasons for the choice of Mauritius as a holding company domicile are:

- In the absence of a treaty capital gains realised on investments in India are subject to tax in India.
- The provisions of the Treaty provide that a Mauritius resident (which includes a Mauritius resident company) will be exempt from tax on capital gains realised in India.
- As Mauritius does not tax capital gains the gains realised on the Indian investments consequently will not be taxed either in India or in Mauritius.

The above position was originally confirmed in a Circular issued in April 2000 by the Indian Central Board of Direct Taxes ("CBDT"). In that circular the CBDT stated that a "Certificate of Residence" (known as a Tax Residence Certificate) issued by the Mauritius Tax Authorities would constitute sufficient evidence as to residence and beneficial ownership in Mauritius for entitlement to the benefits of the Treaty.

The publication of the Circular resulted in a legal challenge by local public interest organisations alleging that India was losing significant revenue as a result of the Treaty provisions. In May 2002, the Delhi High Court ruled in favour of the public interest bodies by quashing the Circular.

At that time the Delhi High Court order caused widespread uncertainty among foreign investors regarding their tax liability in relation to their investments in India. In October 2002, the Government of India and the CBDT, respondents before the Delhi High Court, filed a Special Leave to Petition ("SLP") in the Supreme Court of India. (An independent SLP was also filed by Global Business Institute, a not-for-profit organisation incorporated under the laws of Mauritius.)

After extensive hearings the Supreme Court finally pronounced its ruling in October 2003 setting aside the Delhi High Court order and upholding the Circular to be valid.

In its ruling the Supreme Court stated that it was legitimate for third parties to enjoy treaty benefits by using Mauritius-resident entities and such use of treaties could be regarded as a necessary evil for the promotion of economic development and inbound investment into developing countries.

The Court also ruled that in the absence of any anti-treaty shopping provisions in a treaty, treaty benefits could not be denied to the residents of a country even though such residents might be controlled by non-resident third parties. In the opinion of the Court, if a country is concerned about treaty abuses it should introduce the requisite provisions in its domestic laws to prevent such use of the jurisdiction by non-residents of the country.

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