20 March 2019

Global Tax Alert

Mauritius: Examination of the application of the BEPS MLI

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Executive summary

Mauritius signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the MLI) on 5 July 2017; 76 countries had already signed the MLI on 7 June 2017. At the time of signature, Mauritius submitted a list of 23 tax treaties entered into by Mauritius and other jurisdictions that Mauritius would like to designate as Covered Tax Agreements (CTAs), i.e., tax treaties to be amended through the MLI. Together with the list of CTAs, Mauritius also submitted a provisional list of reservations and notifications (MLI positions) in respect of the various provisions of the MLI. On 10 October 2018, a revised version of the provisional MLI positions was submitted to the Organisation for Economic Co-operation and Development (OECD) Secretariat.

An updated version of the OECD Model Tax Convention on Income and Capital (2017 OECD MTC) was released in November 2017. The 2017 OECD MTC includes significant changes that are the direct result of the OECD/G20 BEPS Project.

One of the underlying objectives of the MLI is to implement the tax treaty changes without the need to conduct bilateral negotiations. This Alert summarizes the practical applications and implications of the MLI for Mauritius, with particular emphasis on treaty abuse.

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Detailed discussion

Application of MLI

The application of the MLI requires a number of steps. To support understanding, the OECD published a step-by-step overview and a flowchart on the application of the MLI. An Explanatory Statement (ES) to the MLI is also available.

Paragraphs 13 to 20 of the ES assist in the approach taken in the MLI, the key features of which are summarized below:

- The MLI does not function in the same way as a protocol to a bilateral tax treaty
- The MLI should enable any jurisdiction to implement the treaty-minimum standards on the prevention of treaty abuse and the improvement of dispute resolution
- Given that the minimum standards can be implemented in various ways, the MLI is deliberately flexible to enable countries to accommodate the positions of different countries, while remaining consistent with its purpose
- Flexibility is also required for the MLI provisions that do not reflect minimum standards

The OECD also issued a guidance note on 14 November 2018 to clarify the entry into effect rules for tax treaties of jurisdictions that deposited their ratification instruments.[1]

The MLI is in force on the first day of the month following the expiration of a period of three calendar months from the date of deposit of the fifth instrument of ratification, acceptance or approval (the three months period starts counting from the date of the fifth instrument of ratification, acceptance or approval). For example, Austria deposited its instrument of ratification with the OECD on 22 September 2017 and it was the first jurisdiction to do so. However, it was only when Slovenia (the fifth jurisdiction) deposited its instrument of ratification on 22 March 2018 that the three-month period started counting. Following the fifth deposit, the MLI entered into force on 1 July 2018.

For each signatory ratifying the MLI after the deposit of the fifth instrument of ratification, the MLI enters into force on the first day of the month following the expiration of a period of three-calendar months beginning on the date of the deposit by such signatory of its instrument of ratification with the OECD. For example, Australia deposited its instrument of ratification with the OECD on 26 September 2018: therefore The MLI entered into force for Australia on 1 January 2019.

The MLI is still not in force for Mauritius, as it has not completed its internal procedures to ratify the MLI. Once Mauritius has completed all the required domestic procedures, Mauritius will be able to deposit the instrument of ratification with the OECD.

Once the MLI is in force, its relevance in the context of a tax treaty with Mauritius depends on a number of factors: first of all, the MLI must have been signed by the other Contracting State. If the other country is not a signatory to the MLI, it will not apply.

Secondly, the fact that the other country is a signatory to the MLI is not alone sufficient for the MLI to apply. The MLI must be in force in both Contracting States. For example, the MLI is in force for the United Kingdom (UK) from 1 October 2018, but the MLI is not yet in force for Mauritius. Therefore, the MLI does not have effect on the UK/Mauritius tax treaty.

Thirdly, even when the MLI is in force for both Contracting States, for the MLI to have an effect on a tax treaty, the tax treaty must be a Covered Tax Agreement (CTA). For a treaty to be a CTA it is necessary that both Contracting States list the respective tax treaty as a CTA in their MLI positions. As per the current preliminary MLI positions of Mauritius, Mauritius did not list the tax treaties with Cabo Verde and India as a CTA. Therefore, the MLI would not apply to the India/Mauritius and Cabo Verde/Mauritius tax treaties. On the same principle, Tunisia did not list the tax treaty with Mauritius as a CTA, and therefore the MLI also would not apply to the tax treaty Mauritius has with Tunisia.

If the MLI applies to a treaty, it is then necessary to match the two countries' MLI positions to determine which MLI provisions will be applicable. As a general rule, a provision of the MLI will be applicable if both Contracting States have taken the same positions with respect to a provision. Mauritius provided a list of preliminary reservations and notifications at the time it signed the MLI, and in October 2018 submitted a revised version of its preliminary MLI positions.

For example, Mauritius reserved its right not to apply Article 8 on Dividend Transfer Transactions to its CTAs. This Article provides that there is a minimum holding period of 365 days for the treaty to apply. Under Article 8(3), a country may reserve the right for the entirety of Article 8 to apply. The reservations are listed in Article 28(1) of the MLI: Article 28(1)(f) of the MLI confirms the reservation on Article 8 of the MLI. Article 28 (3)(b) provides that a reservation made under Article 28(1) and (2) modifies those provisions to the same extent for the other party in its relations with the other party. The reservation is thus applied on a consistent basis by the two States. Taking the example of the minimum period on dividend transfer transactions, it cannot be applied by Mauritius on any dividends paid by a Mauritian resident company. Likewise, the other Contracting State is not allowed to apply the minimum period even though it has not expressed any reservation.

It is irrelevant if the other country has not expressed any reservation, except in cases where the MLI allows an asymmetrical application of the MLI.

Treaty abuse

Certain existing tax treaties already have anti-abuse rules: such rules take a number of forms. The rules, some of which are considered below, may continue to be applicable irrespective of the MLI.

Anti-abuse rule in current tax treaties

Article 11(8) of the UK/Mauritius tax treaty (UK Mauritius DTA) provides that the treaty does not apply if the debt-claim in respect of which the interest is paid was created or assigned mainly for the purpose of taking advantage of the Article on interest and not for bona fide commercial reasons. Article 11(8) of the UK Mauritius DTA may only apply if the main purpose of a transaction is a treaty benefit: the UK MLI positions advised that Article 11(8) is within the scope of the Principal Purpose Test (PPT), while Mauritius did not in the preliminary positions it submitted in October 2018. This results in a mismatch at the level of the notifications provided by Mauritius and the UK on the application of the PPT. Though not yet in force, the Protocol to the Nigeria/Mauritius tax treaty has a similar clause that denies treaty relief on interest, dividends and royalties. Here also there is a mismatch in the position taken by Nigeria and Mauritius on the MLI. Article 23 of the UK Mauritius DTA further provides that the treaty does not apply where income is taxable on a remittance basis in the country of residence. For example, the foreign income of a Mauritian resident is taxable on a remittance basis in Mauritius. Where the foreign income is not remitted to Mauritius, the income is not subject to tax in Mauritius. If it is assumed that the foreign income is UK sourced, no relief under the UK Mauritius DTA will apply if the income is not taxable in Mauritius.

Article 26 of the tax treaty with Sweden has a Limitation of Benefit (LOB) clause that applies, where a company has income primarily from certain activities and such income bears a significantly lower tax under the laws of the State of residence than income from activities carried on within that State.

The LOB seeks to deny treaty benefits on the income of the company and the dividends paid by such a company. The activities that are the subject matter of the LOB are as follows:

- Financial services or shipping
- Headquarters, coordination center or similar entity providing administrative services or other support to a group of companies which carry on business in other States

The Protocol to the Luxembourg tax treaty provides that a Mauritian resident company is not considered to be tax resident in Mauritius for treaty purposes if the company is not liable to tax in Mauritius at a rate of 15% computed in accordance with the Luxembourg income tax laws. Treaty relief is therefore wholly dependent on the Luxembourg income tax laws.

Action 6 of the OECD/G20 BEPS Project identifies treaty shopping as an important concern and provides that treaty abuse should be addressed in one of the following ways:

- A PPT alone
- A PPT and a Simplified LOB provision
- A detailed LOB provision, supplemented by specific rules targeting conduit financing arrangements

In the context of bilateral negotiation, paragraph 90 of the ES provides the following:

Because a PPT is the only approach that can satisfy the minimum standard on its own, it is presented as the default option in paragraph 1. Parties are then permitted pursuant to paragraph 6 to supplement the PPT by choosing to apply a simplified LOB provision. Given that the detailed LOB provision requires substantial bilateral customisation, which would be challenging in the context of a multilateral instrument, the Convention does not include a detailed LOB provision. Instead, Parties that prefer to address treaty abuse by adopting a detailed LOB provision are permitted to opt out of the PPT and agree instead to endeavour to reach bilateral agreement to satisfy the minimum standard. Also, given that Parties preferring a detailed LOB provision may accept the PPT in paragraph 1 as an interim measure, paragraph 17(a) allows such Parties to express the intent in the notification under that paragraph.

The preliminary MLI positions of Mauritius include a statement that the PPT is accepted as an interim measure and it intends to adopt an LOB provision though bilateral negotiation.

A foreign controlled company is not considered to be eligible for treaty benefits unless it carried on an active business in Mauritius under the simplified LOB provision. The challenge for the Mauritian Government through any customized negotiation is the inclusion of genuine holding companies that are autonomous and with the appropriate level of economic substance, consistent with their level of activities as an "active conduct of business." Put another way, if the Mauritian Government adopts the "active conduct of business" concept used in the Simplified LOB provision of the MLI, holding companies established in Mauritius would not qualify for treaty relief. Considering the wide use of Mauritian incorporated entities for tax and non-tax reasons, care is required in any bilateral negotiation so that non-abusive business arrangements are not excluded from the purview of a tax treaty.

The PPT appears to be the appropriate anti-abuse provision for Mauritius: to ensure predictability with the relevant treaty partner countries, engaging with the policy makers of the relevant Government appears to be a wise approach from the perspective of Mauritius to address its inherent tax risks in view of the fact that this will be dictated by the source jurisdictions. Though it does appear from European case law that genuine holding companies are legitimate for tax purposes, the behavior of non-European countries in the application of the PPT is not known.

Under the Simplified LOB provision, a resident that is not a qualified person is entitled to treaty benefits if the resident is engaged in the active conduct of a business in the State of residence and the income from the treaty partner country is incidental to its active business. For the purposes of the Simplified LOB provision, the MLI provides that the term "active conduct of a business" does not include the following activities or any combinations thereof:

- Operating as a holding company
- Providing overall supervision or administration of a group of companies
- Providing group financing (including cash pooling)
- Making or managing investments, unless these activities are carried on by a bank, insurance company or registered securities dealer in the ordinary course of its business as such

An anti-abuse rule on the same lines as the above is also contained in the new tax treaty signed by Japan and Spain on 16 October 2018 in the application of treaty relief for interest, dividends and royalties In the context of new treaties, paragraph 73 of the 2017 OECD Commentary provides that States may consider that some or all activities listed as active conduct of a business may be included.

Under paragraph 6 of Article 7 of the MLI, the Simplified LOB provision may only apply where all Contracting Jurisdictions have chosen to apply it. However, paragraph 7 of the said Article of the MLI provides that the Simplified LOB provision applies to the benefit under a CTA by all Contracting Jurisdictions if the relevant Contracting Jurisdictions agree to its application by notifying the Depositary. Paragraph 7(b) of the same Article also provides that the Simplified LOB provision may apply by only the jurisdiction that chooses to apply the Simplified LOB provision if all the Contracting Jurisdictions that choose not to apply the Simplified LOB provision agree to such application through a notification to the Depositary. In those circumstances, paragraph 16 of Article 7 of the MLI provides that the Contracting Jurisdictions shall endeavor to reach a mutually satisfactory solution that meets the minimum standard for treaty abuse: this is based on the fact that under Action 6, the Simplified LOB provision has to be adopted with a PPT. Paragraph 103 of the ES expressly provides that where a Contracting Jurisdiction prefers to apply the PPT alone and does not affirmatively agree to the application of the Simplified LOB provision under paragraph 17, then the PPT alone applies.

The MLI executed by the UK and Singapore is already in force: Singapore and the UK have both not adopted the Simplified LOB provision so that only the PPT would apply once the MLI executed by Mauritius is in force.

Under the 2017 OECD MTC, the definition of an active conduct of business runs on the same line as the Simplified LOB provision: this applies to both the simplified and detailed version of the LOB. The Contracting States may include financial institutions similar to banks within the definition of active conduct of a business. In the Mauritian context, this may for example include a non-deposit taking institution under the *Banking Act*. Paragraph 73 of the Commentary to the 2017 OECD MTC confirms further that the activities in question do not qualify for treaty relief: the ultimate sentence does however provides a certain degree of flexibility in defining an active conduct of business.

Corresponding adjustments

Article 17 of the MLI is in the context of "Corresponding Adjustments": Article 9(2) of the OECD Model Tax Treaty provides for a corresponding adjustment with a view to avoid double taxation. In the context of the tax treaties signed by Mauritius, the tax treaties with France, Malaysia and Zimbabwe, do not have a clause along the lines of Article 9(2). Incidentally, the corresponding adjustment is the subject matter of Article 24(5) of the tax treaty Mauritius has with the UK.

Article 17 of the MLI seeks to remedy this unintended anomaly.

In the domestic context, it is section 75 of the *Income Tax Act 1995* (ITA 1995) that entitles the Mauritius Revenue Authority (MRA) to adjust the net income of a person: it may only apply if any business or other income earning activity is carried on in Mauritius. Section 75 of the ITA 1995 effectively seeks to protect the Mauritian tax base: it is not surprising that it may also apply in the context of a business carried on in Mauritius by a nonresident company.

In the application of section 75 of the ITA 1995, the MRA may therefore adjust any of the following:

- The gross taxable income attributable to a business or income earning activity in Mauritius
- The allowable expenses insofar as it concerns the taxable income in Mauritius
- A combination of the gross taxable income and the allowable expenditure in Mauritius

Furthermore, section 75 of the ITA 1995 may only apply if the business transaction is with a related party. The interaction of section 75 of the ITA 1995 and the corresponding adjustment Article in the tax treaties imply the impact of any double taxation is mitigated. Practical challenges may arise as a result of the domestic tax laws of the Contracting States. The risks of double taxation exist where the related party is tax resident in a country with which Mauritius does not have a tax treaty.

Section 75 of the ITA 1995 is classified under the International Aspects of Income Tax. It does appear that it may also apply to related party transactions between Mauritian residents. Logically, the MRA should be able to entertain a corresponding adjustment. Financing strategies are common in Mauritius: such strategies are aimed at minimizing external borrowing costs and are not tax driven. Where the MRA imputes a notional interest income, a corresponding adjustment should be considered by the MRA. It is not disputed that the corresponding interest expense may well be treated as non-allowable if, for example, the funds are used exclusively for an activity that generates only exempt income. However, the treatment of interest expense as non-allowable may lead to an inequitable tax outcome. This is on the basis that any exempt income of an entity has a direct bearing on the tax treatment of the expenses, particularly where the entity has both taxable and exempt income.

Use of domestic companies

The *Financial Services Act* was amended so that foreign controlled companies are obliged to apply for a Global Business License (GBL) if they conduct a business principally outside of Mauritius. On 23 January 2019, the Financial Services Commission (FSC), through the Financial Services (Global Business Corporations) Rules 2019 advised that a GBL is not required for Mauritian resident company that has been incorporated or established on or before 31 December 2018 and which did not hold either a GBL1 or GBL2, as the case may be, before 31 December 2018. A Mauritian resident company that does not hold a GBL is desired in view of the fact that it is taxed under the general tax laws applicable to Mauritian residents and is not entitled to any tax incentives.

Implications

- The MLI does not only apply to Global Business corporations: it also applies to any Mauritian resident company and a nonresident company with a place of business in Mauritius.
- A bilateral negotiation on treaty abuse may lead to the specific exclusion of entities having genuine business operations in Mauritius as a non-qualifying person for treaty purposes; equity and parity should prevail in any discussion the Government representatives have with treaty partner countries. The fact that investment holding activities are included in the simplified and detailed version of the LOB provision under the 2017 OECD MTC implies that that any bilateral negotiation would not be an easy task for Mauritius.
- Though the PPT appears to be the approach Mauritius should adopt in the context of the MLI and any new tax treaty, its application should ideally be discussed and agreed with the relevant treaty partner country.

- Increasingly, the use of domestic companies may be appropriate as a result of the tax laws of other countries. The issue of the rules by the FSC on 23 January 2019 does not achieve a level playing field to the extent that it is the year a company is incorporated that dictates the regulatory and tax regimes.
- Mauritian-based entities are also used as a result of the absence of exchange control and its flexible company laws. The question of any treaty benefits, and therefore the MLI, does not arise. Understanding the commercial transactions is critical and any misapplication of section 75 of the ITA 1995 may lead to economic double taxation. Though legal redress is available to challenge any assessment issued by the MRA, investors do not favor a legal approach. The need for clarity and certainty in the application of section 75 of the ITA 1995 is of paramount importance and "striking a deal with the MRA" does not appear to be an alternative the business community would favor.

Endnote

1. See EY Global Tax Alert, *OECD releases guidance for development of synthesized texts and a note clarifying the entry into effect of BEPS Multilateral Convention*, dated 14 November 2018.

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