REVISED TAX TREATY BETWEEN INDIA AND MAURITIUS: IMPACT ON ROUTING FDI OUTFLOW FROM INDIA

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Abstract— Base Erosion and Profit Shifting (BEPS) practiced by major multinational players is one of the chief concerns that clouds effective retrieval of revenue by the governments of the involved jurisdictions. In order to overcome this problem, the Organization for Economic Cooperation and Development (OECD) and European Union (EU) have been working continuously for the past many years on combating such practices so that the jurisdictions are able to garner their fair share of revenue and the aim of sustainable development of the all the nations of the world could be assured. To combat the concerns regarding BEPS, the OECD has proposed various action plans as guidelines, which can be tailored by nations as per their specific requirements and concerns. India signed a Double Taxation Avoidance Agreement (DTAA) with Mauritius in the year 1982 to promote business and investment. India was transcending from a closed economy to an open economy and was looking for the foreign investment, therefore this seemed to be a profitable and a sustainable method for investment. However consequently it was found out that treaty abuse was made in 1983 when signing the DTAA with Mauritius. This defect could only be rectified in 2016. This shows India's stand against tax havens and avoidance of tax in any form. The after effects of the change in the treaty have been studied in detail. It is observed in the study that after signing the treaty there have been direct investments in India instead of routing the investment from Mauritius. Moreover, this has resulted in the revenue authorities deriving their fair share. Therefore, it has been concluded that base erosion and profit shifting activities can be effectively checked by the changed provisions of the treaty.

Keywords: BEPS, DTAA, OECD, EU, Tax Treaty, Foreign Direct Investment

1 INTRODUCTION

Base Erosion and Profit Shifting (BEPS) is one of the most discussed topics of this decade. Under BEPS practices the Multinational Companies (MNCs) of one jurisdiction shift their profits from high tax rates jurisdiction to low or nil tax rates jurisdiction in order to avoid their tax liability. Organisation for Economic Cooperation and Development (OECD) and European Union (EU) have been working continuously for the past many years on combating such practices so that the jurisdictions are able to garner their fair share of revenue and the aim of sustainable development of the all the nations of the world could be assured. In order to achieve the same objective OECD has provided 15 Actions Plans to combat BEPS practices. Action Plan VI which states 'Neutralize Treaty Abuse' and Action Plan VII which states 'Neutralize the artificial avoidance of permanent establishment (PE) status', are directly concerned with India-Mauritius and India-Singapore tax treaty. For the past many decades India had been facing trouble in so much so that a major portion of foreign direct investment (FDI) has been coming from companies set up in Mauritius. Mauritius is the top destination through which FDI comes from. Approximately 33% of the total FDI inflow of India comes from Mauritius. Whereas Mauritius is a top destination of Indian overseas FDI outflow as well. Many of these companies were conduits through which millions of dollars of investment flowed into India and when the investors exited the market; their accumulated wealth went untaxed in India as well as the isle nation. In 1991, India opened its gate for foreign investors to invest in India and observed that a treaty abuse was made in 1983 when signing a Double Taxation Avoidance Agreement (DTAA) with Mauritius. India had been trying to rectify that treaty since then and finally got success in 2016. The main concerns of the Indian government to amend that treaty were:

1. The treaty consequently resulted in double non taxation in India as well as in Mauritius. This happened because tax rate on capital gain from shares and securities in Mauritius was already 0% so India was losing out on its fair share of revenue.
2. By following the practice of 'Treaty Shopping', Indian and other MNCs were constantly using the infamous Mauritius route to invest into India by creating shell companies in Mauritius.

India-Mauritius double taxation avoidance treaty:

Double Taxation Avoidance Agreement is a bilateral treaty between two or more countries to avoid double taxation on the same income in both the countries. It occurs when a resident of one country earns income in another country and this income is liable to tax in both the countries as per the taxation laws of the concerned nations. To avoid such double taxation and promoting business among them, countries enter into such agreements. Almost every country of the world has signed different treaties in one form or the other. These treaties can be tailored as per the individual needs of the countries. On the same lines India also signed a DTAA with Mauritius in the year 1982 to promote business and investment. As India was transcending from a closed economy to an open economy and was looking for the foreign investment, this seemed to be a profitable and a sustainable method. So India signed a treaty with Mauritius as per the provisions of section 90 of the Income Tax Act 1961. It has a total of VI Chapters and 29 Articles. But sometimes these business promoting treaties also tend to convert into treaty abuse because of some unintentional loophole in the provisions of a treaty. Similar happened in the case of India and Mauritius double taxation avoidance treaty.
Example: Where the capital gain was to arise out of investing in shares and securities in India to a person, who was a resident in Mauritius, would have been liable to pay capital gain tax in Mauritius. However, the capital gain tax on shares & securities in Mauritius is Zero. Therefore, this treaty created

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a tax loop between India and Mauritius. After putting in lots of efforts, finally in 2016 India got success and a revised treaty which was signed with Mauritius finally came into force. India has taken its first step and showed the world its determination against black money and its cooperation with the OECD. Before 2016, if any Mauritius organization earned capital gain in India it levied 0% capital gain tax in India. A two years transition period was also provided to investors to settle their investments. From 1st April 2017 to 31st March 2019, capital gains earned by Mauritius persons on the transfer of shares, securities and units of mutual funds was taxed at 50% of the normal capital gain tax rate i.e. 15%. This half rate was not applied on those companies which had proved that their main purpose of business was bona fide and spent more than Rs. 27 lakh in financial year. Such companies were not treated as shell companies. The transfers made on or after 1st April 2019 will attract a capital gain tax at the normal prescribed capital gain tax rate in force.

2 MATERIAL AND METHODS

2.1 Literature Review

Peter Egger, Mario Larch (2006) discussed the impact of tax treaties on outward FDI and stocks. For that study they took a general equilibrium model which could be numerically solved. In the said study, they found significant adverse impact of tax treaties on outward FDI.
Karl p. Sauvant and Lisa E. Sachs (2009) discussed the impact study of Treaties like DTAA, bilateral investment treaties on FDI and investment flows. In this paper they included the many questions which were unanswered. They also considered the case study of DTAA between United States of America (USA) and Ghana.
Hejing Chen, Chunding Li and John Whalley (2015) also explained the impact of treaties like Bilateral Investment Treaties (BITs) and Double Taxation Treaties DTTs) on FDI with special reference to China. They used gravity model and CMM model to statistically check the significance level of impact. They used more than two variables in which FDI was dependent variable and the independent variables were BITs, DTTs, Income and Capital tax treaty (ICT) and Income Tax Treaty (ITT).
International Institute of Sustainable Development (IISD) report (2017) also explained the benefits of investment treaty on FDI inflow. The main focus of that study was whether 'Investment Treaty affects FDI' and 'To what extent it constitutes a benefit'.
Objectives of the Study:
It is generally observed that tax and foreign direct investment has a negative correlation. Many countries charge minimal tax or no tax and provide high secrecy norms to attract FDI and for the same they sign such treaties. But in case of India-Mauritius treaty India's revenue was being doubly affected till the new treaty came into existence. Firstly, maximum FDI in the shares and securities came through the Mauritius route on which India could not levy any tax because it was bound by double taxation treaty regulations.
Secondly, Indian Investors who wanted to invest in the Indian market were also investing in India by incorporating shell companies in Mauritius. So in short India was losing out on its fair share of FDI and revenue through the application of this treaty. In this paper we shall try to observe the impact of the change of treaty on FDI outflow from India to Mauritius. For this purpose these objectives are assigned.
1. The main objective of the study is to determine whether Indian MNCs are using the Mauritius treaty abuse and investing in India from India through Mauritius route by using shell companies.
2. To check whether there is any relationship between tax treaty (capital gain tax rates) and FDI outflow from India to Mauritius.

2.2 Research Methodology

The study focuses on the Indian-Mauritius double taxation treaty abuse and how Indian MNCs used that treaty to invest in India through shell companies of Mauritius. To check the impact of treaty change on FDI outflow from India, sample was collected from Q1 and Q2 of 2016 i.e., before treaty change and Q1 and Q2 2019 i.e., after treaty change. The data was analysed using Regression model and paired T- test. To check the first null hypothesis, "There is no significant relationship between capital gain tax rates and FDI outflow from India", regression model was used whereas the second null hypothesis, "There is no significant relationship between the Indian-Mauritius double taxation tax treaty and foreign direct outflow from India to Mauritius" was verified by using paired t-test.

2.3 Hypothesis

1. H01: There is no significant relationship between capital gain tax rates and FDI outflow from India.
2. H02: There is no significant relationship between the Indian-Mauritius double taxation tax treaty and foreign direct outflow from India to Mauritius.

Table 1: Descriptive Statistics

	Mean	Std. Deviation	N
FDI Mauritius	872.38	780.921	8
Tax rate	7.50	5.669	8

Table 2: Correlations

		FDI Mauritius	Tax rate
Pearson Correlation	FDI Mauritius	1.000	-.782
	Tax rate	-.782	1.000
Sig. (1-tailed)	FDI Mauritius	.	.011
	Tax rate	.011	.
N	FDI Mauritius	8	8
	Tax rate	8	8

Table 3: Variables Entered/Removeda

Model	Variables Entered	Variables Removed	Method
1	Tax rateb	.	Enter

a. Dependent Variable: FDI Mauritius
b. All requested variables entered.

Table 4: Model Summaryb

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.782a	.611	.547	525.780	2.339

a. Predictors: (Constant), Tax rate
b. Dependent Variable: FDI Mauritius

Table 5: ANOVAa

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	2610195.672	1	2610195.672	9.442	.022b
Residual	1658669.585	6	276444.931		
Total	4268865.257	7			

a. Dependent Variable: FDI Mauritius
b. Predictors: (Constant), Tax Rate

Table 6: Coefficientsa

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	1680.183	321.973		5.218	.002		
Tax rate	-107.707	35.052	-.782	-3.073	.022	1.000	1.000

a. Dependent Variable: FDI Mauritius

Table 7: Collinearity Diagnosticsa

Model	Dimension	Eigenvalue	Condition Index	Variance Proportions	
				(Constant)	Tax rate
1	1	1.816	1.000	.09	.09
	2	.184	3.146	.91	.91

a. Dependent Variable: FDI Mauritius

Table 8: Residuals Statisticsa

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	64.57	1680.18	872.38	610.643	8
Residual	-706.927	766.563	.000	486.778	8
Std. Predicted Value	-1.323	1.323	.000	1.000	8
Std. Residual	-1.345	1.458	.000	.926	8

a. Dependent Variable: FDI Mauritius

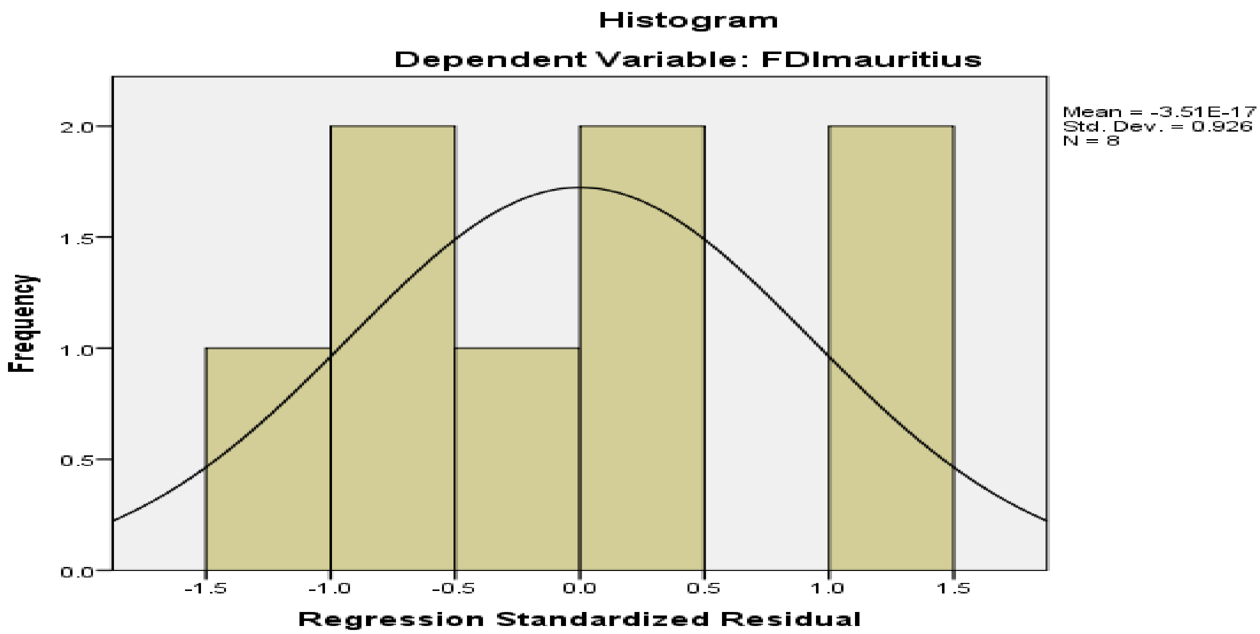
Histogram
Dependent Variable: FDImauritius
Mean = -3.51E-17
Std. Dev. = 0.926
N = 8
Frequency
2.0
1.5
1.0
0.5
0.0
-1.5
-1.0
-0.5
0.0
0.5
1.0
1.5
Regression Standardized Residual

Fig. 1

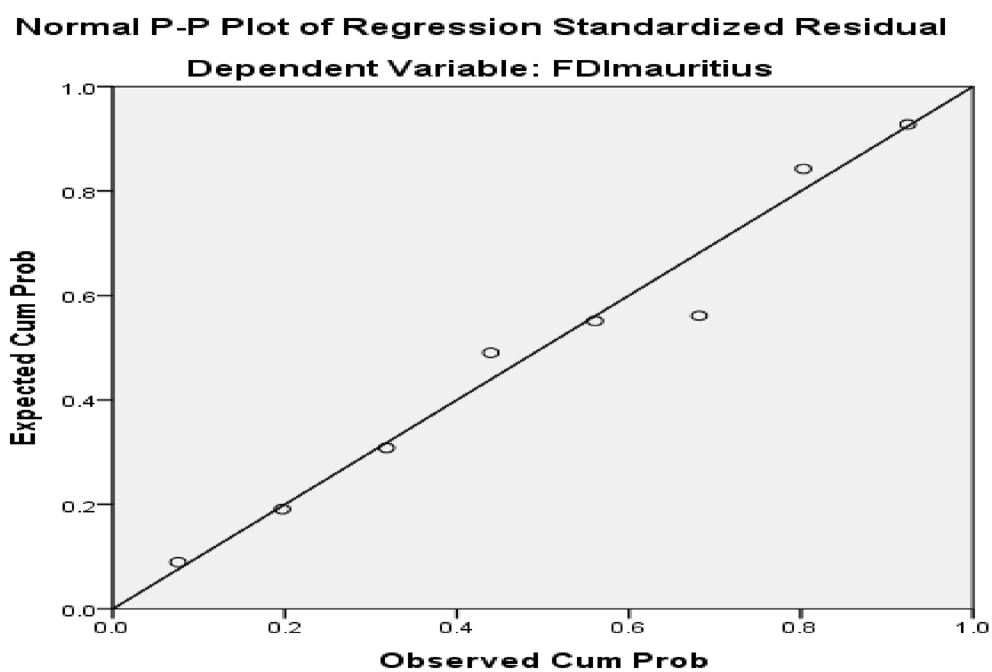
Normal P-P Plot of Regression Standardized Residual
Dependent Variable: FDImauritius
Expected Cum Prob
1.0
0.8
0.6
0.4
0.2
0.0
0.0
0.2
0.4
0.6
0.8
1.0
Observed Cum Prob

Fig. 2

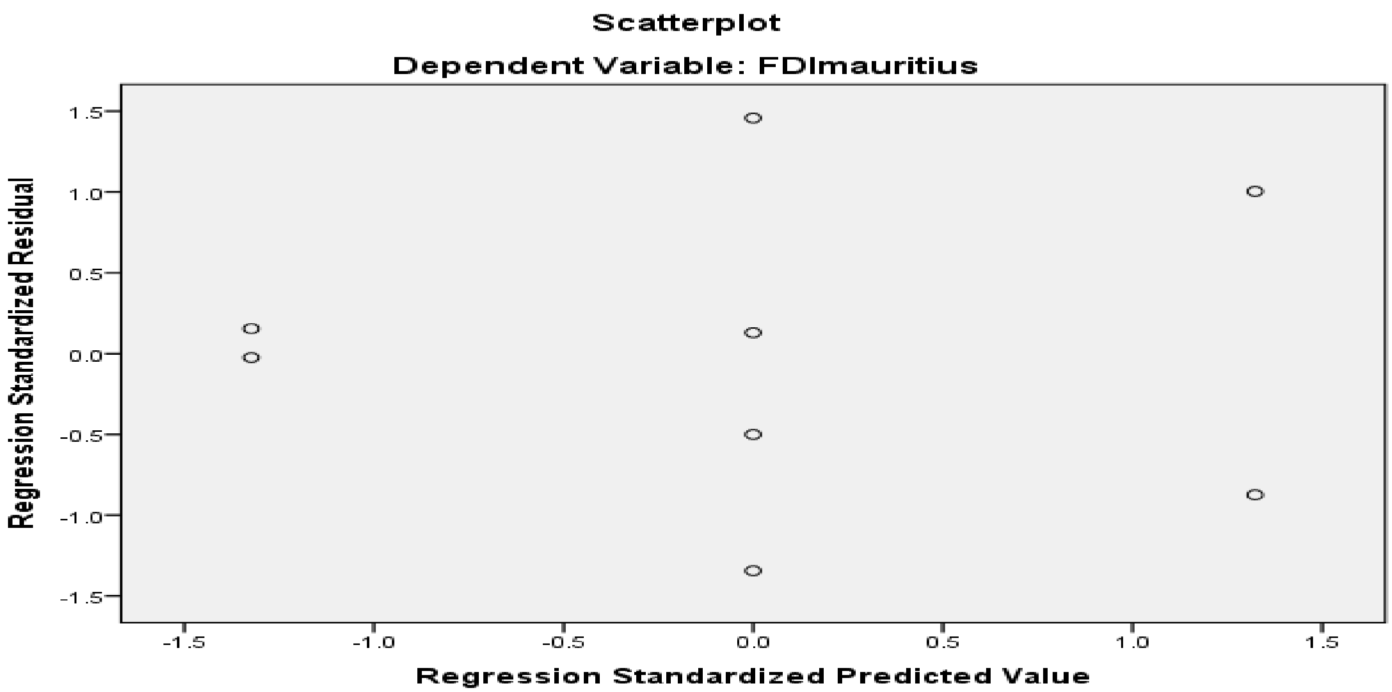

Fig. 3

T-TEST

Table 9: Paired Samples Statistics

		Mean	N	Std. Deviation	Std. Error Mean
Pair 1	before	552.45	6	470.113	191.923
	after	37.9753	6	22.84328	9.32573

Table 10: Paired Samples Correlations

		N	Correlation	Sig.
Pair 1	before & after	6	.759	.080

Table 11: Paired Samples Test

		Paired Differences					T	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
Pair 1	Before Treaty- after treaty	514.47292	453.01665	184.94327	39.06110	989.88473	2.782	5	.039

3 RESULTS AND DISCUSSIONS

The analysis has been given in tables 1 to 8. The descriptive statistics of FDI and tax rates are mentioned in Table 1 which shows the mean value of FDI to Mauritius is 872.38 Million with standard deviation of 780.921 Million. Whereas mean value of tax rates are 7.5 with standard deviation of 5.669. Total data from 8 Quarters was collected as sample from 2016 to 2019.

1. If we examine the significance of relationship of the model we have to look into the Table 5.
2. F= Explained Variance / Unexplained Variance. In Table 5, F was calculated as 9.442, which shows that the regression model is significant.
3. If we check the strength of the regression model, Table 4 ‘Model Summary’ needs to be looked into. Table 4 provides a simple correlation of 0.782 which indicates a high degree of correlation. Table 2 indicates a negative correlation -0.782 Pearson Correlations which means tax rates and FDI to Mauritius have a high degree of negative correlation.

Whereas R2 value shows explained variation in comparison of total variation. Table 4 shows R2 = 0.611 i.e., 61.1% which means 61.1% variations can be explained. This is also very high.

4. Table 5 is the ANOVA analysis, which is also very important. It shows a high F value and the significance is 0.022 which is less than 0.05. It means only 2.2% chances are that capital gain tax and FDI outflow to Mauritius has no significant relationship. In other words 99.8% chances are in favour of the fact that relationship exists. So statistically the first null hypothesis is rejected.
5. If we check VIF level that comes to 1.000 in Table 6, which is less than 5 so it is acceptable and there is no multicollinearity which exists. Durbin Watson results are also within the range of 1.25 to 2.75 (i.e., 2.339) which also show that there is no auto co-relation that exists.
6. Chart 1, i.e., Histogram shows that data are bell shaped or equally distributed or we can say that there is no skewness.
7. Chart 2 P-plot shows that there is no heteroscedasticity in data and the data is homogeneous. It also shows that no significant outlier exists in sample.

Second hypothesis is analyzed by using paired T-test. Significant difference is also seen between the Indian-Mauritius double taxation tax treaty and foreign direct outflow from India to Mauritius. The analysis of statistical results of paired T-test (Tables 9 to 11) is discussed below.

1. The mean value of FDI outflow to Mauritius before treaty change was 552.45 million which was reduced to 37.9753 million after the treaty change.
2. The standard deviation of FDI before treaty change was 470.113 million which was reduced to 22.84328 million after the treaty change between India and Mauritius.
3. Table 10 shows that the paired sample correlation is .759 which is very high with significant level of 0.080.
4. At 95% confidence level, the lower limit of FDI was 39.06110 and upper limit was 989.88473. The significance level or the P value is 0.039 which is less than 0.05. So it can be said that null hypothesis is rejected and there is a significant difference between the Indian-Mauritius double taxation tax treaty and foreign direct outflow from India to Mauritius.

4 CONCLUSION

The analysis shows that the change in India-Mauritius Double Tax Treaty will affect the Indian economy in two ways. Firstly, it ceases the outward FDI flow from India to Mauritius and now Indian investors directly invest in the Indian capital market instead of following the crooked route of forming shell companies in Mauritius and then routing the investment. This way India has been able to find its fair share of revenue from that investment. Secondly, the foreign investors who want to invest in the Indian markets and were diverting their funds through Mauritius can now directly invest in India. This will also help the Indian Government to collect apt tax revenue and boost its economy. To change this DTT Indian government has proven their intention that their economy is strong enough to attract FDI and India does not need to lose its fair share of revenue for FDI. On the other hand India showed her determination against BEPS to the world and her cooperation to OECD to follow its action plans. So it can be summed up that the initiative taken by Indian government to change tax treaty with Mauritius has had positive impact on FDI flows as well as on tax revenue. Now with the help of revised tax treaty India can check base erosion and profit shifting activities which used to take place as a result of the treaty abuse.

5. FUTURE SCOPE

India- Mauritius treaty was just an example of treaty abuse. Treaty abuses are still reported from every nook and corner of the world because of which white collar crimes are still continuing. The treaty between India and Singapore was another example of treaty abuse which was rectified in due course of time by the tax authorities. This research work provides areas in which similar researches may be lead. More than 3000 tax treaties have been signed among the countries to attract FDI and business promotions. Aggressive tax planners all over the world are using these treaties to avoid tax. So the researchers have ample scope to find out the loopholes which instigate such abuse of treaties and their consequent impact on economies of the world and FDI flow.

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