

# EDIT PAGE

**I**N early April 2000, the income tax authorities issued notices to foreign institutional investors (FIIs) based in Mauritius for payment of tax on capital gains from their operations in India. Although, the demands were raised on a select few of them, and for small amounts, the total revenue involved by way of bringing all the concerned FIIs within the ambit of the tax net could run into a few thousand crores. In fact, according to a public interest litigation now pending before the Delhi High Court, the total financial implications of the government move to bail out these FIIs is estimated at about Rs 3,000 crore.

The decision led to consternation in the FII circles who even threatened large scale withdrawal of funds from the country. The reverberations of this were even felt on the bourses with the BSE Index showing a precipitous decline in the next couple of days. Sensing the hostile mood and the possibility of greater damages, finance minister Yashwant Sinha met FII representatives on April 6, and assured them that they would not be taxed in India. Within a week, the Central Board of Direct Taxes (CBDT) issued an appropriate circular on April 13, thereby facilitating withdrawal of the notices.

The government decision to withdraw the notices has since been challenged by a PIL in the Delhi High Court. In its submission to the court, the CBDT has argued that while raising the demand, the assessing officials erred in interpreting the relevant provisions of the Double Tax Avoidance Convention (DTAC) with Mauritius. Considering the fact that the issue had far reaching ramifications, not only in terms of the potential revenue loss but also by way of impinging on the overall environment for attracting investments, one cannot imagine the officials acting without the nod from the top bosses. In other words, the entire government appeared to be solidly behind the move and that the attempt to disassociate was only an afterthought.

While issuing the notices, the assessing officers had argued that FIIs are not residents of Mauritius, that they are residents of countries other than Mauritius and India, and therefore not entitled to the DTAC benefits. This was despite full knowledge of the fact that these companies are incorporated in Mauritius and

## Mauritius bonanza at whose cost?

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had offices located there. Clearly, the government was not inclined to take the existence of an office in Mauritius on its face value. And it was indeed on the right track.

In the true sense of the term, incorporation of a company in a particular country connotes that it should be engaged in normal business

normal business. Mauritius is a small island nation and the only economic activity it can boast of is tourism, besides sugarcane production. On this basis alone, it is virtually impossible to justify the presence of as many as 400 FIIs for normal business activities. One cannot escape the conclusion that the con-

cerned FIIs had set up bases in Mauritius with the prime objective of taking advantage of the DTAC. In view of above and even as the government was fully justified in proceeding against these FIIs, unfortunately, it was flummoxed by the intensity of protests and concomitant

and accordingly prepared itself to deal with it. And if the assessment was that it could not do so, then notices should not have been issued in the very first place. But, by going through the motion and then backtracking, it had ended up lowering its own image. The argument that the concerned officials had erred does not cut much ice.

It is difficult to anticipate at this stage the outcome of the proceedings on the PIL and as to whether or not this would help in changing the course of events. In any case, till the verdict is given, the FIIs will have a peaceful time. However, the finance ministry mandarins need to do some introspection and look beyond the narrow focus of keeping FIIs in good humour. They need to adopt a course which is logical and consistent with the spirit of the DTAC. Its benefit cannot be given to these FIIs as they are not carrying normal businesses in Mauritius. This bonanza is all the more reprehensible when, it is at a huge cost to the national exchequer.

If, the government continues to sleep over the issue, it will create an anomalous situation whereby the domestic companies will be at a serious disadvantage vs the FIIs. A regime under which the latter continue to be exempt from capital gains tax could even prompt the former to transfer funds to tax havens like Mauritius only to be re-invested in India, ala the FIIs route, and make windfall.

The apprehension that an attempt to tax FIIs will affect the pace of foreign investment is baseless. In this context, the major deferrals continue to be an uncertain and fluctuating policy environment on the one hand and the maze of approvals/clearances involved in implementing projects on the other. If only these are effectively tackled, then even without tax sops, foreign funds will come in at the desired pace.

The government should put things back on the rails, by proceeding against these FIIs. If it could even make amendments in the DTAC Act. For instance, a company should be accorded resident status only if it generates a certain minimum percentage of its overall turnover from business within Mauritius. Companies which do not meet this criterion should have no grudge in paying tax.

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activities. Specifically, it means that a major share of its transactions should be conducted in that very country. From a closer look at the underlying economic conditions in

Mauritius, it would appear that majority of these FIIs cannot justifiably fall within the meaning of doing

business in Mauritius. In view of above and even as the government was fully justified in proceeding against these FIIs, unfortunately, it was flummoxed by the intensity of protests and concomitant

concerned FIIs had set up bases in Mauritius with the prime objective of taking advantage of the DTAC. In view of above and even as the government was fully justified in proceeding against these FIIs, unfortunately, it was flummoxed by the intensity of protests and concomitant

'ownership' under the DTAC. In simple words, it meant the officials should not have questioned the motives of these FIIs in setting up shops in Mauritius.

Considering the far reaching financial implications, the government should have anticipated the outrage

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