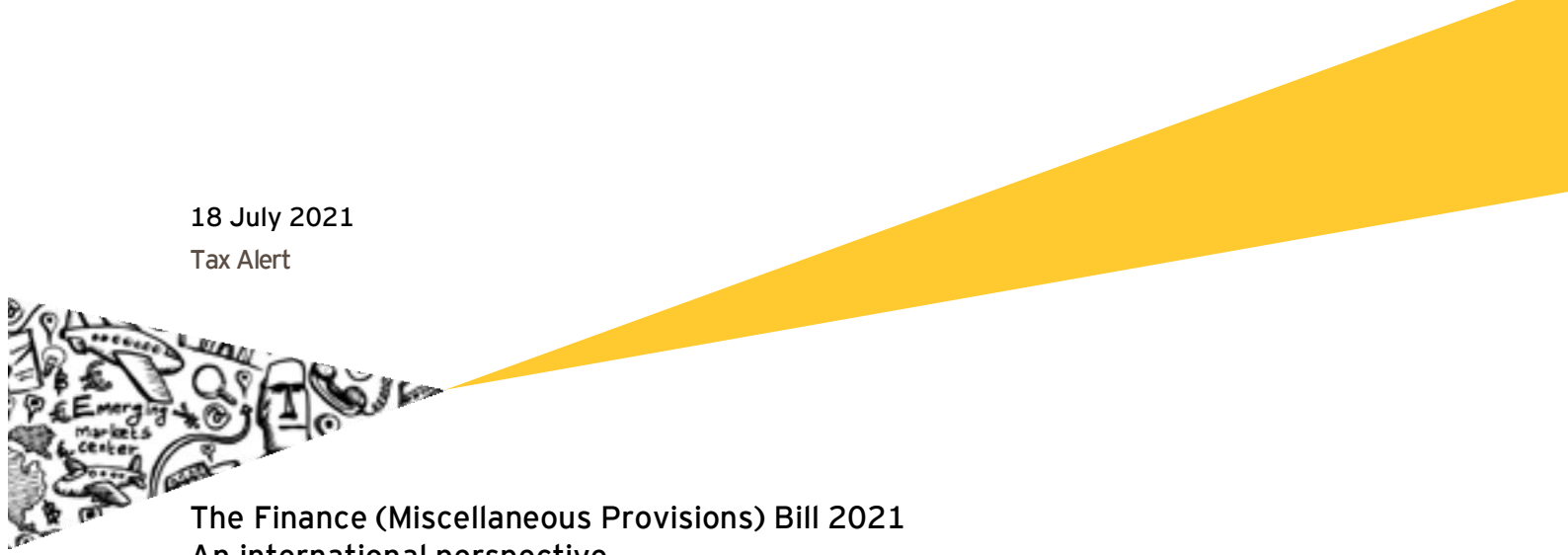


18 July 2021

Tax Alert



The Finance (Miscellaneous Provisions) Bill 2021 An international perspective

The Finance (Miscellaneous Provisions) Bill 2021 (“FMPB 2021”) was made publicly available on Friday 16 July 2021. Many of the fiscal and non-fiscal changes were addressed in the Explanatory Note to the 2021/2022 Budget (“EN 2021/2022”). 93 legislations are being amended and the FMPB 2021 will be the subject matter of the Parliamentary debates as from next week. In this Alert, we highlight certain main changes that should be considered from an international perspective.

Executive summary

- a. The 3% tax rate on export of goods, which includes global trading, will only be available if a company holds an Export Development Certificate (“EDC”). A company that does not have an EDC will thus be taxed at the rate of 15% on the export of goods.
- b. Dividends will only be Mauritian sourced if the company is tax resident in Mauritius. Dividends distributed by a Mauritian incorporated company that is not tax resident in Mauritius will thus not be taxable in Mauritius. Instead the tax aspect of the dividends will be assessed from the country in which the company is tax resident. We believe that a better approach would be to refer to the corporate tax residence of the company only.
- c. The arm’s length is being applied with retrospective effect on non-Mauritian source income. This amendment effectively implies that additional rights are given to Mauritius insofar as the application of the arm’s length principle is concerned. If the amendment is maintained, Government should provide further clarity on its scope and practical application. Otherwise, it will have unintended tax consequences that may lead to double taxation that may not be relieved.
- d. Foundations and trusts will be taxed in the same manner as companies. The proposed change seeks to put all forms all entities at par so that foundations and trusts are treated in the same manner as limited liability companies.

Detailed analysis

Tax rate on export of goods

Export of goods is currently subject to tax at the rate of 3%. Section 38(g) of the FMPB 2021 effectively provides that the 3% tax rate will only apply if the company holds an Export Development Certificate (“EDC”) issued by the Economic Development Board (“EDB”). This amendment was not announced in the 2021/2022 Budget and was also not dealt with in the EN 2021/2022. Section 22 of the FMPB 2021 will also amend the Economic Board Act so that the EDB will be able to issue an EDC.

Regulations and guidelines will be issued in the context of the Economic Development Scheme, pursuant to which the EDC will be issued. We will have to wait for the relevant regulations and

guidelines to be able to assess the impact of this change on companies that are currently engaged in the export of goods.

Sourcing principle on dividend distribution

Dividends will be Mauritian sourced income if the company is tax resident in Mauritius as from the year of assessment 2022/2023. We welcome this measure as it corrects an anomaly in the Income Tax Act (the "Act") and we are also pleased to note that the change is not being implemented in accordance with paragraph C.26(c) of the EN 2021/2022 where it was provided that dividend paid by a non-resident to another non-resident is not taxable in Mauritius.

Under section 38(s) of the FMPB 2021, the dividend income distributed by a foreign incorporated company that is tax resident in Mauritius may be considered to foreign source income on the basis that section 74(1)(f) of the Act will still refer to investment in shares. Where the company is tax resident in a country with which Mauritius has a tax treaty, any conflict may be resolved through the relevant tax treaty.

We feel that a better approach would be to treat any dividend as Mauritian source income once the company is tax resident in Mauritius. This will also be consistent with the manner underlying foreign tax credit is computed whereby the Foreign Tax Credit Regulations refer to only the residence of the company.

Arm's length test

In paragraph A.14 (iv) of the EN 2021/2022, it is provided that the arm's length test in the Act for domestic companies shall equally apply to Global Business Companies.

We have already explained in our 2021/2022 Budget Alert that there is no need to change section 75 of the Act as it does apply to both a domestic company and a company that holds a Global Business Licence under the Financial Services Act.

As the law currently stands, section 75 of the Act only applies if there is a business or other income generating activity in Mauritius. Therefore, it can only apply to the Mauritian source income of the person. Theoretically, the Mauritius Revenue Authority ("MRA") may adjust: (a) the gross taxable income; (b) the allowable expense; or (c) both the gross taxable income and the allowable expense.

To a large extent, section 75 of the Act is analogous to Article 9 of the Organisation for Economic and Co-operation and Development ("OECD") Model Tax Convention ("MTC"). However, Article 9 of the OECD MTC provides the possibility for a corresponding adjustment to address any risk of economic double taxation, whereas section 75 of the Act does not have any such similar clause.

The residence status of the person is not relevant, and the MRA is empowered to adjust the taxable profit of the person based on the arm's length principle. Having a business or other income earning activity in Mauritius generally implies that a foreign company is already registered in Mauritius as a foreign company under Part XXII of the Companies Act and the Business Registration Act.

Section 75 of the Act is an anti-avoidance measure that seeks to protect the tax base of Mauritius and is consistent with the main thrust of the OECD/G20 Base Erosion and Profit Shifting Project that seeks to align taxing rights with economic activities and value creation. In its current form, section 75 of the Act applies to the taxable profits of the business or other income generating activities in Mauritius.

We presume that section 38(s) of the FMPBA 2021 is the implementation measure insofar as paragraph A. 14(IV) of the EN 2021/2022 is concerned. Section 38(s) provides that the words "or from Mauritius" should be inserted after the words "in Mauritius" wherever they appear. If we

consider section 75 (1)(a) of the Act for example, the current sub-section and the sub-section with the proposed amendment is as follows:

Current

(1) *This section shall apply to any case where-*

(a) *any business or other income earning activity carried on in Mauritius-*

With FMPB 2021

(1) *This section shall apply to any case where-*

(b) *any business or other income earning activity carried on in Mauritius **or from Mauritius-***

With the proposed amendment under section 38(s) of the FMPBA 2021, section 75 of the Act may apply to income that is not connected to any business or other income earning activity in Mauritius, unless the phrase "or from Mauritius" is linked to any business or other income earning activity in which case the proposed amendment does not have its *raison d'être*. This therefore means that it will apply to cases where the business or income earning activity is outside of Mauritius.

Most countries have an anti-avoidance clause modelled on same premise as section 75 of the Act so that both the MRA and the foreign country may adjust the taxable profits of an activity a Mauritian resident has outside of Mauritius with the proposed amendment. Furthermore, it is the country where the underlying activity is performed that is in a better position to assess the arm's length principle though it may seek the assistance of Mauritius as the country of residence. With the proposed amendment, both the country of source and Mauritius may seek to apply the arm's length test on same profits. This will give rise to economic double taxation that will be unrelieved and is incompatible with basic international taxing principles.

We note that section 38(s)(ii) provides that the amendment under section 38(s)(i) is effective as from the commencement of the Act. The amendment is thus made with retrospective effective and has broader consequences and its legitimacy may well be challenged.

The Act repealed the Income Tax Act 1974 ("ITA 1974"). Sections 43 (1) and (2) of the ITA 1974 were similar to section 75(1) and (2) of the Act, except that section 75 of the Act is classified under the "International aspects of income tax" and section 75(3) of the Act empowers the Minister to issue regulations for the purposes of section 75 of the Act.

We are hoping that section 38(s) of the FMPB 2021 is not enacted in its entirety.

Foundations and trusts

Foundations and trusts would no longer be able to submit declaration of non-residence under sections 49A(3) and 46(3) of the Act respectively. To the extent that a trust and a foundation are both considered to be a company under section 2 of the Act, the exemptions applicable to companies, for example on foreign dividend and interest, should be available to a foundation and a trust, as the case may be.

A foundation and a trust are also not subject to Corporate Social Responsibility. Transitional provisions have been introduced so that the exemption may apply up to the year of assessment 2024/2025 where the foundation or the trust, as the case may be, has been set up before 30 June 2021.

Foundations and trusts are not conceptually the same as limited companies and it is hoped that this will be understood in the application of the Act by the MRA insofar as certain other areas are concerned. For example, the concept of retained earnings does not exist for a trust so that the definition of dividends in section 2 of the Act does not apply to a trust, irrespective of the fact that the distribution made by a trust is considered to be a dividend under sections 2 and 46(4) of the Act.

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