Taxing times: I-T department tightens scrutiny of FPIs based in Mauritius

Over half a dozen receive demand letters from dept

Tax Experts Highlight That Under General Anti-Avoidance Rules (GAAR) And The Proposed PPT, Tax Benefits Should Not Be The Primary Motive For Establishing A Fund In Mauritius.

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The income-tax (I-T) department has intensified its scrutiny of foreign portfolio investors (FPIs) in Mauritius who are claiming tax benefits under the India-Mauritius treaty.

In the past two weeks, over half a dozen Mauritius-based FPIs have received notices from the I-T department regarding their Tax Residency Certificates (TRCs), according to sources.

"The department requested copies of TRC applications. Some FPI administrators declared no permanent place of business in Mauritius, which could justify denying tax benefits. Five to seven FPIs received demands to recover taxes on derivatives income," said a source with direct knowledge of the developments.

The Central Board of Direct Taxes (CBDT) did not respond to emailed queries by the time of going to press.

Mauritius ranks fifth in terms of assets under custody by FPIs, at ₹3.57 trillion, according to data from the National Securities Depository Limited (NSDL). More than 600 Mauritius-based FPIs are currently registered with the Securities and Exchange Board of India (Sebi).

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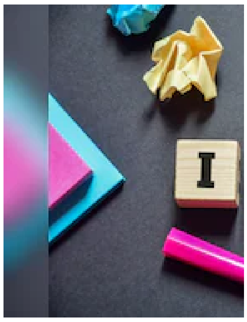

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Last year, the Supreme Court stayed a Delhi High Court ruling on TRCs that favoured lower tax rates for foreign investors. The case, involving Blackstone Capital Partners, is pending a final hearing.

A TRC is a mandatory threshold requirement to establish the residency of a taxpayer in a treaty partner country under the Double Taxation Avoidance Agreement (DTAA) and the Income-Tax Act. However, legal experts said it could not be regarded as a blanket entitlement to treaty benefits.

"Along with TRC, it should satisfy other conditions of the treaty, such as limitation of benefits (LOB) or principal purpose test (PPT) provisions, which aim to prevent treaty abuse. Tax authorities are increasingly seeking evidence that the entity claiming treaty benefits has real business operations and is not a conduit," said Kunal Sharma, partner, Singhania & Co.

However, several tax experts believe TRCs have been recognised by Indian courts as conclusive evidence of a taxpayer's residential status, which makes them eligible to claim treaty benefits.

"Sometimes there may be practical difficulties wherein objections may be raised by the tax department on account of different formats and/or missing information. However, these cannot be grounds for denial of treaty benefits, which are codified under law," said Pallav Pradyumn Narang, partner, CNK, a chartered accountant firm.

Punit Shah, partner at Dhruva Advisors, said TRCs were generally sufficient to establish treaty eligibility, according to the law, judicial rulings, and CBDT circulars. "However, tax authorities are closely examining FPIs' backgrounds, including constitution documents, regulatory filings, beneficial ownership declarations, and board activities, particularly for Mauritius and Singapore-based entities," Shah said.

Experts warn that this heightened scrutiny may lead to increased litigation.

Tax experts highlight that under the General Anti-Avoidance Rules (GAAR) and the proposed PPT, tax benefits should not be the primary motive for establishing a fund in Mauritius.

"Funds must demonstrate sufficient commercial substance in Mauritius, aligned with their operations, to secure treaty benefits on derivatives, interest, and dividend income," said Rajesh Gandhi, partner at Deloitte.

Gandhi said GIFT City offers FPIs a competitive edge due to its clarity on GAAR and PPT, which reduces tax-related uncertainty.

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