India to tax Mauritius investments for first time since 1983

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NEW DELHI/MUMBAI (Reuters) - India will start imposing capital gains tax on investments coming from Mauritius starting next year, after the two countries agreed to amend a three-decade old treaty that brought in billions of dollars in investment but was suspected of abetting tax evasion.

The tax will apply to investments made from April 1, 2017. It will be imposed at 50 percent of the domestic rate - now 15 to 20 percent, depending on the instrument and length of investment - until March 31, 2019, for companies already established in Mauritius. The full rate will apply for all companies after that.

The amendment of the treaty is a victory for Prime Minister Narendra Modi's government, after previous administrations had also unsuccessfully tried to change the terms of the treaty.

Signed in 1983, the treaty has been a cornerstone of Mauritius' rise as a financial centre, and it has allowed the country to become the source of the biggest foreign investments into India.

But the treaty's terms have been a growing irritant to India, which has long suspected a chunk of the funds are not real foreign investments, but come from rich Indians routing cash through the island to avoid Indian taxes, a practice known as "round tripping".

Recovering untaxed wealth stashed abroad by rich Indians has been a central goal of Modi's government. Like other governments, it has also tried to limit the use of the kind of tax havens exposed by the trove of documents called the Panama Papers.

"This is a colossal tax development and will have a significant impact for numerous institutional funds, asset managers and private companies which have used the Mauritius route to invest into India," said Rajesh H Gandhi, a partner at Deloitte Haskins & Sells LLP.

However, investors fear the tough new terms will scare off foreign funds, many of which had set up in Mauritius to avoid paying any capital gains taxes in India and pay only a limited rate in Mauritius.

But analysts said the new treaty was largely along expected lines. They welcomed the government's move to impose the capital gains taxes only on future investments from Mauritius, not existing ones. Many investors had seen the changes as inevitable as governments get tougher on taxes around the world.

"You have to laud the government's efforts in how they have structured the deal, and what's important is that they have not touched past investments, so there is no risk of capital flight," said Rahul Mitra a partner at KPMG.

India has attracted $278 billion in foreign equity investments since 2000. A third of that came from Mauritius, though in recent years it has faced growing competition from Singapore, which is seen as offering beneficial tax benefits but a more transparent regulatory environment.

India and Singapore will now need to renegotiate their own double tax-exemption treaty, given rules that stipulated any changes to the capital gains exemption clause of the treaty with Mauritius would also lead to changes in the Singapore agreement.