INTERNATIONAL TAX PLANNING OPPORTUNITIES THROUGH MAURITIUS

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I thank The Offshore Institute and MOBAA for giving me this opportunity to express my thoughts on the subject *"International Tax Planning Opportunities Through Mauritius"*.

We may discuss :

I	Tax planning opportunities that Mauritius offers at present.
II	Challenges posed to such tax planning – Advance Ruling in the matter.
III	Challenges posed to such tax planning – Other issues.
IV	What amendments may be carried out in the Mauritius Income-tax Act so that the challenges can be faced.
V	What care may be taken by the professionals so that their planning may not face problems in future because of these challenges.
Annexure I	Tax planning through a Mauritius Bank.

I Tax planning opportunities that Mauritius offers at present

1. There are several opportunities offered by Mauritius for International Tax Planning. Since this august gathering is expert in International Taxation and Offshore Financial Centers, I am simply listing out the common opportunities. The planning which offers real, complex legal challenges is discussed at length.

1.1 Savings on account of Capital gains and lower rates of tax on dividend are too well known to need any detailed discussions.

1.2 Mauritius companies may hold patents, brand names and rights to intangible properties. These companies may earn royalties and technical know-how fees. Eventually, these companies may become large networth companies helping further investments and short term as well as long term financing of group companies.

1.3 By subscribing to debentures and other loan instruments of the subsidiaries in the industrialised countries, taxation within the industrialised countries can be reduced. However, Indo-Mauritian treaty is disadvantageous & this may be avoided.

1.4 Mauritius offers opportunities for floating banks. Banks within Mauritius may offer loans to subsidiaries. These loans may earn interest within industrialised countries without payment of tax. This is beneficial.

1.5 There are several high net worth individuals whose children have settled in different countries. They may find it more convenient to settle their will-trust & related companies in Mauritius.

1.6 "Offshore" companies & "International" companies can be converted from one category to another. This offers good flexibility of claiming the Double Tax-Avoidance Conventions (DTC) relief when necessary.

1.7 Captive Insurance Companies can be helpful in the overall plans.

1.8 Mauritius has been successful in incorporating "tax sparing" clause in most of its DTCs. This may be helpful in some cases.

1.9 Mauritius can be an ideal offshore center for holding companies. Several groups in Asia and Africa are globalising their business. They want to open up their operations in several countries. They generally require separate companies in each country. Instead of holding all these companies through a high tax country or through a country with foreign exchange restrictions, it may be more flexible and economic to hold all the companies through Mauritius. With its wide network of DTCs, Mauritius can be helpful.

Notes: 1. Treatment of interest (1.3) & (1.4) is explained with an example in the annexure 1. The treaty implications are also given in the annexure. The annexure may be discussed at the conference only if time permits.

2. Having a jurisdiction which has no foreign exchange restrictions and which offers considerable flexibility has its own advantages. These advantages have their own independent value apart from the tax benefit.

Average per capita GDP in India per year is Rs. 14,000/-. The minimum amount of annual income when the earner becomes liable to tax is Rs. 50,000/-. In other words, almost 80% of the people earning less than Rs. 50,000/- have no liability to pay any Income-tax.

Agriculture forms 29% of the GDP. Agricultural income is totally tax free.

Considering both the above exemptions, out of a population of 1 billion, only 15 million people pay Income-tax. Does it mean that the balance 985 million people are not residents of India ?

If an Indian farmer has some income from United Kingdom, can UK refuse to give the DTC relief because the farmer is not liable to tax in India ?

Can it be said that - a person is liable to tax if he is resident of that country by way of domicile, residence etc; there is an Income-tax Act in that country; and if that person earns taxable income he would be liable to pay tax. The fact that he has below taxable income or exempt income does not make him a non-resident of that country.

5.1.1 A contrary view may be - that a person not liable to pay any tax in the current year may be a resident under other laws. He may be entitled to vote, to reside in the country, to do business in the country etc. All other laws may apply. However, for the purpose of DTC, he will not be considered a resident since he is not liable to tax in that country. An Indian farmer may earn interest, dividend and pension from UK. In India, his agricultural income will be tax exempt. However, all the incomes earned from UK will be liable to tax both in India as well as in UK. Hence he can be considered as a resident of India.

In other words, the examples given in 5.1.1 above may not hold ground. The relevant issue is – the income being considered should be liable to double tax for claiming relief. Whether other incomes are taxable or not is not relevant.

5.2.1 India gives tremendous importance to exports. The country is in need of earning more foreign exchange. For this purpose, all kinds of direct and indirect tax reliefs are provided to exporters. All export incomes are exempt from Income-tax in India.

Can it be said that similarly, Mauritius wants to develop an offshore finance centre. It wants to develop investment opportunities. Hence Mauritius does not levy any Income-tax on capital gains.

In both the cases – an exporter in India and an investor in Mauritius – is still resident of his country. The exemption provided for encouraging an activity cannot be held against a person's claim of residence.

5.2.2 The ratio in Cyril Pareira's case is that encouraging exports and offshore investment is fine. However, if there is no double tax, there cannot be a relief under **Double Tax Avoidance** Convention.

5.3 When Mauritius offers a company to elect voluntarily a tax rate of anywhere between 0% to 35%, is it really a tax liability? Does liability mean something compulsory, something irrespective of one's own volition or some payment made voluntarily. Where the statute does not impose a compulsory liability but the person **voluntarily** chooses to pay tax can it be said that "it is a **gift by the person** to the country and not a tax"!

I have a strong belief that some day some court will hold that where a person has voluntarily elected to pay tax, or pay a higher tax, it cannot be said to be "liable to tax".

To avoid the risks involved, it is better to form companies under the new regime where there is a compulsory 15% tax. For all new investments, have new companies. If there are substantial tax liabilities, and if DTC relief is essential, avoid companies which have an option to pay tax.

5.4 It is also possible that some court or even government may consider an automatic foreign tax credit in bad light.

III - Challenges in General

The challenges that may be posed to Indo-Mauritius DTC may be listed as under:

1. There is no **liability** to tax in Mauritius. This is already discussed at length.

2. Using Mauritius amounts to **"Treaty-Shopping"**. There are some clauses specifically drafted to avoid treaty-shopping. Emphasis is laid on "Beneficial Ownership".

   Countries like U.S.A., organisations like OECD & EU are turning more & more against "Treaty Shopping".

3. EU & OECD both have come out with reports on **"Harmful Tax Competition"**. They are taking action on it. There may be a time when DTCs with countries offering harmful tax competition may be reviewed.

4. More & more Governments will be going for **"Transfer Pricing"**, **"Controlled Foreign Companies"** and "Anti-Tax Avoidance" regulations like **"Thin-Capitalisation"** etc.

   A corporate structure made today, in absence of such regulations may be useful today. When the relevant Government wakes up & makes necessary regulations, the structure may not be useful.

IV – Mauritius Statutes

1. Mauritius Income-tax Act & Mauritius Offshore Business Activities Act may be amended to permit a group of entities that have a compulsory tax of **35%**. This will facilitate better utilisation of Under-Lying Tax Credit.

   Note: Rate of 35% is suggested as Mauritian resident companies are chargeable @ 35%. A higher rate cannot be justified.

   Precaution - If non-residents have options to select two kinds of companies – (I) with 15% tax & (ii) with 35% tax; then the 35% tax may face the risk of being labelled as – "voluntary gift to Government". This has to be avoided.

   15% tax rate companies are termed "Tax Incentive Companies" – MIT, First Schedule, Part II.

   Non-Residents may be allowed to form "Ordinary Companies" – Part IV – which bear 35% tax rate. This issue has detailed legal implications.

2. MOBA as well as Mauritius consultants have to **compete** other well established offshore centres.

3. The provisions covering "tax sparing clause" may be expanded to cover the offshore companies. This can be achieved at the stage of negotiating for DTCs.

V – Precautions by Professionals

The best policy at the stage of planning is to avoid speculative litigation. The result of litigation may be uncertain. One can only minimise the risks and proceed.

1. Investors & Professionals may plan the corporate structure & management to give substance to Mauritius base – to the extent possible.

   If there is real management & decision taking in Mauritius, the charge of "treaty shopping" can be avoided.

2. When shareholders in the offshore company are from various countries, a valid reason exists for making a company in an offshore centre. The charge that the company is formed only to avoid taxes can be avoided.

The above two measures may not be possible in many cases.

3. In all cases, it will be advisable to go for some tax. File regular Income-tax returns & obtain tax assessment orders. To a great extent, this may be helpful in establishing "tax residence".

4. All new investments may be made through new companies having a compulsory tax @ 15%. This will go a long way in establishing "liability to tax" , and hence residential status.

5. Consider advantages other than tax savings. If the structure is so planned that the group is reaping these benefits; even if tax benefit is lost for any reasons; the loss would be manageable.

   In fact, there may be situations where claim under DTC is not important. Even "International Companies" may be formed in such cases.

6. What is applicable to Indian Income-tax Act and Indo-Mauritian Treaty may, to a large extent, be applicable to other countries also. One may have to study the relevant provisions and then decide on the precautions to be taken for each country.

Conclusion - Mauritius offers good opportunities for International Tax Planning. A careful & judicious use of the centre can give long term benefits.

I am glad to have offered some of my humble submissions for your consideration.

I sincerely thank all the distinguished faculty members & delegates. I am sure to return richer in knowledge.

Rashmin Sanghvi.

Annexure I

Tax Planning Through a Mauritian Bank

Consider the case of some NRIs investing in a regular manufacturing company in India through Mauritius. How the Indian tax may be reduced by using debt.

Sr.No	**Particulars**	**Rs.** **No Debt.**	**Rs.** **Debt.**
1.	Indian company's profits before tax, interest & dividend	1,000	1,000
2.	Less : Interest on debentures	NIL	300
3.	Less : Interest paid on "External Commercial Borrowing" from a Mauritius Bank.	NIL.	500
4.	**Net Profit.**	**1,000**	**200**
5.	Indian Corporate Income-tax @ 35%	350	70
6.	**Balance available**	**650**	**130**
7.	Distribution tax in Indian U/s. 115-O 10% of dividend. [Figure in (6) / 11]	60	10
8.	Net Dividend payable to Mauritian company.	590	120

9.	Indian Income-tax on debenture interest paid to the Mauritian company. @ 48% (Please see Note No. 1).	-	144
10.	Remittance of net interest to Mauritius (300 – 144)	-	156
11.	Income-tax on interest paid to the Mauritian bank. [Article 11(3)(c)]	-	NIL
12.	Remittance of net interest to the Mauritian Bank.	-	500
13.	Total taxes paid in India. 5 350 70 7 60 10 9 - 144 11 - - ----- ----- Total .. 410 224 === === Saving	410	224 176
14.	Total remittances to Mauritius Dividend 590 120 Debenture Interest NIL 156 Bank Interest NIL 500 ----- ----- 590 776 ----- -----	590	776

Observations:

1. For bank interest, there are two-way savings-

   The Indian company gets deduction of expenditure – Hence it saves corporate tax – 35%.
   The remittance to Mauritius will not be as dividend. Hence the Distribution tax at 10% will not be applicable.

   The receiving bank's interest income will not be taxable because of DTC.

2. In the above example, if debentures are replaced by Mauritius bank loan – further tax of Rs. 144 will be saved (Sl. No.9). Total tax saving can be Rs. 320.

   Precautions: the Mauritian Bank should genuinely be in the business of banking.

There are different restrictions in India on the amounts that can be borrowed. Though there is no rule against “thin capitalisation”.

Notes:

1. Article 11 of the Indo-Mauritian DTC leaves the interest to be taxed at the rates as per source country’s laws. In India, the rate for foreign companies is 48%. While planning corporate financial structure, debentures may be avoided. This example highlights its losses.

2. Dividends declared by an Indian company are free from Income-tax S. 10(33).