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Global Tax Alert

Mauritius enacts changes to tax regime for corporations with global business licenses

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Executive summary

On 9 August 2018, the Finance (Miscellaneous Provisions) Bill was approved by the Mauritian Parliament. It is important to note that there was no debate subsequent to the issue of the said Bill so that it was assented without any amendments. As background, the Bill addressed changes that were summarized in the EY Global Tax Alert, *Mauritius proposes changes to tax regime for corporations with global business licenses and banking institutions*, dated 5 July 2018.

The changes under the *Income Tax Act* (the Act) take into account Action 5 of the Organisation for Economic Co-operation and Development (OECD)/G20 Base Erosion and Profit Shifting (BEPS) Project on Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance. The regulatory aspects of entities engaged in cross-border transactions have also been substantially reviewed. The exemptions highlighted in this Alert apply to all Mauritian resident companies as one regime will apply to all Mauritian resident companies. At the same time most of the exemptions depend on the level of substance of the relevant company.

It is important to note that a consultation process is in place and further changes may be made in the coming months to ensure that the new regime does not have any unintended consequences, particularly from a business perspective.

Building a better working world

It is anticipated that the Government will consider revisiting the changes that impact the use of Mauritian entities that are respected by foreign tax laws and are in compliance with the OECD/G20 BEPS Project. In particular, the denial of a foreign tax credit (FTC) to domestic companies implies that a Mauritian resident company will have to bear an additional cost of 2% on its taxable profits, even though such profits have been taxed at a rate higher than 17% in one or more foreign countries. It is for this reason that in a number of cross-border transactions, only a domestic company can be used.[1]

Regulations are expected to be issued with respect to the FTC mechanism in view of the fact that the 2018/2019 provided for the repeal of the presumed foreign tax regime.

This Alert summarizes the main changes made by the *Finance (Miscellaneous Provisions) Act 2018* (FMPA 2018) to Global Business corporations.

Detailed discussion

Legal framework

Global Business License

As announced in the 2018/2019 Budget and summarized in the Global Tax Alert issued on 5 July, a single licensing regime will apply as from 1 January 2019 so that the Financial Services Commission (FSC) will no longer issue a Category 1 Global Business License (GBL1) or a Category 2 Global Business License (GBL2), as the case may be, under the *Financial Services Act* (FSA).

The new license will be known as a Global Business License (GBL) and will also be mandatory if a foreign controlled company wishes to conduct its business principally outside Mauritius or with such category of persons as may be specified in the FSC Rules.

The holder of the GBL is required to carry out its income generating activities in or from Mauritius though the direct and indirect employment of suitable qualified persons should incur a minimum level of expenditure in accordance with its level of activities. It is mandatory for the holder of a GBL to be administered by a management company.

Currently, the requirement that the entity should conduct its business principally outside of Mauritius is not consistent with the obligation that the core income generating activities should be carried on in Mauritius. Hopefully this will be addressed during the public consultation period.

The FSC is empowered to direct a GBL to cease part or all of its business: it may also instruct the GBL to take any such remedial action it considers relevant where a GBL does not comply with the FSC rules or guidelines.

It is anticipated that the FSC will consult with all the relevant stakeholders in the context of the rules and guidelines insofar as it concerns the amendment made by the FMPA 2018 to the FSA.

Authorized company

An authorized company is a new category of company (intended to replace GBL2). A foreign-owned company is regarded as an "authorized company" where its business is conducted principally outside Mauritius or with such category of persons as may be specified in the FSC rules and its place of effective management (POEM) is outside of Mauritius.

Transitional provisions

License issued on or before 16 October 2017

A valid GBL1 or GBL2 issued to a company on or before 16 October 2017 shall continue to be governed by the FSA through 30 June 2021, before the FMPA 2018 amendments take effect. A company with a GBL1 shall be deemed to hold a GBL after 30 June 2021 while a GBL2 shall lapse on or after 30 June 2021.

License issued after 16 October 2017

A valid GBL1 or GBL2 issued subsequent to 16 October 2017 shall continue to be governed by the FSA through 31 December 2018 before the FMPA 2018 amendments take effect. A company with a GBL1 shall be deemed to be a GBL after 31 December 2018 while a GBL2 shall lapse on 31 December 2018.

Definition of foreign-sourced income

Income from transactions with nonresidents and GBL1 or GBL2 corporations would be considered to be foreign-sourced income through 30 June 2021, when the GBL1 was issued to the company on or before 16 October 2017.

The purpose of this transitional provision cannot be in the context of the presumed foreign tax: this is based on the fact that the presumed foreign tax is expected to terminate on 31 December 2018.

GBL2 issued on or before 16 October 2017

Income of a GBL2 shall continue to be exempt from corporate tax through 30 June 2021. The exemption shall not apply to the following:

a. Income from intellectual property assets acquired from a related party after 16 October 2017
b. Income from intellectual property assets acquired from an unrelated party or such newly created intellectual property assets after 30 June 2018
c. Income from such specific assets acquired or projects started after 31 December 2018

To date a GBL2 company has not been required to submit any tax return. Companies now required to submit a tax return should ensure that they have the appropriate information and documents to be able to compute the portion of the income that is taxable.

The new partial exemption

A partial exemption, applicable to GBL and all other Mauritian resident companies, will be effective from 1 January 2019. The exemption is based on 80% of the relevant income: the following highlights the partial exemption insofar as it applies for foreign dividends, foreign interest, foreign permanent establishments, leasing of aircrafts and ships and the income of certain service providers. With this change, any expenses directly linked with the income would effectively be apportioned.

Practical challenges will arise in the application of the new rules: consider the example of a company that contracts a bank loan to invest in the equity shares of a foreign company. In the first years it may not have any dividend income and will incur interest expense. However, the company does not know if it will apply the partial exemption or tax the dividend income in full and claim the related FTC. A number of permutations exist and it would be useful if a methodology that is fair and above all does not lose sight of the commercial aspects of the transaction can be discussed and agreed with all the stakeholders.

Foreign dividends

The exemption only applies if the dividend has not been allowed in the source jurisdiction and the Mauritian shareholder satisfies the conditions relating to substance as may be prescribed.

Ideally, all foreign dividend income should be exempt so that all dividends are treated at par for Mauritian tax purposes, irrespective of the residence status of the distributing company and the shareholders.

It is hoped that the Mauritius Revenue Authority (MRA) will adopt a practical approach in connection with the condition that the dividend distribution should be treated as a non-allowable deduction in the source country. To date the regulations on the substance requirements have not been issued and we assume that the requirements would cover for all the possible scenarios in terms of the residence of the shareholders and nature of business.

An investment holding company that is wholly owned by Mauritian residents may not legally have any business premises at its disposal and may not have any obligation to defray any expenses it requires for its activities. This does not mean that Board meetings are not held in Mauritius by resident directors who are citizens of Mauritius. It would be unfair to deny the partial exemption in such instances.

Foreign interest

The exemption only applies if the lender is a company and also satisfies the conditions relating to substance requirements.

Like the substance requirements on foreign dividends, the regulations on substance requirements have not yet been issued. Unlike foreign dividends, the tax treatment in the source country is not relevant. With the change in the tax reform for banks, it is not surprising to note that the exemption does not apply to banks. It is hoped that the partial exemption on its own will not pose any risk to the application of any tax treaty, particularly in cases where the right to tax rests with Mauritius only and the interest is fully deductible in the computation of the taxable profits of the borrowing entity. To the extent that the exemption applies to only foreign interest, the tax treatment does not appear to achieve a level playing field.

Permanent establishment situated outside of Mauritius

The exemption also applies to a Mauritian resident company that has a permanent establishment (PE) in a foreign country.

The exemption does not depend on the level of the substance of the Mauritian resident company. The existence of a PE in a foreign company in itself implies that the foreign country has the right to tax the profits attributable to the PE. Business profits that emanate from the foreign presence of a Mauritian resident company that does not give rise to a PE does not appear to qualify for the exemption. It would be useful to understand the information and documents that the MRA would require for the purposes of the exemption.

Income from leasing of ship and aircraft

This exemption applies to income of a company engaged in shipping and aircraft leasing.

The regulations on the level of substance have not yet been prescribed. The substance requirements appear to apply to only the foreign income of the entity. It is assumed that the exemption is in respect of operating leases.

Chartering income of the registered owner of a foreign vessel is still exempt. This exemption is still available if the ship is registered in Mauritius: where the ship is owned by a Mauritian incorporated company, it should **not** be under the control of citizens of Mauritius.

Income of certain service providers

80% of the income from of a collective investment scheme (CIS), closed end fund, CIS manager, CIS administrator, or asset manager, as the case may be, would be exempt. The service provider should be either licensed or approved by the FSC.

Though the law provides that the exemption applies only if the income is foreign sourced, we understand that this will not be a condition: otherwise the exemption would not apply in practice. The conditions on substance have not yet been prescribed. It does appear that the exemption is based on the status of the service provider and not the nature of income of the relevant service provider.

Tax status of an authorized company

An authorized company would be required to submit a tax return to the MRA.

Unlike, a company with a GBL2 under the FSA, the income of an authorized company is not exempt from tax. It would therefore be incorrect to conclude that the authorized company is effectively replacing a company with a GBL2 under the FSA.

Such a company is not considered to be Mauritian tax resident so that its foreign-sourced income would be outside the scope of the Mauritian tax system. Passive foreign income like dividends, interest and royalties would thus not be subject to tax in Mauritius. The country of source will generally have the taxing rights to such income, unless the country in which the POEM of the authorized company is situated has a tax treaty with the source country and the treaty provides for a favorable withholding tax rate. Other conditions may have to be complied with if treaty relief is sought. The country where the POEM is situated may also tax the worldwide income of the company, unless it domestic law provides for a territorial regime.

Its Mauritian-sourced income would be subject to tax at the rate applicable to domestic companies and it is not exempt from Corporate Social Responsibility.

Consider the scenario where an authorized company is engaged in international trading. With the wide definition of export of goods further to the amendment made by section 35(a)(ii) of the FMPA 2018, such an activity is subject to a corporate tax rate of 3%. Thus, the taxable profits would be subject to a tax rate of 5%. Such an activity should also not be within the purview of section 75 of the Act, as the income earning activity is executed outside of Mauritius. The outcome of this scenario remains on the fact that the Mauritian sourced income of any Mauritian incorporated company includes an income earning activity carried outside of Mauritius. Though Mauritius is allowed to tax the income, it does not have the jurisdiction to apply the anti-avoidance section on transactions not at arm's length. This is the subject matter of the tax laws of the country where the seller is based: otherwise Mauritius and the other country would be allowed to adjust the same price. It is not thus surprising that section 75 of the Act only applies where the underlying activity is in Mauritius.

An authorized company is not the subject matter of any of the exemption that is dealt with in the Second Schedule to the Act.

Since it is considered to be a foreign company, any dividend distribution made to a foreign shareholder should also be outside the scope of Mauritius: such dividends should not be considered to be Mauritian-sourced income.

The below summarizes the important tax aspects of an authorized company.

	Relevant jurisdictions		
	Mauritius	Country where POEM is situated	Source country
	Taxing right		
Foreign-sourced income	Outside the scope	May be taxed	May be taxed
Mauritian-sourced income	Generally taxable	May be taxed	Not applicable
Capital gains tax	Outside the scope	May be taxed	May be taxed
Dividend distribution	Outside the scope	May be taxed	Not applicable

Endnote

1. It is important to note that if a GBL company is used, it is considered to be a controlled foreign company (CFC) for example in the country where the parent is tax resident. This is on the basis that once a company that qualifies for one or more incentive in Mauritius is used, it is treated as a CFC. For this reason, in a number of cases use of a domestic company is required as its tax regime applies to all Mauritian residents. Before the FMPA 2018 amendment there was no additional tax cost in Mauritius as a result of the foreign tax incurred. With this change the domestic company is obliged to pay 2% even though it may have already paid 30% on the same income in another country.

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