THE LEGAL AND TAX ARCHITECTURE OF COLLECTIVE INVESTMENT FUNDS IN MAURITIUS

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Abstract

Mauritius is a small island nation in the heart of the Indian Ocean that is effectively an Offshore Financial Centre (OFC). The Global Business regime in particular which benefits from low effective tax rates and an extensive double tax agreement (DTA) network has led to Mauritius being deemed to be a gateway to investment in Africa and Asia. Whilst this has facilitated significant investment into those regions it has also created the opportunity for harmful tax practices that see tax being levied in jurisdictions where there is little or no substantive economic activity. Collective Investment Vehicles (CIVs) have also taken advantage of the regime and established themselves in Mauritius in order to ensure that minimum tax is paid on investments made. The OECD's Base Erosion and Profit Shifting project has, however, had an impact on the Global Business regime. This article explores the legal structure of CIVs in Mauritius as well as the tax regime governing them. It also analyses the ways that the Global Business regime has been abused, the changes the regime has been subjected to following the BEPS project and the impact if any that the amendment are likely to have on the CIV industry and to Mauritius status as an OFC.

Keywords: Collective investment vehicles, OFC, tax avoidance

1. INTRODUCTION

Mauritius is a small island nation in the middle of the Indian Ocean with a population of 1,271,893 (World Population Review, 2020). It has been a prime destination for commerce and trade for the last two decades and has a burgeoning economy with a Gross Domestic Product of USD 14.18 billion in 2019 (World Bank (2019a). When Mauritius gained independence in 1968, its economy largely revolved around sugarcane farming and industries accessory to it. Since independence, the government focused on moving away from a mono-crop inward looking economy towards an export-oriented and diversified economy. It did this by expanding its manufacturing, financial service, Information Communication and Technology (ICT) and tourism sectors. Presently, the agriculture sector contributes to 4% of the GDP of Mauritius while the manufacturing sector contributes 21.8% and the services sector contributes 74.1% (Central Intelligence Agency, 2019).

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In the 1990s, Mauritius evolved to become a booming OFC following the regulatory reforms enacted in 1992 which saw the creation of the Mauritius Offshore Business Activities Authority (MOBAA). The MOBAA's mandate was to promote and regulate innovative offshore activities. The offshore business regime was largely regulated by the Offshore Trusts Act, 1992 and the International Companies Act, 1993 which allowed for the incorporation of International Business Companies. Thereafter, in 2001, the Financial Services Commission (FSC) took over the MOBAA and the offshore regime was converted into the Global Business regime which is a preferential regime available in Mauritius for resident corporations proposing to conduct business outside Mauritius.

The Global Business regime has since thrived due to low tax rates, a robust banking, legal and accounting regime as well as an extensive Double Tax Agreement (DTA) network having concluded over 46 DTAs (MRA, 2020). It also has ratified 28 Investment Promotion and Promotion Agreements (IPPAs) (UNCTAD, 2020) which are bilateral agreements between governments that protect and encourage investment made by Mauritian companies overseas and often provide for free repatriation of investment capital and returns. These IPPAs increase investor confidence by ensuring a fair and equitable protection of investments made by Mauritian companies overseas and confer significant advantages to companies investing in Africa through Mauritius.

As a result of its generally favorable business environment, it is positioned as a favorable investment platform for Africa and Asia (Hague & Doman-Brette, 2017). Evidencing the creation of an enabling environment, Mauritius ranks 20th globally and first in Africa on the Ease of Doing Business Index, (World Bank, 2019b). It also ranks 1st in Africa on the Mo Ibrahim Index of African Governance (IIAG) (Mo Ibrahim Foundation, 2018). In positioning itself as a gateway to doing business in Africa and Asia, Mauritius has become an OFC it being a jurisdiction that provides financial services to nonresidents on a scale that far exceeds the needs and size of its domestic economy (Zorome, 2007). While OFCs often play a significant role in overcoming barriers to investment in developing countries by providing investors with secure jurisdictions, financing structures for risk pooling, and tax neutrality (Tyson, 2019) they however, are also used by entities whose main aim is to park assets and avoid tax. Mauritius therefore serves as an excellent jurisdiction to serve as a case study for this article due to its unique positioning as a conduit for investment in Africa and Asia.

Taken together, the article presents a sophisticated analysis of the structure and tax treatment of the Collective Investment Fund market in Mauritius with a particular focus on the implications the use of the Global Business regime has had. It will consider the impact of the regulatory changes that have resulted from the

Organization for Economic Co-operation and Development's Base Erosion and Profit Shifting (OECD-BEPS) project. It will also consider the impact of the OECDs work on transparency and exchange of information has had on Mauritius.

Against this background this article is structured into 5 sections. Section 1 gives a brief overview of Mauritius and the reason for the research of the CIV industry in Mauritius. Section 2 conceptualizes the structure of the CIV industry in Mauritius. Section 3 illustrates the domestic taxation of CIVs in Mauritius whilst section 4 highlights the taxation of CIVs in a cross-border context both prior to and after the OECD BEPS project and showcases the how the Global Business regime has been used to avoid tax. Section 5 investigates the impact of the changes to the global business regime and Section 6 concludes the article.

2. UNDERSTANDING INVESTMENT FUNDS

This section conceptualizes the legal and regulatory framework of Mauritius CIVs and considers the history of CIV to give perspective of their usefulness and illustrate why they have continued to gain popularity as investment vehicles.

2.1. Conceptualising CIVs

The OECD and the United Nations (UN) both define (CIV) as funds that are widely-held, that hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established (ICG, 2010). Anything that does not meet this definition falls under the category of non-CIV funds. As such, funds that are only held by one or a few institutional investors and that do not have a diversified investment portfolio such as private equity funds fall short of meeting the definition (UN, 2018). CIVs can take a variety of legal, operating and management structures. They may either be open-ended or close-ended. Open-ended funds allow investors to issue and redeem shares at any time. Investors usually will be allowed to purchase shares in the fund directly rather than being restricted to purchasing shares from existing shareholders. Close-ended funds on the other hand will usually issue a fixed number of shares at the outset with subsequent investment only being possible when shares are traded among investors. Investors in close-ended funds will usually not have control on exiting the fund and non-CIVs will be the preferred investment vehicle for private equity funds. Mauritius law allows for the formation of both categories of investment companies i.e. open-ended funds which are generally known as Collective Investment Schemes (CIS) and close-ended funds which are commonly known as private equity funds. Close ended-funds will generally be subject to less regulation than CISs. CIVs which are the subject of this article are commonly referred to as CISs in Mauritius.

2.2 History of Investment Funds

Understanding the history of CIV is important because it gives context to their usefulness as investment vehicles and the reason why they continue to gain importance on the international stage and ultimately in Mauritius. As such, a brief historical discussion follows.

The first investment trust was a close ended fund named *Eendragt Maakt Magt* which translates to "Unity Creates Strength" (Rouwenhorst, 2004). It was formed in 1774 by a Dutch merchant who invited subscriptions from investors. The fund was formed following the financial crisis in 1772-1773 which saw British banks become bankrupt due to their overextension in the British East India Company. The fund's aim was to bring together small investors to spread risk by investing in Austria, Germany, Denmark, Spain, Sweden, Russia and plantations in Central and South America (Rouwenhorst, 2004). At the time of its formation, the Amsterdam Stock Exchange was already operating. The CIS invested in bonds issued by foreign governments and banks as well as plantation loans in the West Indies. It offered a total of 2000 shares up for subscription and once those shares were placed, participation in the fund was only possible by buying shares in the secondary market (Rouwenhorst, 2004).

Following the success of *Eendragt Maakt Magt,* a group of Utrecht bankers came together to form the *Voordeelig en Voorsigtig Negotiatie* in 1776 and the *Concordia Res Parvae Crescunt* in 1779. The fortunes of these early mutual funds was closely linked to the West Indies plantations which were their predominant investment. The break out of the fourth Anglo-Dutch war in 1780 resulted in delayed shipments of Dutch colonial agents, thus affecting proceeds which acted as security for plantation loans. By the end of the century, all three funds had disappeared from the official price record of the Amsterdam Stock Exchange and ultimately the funds were dissolved, and their shares redeemed (Rouwenhorst, 2004).

The next batch of investment funds were formed between 1780 and 1790 and they largely speculated on the future credit of the United States. As a result, France, Netherlands and Spain were among the nations that financed the American Revolution (Rouwenhorst, 2004). The first fund formed outside Netherlands was the Foreign and Colonial Government Trust in 1868 in the United Kingdom almost a century later. It invested in foreign government bonds. This fund is still in existence today and is valued at $4billion (Rouwenhorst, 2004). At the time of its formation funds had the option of registering either as companies or trusts. Most of them chose to be structured as trusts given the bad reputation that companies had due to their unlimited liability at the time and the belief that good trustees would be more reliable. Elsewhere in the United States, the first investment funds were

formed in the 1890s (Rouwenhorst, 2004).

In Africa, CIVs were first established in South Africa in 1965 (Meyer-Pretorius & Wolmarans, 2006). These CIVs took the form of Unit Trusts that invested in tradable equities. Mutual funds in Mauritius were first formed in Mauritius in the 1990s (Nitish et al, 2009). As of 2001, offshore mutual funds in Mauritius were managing assets of up to $6.7 billion about 15 times the GDP at the time, while domestic mutual funds' assets were relatively small (IMF, 2003). The offshore fund sector experienced considerable growth, with there being considerable indirect positive effects on telecommunication, the development of world-class legal, accounting, auditing, financial and asset management skills (Sacerdoti et al, 2005). As of 2009, nearly US$20 trillion was invested through CIVs worldwide (Investment Company Institute, 2009). This number significantly grew because of the numerous advantages provided to small investors who invest through CIVs and by 2019, the total worldwide assets invested in regulated open-end funds amounted to US$ 46.7 trillion (Investment Company Institute, 2019). Having provided a brief historical account of CIV, the next section explains the advantages of investing using collective.

2.3 Advantages of investing using Investment Funds

There are several advantages collective investment vehicles offer. These are listed and considered below.

2.3.1. Reduction of risk through diversification

The Nobel-prize winning idea of the benefits of diversification of portfolios was first put forward by Markowitz according to whom diversification reduces portfolio risk (Markowitz, 1952). Diversification takes place where investors invest in more than one asset/investment. Holding a portfolio of different investments reduces investors' portfolio risks by allowing them to invest in securities in different industries. Diversification allows investment in stocks and securities that would each react differently to the same event. This therefore shields the investor from incurring losses on the entire portfolio following the occurrence of a single event as the investor balances the losses incurred on certain investments with investments that remain unaffected by the event and/or fare better hence ensuring the entire portfolio value remains good. This puts investors in a better position to manage risk.

Based on such advantage, CIVs generally hold a large number of securities within their chosen asset class (i.e. stocks and bonds). The pooling together of savings in a CIV allows smaller investors to diversify their portfolio and spread their risk (Ciccotello, 2010). Accordingly, investors are able to reduce their exposure to

losses due to the decline in the value of a single security in a similar manner that larger investors are able to. Although small investors can diversify their holdings without investing in CIVs the investment through CIVs allows them to do this on a larger scale in a cost-efficient manner.

2.3.2. Cost efficiency

A small investor who attempts to by-pass CIVs and other intermediaries and invest directly would incur substantial costs. Traditional finance theory instructs the investor to diversify his risks between equity and debt securities, real estate, and other assets (Jin, 2019). Investors are also urged to diversify across international markets in order to hedge currency and market risk. In addition, they are ideally required to change their allocations of assets over time to ensure their risk profile matches their age and timeline to retirement. A small investor who tried to satisfy all of those demands through directing his own portfolio would spend substantial time and incur significant transaction costs that might be out of all proportion to the actual amount invested (ICG, 2010). Investors both institutional and small therefore, benefit from reduced costs when they invest through the use of CIVs.

2.3.3. Professional management

Another advantage of investing using CIVs is that they usually hire full time professionals/specialists to manage investment portfolios. These managers have real time access to in-depth market information that enables them to make timely decisions about what securities to invest in and/or divest from in a cost-effective manner. They also sign investment advisory agreements which give the manager the mandate to select securities to invest in and to monitor the fund's performance on a day to day basis (Ciccotello, 2010).

2.3.4. Economies of scale

Where numerous investors come together to pool their investments, the cost of paying investment advisory fees is shared. Funds can enjoy economies of scale by spreading the cost of expenses and fees. By increasing the number of assets under management, funds can spread fixed costs over a large base and receive a higher return per each dollar invested. This will eventually result in a lower expense ratio charged to investors (Smith, 2010).

2.3.5. Investor protection

Investors in CIVs can also benefit from investor protection. This is because a robust framework for the regulation and protection of investors will usually exist. As such, these investors will more often than not be protected from fraud, theft and

other abuses (St Giles, M Alexeeva E & Buxton S, 2003). The development of collective investment fund sectors is directly proportional to the existence of a robust legislative framework for the protection of investors. Without a reliable regulatory system, the public will lack confidence in funds (St Giles, M Alexeeva E & Buxton S, 2003). Investment funds in Mauritius for example are regulated by the Securities Act 2005, the Securities (Licensing) Rules 2007, the Securities (Preferential Offer) Rules 2017, the Financial Services Act 2007 and the Securities (Collective Investment Schemes and Close-ended Funds) Regulations 2008. The funds and their intermediaries are regulated by the Financial Services Commission (FSC) which ensures that they meet various operational requirements aimed at protecting investors. Such requirements include audit requirements, distribution and marketing requirements, investment restrictions etc.

2.3.6. Flexibility

Another advantage of investing using CIVs it that they offer flexibility to their investors given that investment and divestment is usually fairly simple. This is because securities issued by CIVs can easily be redeemed and transferred with minimal restrictions. This is the case especially when contrasted with investment and divestment in insurance policies and pension funds which may levy penalties for early withdrawal (St Giles, M Alexeeva E & Buxton S, 2003). When investing in shares of a CIV, investors simply need to complete an application together with documents of identification and will usually have participating shares in the CIV allotted to them within a few days. Upon divestment, investors simply write to funds requesting redemption of all or any participating shares by completing a redemption notice form soon after which redemption proceeds are paid.

Furthermore, collective investment vehicles provide flexibility in that they are often structured to meet a variety of needs. Funds can for instance be set up for capital growth in the mid-long term, for income, for exposure to domestic markets or worldwide markets etc. Investors are therefore free to invest in funds that best suit their needs. Whilst these advantages are particularly beneficial to small individual investors, institutional investors are also increasingly using CIVs. It is therefore expected that CIVs will continue to gain significance in developing countries where there is an increasingly expanding middle-class (UN Committee of Experts, 2018).

2.3.7. Tax Advantages

Generally, countries which have marketed themselves as low-tax or offshore domiciles jurisdictions will have the most varied range of structural choices available to them in order to attract investment. They create a legal and fiscal environment that is attractive to funds in order to bring in revenues to domestic

service providers to funds(St Giles, M Alexeeva E & Buxton S, 2003). Offshore investment funds will most likely be located in a low-tax or no-tax jurisdiction. Their assets will usually be managed by a professional investment advisor or investment manager in a higher tax jurisdiction. These funds will usually be carefully structured in order to avoid having the fund being taxable in the jurisdiction where the manager or investment advisor is based (Wells, 1999). These advantages of CIV illustrate the reasons why CIVs have gained importance as investment vehicles. This has resulted in various jurisdictions, including Mauritius, introducing preferential tax regimes that encourage their establishment therein. This has to a certain extent contributed to the development of Mauritius as an OFCs.

3. STRUCTURE OF THE CIV ARCHITECTURE IN MAURITIUS

In this section, the structure of CIVs in Mauritius is explored as it paints a picture of how CIVs operate and how CIVs operate in a cross-border context. This will help understand how Mauritius has developed a regime that enable them to be used for tax avoidance.

3.1. The CIV Structure

Investment in interests in CIVs can either be direct or indirect. Direct interests will usually be acquired between the ultimate investor and the CIV, while indirect interests in CIVs will be through intermediaries such as banks, insurance companies and independent financial services. Interests in CIVs acquired through intermediaries are registered at the CIV level through nominee accounts (OECD, 2010). Where we have an indirect investor, the intermediary will know the investors while the CIV will only know the intermediaries. The investor's identity will usually be highly proprietary information for the intermediary (OECD, 2010). The managers of the CIVs may also hire unaffiliated parties to provide legal, audit, tax consulting and custodial services and it is common for non-core services to be outsourced.

The CIV will also have distribution agreements with either affiliated or non-affiliated parties. These distributors will enter into distribution agreements that will allow them to distribute the CIVs shares. Distributors may market CIVs domestically or globally. CIVs marketed domestically market the interest of the CIVs to investors that are in the same jurisdiction as the CIVs marketed global market the interest of the CIVs to investors that are based in jurisdictions that are different from those of the CIVs. As a result, there may be many layers of intermediaries between the CIV and the beneficial owner of the interest in the CIV and these intermediaries may be located in different countries other than the issuer, the CIV and the investor (UN Committee of Experts, 2018).

Funds may also be open-ended or close-ended. Open-ended funds are obliged to redeem or buy back their shares on a regular basis as investors join and leave the fund (St Giles, M Alexeeva E & Buxton S, 2003). Open-ended funds form the majority of the type of funds internationally. Close ended funds however have a fixed number of shares and capital in issue. They have an initial offer period to raise capital and after that period they close to further subscription (St Giles, M Alexeeva E & Buxton S, 2003). Where subscribers fail to invest to an initial offer of a close-ended fund they can only subscribe to shares in such a fund where an existing subscriber agrees to sell their stake in the fund (St Giles, M Alexeeva E & Buxton S, 2003).

CIVs may also be managed internally or externally. Internally managed funds rent their own equipment, their own offices and their own staff. These however are extremely uncommon. CIVs managed externally which form about 99% of the fund have a separate company established to manage the fund. CIVs with external management are managed by an external fund manager known as a management company. These management companies will usually have a management contract pursuant to which they earn a management fee worth between 0.20% to 3% of the value of the funds that they manage (St Giles, M Alexeeva E & Buxton S, 2003).

3.2. The Tax Structure

The tax structure that favours CIVs is one which is based on tax neutrality (Ciccotello, 2010). Tax neutrality requires that direct investors and indirect investors to be treated equally for tax purposes i.e. an indirect investor investing through a CIV should not be in a worse off position than an investor investing directly. Both parties should be entitled to the same tax benefits and no difference should result from direct or indirect investment where an intermediate vehicle exists between the investor and the investment (Blum, 2016).

There are four methods to achieving tax neutrality. First, by treating the CIV as a taxable entity and subsequently applying to the CIV a material or personal exemption from tax. This means that the income of the CIV is not subject to tax as long as the requirements for the exemption are met. Here the investment vehicle is fiscally opaque but entity level tax is eliminated. This changes both the timing of taxation and the character of the income in the hands of the investor (Blum, D & Pinetz E, 2016). Second, by characterizing the CIV as fiscally transparent. This would therefore mean that the profits and losses of the CIV are directly attributed to the investors for tax purposes. The investor is taxed on their share of the income on a current basis. Neutrality in this instance is achieved by the choice of legal entity rather than due to the application of any special tax regime. The third method of attaining neutrality is by entitling the CIV to deduct dividend distribution from

its taxable base and the fourth method of attaining neutrality is by subjecting the CIV to 0% tax rate. At the investor level, the investor could be granted a full tax credit for taxes paid. (Ciccotello, 2010)

Entities that are fiscally transparent will more often than not use the second method to achieve neutrality while entities that are opaque will use the rest of the methods to achieve neutrality in a domestic context. The method employed by Mauritius is the first given that CIVs that are based in Mauritius use the global business regime that allows them to have an effective tax rate of 3% in most cases. This encourages the abuse of Mauritius' DTA network via treaty shopping and round tripping. Having identified the type of CIV structure and tax policy employed by Mauritius, the next section builds a detailed understanding how CIVs work within the Mauritius legal and institutional framework. It then sets out the tax implications of establishing a CIV in Mauritius and how the Global Busines regime has been abused thus contributing to Mauritius' status as an OFC.

4. OPERATIONALISING CIVS IN MAURITIUS

4.1. Legal and institutional framework

CISs and close-ended funds looking to operate in Mauritius must be registered by the Financial Services Commission under the Securities Act, 2005 in the manner set out in the Securities (Collective Investment Schemes and Close Ended Funds) Regulations 2008. The authorization process for both open-ended and close-ended funds is the same. Intermediaries, custodians, CIS managers and fund administrators undergo rigorous screening prior to being licensed by the Financial Services Commission after which they are continually monitored for compliance with existing laws and regulations.

CISs will usually be commonly structured as *sociétés*, limited partnerships or trusts, such funds will generally take the form of private/public limited companies, protected cell companies and in rare circumstances limited companies (Hague & Doman-Brette, 2017). Close-ended funds will usually be structured as a company, a trust, a limited partnership, a foundation or a protected cell company. Funds can either be domestic funds or global funds. Domestic funds are funds authorized to operate as retail funds in Mauritius. Global funds on the other hand have target mainly non-resident investors and make most of their investments outside Mauritius; they must obtain a global business license pursuant to the Financial Services Act, 2007. The Financial Services Commission as the regulator for all non-bank financial services activities regulates both domestic and global funds.

Foreign funds may also operate in Mauritius. These are funds which are established in foreign jurisdictions and are not restricted as to the type of investors targeted and

the amount of investment made. Such funds may only be permitted to operate in Mauritius where they are regulated in their county of domicile and there is a co-operation agreement with the regulator in the foreign jurisdiction. While domestic retail funds will usually be subscribed to by local investors, they are not prohibited from having both domestic and foreign investments. On the other hand, retail funds that are predominantly subscribed by foreign investors will usually be licensed under the global scheme. It should be noted that foreign retail funds in Mauritius is dominated by far by foreign retail funds (Hague & Doman-Brette, 2017).

4.1.1. Public or Private Companies

Funds structured as companies are regulated under the Companies Act, 2001. The registrar of companies is the regulator in respect of all corporate matters. Private companies are companies either limited by shares or by guarantee whose shares cannot be offered to the public. They are restricted from having more than 25 shareholders. Public companies on the other hand may be publicly traded. They are however subject to more onerous reporting and compliance requirements by the Financial Services Commission which is the regulator for non-banking financial services.

4.1.2. Limited Partnerships

Funds structured as Limited Partnerships are regulated under the Limited Partnerships Act, 2011. Such vehicles have features of both companies and partnerships. They are governed by partnership agreements that guide the conduct of its business. They have general partners who have unlimited liability and limited partners who have limited liability and can elect to have separate legal personality. Unless otherwise specified in the partnership agreement, Limited Partnerships have perpetual succession. Where Limited Partnerships mainly conduct their business outside Mauritius they can apply to the FSC for a Global Business License.

4.1.3. Limited Liability Partnership

Funds structured as Limited Liability Partnerships under the Limited Liability Partnership Act, 2016. LLPs have separate legal personality and are capable of suing and being sued. Unlike the Limited Partnership, all partners may take part in the management of the LLP. In addition, the liability of all Limited Partners is limited to their capital contribution. The partners however will retain unlimited liability for their own wrongful acts. LLPs can apply to the FSC for a Global Business License. An LLP must appoint a manager that is resident in Mauritius at all times. The manager of a domestic LLP should be qualified as a secretary. If an LLP holds a Global Business License, the manager does not have to be resident in Mauritius although its manager must be a licensed Management Company.

4.1.4. Sociétés

Funds established as Sociétés are governed by the Mauritius Civil Code (*Code Civil Mauricien*) and the Mauritius Commercial Code (which is called the *Code de Commerce*). A *Société* must have at least two partners and it must be governed by a partnership deed. They will usually have limited liability unless the partnership deed states otherwise. With the exception of unregistered partnerships (*sociétés en participation*), they will generally be separate legal entities.

4.1.5. Trusts

Funds structured as Trusts are regulated under the Trusts Act, 2001. Assets are transferred from the settlor to trustees to hold for the benefit of beneficiaries. They are created by drawing up a Trust Deed which must state its objects, intention and duties of the trustees. The advantage of using trusts is that a distinction is drawn between formal and legal ownership of property, the trustee and the beneficiary. Trusts do not need to be registered and settlors of the trusts can be resident or non-resident in Mauritius.

4.1.6. Protected Cell Companies

Funds structured as protected cell companies are regulated under the Protected Cell Companies Act, 1999. These are companies with a single legal entity that may however be separated into cells so that the assets and liabilities of one cell do not affect the other. They are usually incorporated to carry out a global business and have the advantage of simplifying administration and reducing costs of operation. Qualified business activities that PCCs may carry out are asset holding, insurance, collective investment schemes, specialized investment schemes and structured finance.

4.1.7. Foundations

Funds established as foundations are governed by the Foundations Act, 2012. These are similar to trusts but have the administrative flexibility of a company. Foundations are particularly appealing to clients from civil law countries where the trust concept is not familiar or those who wish to use a legal entity for their activities while retaining the advantages and flexibility of a trust. Foundations that have separate legal personality and can apply for a Global Business License.

4.2. Domestic taxation of investment funds

The taxation of funds will more often than not depend on the legal form that the

funds take. The CIV will be taxed differently or not at all depending on the domestic legislation.

4.2.1. Companies

Companies will generally be tax resident in Mauritius where they are either incorporated in Mauritius or where their central management and control is in Mauritius. Residents in Mauritius are taxed on a worldwide basis while non-residents are taxed on only Mauritius-source income. The domestic corporate tax rate is 15%. Pursuant to Para 41, Sub-Part C, Part II, Second Schedule Income Tax Act (ITA), while locally sourced dividends are exempt from income tax, all foreign sourced income can benefit from an 80% partial exemption under the global business regime. Retail funds that have suffered more than 12% withholding tax can instead opt to claim a credit for actual taxes paid in place of resorting to the partial exemption regime pursuant to the Income Tax (Foreign Tax Credit) Regulations, 1996. Corporate Social Responsibility (CSR) tax of 2% is chargeable on income. There is no withholding tax on dividends, interest or royalties. There is also no capital gains tax or estate duty as there is no tax payable on the disposal of securities pursuant to Item 7, Sub-Part C, Part II, Second Schedule as amended by the Income Tax (amendment of schedule) (No 2) Regulations, 2018.

4.2.2. Limited Partnerships

Although a rare occurrence, retail investment schemes may also be set up as limited partnerships. Limited Partnerships will generally be tax transparent and will allow all profits and losses to be carried through to the limited partners who will be subject to tax on their respective share of profits. Where this is the case, the Limited Partnerships will be unable to benefit from the network of DTAs.

4.2.3. Limited Liability Partnerships

These are by default tax transparent so long as the LLP has its seat in Mauritius or at least one partner resident in Mauritius. Each partner is liable to tax on their share of income at the individual level. Partners who are not tax resident will only be liable to tax on Mauritius source income. LLPs allow investors looking for a pass-through vehicle to have minimum exposure to the jurisdiction in which it is domiciled. An LLP holding a General Business License from the FSC may opt to be tax opaque and taxed as a company. Such an LLP will benefit from the extensive network of DTAs and IPPAs.

4.2.4. Sociétés

Sociétés resident in Mauritius are not liable to income tax as they are tax

transparent. Each partner is liable to income tax on their share of income. Non-resident Sociétés are however liable to income tax as if they were companies.

4.2.5. Trusts

Trusts like companies are subject to tax at the rate of 15%. In order to be tax resident in Mauritius, trusts must apply for a Tax Residence Certificate with the Commissioner of Income Tax. Resident Trusts may benefit from DTAs. Distributions from Trusts are exempt from tax at the level of the beneficiaries. However, where trusts have non-resident settlors and beneficiaries and the main purpose of the Trust is carried on outside Mauritius, the trust can elect to be treated as non-resident and be exempt from tax.

4.2.6. Protected Cell Companies

Protected Cell Companies (PCCs) pay tax on a cell basis where they have elected to prepare separate financial statements in respect of each cell. Aside from that their taxation follows the normal tax regime of companies and resident PCCs are taxed at the rate of 15%. They may also qualify as a global business company.

4.2.7. Foundations

Like companies, foundations are taxed at the rate of 15%. Foundations that have non-resident founders and beneficiaries may elect to be exempt from income tax. Foundations may also qualify as Global Business Companies and elect to be tax resident in Mauritius and benefit from DTAs.

4.3. Cross-border taxation of investment funds

Non-residents with a taxable presence in Mauritius are only taxed on Mauritius-source income, subject to the terms of any double taxation agreement. There is also no withholding tax on dividends or on the remittance of the profit payable by a Mauritian company to its foreign parent company, or by a Mauritian branch to its foreign head office. In addition, there is also no capital gains tax chargeable on gains arising from the sale of property in Mauritius (Fitzgibbon, 2019). The Global Business regime has contributed significantly to the establishment of Mauritius as an OFC. It allows entities with a Global Business License to benefit from significantly low effective tax rates and a myriad of DTA benefits. It is regulated by the Financial Services Act, 2007.

An OFC has the potential to erode the tax base of other States when revenue is transited out of those States and routed through IFCs. Common practices that erode tax bases are through treaty abuses complemented by the tax secrecy. These

concerns have been taken up at the OECD level that initiated the BEPS project to counter and minimise tax evasion practices. Mauritius joined the OECD Base Erosion and Profit Shifting (BEPS) project in November 2016 and committed to implementing the minimum standard on tax treaty abuse, harmful tax practices and country-by-country reporting. Consequently, in August 2018, the Finance (Miscellaneous Provisions) Bill, which proposed significant changes for the taxation of the global business regime, was approved. The enactment of the Finance (Miscellaneous Provisions) Act 2018 (Finance Act) effectively overhauled the Global Business regime. The sub-sections below will consider the type of tax treatment of non-residents in Mauritius prior to and after the government joining the OECD BEPS project.

4.3.1. Pre-BEPS Regime

Under the pre-BEPS regime, entities primarily operating outside Mauritius could apply to the FSC to be designated as Global Business Companies pursuant to the Financial Services Act 2007. The licenses would either be Category 1 Licenses (GBC1) or Category 2 Licenses (GBC2). GBC 1 entities were deemed to be tax resident in Mauritius and liable to income tax at the rate of 15% on chargeable income. They however enjoyed a Deemed Foreign Tax Credit (DFTC) of 80% which effectively saw their effective tax rate go down to 3% regardless of whether they had actually suffered any foreign taxes. This deemed foreign tax credit mechanism operated alongside an actual tax credit mechanism. As such tax credits on foreign income could still be granted where the tax rate on foreign income was higher than 80% of the tax that was payable in Mauritius with the potential effect that tax rates could be as low as zero percent (Hague & Doman-Brette, 2017).

It should be noted however that prior to the enactment of Finance Act 2018, only global schemes were able to benefit from the DFTC. This allowed them to claim a credit of up to 80% without having to prove that they had in fact incurred any tax. The maximum tax rate for these global schemes was therefore a maximum of 3%. GBC 1 entities also enjoyed the benefits of the Mauritius DTA network. They had to apply for a Tax Residence Certificate from the Mauritius Revenue Authority and such status would be granted where they met the statutory requirements.

GBC 1 entities could engage in any legal activity and companies, branches of foreign companies, trusts, PCCs, foundations and partnerships could apply for the license. Whereas most countries tax capital gains, the Tax Treaties which are based on the OECD Model Tax Convention allocate the taxation of capital gains tax to the residence jurisdiction. Mauritius however does not levy capital gains tax. As a result, GBC1 companies that were established in Mauritius and operating in a foreign jurisdiction had the right to tax realised capital gains in the country of domicile i.e. Mauritius where no capital gains tax was payable. Additionally,

withholding taxes levied by the Double Tax Conventions negotiated with Mauritius in most instances tended to be so low that the source countries were effectively denied revenue.

In order to benefit from the beneficial provisions of the DTAs many companies set up shell entities that were managed from countries other than Mauritius and used them to route profits into Asia and Africa. MNEs would attain this goal by locating intermediate holding companies in Mauritius in order to benefit from the extensive DTA network, non-existent withholding tax on outflows and liberal substance requirements. (Beer S & Loeprick J, 2018) This structure allowed many corporations to set themselves up in Mauritius as they could easily transfer money in and out of Africa and Asia without incurring much tax and allowed multinationals to hide their profits and assets away from the authorities and the public. The old India-Mauritius treaty has been estimated to have cost India USD 10-15 billion in lost revenue in capital gains tax, and withholding tax on dividends, interest and royalty payments (Khetan, 2020).

GBC 2 entities on the other hand were not deemed to be tax resident and were exempt from paying corporate tax. They however did not qualify for DTA relief and were restricted from carrying out any financial services activities. They however enjoyed confidentiality as a major benefit as information on beneficial ownership could be kept private. They could also be formed without any paid up capital and had no accounting or reporting requirements. As a result, these companies could be used in Mauritius for purely artificial arrangements aimed at tax avoidance primarily. These entities were extremely suitable hiding money and for tax evasion.

The GBC1 and GBC2 entities significantly contributed to the erosion of the tax base particularly in developing countries with which Mauritius had completed a large number of DTAs. They also affect the location of financial and other service centers, distort trade and investment patterns and undermine fairness and neutrality in tax systems. In order to counter the ability of corporations to easily shift profits from one jurisdiction to another and therefore erode the tax base due to the geographical mobility of their activities the OECD begun its work on harmful tax practices begun in 1998 when it published the report titled, *Harmful Tax Competition: An Emerging Global Issue* (the 1998 Report). This report begun the work of the OECD on tackling the use of harmful tax practices and created the Forum on Harmful Tax Practices (FHTP). The aim of the work was to reduce the distortionary influence of taxation on the location of economic activity and to create a level playing field by discouraging a harmful race to the bottom.(OECD, 2015)

Pursuant to the 1998 Report regimes were considered to be preferential where they offered preferential treatment to certain regimes when compared to the general

principles of taxation in the relevant country (OECD, 1998). The 1998 Report identified four key factors and eight other factors to determine whether a preferential regime was potentially harmful. The four factors were; one, the regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities. Two, the regime is ring-fenced from the domestic economy. Three, the regime lacks transparency and four, there is no effective exchange of information with respect to the regime.

The eight other factors were that first, there is an artificial definition of the tax base; second, there is failure to adhere to international transfer pricing rules; third, foreign source income is exempt from residence country taxation; fourth, there is a negotiable tax rate or tax base; fifth, secrecy provisions exist; sixth, there is access to a wide network of tax treaties; seventh, the regime is promoted as a tax minimization regime; and eighth, the regime encourages structures that lack economic substance and that are purely tax driven. In order for the regime to be found to be harmful, the first test which states that there is no or low effective tax rate had to have been met. Where a regime was determined to be potentially harmful based on the factors above the regime could subsequently be determined to not be harmful where it was determined that the regime created new economic activity rather than shifted it from one jurisdiction to the next, where it was determined that the level of activity in the host country was commensurate with the income invested therein and finally where the primary reason for the location of the business was not the preferential regime (OECD, 1998).

Based on the above criteria, the OECD issued a progress report in 2000 identifying 47 potentially harmful regimes as well as a list of 35 jurisdictions that were deemed to have met the tax haven criteria. Mauritius was however not included on this list as it had made commitments to transparency and exchange of information and was therefore considered to be a co-operative jurisdiction. While the OECD continued to publish its list of tax havens this had little impact on Mauritius as the compliance with commitments to overhaul its preferential tax regimes amounted to little more than an unkept promise given that Mauritius only overhauled its regime over 10 years later. Over time the tax haven work was taken over by the Global Forum on Taxation (which eventually became the Global Forum on Transparency and Exchange of Information for Tax Purposes in 2009). The Global forum undertook the work on transparency and exchange of information and worked on developing the Agreement on Exchange of Information in Tax matters as well as standards on transparency relating to the availability and reliability of information. Since 2006 the Global Forum worked on assessing the progress of implementation of those standards.

Whilst these developments on the international scene had the potential to bring about real long-lasting change, the politics involved in implementing the standards

fairly to both OECD members and non-members meant that often small, low-income jurisdictions featured on the lists. While publication on the list often had an impact on a jurisdiction's popularity as a business destination, the lists often lacked the requisite impact as the mere commitment to review regimes meant that those countries were deemed to be cooperative. The lack of effectiveness of the lists is evident from the fact that by 2009 there were no countries included on the list of uncooperative jurisdictions.

4.3.2. Current developments after Mauritius joined the OECD BEPS Project

Effective 1st January 2019, GBC 1 and GBC 2 entities were abolished. The GBC 1 has been effectively replaced by the Global Business License while the GBC 2 has been replaced by the Authorised Company regime.

GBC1 – Global Business License

Resident corporations held or controlled by non-residents that are primarily operating from outside Mauritius will therefore need to apply for a Global Business License. Under the Global Business License (GBL) regime, the 80% DFTC previously enjoyed by GBC 1 Companies has been abolished and replaced with an 80% Partial Exemption regime which will be applicable to GBL companies as well as domestic companies. The Partial Exemption Regime will apply to foreign sourced dividends, interest from overseas companies, profits attributable to permanent establishments of non-resident companies and foreign sourced income accruing to CIVs, CIS managers, CIS administrators and investment managers. Companies that have claimed the partial exemption will not be entitled to foreign tax credits (whether actual or deemed) pursuant to Section 77 (4)(a) of the Income Tax Act, 1995.

On 16 August 2019, the Income Tax (Amendment No. 2) Regulations were passed that provided for substance requirements of the GBL regime effective 1 July 2019. In order to be eligible for partial exemption, the company will need to satisfy substance requirements. The GBL holders are required to carry out its core income generating activities in Mauritius by directly or indirectly or indirectly employing a reasonable number of qualified persons to carry out its core activities and also having a minimum level of expenditure that is proportionate to its activities pursuant to Regulation 23D, Income Tax Regulations (1996). The assessment by the FSC of these requirements will be on a case-by-case basis.

Although the Regulations allow for the outsourcing of relevant activities the following conditions apply; first, there must be adequate monitoring of outsourced activities; second the outsourced activities must be conducted in Mauritius; and finally, when evidencing the economic substance of a service provider, an entity's

activities will only be counted once and not multiple times by multiple companies. The FSC issued Circular Letters CL1-121018 and CL151018 on 12 October 2018 and 15 October 2018 respectively to provide clarifications and indicative guidelines on the new enhanced substance requirements for the GBC also provide a list of core income generating activities that must be conducted by GBL holders.

GBLs must also be managed and controlled from Mauritius and must be administered by a management company. When determining management and control the FSC will consider: whether the GBL has at least two resident directors; whether the GBLs principal bank account will be maintained in Mauritius; whether the GBL will maintain its accounting records at its registered office in Mauritius; whether the statutory financial statements will be prepared and audited in Mauritius; and whether the GBL will provide for meetings which will include at least two directors from Mauritius. Both CISs and close-ended funds are required to carry out investment of funds from within Mauritius. CIS managers are required to actively manage funds from Mauritius and CIS administrators are required to provide services with respect to operation and administration of the CIS from Mauritius. Funds will also be required to incur a minimum annual level of expenditure of USD 25,000. They will also be required to directly or indirectly employ at least 1 suitably qualified person.

Where Licenses were issued on or before 16 October 2017, existing GBC1 companies will be grandfathered until 30 June 2021. Where licenses were issued after 16 October 2017, GBC1 companies were grandfathered until 31 December 2018 after which they were deemed to be GBLs. Controlled Foreign Company rules were also introduced by the **Finance (Miscellaneous Provisions) Act, 2019. They apply where a Mauritian resident company carries on business through a Controlled Foreign Company (CFC) and defers dividend distribution to Mauritius using non-genuine arrangements.**

GBC2 – Authorised Company

Effective 1 January 2019, the use of GBC2 entities was abolished and new type of company, the Authorised Company was introduced pursuant to the **Finance (Miscellaneous Provisions) Act 2018 that amended the Financial Services Act, 2007.** Authorised Companies are treated as non-resident for tax purposes do not have access to DTAs. As such, the foreign source income is non-taxable in Mauritius. Authorised Companies will only be established where the majority of shares, votes or legal and beneficial interest of the company are controlled by non-residents, the principal place of business is outside Mauritius and the place of effective management is outside Mauritius. They are required to have registered agents in Mauritius which must be a management company who is responsible for filing annual tax returns and maintaining board minutes and resolutions. Authorised

Companies are, however, prohibited from carrying out the business of collective investment funds.

GBC2 licenses issued on or before 16 October 2017 will be grandfathered until **30 June 2021**. After this date, the company can either apply to be an Authorised Company or a GBL - or be dissolved. GBC2 licenses issued after 16 October 2017 were grandfathered until **31 December 2018.** Those GBC2 licenses have now lapsed and a company can either apply to be an Authorised Company or a GBL - or be dissolved. Whilst these changes signify Mauritius' commitment to overhauling the Global Business regime, many of these changes appear to be cosmetic. The 80% DFTC previously enjoyed by GBC 1 Companies has been abolished and replaced with an 80% Partial Exemption regime which will be applicable to GBL companies. Although the tax credit is no longer only available for use to only Global Business entities which primarily operate outside Mauritius, thus removing the elements of ring-fencing that effectively protected the country's tax base domestically while creating a harmful regime that encouraged treaty shopping, the harmfulness of the new regime is still maintained as the DFTC has been merely renamed to a partial exemption. The next section illustrates how the Global business regime has facilitated tax abuse.

4.3.3 Abuse of the Tax Treaty Network by Mauritius

The global business regime has been subject to abuse by CIVs that channel their investments into Asia through Mauritius. The "Mauritian route" in particular which took advantage of the old India-Mauritius DTA saw Mauritius become the main provider of Foreign Direct Investment (FDI) to India, with 32% of Indian FDI coming from Mauritius between 2016 and 2019. The second highest of FDI into India was Singapore which provided a distant 20% of FDI (DIPP, 2019). This was despite the fact that Ebene, the heart of the city's financial services industry, only has a few office blocks. The Mauritius route has therefore been the preferred route for investment into India despite the absence of significant income generating activity in Mauritius (Yadav & Bhopal, 2018). This is because the India-Mauritius tax treaty provided for capital gains arising in India from the disposal of any securities in India to be only taxed in Mauritius (Aykut, Sanghi & Kosmidou, 2017). As a result, investors preferred to use Mauritian entities to hold investments in India as divestment would result in no CGT taxation instead of as much as 40% in India.

Harmful tax practices such as treaty shopping and round tripping were therefore encouraged by both counties' tax regimes. Treaty shopping involves the improper use of DTAs whereby a person who is not a resident of a Contracting State establishes an entity that would be a resident of that State in order to reduce or eliminate taxation in the other Contracting State through the benefits of the tax

treaty concluded between those two states (OECD, 2017(b). This possible because entities are considered independent of the parent companies that own them despite the fact that they are under that parent company's control (Borrego, 2017) Taxpayers therefore reduce their tax liability by taking advantage of treaties between a source country and other jurisdictions other than their residence countries. Tax benefits enjoyed include reduced withholding tax rates in the source country and the country of residence of the entity and low or non-existent taxes in the country of residence of the country of residence (Plowgian, Riccardi & Mueller, 2017).

Such treaty shopping encourages intermediary transactions that lack any economic substance and diminish the principle of reciprocity whereby two states agree to allocate taxing rights between themselves (Rohatgi,2001). Although such transactions are not necessarily illegal, they encourage artificial arrangements whose sole purpose is to avoid tax. Round tripping on the other hand involves shifting funds overseas in order to reinvest them in the source jurisdiction so as to enjoy reduced tax rates by taking advantage of tax treaties (Wayne M. Morrison,2009). This is achieved by moving money through various entities from a jurisdiction through shell companies in another jurisdiction and the subsequent return of such funds to the original jurisdiction as FDI. Such transactions lack any economic substance and are geared at taking advantage of beneficial DTAs. Significant amounts of the FDI moving into India through Mauritius had their source in India with the result that such income would benefit from the non-existent Mauritius capital gains tax.

The capacity for treaty abuse has been recognized by several of Mauritius' treaty partners and has led to the renegotiation (either ongoing or anticipated) of a number of her tax treaties. India for example completed the renegotiation of its tax treaty with Mauritius in 2016 after 20 years of negotiation, by shifting the residence based test for capital gains under the India-Mauritius treaty to a source-based test and thereby making the disposal of shares in Indian companies subject to tax in India. In the same year, South Africa renegotiated its tax treaty with Mauritius. Whereas the old treaty provided for a zero withholding rate on interest and royalties in the source state, the new treaty provides for 10% withholding tax rate on interest and a 5% withholding tax rate on royalties. It also restricts the taxation of capital gains on the disposal of shares to the state of residence where the shares derive 50% of their value from immovable property in the state of residence. This is an anti-abuse rule restricts the capacity for round tripping and treaty shopping.

Other jurisdictions that are renegotiating their tax treaties include Namibia and Uganda. Senegal terminated its treaty with the island nation and fresh negotiations are underway for a new tax treaty. The Kenya-Mauritius DTA was challenged and struck down by Kenya's High Court for technical reasons in March 2019. The

treaty was challenged on the ground that it applied low withholding tax rates on interest (10%), dividends (10%) and royalties (5%) and that it restricted that taxation of capital gains on the transfer of shares to Mauritius. The treaty has now been tabled in parliament and is now in force in its initial form. Kenya's domestic anti-abuse legislation in section 41(5) of the Income Tax Act, CAP 470, according to which the benefits of a tax treaty shall not be available if 50% or more of the underlying ownership is held by a person that is a non-resident of a contracting, will go some way in preventing tax treaty abuse. The next section will evaluate whether Mauritius' commitment to the BEPS project have had an impact on the regime or have simply reinforced the destinations status as an OFC.

5. THE INTERNATIONAL RESPONSE TO THE USE OF INVESTMENT FUNDS FOR TAX ABUSE

Having explained the general structure of CIVs, their significance as well as the general tax regime that applies to CIVs in Mauritius as well as the manner in which the Global Business regime has been used to evade tax and has reinforced Mauritius status as an OFC the next section will expound on the impact the BEPS project has had on the regime and whether the amendments have had resulted in any meaningful change. The OECD, recognising the need to prevent profit shifting and base erosion expressed the need to has addressed this issue through the Base Erosion and Profit Shifting (BEPS) project through 15 action points aimed at closing the loopholes in international taxation.

The remainder of this sub-section will interrogate the implementation of the BEPS project as it relates to CIV industry in Mauritius from two perspectives. The first relates to the BEPS Action Plan 6 on the Prevention of the Granting of Treaty Benefits in Inappropriate Circumstances as implemented by the ratification of the Multilateral Instrument; the second will touch on the BEPS Action plan 5 on Harmful Tax Practices as implemented by domestic changes to the Global Business regime and the third will touch on the impact of BEPS Action plan 13 on Country-by-Country reporting. It should be noted that whereas the changes envisioned under the Pillar 2 Global Anti-Base Erosion (GLOBE) proposal, which recommends a minimum tax for MNEs will have a significant impact on the Global Business regime, this will not be considered at present as the proposals are yet to be adopted.

5.2 BEPS Action plan 6 on the Prevention of the Granting of Treaty Benefits

The BEPS Action plan 6 identifies treaty abuse done via treaty shopping as one of the most important sources of BEPS concerns (OECD, 2015 (a). As this was a priority area, the OECD published its final report in October 2015. The report addressed the use of treaty provisions and domestic rules to prevent the granting of treaty benefits. It is important however to note that the tackling of treaty abuse is

not new to the OECD. The 2003 revisions to the commentary of Article 1 for instance gave guidance to tax authorities on how to counter treaty abuse. From 1977 to 2003, the role of tax treaties was the elimination of double taxation in order to encourage international trade. The fact that such treaties were not intended to be used to facilitate tax avoidance and evasion appeared to be an afterthought. It is only following the revision of the Commentary in 2003, that the prevention of tax avoidance and evasion become a self-standing purpose of tax treaties (De Broe & Luts, 2015).

The OECD through its BEPS Action Plan 6 on *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* addresses treaty abuse through various approaches. First it proposes the use of a general anti-abuse rule (GAAR) based on the principal purpose test. Second, it proposes the use of a Principal Purpose Test (PPT) together with a specific anti-abuse rule (SAAR), the limitation-on-benefits rule (either in a simplified version or a detailed version) may restrict the conditions under which treaty benefits may be awarded. These may be based on legal nature, ownership and general activities of the entity. Finally, it proposes the use of a detailed LOB provision, supplemented by a mechanism that would deal with conduit arrangements not already dealt with in tax treaties (De Broe & Luts, 2015).

While the SAARs tackle already detected loopholes, the GAARs apply a general rule to counter tax planning that leads to unacceptable loss of tax revenue by denying treaty benefits that are against the purpose of the law. The GAAR therefore doesn't describe the precise structure of the transaction that is illegal. It instead considers the objective of the transaction (Kolosov, 2017). The PPT is an OECD BEPS GAAR which denies the grant of treaty benefits where the principal purpose of the transaction is to obtain treaty benefits (Scherleitner, 2017). On 18th October 2019, Mauritius deposited its instrument of ratification of the Multilateral Instrument for BEPS tax treaty related measures (MLI) with the OECD and it entered into force on 1 February 2020. As a result the tax treaty related measures developed through the BEPS project will be implemented in existing tax treaties in a synchronized manner without Mauritius having to conduct additional negotiations between treaty partners (Gomes, 2018). The MLI is intended to advance the agenda of the OECD BEPS project by modifying existing treaties. Where two countries that have bilateral tax agreements with each other indicate that they would like to MLI to apply to those treaties, the agreements become covered tax agreements. (CTAs). The CTAs then become subject to both of the provisions that each jurisdiction has adopted (Morley, 2019). It should however be noted that even where a tax treaty becomes a CTA, where one party to the CTA has made reservations against a provision it will not apply (Morley, 2019)

Of the 46 income tax treaties in the network of tax treaties signed by Mauritius, there are 44 that are identified as CTAs. 17 are subject to the other treaty-partner

country signing the MLI, while two will not be changed as those countries have not chosen Mauritius as a CTA. The remaining 25 have been changed by the ratification of the MLI0 (OECD, 2020). Whereas the MLI includes a simplified Limitation on Benefits Article, Mauritius has indicated that it will adopt Article 6 and 7 of the MLI which implement include a general statement on the purpose of treaties as well as the PPT respectively. It should however be noted that Article 6 and Article 7 of the MLI are mandatory provisions against which reservations cannot be made. Additionally, Mauritius has indicated that Article 7 (4) will apply to all its treaties except that which it has with Germany. This allows the treaty benefit to be granted where the tax authority is satisfied that the treaty benefit would be appropriate in the absence of the transaction or arrangement considering all the facts and circumstances.

Before we delve into the discussion on the impact Article 6 and 7 of the MLI will have on CIVs based in in Mauritius, it should be noted that in interpreting the MLI, the ordinary principle of treaty interpretation shall apply, that is, that a treaty should be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose. While the provisions in the MLI may not always correspond with the provisions in the commentary that was developed during the course of the BEPS project, they remain applicable in interpreting the MLI where they do. This is because they (the OECD Model Tax Convention Commentaries) reflect the object and purpose of the MLI which is to implement the tax treaty related BEPS measures (OECD, 2017(a). In any case the PPT in Article 7 of the MLI is exactly the same as the PPT test set out in Article 29, paragraph 9 of the OECD Model Convention, 2017.

It should also be noted that CIVs will usually be entitled to treaty benefits where they are considered to be a “person”, a “resident of a contracting state” and are the “beneficial owner” of the income they receive. Once all these tests are passed, they must also pass limitation of benefits test (Blum/Seiler, 2016). Limitation on benefit clauses will therefore only apply to treaty entitled entities. For the purposes of this article, these conditions requirements will not be further investigated as Mauritius generally subjects its entities to tax even where they are tax transparent if they are to be entitled treaty benefits. Finally, it should also be noted that there existed domestic anti-abuse measures in some of the countries that are treaty partners with Mauritius. A discussion on those measures will however be outside the scope of this article as those measures will only complement the newly adopted BEPS measures (Gomes, 2018)

5.2.1 Article 6 of the MLI

Article 6 of the MLI changes the preamble of all CTAs that includes wording to the effect that the common intention of the treaty is to eliminate double taxation

without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements. This provision is a mandatory minimum standard that states cannot opt out of unless they reserve the right for the article to not apply where they already have the same language within their CTAs.

This is a fundamental shift in the objectives of tax treaties. This is because tax treaties were initially only concerned with the allocation of taxing rights between states without interfering with the sovereign taxing rights of states under domestic law and mandating states to exercise their taxing rights. States were therefore free to use provisions in their domestic law to either tax or not tax certain streams of income (De Broe & Luts, 2015). This provision may however be problematic where capital gains taxes are concerned. This is because capital gains tax on the sale of shareholdings may only be taxable in the state of residence of the state of the alienator pursuant to article 13(5) of the model tax convention. The state of residence of the alienator may however opt to not levy capital gains tax in its domestic law as is the case in Mauritius.

This addition to the treaty therefore raises concerns about the instances of double non- taxation. While this may be problematic for CIVs established in Mauritius, it has been argued that the purpose and object of the treaty do not form part of the context of the treaty and that statements in the preamble will not offer adequate guidance to tax administrations and courts in the interpretation of the treaty. This is because a treaty's object and purpose should be included in its operative provisions. (De Breo, 2015).

5.2.2. Article 7 of the MLI

Article 7 (1) of the MLI sets out the PPT as follows: *"Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement."* The biggest criticism of the PPT test is that it is a largely subjective test that confers a great deal of discretion to the taxing authority (Cunha, 2016). Despite the fact that the OECD Commentaries make it clear that it should not be immediately concluded that the main purpose of a specific arrangement is for the attainment of the treaty benefits by merely reviewing the effects of an arrangement, the test PPT remains fairly vague leaving tax authorities with a great margin of discretion (Weber, 2017).

While the commentaries give with one hand by providing that the purpose of an arrangement must be determined after undertaking an objective analysis of the aims and objects of all persons involved in an arrangement, they take away with another by providing that tax authorities do not need to find conclusive proof of such intent (OECD, 2017(b). The subjective nature of the test therefore fails to provide a sufficiently clear standard that is capable of being complied with (Cunha, 2016). This type of subjective test focusing on the intentions of the taxpayer has been broadly criticized in the literature (Pinetz, 2016)(Kolundzija, 2016).

Additionally, the commentaries provide that the obtaining of treaty benefits does not need to be the sole or principal purpose of structuring an arrangement. Obtaining a tax benefit simply needs to be one of the principal purposes of the transaction (OECD, 2017(b) As a result, even where commercial reasons exist for the adoption of a structure, the benefits of a tax treaty could still be denied.(Danon, 2018) It is unacceptable to refuse the granting of treaty benefits simply because they one of the purposes of the entity is to access treaty benefits and pay less tax. This is because tax treaties are also meant to facilitate trade that would not have occurred but for the treaty as tax is one of the largest cost for businesses and to require businesses to not take tax considerations into account as one of their principal purposes would be irrational. Treaty benefits should only be denied where an arrangement is only solely or predominantly inspired by treaty benefits (De Broe, 2015).

In addition, investment vehicles are established in a jurisdiction for both tax and non-tax reasons. One of the main aims of investment vehicles is to pool capital from investors resident in a wide range of jurisdictions. As a result, the funds will have investors resident in several other foreign jurisdictions. This decision is a commercial decision that is not for the principal purpose of enjoying tax benefits. The result is that the PPT has a very low threshold that may prevent CIVs from enjoying treaty benefits simply because they also enjoy treaty benefits despite the fact that one of the main reasons for the transaction was a commercial one.(De Broe & Luts, 2015) Although the commentaries attempt to safeguard against this by providing that it is unlikely that a principal purpose will be considered to be for the obtaining of a treaty benefit where an arrangement is inextricably linked to a core commercial activity, this benefit is only available where an arrangement's form has not been driven by considerations of obtaining a benefit (OECD, 2017(b). This implies that as long as tax considerations have been made the PPT is automatically failed.

In any case there is no guidance of how a tax authority will distinguish between a principal purpose and a secondary purpose. This leads to uncertainty as different tax authorities will be able to arrive at different conclusions despite being faced with the same scenarios (Lang, 2014). The commentary also provides little

guidance on the difference between several principal purposes and one principal purpose and an ancillary purpose (De Broe & Luts, 2015). The OECD Final Report on Action 6 provides an example of when a collective investment vehicle will be deemed to pass the principal purpose test (OECD, 2015(a). This test is replicated in the OECD commentary (OECD, 2017(b). In that example, a CIV established in State R invests in entities resident in state S. State R has an extensive treaty network and there exists a tax treaty between state R and state S which guarantees reduced withholding tax rates. The majority of investors in the CIV are resident in state R and only 15% of its investments are in sate S. The CIV also pays taxes in state R on income not distributed during the year.

Plowgain in analyzing this example highlights that while some form of guidance exists as to when the principal purpose test would apply, the example would only apply to a narrow set of circumstances. First a majority of the investors in the CIV would need to be resident in the same state as the CIV. This is problematic for a variety of reasons; first because CIVs will usually have investors resident form several jurisdictions and second; because even if this were the case it would be difficult to prove the residence of the CIV investors. This requirement that the state of residence of the investors in the CIV be identified proves particularly difficult because direct holdings in the CIV form the minority of CIV investments as interests in CIVS are mostly held through one or more intermediaries such as brokers, banks and financial intermediaries. The CIV itself may hold securities through one or more layers of intermediaries. This is problematic because the interests held through intermediaries are often registered on the books of the CIV in the name of the intermediary because intermediaries deem the identity of the CIV as valuable competitive information. Additionally, this makes it easier to aggregate purchases and sales of interests so that a net purchase or sell is effected in the intermediary's account (Plowgian, Riccardi & Mueller, 2017).

The next issue with the example is that it requires CIVs with only a small minority of investment portfolio to be in companies resident in state S. CIVs with a mandate to invest in a particular jurisdiction are therefore excluded. (Plowgian, Riccardi & Mueller, 2017). Few CIVS would therefore be able to meet the conditions set out in this test and where they to meet the test, they would do so with significant difficulty. From the above it is clear that the new PPT has the potential to restrict the granting of treaty benefits to CIVs based in Mauritius.

5.3 The Impact of BEPS Action 5 on Countering Harmful Tax Practices More Effectively, considering Transparency and Substance

Whilst the final report on BEPS action 5 on countering harmful tax practices was completed in October 2015, the FHTP has revamped its work on harmful tax competition which begun in 1998 when the OECD published its report on Harmful

Tax Competition. The importance of this work and its relevance to the international tax landscape has resulted in the inclusion of this theme in the *Action Plan on Base Erosion and Profit Shifting, OECD, 2013* which was approved by the Committee on Fiscal Affairs (CFA) in June 2013 and endorsed by the G20 Finance Ministers and G20 leaders in July 2013 and September 2013 respectively.

Action 5 in particular tasked the FHTP to revamp the work on harmful tax practices by improving transparency, ensuring the spontaneous and compulsory exchange on rulings related to preferential regimes and introducing a substance requirement for preferential tax regimes (OECD, 2013). The report particularly highlighted the fact that the rules at that time worked well within a domestic or a bilateral setting but however fell short where third countries were involved. It further aimed to ensure that income was allocated to jurisdictions where the economic activity that generated that income took place. In accordance with its objectives, the FHTP has focused on coming up with new substantial activity requirements for preferential regimes and spontaneous exchange of rulings related to preferential regimes.

As earlier stated, Action 5 of the BEPS Action plan required the FHTP to revisit and revise the work it had done on harmful tax regimes. This resulted in the development of the substantial activity requirement as set out in the 2014 Progress Report (OECD, 2014) as restated and developed in the 2015 report (OECD, 2015 (c). The substantial activity requirement built on the 8th other factor in the 1998 report and has now been given more importance in determining whether a preferential regime is harmful. Although a there are clear rules determining the determination of the type of activity that relates to IP and non-IP regimes this discussion will focus on the treatment of non-IP regimes.

As it concerns the substantial activity requirement for non-IP regimes, the preferential regime must only grant benefits to taxpayers who undertook significant income-generating activities within the jurisdiction (OECD, 2015 (c). There must be a link between the revenue subject to the preferential regime and the activities carried out to generate such revenue. The definition of what core income generating activities are is set out in the 2015 report. The FHTP after considering a number of suggestions settled on the “nexus approach” which requires substantial activity to be carried out in a jurisdiction before an entity can benefit from a preferential tax regime in that jurisdiction. The approach uses expenditure incurred as a proxy for economic activity (OECD, 2015 (c). It should be noted however that this nexus approach was developed in the context of IP regimes although it has been applied to non-IP regimes. The FHTP’s work as it concerns the substance requirement involved the review of both IP and non-IP preferential regimes following which the relevant countries were given the opportunity to amend the relevant features of their regimes. The FHTP’s work is meant to extend beyond the review of preferential regimes within the OECD as it is meant to also review preferential

regimes in third countries as well.

The Action 5 Report is one of the four BEPS minimum standards and required all members of the Inclusive Framework to commit to implementing Action 5. This involved the assessment of preferential tax regimes, the peer review of the transparency framework and finally the review of the substantial activities requirements. Although the FHTP in its 1998 report had considered the application of the substantial activity requirement to non-IP preferential regimes a more detailed consideration of how those requirements would apply was considered in Resumption of application of substantial activities factor to no or only nominal tax jurisdictions (OECD, 2018).

Jurisdictions with no or only nominal tax jurisdictions were required to define the core income generating activities for each business; to ensure core income generating activities were undertaken; to require entities to have an adequate number of employees to undertake activities; and to have a transparent mechanism to monitor compliance. In compliance with BEPS Action 5, Mauritius overhauled its regime by introducing the new substance requirements discussed in section 5 according to which core income generating activities must be carried out in Mauritius before entities can qualify for the partial exemption regime. In addition, there must be a minimum annual expenditure of USD 25,000 for a CIV in Mauritius and USD 30,000 for a fund manager. There must also be a minimum number of employees in Mauritius i.e. 1 employee for a fund and 3 employees for a fund manager.

While the partial exemption regime has been reviewed to include the need for substance requirements to be met and the Global Business regime, the deemed foreign tax credit has simply been replaced with a partial exemption regime. This has been noted by the Code of Conduct Group (Business Taxation) of the European Union which has been publishing blacklists since 2017(Council of the European Union, 2019). It should however be noted that the Code of Conduct Group did not recommend Mauritius for inclusion in the EU list of non-cooperative jurisdictions for tax purposes as it had not failed any of the EUs other criteria in 2019 (The EU list of non-cooperative jurisdictions for tax purposes, 2019). While Mauritius has committed to the EU that it would amend its new regime by the end of 2019, this did not take place. It should however be noted that Mauritius has continued to commit to overhauling its regime and has never featured on the EU blacklists. The question of its commitment to true lasting change therefore arises. With that being said, the CIV regime will undoubtedly have to change as a result of these new substance requirements will mean that actual fund management activity will need to take place in Mauritius.

In addition to the FHTPs work on substance requirements, it is also mandated to

monitor and review work on the spontaneous exchange of information on rulings. The review is meant to cover the scope of rulings as well as the information provided by tax administrators to assist with the identification of BEPS risks. Mauritius is deemed to be compliant, having met all the Terms of Reference of the review. This aspect of the Action point has therefore had an impact on the taxation of CIVs in Mauritius in that any undertaking given by the Mauritius Revenue Authority to a taxpayer must be spontaneously exchanged. This will reduce opportunities for the use tax avoidance and other BEPS related risks as there will be visibility over the tax treatment of CIVs.

5.4 The OECD's work on BEPS Action 13 on Country-by-Country reporting

Multinational entity (MNE) groups have often used tax havens as a destination for the location of corporate headquarters and holding companies because of their low effective tax rate and extensive DTA network. These structures have historically been used to shift profits from other jurisdictions through abusive transfer pricing.. This is achieved by the manipulation of the transfer price of intragroup services whereby these services are deemed to be provided by the MNE Hold Cos located in the tax haven to the MNEs located in a high tax jurisdiction, where real economic activity is carried out, at a high price. As these are booked as deductible in the subsidiaries, profits are shifted to the low tax jurisdiction and subsequently taxed at a lower tax rate. This has the net effect of reducing the overall tax bill of the MNE group.

Other ways of using such abusive transfer pricing involve the use of high interest loans provided by members of the MNE group located in tax havens to thinly capitalized affiliates located in high tax jurisdictions. These highly leveraged subsidiaries shift profits by achieving significant disallowance of intercompany debt. Alternatively, the same effect can be achieved through the housing of intellectual property in the tax haven and the subsequent licensing of them to affiliates located in high tax jurisdictions that make significant payments of royalties and licensing fees. While the above practices apply to MNE groups generally the same principles will apply to CIVs structured as MNE groups. For the remainder of this part, the effect of the transfer pricing rules will be considered from the perspective of CIVs structured as such.

In Mauritius, there is evidence that such abusive transfer pricing has been used by MNE groups despite the fact that little or no economic activity is carried out. Action Aid has for example exposed the use of the Mauritius OFC to shift profits from Southern Africa by the British sugar giant Associated British Foods group through the use of significant purchasing and management fees as well as high interest rates on intragroup loans (Action Aid, 2013). A similar practice has been documented by Finance Uncovered according to which as much as 55% of the management and

technical fees paid by subsidiaries in Ghana, Nigeria and Uganda were paid to a Mauritius holding company (Hold Co) (Finance Uncovered, 2015). The International Consortium of Investigative Journalists (ICIJ) has also documented the prevalence of this practice. By inflating expenses and fees paid to companies with their home office located in Mauritius, multinational entities have shifted income out of developing countries and reduced their taxable income. The ICIJ for example showed that the private equity fund known as Pegasus Capital Advisors bought Six Senses, a luxury spa and hotel brand with 30 operations in more than four continents, used an entity based in Mauritius known as Sustainable Luxury Mauritius Ltd as a place to locate the management headquarters of its new investment. Despite the fact that the company had no employees, it received management income for the use of the Six Senses logo around the world (Fitzgibon, 2019).

While the OECD advocates for the use of the arm's length principle to curb such practices both in the Model Tax Convention and the OECD Transfer Pricing Guidelines, the practice continues to be a major cause of BEPS due to the difficulty with implementing the guidelines. This is particularly the case for developing countries which lack administrative capacity when it comes to transfer pricing. In Mauritius, the problem is compounded by the fact that there is no transfer pricing legislation. The arm's length principle is briefly acknowledged as a standard applicable in Mauritius in section 75 of the Mauritius Income Tax Act, 1995. In addition, Article 9 in Mauritius Double Tax Agreements replicates the OECDs arm's length standard. Aside from this there is no legislative framework surrounding transfer pricing in Mauritius and the status of the OECD Transfer Pricing (TP) Guidelines remains ambiguous (Beebeejaum, 2019). It is therefore doubtful that the work the OECD has done in revising the TP guidelines as part of BEPS Action 8-10 will have any meaningful effect in Mauritius. As such, they will not be considered further in this article. The OECD's work under BEPS action 13 on Country-by Country (CbC) reporting will however have an impact, albeit limited, as will be discussed below.

Under BEPS Action 13 one of the key objectives is that profits must be reported where economic activities that generate them are carried out and where value is created (OECD, 2015 (b). The Action Plan created revised standards for transfer pricing documentation and a new template for reporting of income. The new standard requires greater transparency on the global income allocation, economic activity and taxes paid by Multinational Entities Groups and significantly changes transfer pricing documentation requirements. The BEPS Action plan requires MNE Groups with consolidated global revenue of EUR 750 million and above to report on tax paid, capital, accumulated earnings, number of employees, tangible assets and main business activities in their country of residence. In January 2017, Mauritius signed the Multilateral Competent Authority Agreement on the

Exchange of Country-by Country Reports (CbC MCAA). By signing that agreement, Mauritius agreed to bilaterally and automatically exchange CbC reports with other signatories. In line with that agreement, Mauritius passed the Income Tax (Country-by-Country Reporting) Regulations 2018 (hereinafter referred to as "Regulations") on 22 February 2018. CbC reports will therefore be required by entities with their Ultimate Parent Entity or Surrogate Parent Entity in Mauritius. Information obtained through CbC reports will be used by the Mauritius Revenue Authority during transfer pricing audits for the assessment of BEPS related risks.

The CbC reports are important because they firstly give taxing authorities visibility over how income is allocated by MNEs and taxed across the jurisdictions in which they operate and secondly, they allow taxing authorities to determine how MNEs intercompany transfer pricing should be audited (Brennan, 2014). Given that there is currently no legal requirement to prepare transfer pricing documentation, the requirement to provide CbC reports will have a significant impact on MNEs that meet the requisite threshold. This is because it will be easier to have an overview of where real economic activity is being carried out and subsequently interrogate the use of abusive transfer pricing to shift profits. This may also assist treaty partners who invoke the mutual assistance procedure because at present transfer pricing abuses fail detection in Mauritius as the government lacks the resources, capacity and the legal framework to allow it to detect fixing of prices between related parties (Beebeejaum, 2017). The requirement to keep some form of TP documentation may have a significantly positive effect as it has been shown that the implementation of transfer pricing documentation requirements has been found to reduce profit shifting by around 50 per cent on average (Beebeejaum, 2019).

It should be noted however that developing countries have largely opted to not be signatories of the CbC MCAA. As a result, the mechanism that will allow them to access the CbC reports, is the exchange of information mechanism. This will however only be possible where those countries have legislation in place requiring the MNE parents that meet the threshold to keep CbC reports; exchange of information mechanisms exist (including being a member of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, tax treaties or Tax Information Exchange Agreements (TIEAs) incorporating exchange of information); protocols must exist to allow for exchange of CbC reports under exchange of information agreements; and those countries have domestic legislation or guidance containing the 'appropriate use' condition on how CbC reports should be used. Given the extensive requirements to benefit from CbC reporting, these requirements have largely not been met by most developing countries. In any case, the threshold turnover is too high to capture most funds structured as MNE groups. As a result, the BEPS changes to the transfer pricing documentation requirements may not easily be met and the changes may only have effect in a limited number of cases. As a result, without the existence of any legal requirement for the

maintaining of transfer pricing documentation, Mauritius may continue to be a destination that is used for abusive transfer pricing given its status as a tax haven.

6. CONCLUSION AND RECOMMENDATION

From the above, it is clear that Mauritius tax treaties have been the subject of abuse and different jurisdictions are alive to this fact. Whilst several jurisdictions have renegotiated or are in the process of renegotiating their tax treaties, the process is a long and difficult one and entities have continued to try to benefit from the use of Mauritius as a low tax jurisdiction as afforded by the global business regime. The amendments made to the global business regime brought about by the BEPS project will require CIVs operating in Mauritius to perform some economic activity in Mauritius. Whilst these provisions will require fund management activity to be actually carried out in Mauritius and discourage the use of conduits the thresholds for the amount of expenditure carried out remain significantly low. Additionally, only one employee will be required to be based in the country. As a result, CIVs will be required to do very little in order to benefit from the global business regime. From a developing country perspective, this will mean that the destination could still easily be used for treaty shopping with the resultant abuse of the bilateral nature of tax treaties. Higher thresholds should be required for the meeting of the substantial activity requirement for any meaningful impact to be made.

Whilst the PPT introduced by the OECD may in principle curb abusive tax practices, its application will be left to jurisdictions that may interpret it differently. This may have no new effect in Mauritius it had a domestic anti-abuse provision in its Income Tax Act, 1995 that was framed in the same way as the PPT (See Section 90 Income Tax Act, 1995). It would therefore be recommended that a SAAR be implemented that would require a specified percentage of owners of CIVs to be based in Mauritius before they can benefit from tax treaties. Finally, although the imposition of the CbC reporting requirements has the potential to reduce instances of abusive transfer pricing, this will have limited application for the CIV industry as the thresholds for an MNE group to be required to file CbC reports is particularly high. Additionally, domestic transfer pricing legislation should be enacted with the OECD Transfer Pricing Guidelines being made applicable in order to ensure transfer pricing abuses by CIVs do not continue.

Reinforcing the fact that these changes are largely cosmetic, Mauritius has continued to feature negatively on the international landscape as the ICIJ's investigation that resulted in the Mauritius leaks has shown how Mauritius transformed itself into a tax haven that helps companies avoid paying taxes in Africa, Asia and the Middle East. While the island has marketed itself as the gateway to the Indian ocean, it appears to have strategically positioned itself as a jurisdiction of choice for the routing of investments due to its low tax rates and

wide DTA network. The Mauritius government's response has been to simply deny all allegations and indicate that it has overhauled its tax regime and as such the information in the leaks is obsolete. This however does not signify any real commitment to long lasting change and at present the Global Business regime continues to reinforce Mauritius status as an OFC. However, if the BEPS minimum standards are properly applied, the Mauritian economy has a real chance at developing its fund management industry. Given the fact that GBLs will continue to enjoy reduced tax rates under an extensive DTA network, Mauritius will continue to be the destination of choice for investors looking towards investment in Africa despite the new more stringent domestic anti-abuse provisions.

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