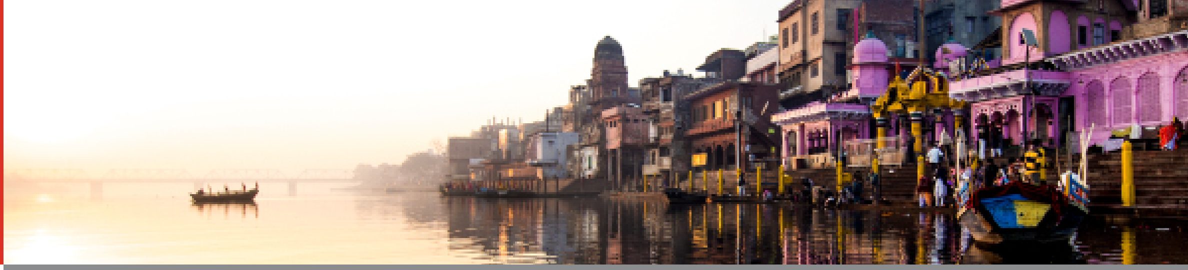
Tax Alert
May 2020



India Desk
in Mauritius

Abolition of Dividend Distribution Tax ('DDT') and introduction of tax on dividends in the hands of the recipient

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India Desk in Mauritius

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In Brief

With effect from 1 April 2020, the Dividend Distribution Tax ('DDT') was abolished and a withholding tax ('WHT') was introduced on the payment of dividend. As a result, dividend is now only taxed in the hands of the recipient. Under the Mauritius-India Double Tax Avoidance Agreement ('DTAA'), an Indian company paying dividends to a Mauritius entity has to withhold tax at source at a preferential rate of either 5% or 15% subject to the Mauritius company being the beneficial owner of the dividends, tax resident in Mauritius and fulfilling the limitation of benefits clause. The concept of beneficial ownership is not defined under both the Mauritian and Indian domestic tax laws. In practice, we have seen instances where the Indian tax authorities have taken an aggressive approach and have denied treaty benefits to companies. The beneficial ownership and tax residency status assessment is made on a case to case basis and the tax tribunal assesses several aspects in terms of substance, decision-making and commercial rationale behind transactions before allowing treaty benefits. As such, where Mauritius entities wish to take advantage of the preferential rates under the India-Mauritius DTAA, it is important to evaluate how the Indian tax authorities will assess the residency and beneficial ownership status of the company.

Abolition of Dividend Distribution Tax ('DDT') and introduction of tax on dividends in the hands of the recipient

Old Regime

Previously, an Indian company was required to pay Dividend Distribution Tax ('DDT') equivalent to 20.555% (including surcharge and cess) on dividends paid to its shareholders on or before 31 March 2020. There was no withholding tax on the dividends distributed by the Indian company and such dividends were exempt in the hands of the recipient irrespective of whether the recipient is a corporation, a passthrough or an individual. In the case of specified Indian resident shareholders, such dividend was additionally taxable at 10% (plus surcharge and cess).

New dividend regulations

On 01 February 2020, the Government of India released its Union Budget proposals for the year 2020-21. It proposed amendments to the provisions relating to taxation of dividend. On 27 March 2020, these proposals were approved by the President of India and are applicable as from 01 April 2020. Accordingly, an Indian company paying dividends is no longer liable to DDT but should instead withhold tax at source at the time of payment of the dividend since the recipient of the dividend is now subject to tax. Under the Indian domestic tax law, the withholding tax ('WHT') on dividends paid to resident shareholders is 10% whereas the rate to non-resident shareholders is 20% (plus applicable surcharge and cess).

However, preferential WHT rates are available under the double taxation avoidance agreements ('DTAAs') that India has with other countries provided that the recipient of such dividends fulfils the eligibility criteria.

Mauritius shareholders may claim lower WHT rates under the India-Mauritius DTAA as follows:

- WHT at 5% if the shareholder is a beneficial owner which holds directly at least 10% of the capital of the Indian company paying dividend; or
- WHT at 15% in any other case.

In addition, to qualify for treaty benefits under the above DTAA, the shareholders have to be a tax resident in Mauritius and fulfill the limitation of benefits clause. Otherwise, WHT at the rate of 20% (plus applicable surcharge and cess) will apply.

Tax residency test - for Mauritius shareholders

In Mauritius, the 'central management and control' test is used to determine a company's tax residency status to obtain a tax residency certificate ('TRC') and avail of treaty benefits. India, on the other hand, uses the concept of place of effective management ('POEM') to determine tax residency. For a company to be tax resident in Mauritius, it would need to ensure that its POEM is outside India. There are some judicial precedents where the Indian tax authorities have challenged the tax residency of a Mauritius company by asserting that its POEM is outside Mauritius and have looked at POEM from a more holistic view to determine tax residency.

Beneficial ownership - can the test be met by Mauritius shareholders?

The concept of beneficial ownership has been subject to a lot of debates and the controversies around it have reached the highest courts across the world. The beneficial ownership assessment is generally made on a case to case basis and tax tribunals assess several aspects in terms of substance, decision-making and commercial rationale behind transactions before granting or denying treaty benefits. As such, where Mauritian entities wish to take advantage of the preferential rates under the India-Mauritius DTAA, it is important to evaluate how the Indian tax authorities may assess the beneficial ownership status of these companies.

The term 'beneficial owner' is not defined in the Indian tax laws or DTAA. Courts have generally interpreted it to mean an owner who enjoys the real benefits of ownership, even though the title to the property may be in another name.

The Indian Ministry of Finance has issued a circular in the year 2000 to grant a Mauritius shareholder, with a valid tax residency certificate ('TRC'), to qualify as "tax resident" and "beneficial owner" for tax treaty purposes. However, while adjudicating upon the beneficial ownership test, Indian courts have not restricted themselves to the above mentioned circular and have also analysed the underlying facts, thus making it pertinent to have the requisite documentation in place.

Mauritius shareholders are generally intermediate holding companies in group structures and the funds generally flow to investors in different parts of the world. Even if Mauritius shareholders rely on a valid TRC (issued by the Mauritius Revenue Authority) to take benefit from the reduced rate of 5% under the India-Mauritius DTAA, this may be challenged by the Indian tax authorities (as we have seen in the assessment of beneficial ownership around capital gains tax in the past). More than 75% of litigation cases in India on beneficial ownership relating to capital gains tax involve Mauritius. There are instances where treaty benefits were denied on the basis that the Mauritius company was deemed to be merely a conduit in the group structure and another group company in a third country was considered to be the actual beneficial owner of the shares.

Mandatory filing in line with the new dividend regulations

Indian companies are now required to report to the Indian tax authorities and banking institutions, via mandatory filings on dividend payments. Mauritius shareholders are also required to file tax returns in India to disclose the dividends received from India, where the lower WHT rate of 5% has been applied. Whilst the Indian Tax authorities may use a wide range of factors in determining beneficial ownership, in practice, paper trail evidence remains critical, similar as they do in previous disputes on capital gains. Failure to provide appropriate documentary evidence to satisfy the request of the Indian tax authorities may lead to tax assessments.

Way forward

In light of the above, it is recommended that shareholders review their ownership structure, documentary evidence as well as board decision making process to gauge the risk of a 'beneficial ownership' challenge by tax authorities and to strategise the way forward. This process should be properly documented before the dividend is paid.

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Key impact of the new dividend regulations on Mauritius companies

- Dividends paid by an Indian company are no longer exempt in India and any Mauritius recipient shareholder of such dividends is taxable in India. The burden has shifted from the payee (Indian company) to the shareholder (Mauritius shareholder) and the latter will now receive dividend income net of WHT.
- As stated above, the Mauritius shareholder may claim a lower rate of tax available under the India-Mauritius DTAA, subject to satisfying certain conditions.
- The Mauritius shareholder is required to file tax returns in India to disclose the dividends received from India, where the lower rate of 5% is applied.

Illustration

As illustrated below, whilst the tax impact on the Mauritius shareholder (holding less than 5% in an Indian company) under the old DDT regime was minimal, the new dividend WHT regulations may result in a greater tax leakage.

	Old DDT Regime		New Dividends Regulations		
	Treaty/No-Treaty		BO-Treaty		No BO-No Treaty
Shareholding in Indian company	<5%	>5%	<10%	>10%	Irrespective of % of shareholding
Dividend from India	100	100	100	100	100
Tax in India:					
DDT	20.56	20.56	0	0	0
WHT	0	0	15	5	20
Corporate Tax	20	20	20	20	20
Total Leakage in India	40.56	40.56	35	35	40
Impact on MU Co:					
Dividend income (gross)	100	100	100	100	100
Tax payable at 15%	15	15	15	15	15
Deemed/Foreign tax credits utilised	-12	-15	-15	-15	-15
Total Tax Leakage in MU	3	0	0	0	0
Total Tax Leakage (India + MU)	**43.56**	**40.56**	**35**	**25**	**40**
				Note 1	

Note 1:
Potential overall tax savings for a Mauritius Company holding more than 10% shareholding in an India Company

BO - Beneficial Ownership
DDT - Dividend Distribution Tax
WHT - Withholding Tax
Treaty - Co benefiting from India/Mauritius DTAA
No-treaty - Not taking benefits under India/Mauritius DTAA

Assumptions:

- No expense

**The less than or greater than 5% shareholding was only used for the purposes of claiming relief for DDT tax credit under the Mauritius tax laws. Given that DDT has now been removed, this % shareholding is no longer of relevance*

*** 80% DFTC or 80% exemption subject to satisfying certain conditions*

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How can we help:

Understand

- Understand the facts of the Indian investment, related functions and decisions taken in the group
- Discussion / meetings with relevant personnel to understand the existing processes and documentation

Risk Assessment

- Review the existing processes and documentation
- Identify the parameters relevant for tax residency test and beneficial ownership test of company
- Evaluate facts of the case in light of relevant parameters and assessing the tests

Defence strategy

- Put together the relevant documentation in terms of dividend payment and ensure that POEM is outside India
- Provide a set of tailored safeguards and protocols based on underlying facts
- Advise on requirement to approach Indian tax authorities to seek clarity

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