The India-Mauritius DTAA Protocol and the Principal Purpose Test: Treaty Entitlement, Substance and the Post-2017 Investment Landscape

Historically, Mauritius has been a major route for foreign investment into India because the India-Mauritius treaty provided advantageous tax treatment, particularly for capital gains. Cumulative FDI equity inflows from Mauritius into India during January 2000 to December 2023 were approximately USD 171.11 billion, representing 26% of total FDI, and Mauritius remained the second-largest source of FDI into India after Singapore in FY 2023-24.

On 7 March 2024, India and Mauritius signed a Protocol1 that amends the India-Mauritius Double Taxation Avoidance Agreement (**2024 Protocol**) by replacing the Preamble to the DTAA and inserting art. 27B, “Entitlement to Benefits”. The Mauritius Cabinet ratified the 2024 Protocol at its Cabinet meeting held on 17 July 2026. India is yet to ratify the 2024 Protocol. The 2024 Protocol will take effect once India also ratifies it.

Introduction of Principal Purpose Test

The 2024 Protocol introduces a Principal Purpose Test, or PPT, into the India-Mauritius DTAA, reflecting the OECD/G20 BEPS minimum standard on treaty abuse. Under the PPT, a treaty benefit may be denied where, having regard to all relevant facts and circumstances, it is reasonable to conclude that obtaining that benefit was one of the principal purposes of an arrangement or transaction that resulted directly or indirectly in that benefit. The benefit must nevertheless be granted where it is established that granting the benefit in those circumstances would be in accordance with the object and purpose of the relevant treaty provision. The PPT would therefore provide the Indian tax authorities with an express treaty-based anti-abuse rule, distinct from domestic GAAR and judicial scrutiny of sham or colourable arrangements.

At present, treaty entitlement may be examined under the domestic charging and source provisions, the conditions contained in the DTAA itself, statutory conditions for treaty relief, GAAR, and judicially developed anti-abuse principles. GAAR is the principal domestic general anti-avoidance regime; separate questions may also arise concerning tax residence, beneficial ownership, legal and commercial substance, the character of income, and the applicability of the relevant treaty article.

GAAR determinations involve a statutory referral-and-approval mechanism involving the Principal Commissioner or Commissioner and the Approving Panel; an Assessing Officer cannot unilaterally make a final declaration that an arrangement is an impermissible avoidance arrangement. Under the Income-tax Act, 1961, the substantive GAAR provisions are contained in Chapter X-A, comprising sections 95 to 102, and the procedural mechanism is contained in section 144BA. For the tax years governed by the Income-tax Act, 2025, the corresponding provisions are contained in Chapter XI, comprising sections 178 to 184, read with section 274 and the applicable Income-tax Rules, 2026. By contrast, once the Protocol is effective, the PPT would provide a distinct treaty basis for denial of a treaty benefit, subject to the ordinary assessment process, the applicable treaty and statutory interpretation, evidentiary standards, appellate remedies and judicial review

What the Principal Purpose Test changes

The PPT is broader than a pure “sham” inquiry. It does not require the arrangement to be legally ineffective or fictitious; however, it also does not permit treaty benefits to be denied merely because tax considerations were relevant. The question is whether, objectively and on the totality of the facts, treaty-benefit acquisition was one of the principal purposes of the arrangement or transaction.

This is significant for Mauritius holding companies and investment vehicles because the existence of a tax residency certificate, directors, bank accounts, or some operational substance may no longer be sufficient by itself. The relevant

[1] https://www.mea.gov.in/Portal/LegalTreatiesDoc/MU24B4377.pdf

inquiry becomes whether the structure has credible commercial rationale beyond obtaining India-Mauritius treaty benefits.

In practical terms, the PPT may invite scrutiny of:

- Why Mauritius was chosen as the holding or investment jurisdiction;
- Whether the Mauritius entity has commercial substance proportionate to its claimed role;
- Who makes investment and exit decisions;
- Whether the entity bears real economic risk;
- Whether the arrangement has non-tax commercial objectives; and
- Whether the timing, routing, and documentation suggest treaty shopping.

Grandfathering and older investments

Under the India-Mauritius treaty, investors from Mauritius are spared Indian capital gains tax on sale of shares acquired before April 1, 2017. CBDT Circular No. 1/2025 clarified that the PPT will apply prospectively and will not disturb the treaty's existing grandfathering protections for pre-April 2017 investments. However, there is continuing uncertainty for legacy structures that are not covered by the specific grandfathering provisions. A pre-2017 shareholding may retain its protected capital-gains treatment, but other income streams or other arrangements may still raise PPT questions depending on the facts and the effective-date mechanics.

The following treaty benefits could become more vulnerable to challenge once the PPT is operative:

- Capital-gains benefits available under the transitional Article 13 regime for qualifying shares acquired on or after 1 April 2017 and transferred during the transitional period from 1 April 2017 to 31 March 2019, subject to the applicable limitation-of-benefits conditions.
- Dividend withholding relief under Article 10, where the Mauritian recipient is the beneficial owner and satisfies the applicable ownership threshold. The treaty ceiling is 5% of the gross dividend where the beneficial owner is a company holding at least 10% of the capital of the Indian payer, and 15% in other cases, subject to domestic law and the remaining treaty conditions.
- Treaty claims concerning income from derivatives or other financial instruments may also invite PPT scrutiny where the taxpayer relies on a DTAA allocation rule, including a claim that the income is taxable only in Mauritius in the absence of an Indian permanent establishment. The Indian treatment of derivative income remains dependent on the nature of the instrument, the taxpayer's status, the characterisation of the income, the relevant domestic-law provisions and the applicable treaty article.

The "irrespective of taxable years" issue

The Protocol's reference to its application irrespective of the taxable years to which the relevant taxes relate raises a question concerning the temporal reach of the revised preamble and PPT. That wording should be read together with the Protocol's entry-into-force provision and CBDT Circular No. 1/2025, which states that a PPT incorporated bilaterally through an amending protocol applies prospectively from the date on which the relevant protocol enters into force. The appropriate view is therefore not that the PPT retrospectively alters the tax consequences of completed transactions, but that, after entry into force, it may be relevant to treaty claims made in respect of earlier arrangements where the relevant benefit is claimed for a period to which the Protocol applies. The specific grandfathering available for shares acquired before 1 April 2017 remains protected.

Impact of Tiger Global Litigation

The proposed PPT assumes particular importance against the background of the Tiger Global litigation, which brought into focus the extent to which a Mauritian holding company may claim treaty protection where the wider investment arrangement is alleged to lack independent commercial substance. The dispute illustrates that a tax residency certificate, while material evidence of treaty residence, does not by itself resolve every question concerning treaty entitlement, beneficial ownership, the commercial purpose of an interposed entity, or the character of an offshore transfer. Under the pre-PPT treaty framework, such issues have ordinarily arisen through domestic anti-avoidance provisions and judicial examination of the facts and legal form of the arrangement. The proposed PPT would add an express treaty-based inquiry into whether obtaining the India-Mauritius treaty benefit was one of the principal purposes of the relevant arrangement or transaction. Accordingly, the practical lesson from Tiger Global is not that Mauritius structures are inherently ineffective, but that investors must be able to demonstrate genuine commercial rationale, real decision-making functions, economic risk assumption, and contemporaneous documentary support for the structure. The historical treaty position had afforded significant weight to Mauritian residence and the CBDT's treatment of a Mauritian tax residency certificate, but the proposed PPT will require treaty entitlement to be examined in the context of the arrangement as a whole.

Practical implications for foreign investors using Mauritius

Once the Protocol becomes effective:

- **Treaty residency alone will not be dispositive**

A Mauritius tax residency certificate remains material evidence of treaty residence and is necessary to access treaty relief under Indian domestic law. It will not, however, conclusively resolve a PPT inquiry concerning the purpose of the relevant arrangement or transaction.

- **Substance must be functional, not merely formal**

The issue is not just whether the Mauritius entity has offices, directors, and records. The stronger question is whether it performs genuine investment, governance, risk-bearing, and decision-making functions.

- **Investment memoranda and board records become more important**

Investors should expect scrutiny of contemporaneous documents showing why Mauritius was commercially appropriate apart from tax benefits.

- **Grandfathered capital gains remain protected, but not every legacy benefit is necessarily insulated**

CBDT guidance2 protects pre-April 2017 capital-gains grandfathering, but there will be uncertainty for other legacy structures and benefits outside that specific grandfathering protection.

- **Post-April 2017 structures warrant particular review**

Investments made on or after April 1, 2017 may be within the zone of future PPT relevance once the protocol enters into force. For shares acquired on or after 1 April 2017, India has obtained source taxation rights under Article 13, with a concessional 50% rate during the transitional period from 1 April 2017 to 31 March 2019, subject to the prescribed limitation-of-benefits conditions.

ELP Comments

Mauritius' ratification of the India-Mauritius tax Protocol is a significant anti-abuse development. The Protocol does not terminate the India-Mauritius DTAA or automatically deny treaty benefits to Mauritian investors, rather it introduces an express treaty-based basis on which India may deny a benefit where obtaining that benefit was one of the principal purposes of the relevant arrangement or transaction, unless granting the benefit would accord with the object and purpose of the relevant treaty provision. Mauritius remains a viable jurisdiction for investment structures supported by genuine commercial rationale, real decision-making functions, economic risk assumption and appropriate contemporaneous documentation. However, structures whose principal commercial function is to obtain treaty relief will face materially greater scrutiny once the Protocol becomes operative.

[2] CBDT Circular No. 1/2025, dated 21 January 2025, "Guidance for Application of the Principal Purpose Test under India's Double Taxation Avoidance Agreements."

We hope you have found this information useful. For any queries/clarifications please write to us at insights@elp-in.com or write to our authors:

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