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Foreword

Since its inception in July 2006, the MRA has left no stone unturned to modernise the tax administration. One way the MRA aims to achieve this is through constant innovation and engagement with stakeholders while focusing on its overall objective of collecting revenue in the most effective and efficient manner. Apart from taxes and duties, the authority has been collecting payments in respect of Environment Protection Fee, Passenger Levy and Advertising Fee. Since January 2018, the MRA has also been entrusted the responsibility to collect contributions to the National Pension Fund (NPF), National Savings Fund (NSF), HRDC Training Levy and Recycling Fee on behalf of the Ministry of Social Security. With a view to facilitate employers, a joint PAYE/NPF/NSF return has been developed. It is now also possible to conduct joint audit of PAYE and pension contributions.

Turning to international tax, a landmark achievement has been the signature by Mauritius, in July 2017, of the Multilateral Instrument (MLI). This will assist in combatting tax evasion and avoidance through cross-border collaboration. Although Mauritius has generally adequate legal framework, controls and processes in place, further changes have to be brought to existing legislations in order to comply with standards set out by the Forum on Harmful Tax Practices and the EU in the fight against international corporate tax avoidance. As an international financial centre, compliance with international standards on tax transparency is of utmost importance. In that context , the MRA can exchange information with 140 countries under the global tax transparency standards of the Organisation for Economic Cooperation and Development (OECD). But as the world's business landscape evolves rapidly, there are various new measures being adopted to mitigate profit shifting and tax avoidance. One such measure is the Country by Country Reporting (CbCR).

The publication of this magazine is in line with MRA's communication strategy and would not have been possible without the support and dedication of our staff. Inside this edition you will find a blend of articles relating to issues mentioned above and other topics to keep our readers abreast of the latest technical changes affecting our profession today. We thank those who have contributed to the realization of this present issue and hope that it will enable our staff to have a better understanding of the subjects covered.

We look forward to the next edition and would strongly encourage staff to use this platform to share their knowledge and experience by sending their articles on **technicaljournal@mra.mu**

*"The best way to not feel hopeless is to get up and do something.
Don't wait for good things to happen to you. Go out and make some good things to happen"*
Barack Obama

INTERVIEW

Sudhamo Lal

Director-General, Mauritius Revenue Authority

Sir, could you tell us a bit on the Commonwealth Association of Tax Administrators (CATA) and how you were elected as President of this international organization for a second time?

CATA was established in 1978 by a decision of the Commonwealth Finance Ministers to help member countries develop effective tax administrations that promote sustainable development as well as good governance. I consider CATA to be unique as I believe it to be the sole organization which provides a common platform to revenue organizations of 46 commonwealth countries.

As regards taking the office as President at CATA, well it all happened during the 14th CATA General Meeting held in Fiji in November 2018. Mauritius was elected to hold the presidency for the period 2018 to 2021. Most probably, my experience as Chairman of CATA from 2015 to 2018 and as President from 2009 to 2012 may have swayed in my favour.

Tell us about your involvement with the African Tax Administration Forum (ATAF).

Indeed, I am the current Vice-Chairman of ATAF. ATAF is a relatively new organization. It was founded in 2009 with the objective of creating a platform to promote and facilitate mutual cooperation among African Tax Administrations with the aim of improving the efficiency of their tax legislation and administration. Mauritius signed the ATAF Agreement on the 24th of January 2012 and was one of the five founding Signatories to this agreement in formalising the establishment of the Organisation. Today ATAF counts 38 member countries including Mauritius from the whole African continent. Given the long standing partnership of the MRA with both French and English speaking African countries, I was elected Council Member of ATAF in September 2014. In October 2016, I was elected to serve as Vice-Chairman of ATAF for the next two years and in October 2018, I have once more been elected as Vice-Chairman.

> It was challenging to host such an important event especially when it was just a few months after the coming into operation of the MRA.

Is there any CATA event which has marked you the most?

My journey with CATA has been long. Both as Chairman of CATA and its former president, I had the opportunity to attend several General Meetings and Annual Technical Conferences. To single out the most memorable one would be indeed difficult for me. But I would surely refer to the 27th Annual Technical Conference held on our soil in August 2006. It is still vivid in my mind. It was challenging to host such an important event especially when it was just a few months after the coming into operation of the MRA. We successfully organized and hosted such an event with 113 delegates representing 29 member countries in attendance. Special guests from China, Japan, Thailand and Zanzibar as well as representatives of international organizations such as GIZ and SADC enhanced the conference through their contributions.

"Example is leadership"
Albert Schweitzer

What benefits did the MRA derive from its membership with such organisations?

MRA staffs regularly attend workshops and technical conferences organized by CATA and ATAF. They provide participants with an opportunity to exchange views and experiences on various taxation issues with their counterparts from other tax administrations. Attending technical workshops has allowed our staff to come back with fresh ideas in the tax administration arena and this has definitely brought a value addition in the day to day operation of the MRA. It has also provided our employees with networking opportunities with colleagues coming from revenue administrations belonging to commonwealth countries. To ensure that the voice of Africa is heard, ATAF is participating actively in Working Parties 1 and 6 of the OECD for the implementation of the Base Erosion and Profit Shifting (BEPS) project. ATAF has set up the VAT, Exchange of Information and Cross Border Transactions Technical Committees. Mauritius is a member in those committees and is contributing to the work being carried out on the 'Digital Economy' and exchange of information. In addition, for our benefit, ATAF has released various products, amongst others the African Tax Outlook (ATO) magazine, the ATAF Model Double Taxation Agreement and the ATAF Mutual Assistance Agreement in Tax Matters (AMAATM). I have to mention that the MRA has contributed towards the launching of the ATO magazine which is a crucial product to African tax authorities in implementing reforms and policies to broaden their tax base, narrow tax gaps, simplify and improve fairness in tax systems and enhance overall voluntary compliance. Of course, the MRA has built capacity from the trainings provided by ATAF and CATA and has had the opportunity to share experiences and good practices with the other members.

Could you please elaborate on training courses offered to MRA officers by both organisations?

MRA officers of different grades had the opportunity to follow the ATAF basic online courses and the intermediary face to face sessions on tax treaties and tax audit. In addition to this, with a view to generate a pool of tax leaders, policy makers and administrators to enhance African expertise, the Executive Master's in Taxation (EMT) programme was launched by ATAF and two of our tax officials had the opportunity to join the cohorts of the EMT Programme. Part of this training was carried out at the MRA's Training Academy with the participation of our resource persons.

Every year, MRA officers participate in the Training on Interpretation of Tax Treaties (TOIT) jointly organised by the Inland Revenue Board of Malaysia and CATA. The latter has also organised various courses on management and leadership.

In the wake of new challenges, how would tax administrations benefit from CATA and ATAF in the future?

The fiscal landscape is in perpetual evolution. Globalization and digitization of the world economy create both opportunities and risks to tax administrations in their quest to collect revenue. There are indeed tough challenges lying ahead of revenue administrations worldwide. Base Erosion and Profit Shifting (BEPS), Automatic Exchange of Information, taxation of digital services, block chain technology, data analytics, etc. are some of the hot topics that cannot be ignored by a tax administration and will have to be considered by our members in the coming years and I will even dare in adventuring to say in the coming months. For instance, with the Common Reporting Standard (CRS), tax administrations have started receiving bulk data. The effectiveness of CRS implementation will depend on the ability of administrations to perform risk based analysis to identify risky cases. Data security and safeguard will also be a great challenge. But rest assured CATA and ATAF workshops on such technical issues are in the pipeline. Capacity building of tax officials from our member tax administrations would allow them to develop their expertise in these fields. They would be better equipped to face the upcoming challenges and bring efficiency gains in their respective tax administrations.

"

One of the biggest challenges for the MRA will be to make the maximum of the new information technology

Artificial intelligence, robotics and data analytics will be the drivers of efficiency in tax administration and the MRA cannot remain remote to such drivers.

How do you see MRA in next 10 years?

One of the biggest challenges for the MRA will be to make the maximum of the new information technology. Artificial intelligence, robotics and data analytics will be the drivers of efficiency in tax administration and the MRA cannot remain remote to such drivers. We shall see MRA as an organisation where data/information will speak through the exploitation of information received through third party sources. MRA must not be seen as tax assessment producing factory. Our human resources should also be ready to work in this digital transformation. In the same vein, I can see large number of MRA officers in a position to work from home, thanks to information technology.

You may be aware that one of our core values is the development of the organisation in a manner which promotes a transparent and accountable administration. Consequently, in ten years' time the concept of Cooperative Compliance will be a new tax culture at MRA.

Actually, we are in a building which we rent in Port Louis. I think in ten years' time we shall have a modern building equipped with all technologies.

A final question to you, Sir. On the occasion of the National Day 2018, you were rewarded for your contribution in the administration and collection of taxes. Can you share with our readers your secret for this achievement?

Yes, indeed I have been conferred the award of the Commander of the Order of the Star and Key of the Indian Ocean (CSK). Well, before answering, I would like to quote what Margaret Thatcher had said:

"I do not know anyone who has gotten to the top without hard work. That is the recipe. It will not always get you to the top, but it will get you pretty near".

So, there is no secret in receiving such an award. It is all about hard work, perseverance, good health and some luck. I need to mention that I was not alone throughout this journey. The contribution of my management team and the 1,500 employees has been significant. I seek this opportunity to dedicate the award to the whole MRA family.

Interview by
Mrs. Mukhta Toofanee and Mrs. Pavina Jhoollun, country correspondents.

VAT
The Destination Principle

Mrs. Champawatee Gunnoo
Director,
Medium and Small Taxpayers Dept.

VAT is meant to be a broad-based tax, imposed and collected along the production / distribution chain so that the burden lies on the final consumer, that is, private individuals and entities involved in non-business activities. Thus the burden of VAT is not meant to lie on taxable businesses except where the legislation explicitly provides for that, e.g in case of non-allowable input tax.

With regard to international trade, the destination principle ensures that VAT is ultimately levied on the final consumption that occurs within the taxing jurisdiction. Under the destination principle, exports are free of VAT, whereas imports are taxed on the same basis and at the same rates as local consumption. The destination principle' is the opposite of the ''origin principle' whereby each jurisdiction levies VAT on the value created within its borders.

To ensure that there is no unintended non-taxation or double taxation, the OECD VAT/ GST guidelines provide in its main rule that for consumption tax purposes, internationally traded services and intangibles should be taxed according to the rules of jurisdiction of consumption. Where does consumption take place? In its guidelines, the OECD makes a distinction between business to business (B2B) supplies and business to consumer (B2C) supplies.

For B2B supplies, the guidelines stipulate that

1. The jurisdiction in which the customer is located has the taxing rights over internationally traded services or intangibles.
2. The identity of the customer is to be determined by reference to the business agreement.
3. Where the customer has establishments in more than one jurisdiction, the taxing rights accrue to the jurisdiction where the establishment/s using the service or intangible is (are) located.

The OCED further recognizes that the customer location may not lead to an appropriate result when considered against the criteria of neutrality, efficiency of compliance and administration, certainty and simplicity, effectiveness and fairness. In these specific circumstances, a proxy other than customer location, which would give a better result is allowed.

The guidelines also stipulate that for internationally traded B2B supplies of services and intangibles directly connected with immoveable property, the taxing rights may be allocated to the jurisdiction where the property is located.

As regards B2C supplies, the OECD guidelines stipulate that;

The jurisdiction in which the supply is physically performed has the taxing rights over B2C supplies of services and intangibles that:

- Are physically performed at a readily identifiable location,
- Are ordinarily consumed at the same time as and at the same place where they are physically performed; and
- Ordinarily require the physical presence of the person performing the supply and the person consuming the service or intangible at the same time and place where the supply of such a service or intangible is physically performed.

For B2C supplies that are not covered by the above criteria, the guidelines stipulate that the jurisdiction in which the customer has its usual residence has the taxing rights.

Moreover, as it is the case for B2B supplies, the OECD allows the use of a proxy other than customer location in the case of B2C supplies also. This would be the case where such proxy would lead to a significantly better result when considered under the criteria of neutrality, efficiency of compliance and administration, certainty and simplicity, effectiveness and fairness.

To what extent is the application of our VAT legislation compatible with the destination principle? This can be answered by a careful analysis of the relevant sections of the VAT Act and their practical applications.

In the case of goods, the clarity of the VAT provisions as well as the existence of border controls makes the implementation of the destination principle generally effective. However, with the development of e-commerce, goods which would otherwise have attracted VAT on bulk importation are now imported in small quantities which fall within the exemption limit at importation.

Also, the digital economy allows products such as music and films to escape border controls.

As regards services that are traded internationally, where the services are provided by a VAT registered person, the appropriate identification of the recipient of the supply and consequently the proper application of the Fifth Schedule would ensure the implementation of the destination principle. On the other hand, unless the charging provision of Section 9 and the reverse charge provision of Section 14 are refined, VAT on services consumed in Mauritius will in many cases continue to escape VAT in Mauritius.

Recent Changes to Accounting Standard

Mr. Mario Hannelas
Director,
Large Taxpayers Dept.

Do you know the recent changes to accounting standards which may be of great relevance to our tax auditors?

The following key changes will impact how companies, especially large ones, prepare their reports:

- IFRS 9 – Financial Instruments
- IFRS 15 – Revenue from Contracts with Customers
- IFRS 16-Leases

The first recent change to accounting standard has to do with Financial Instruments –IFRS 9. This IFRS concerns both financial companies as well as non-financial companies (such as manufacturers, retailers, service companies, etc.). In fact, every single company has some financial instruments in its accounts, for example, trade receivables. Among the various changes to accounting standard in IFRS 9, the major one that will affect most organisations is the new impairment model that is prescribed by the standard specifically, the new credit loss model based on expected losses instead of incurred losses as per IAS 39. Though the new IFRS 9 is relevant for a large number of companies, the most significant change resulting from the standard is how banks account for loan losses.

The second recent change in accounting standard concerns accounting for revenues which is of particular interest to us because some companies like to manipulate profits by either overstating or understating revenues. For tax purposes they will understate profits in order to pay less tax. This is partially due to intentional manipulation but also because of insufficient guidance and rules relating to revenue recognition. That's the reason why we now have IFRS 15 which contains guidance for transactions not previously addressed (e.g. service revenue, contract modifications) and improves guidance for multiple-element arrangements. IFRS 15 identifies a five stage process to follow in recognising revenue. For more details on the 5 steps model, please refer to the Article in this issue of the magazine entitled "IFRS 15 – Revenue from Contracts with Customers".

The third recent change in accounting standards is about lease accounting IFRS 16. Off-balance sheet financing is when assets or debts are not shown in the company's balance sheet. Operating leases were a perfect example of this. IFRS 16 seeks to eliminate the risks that organisations will end up in off-balance sheet financing. Accounting for leases in the lessee's financial statements changed and lessees are no longer required to classify a lease as either operating lease or finance lease. Instead, they should account for all leases in the same way under the new standard (debit right-of-use asset, credit lease liability). Lessees will need to show all the lease right in the statement of financial position instead of hiding them in the notes to financial statements.

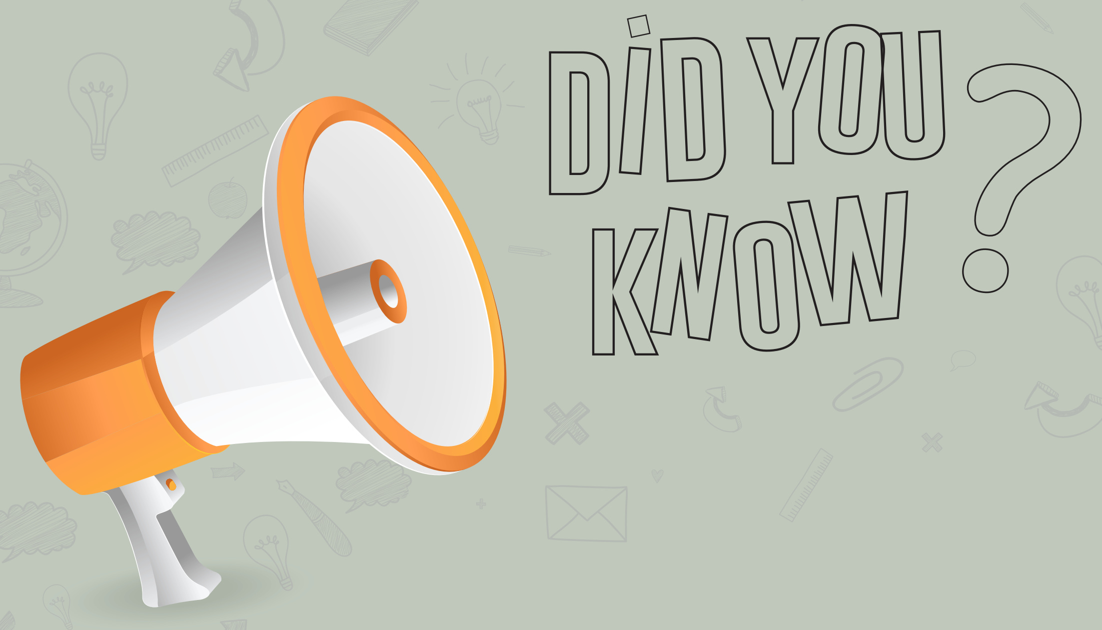
IFRS 9 and IFRS 15 apply to an entity's first annual Financial Statements for a period beginning on or after 1 January 2018 while IFRS 16 is effective for periods beginning on or after 1 January 2019.

At the level of the MRA, a working committee comprising of senior officers of tax compliance departments has been set up to examine IFRS 9, IFRS 15 and IFRS 16 and to come up with recommendations on any tax implications arising from the changes to the accounting standards. In the light of their recommendations, practice notes will be issued showing MRA's stand on the income tax implications arising from the adoption of each of the abovementioned IFRS including the following:

i. circumstances where MRA can accept the accounting revenue as determined in accordance with the IFRS as the revenue figure for income tax;

ii. Circumstances where MRA cannot accept revenue as determined in accordance with IFRS as the revenue for income tax purposes and the income tax adjustments needed under such circumstances; and

iii. the transitional tax rules relating to the adoption of the IFRS.



1

Voluntary disclosure of income scheme Foreign Assets

A person making a voluntary disclosure on or before 31 March 2020 under the scheme will be subject to tax on the disclosed chargeable income held overseas at the rate of 15 % free from any penalty and interest.

2

Additional deduction

A company operating a hotel will be able to claim 150% of the expenditure incurred on cleaning, renovation and embellishment works in the public realm from their taxable income.

3

Additional exemption

The income exemption threshold (IET) can now be claimed in respect of 4 dependents instead of 3 dependents.

4

Acquisition of fast charger for an electric car

The total investment made in relation to the acquisition of a fast charger for an electric car can be claimed as a deduction by an individual deriving emoluments or business income.

The Salomon Principle

Mr. Fazullah Abdoolatiff
Section Head,
Medium and Small Taxpayers Dept.

A company comes into existence on incorporation and this gives it a legal personality of its own. It is separate from the members which form part of it and can sue and be sued in its own name. It has an existence of its own and will continue to exist even if its members pass away or are no longer shareholders of the company. The share capital and all assets belong to the company and it is also liable to its creditors. Due to this principle, it is the company which is the claimant for any wrong done to it and liable for any tort done. In short it has a separate legal corporate entity of its own and this principle was settled in the case of Salomon v Salomon Co Ltd (1897) AC 22.

Aaron Salomon was a boot and leather merchant. Together with members of his family he formed a company by the name of Salomon & Co Ltd and sold his business to the latter for an amount of £ 39000. The purchase consideration was made in terms of £ 10000 debentures, £ 20000 in shares and the balance in cash. In less than one year, the company ran into difficulties and went into liquidation at the behest of creditors. As owner of the debentures Mr Salomon claimed an amount of cash in priority to the creditors. He succeeded in obtaining it and nothing was left for the unsecured creditors. On behalf of the creditors, it was contended that the company was a sham and an agent for Salomon and that he should be made to indemnify the company in respect of its debts.

The case came before the House of Lords where the principle that the company was a separate legal entity from the shareholders who controlled it was affirmed and that it was not to be considered as an agent. It was also set out that Mr. Salomon was not liable to indemnify the creditor, thus giving effect to the limited liability doctrine.

Generally, stakeholders of a company must be aware of the fact that the liability of a company is limited. This implies that, in the event of insolvency, unsecured debts are settled only if liquidity is available after settlement of secured debts. In the case of Salomon, the creditors should have been aware at the very outset that any lending to the company bore some risks and, on liquidation, the probability of recouping their money was minimal given that these were unsecured debts.

In their judgment, the House of Lords laid down that a company is an artificial and juristic person which does not have the body of a natural person but who however depends on natural persons such as directors , officers etc for its management and activities. These persons only represent the company and anything they do within the scope and authority of the company bind the company. To quote **Lord Macnaghten** "… The company is different altogether from subscribers… And, though it may that after

The Salomon Principle *Cont'd*

incorporation the business is precisely the same as it was before and same persons are managers and same hand receive the profit, the company is no agent for subscribers or trustee for them. Nor are the subscribers as members liable in any shape or form, except to the extent and manner prescribed by the Act."

From the judgment given in the Salomon case, the advantage of setting up a limited liability company was that the shareholders had a liability limited to the amount which they held in the company. However, any benefit ultimately goes to the individuals who are the real beneficiaries as spelt out in **Gallagher v Germania Brewing Co**"…for while , by fiction of law, a corporation is a distinct entity, yet in reality , it is an association of persons who are in fact the beneficiaries of corporate property."

The Salomon principle at times produces results which are unjust and absurd as the company's corporate personality may be used to do improper and illegal actions or commit frauds. In such cases, the veil or facade which has been created between the company and the persons has to be lifted or removed to find out the persons who are really guilty and in certain cases to see if the incorporation is not a sham. However, the principle laid down in the Salomon case has been strongly adhered to and followed and it is only in cases where the existence of **'façade'** is established that the principle has been overruled. One such case is **Jones v Lipman (1962) 1 WLR**, where the judge lifted the corporate veil. In this case, Lipman had agreed to sell a property to the claimants but after entering into the contract eventually changed his mind. To circumvent things, he sold the property to a company in which he owned nearly all the shares. **Russell J** ordered against Lipman and in his judgment described the company as "the creature of the first defendant, a device and a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity."

Although the Salomon principle stands strongly, with the passage of time, it is being realised that it cannot be extended to companies indulging in fraudulent schemes and using incorporation as a cloak to hide mischievous motives.

In such cases the corporate veil has to be lifted and the decision taken in Salomon case bypassed. Such decisions were taken in the case of **Re A Company (1985) BCLD 333**, where it was held that the court would use its power to lift the corporate veil if it was necessary to prevent an injustice. Such was the case in **Creasy v Beachwood Motors Ltd (1992) BCC638**. However, the reasons put forward in these cases was overruled in the case of **Adams v Cape industries plc (1990) BCC786** and **Ord v Belhaven Pubs Ltd (1998) BCC 607** wherein it was considered that the principle in the Salomon case cannot be rejected for the sole reason that justice so required and corporate veil should only be lifted in special circumstances where there is indication it has been used as a façade to conceal the true motives.

It can therefore be said that after more than hundred years, the principle laid down in Salomon still holds good in court cases.

> However, it has to be added that changes have been brought to relevant legislations to dilute the strength of the Salomon doctrine and make directors and subscribers more accountable.

The pertinence of the Solomon principle arises in cases where audits are carried out simultaneously in cases of family owned companies and the directors/shareholders. The outcome of the audit may result in additional chargeable income for the company and undeclared income in the case of the directors/shareholders (based on a Net worth exercise). In such cases, it is argued on behalf of the directors/shareholders that there is double taxation as the undeclared income on which they are being assessed is from the additional profits of the company which had also not been declared. The dilemma then rests on the auditing officer as to whether such contention is to be accepted.

Whilst the Salomon principle makes a distinction between a company and its shareholders, revenue laws provide for those who represent a company and act on behalf of it as agents. Section 81(2) of the Income Tax Act (ITA) and Section 63A of the Value Added Tax (VAT) Act read as follows:

81(2) of the ITA

"Every secretary, manager or other principal officer of a company, société or other body of persons shall be deemed to be the agent of the company, société or other body of persons in respect of income derived by it."

63A of the VAT Act

"(1) The principal officer of a private company shall -

a. be answerable for the doing of all such things as are required to be done by that company under this Act;

b. be required to retain out of any money or property of the company, so much as is sufficient to pay VAT which is or will become payable by that company; and

c. be personally liable in respect of the VAT payable by that company to the extent of any amount he has or should have retained under paragraph (b)

(2) For the purpose of subsection (1), "**principal officer**" means the executive director, or any other person who exercises or who is entitled to exercise or who controls or who is entitled to control, the exercise of powers which would fall to be exercised by the Board of directors."

In relation to the above, it is worthwhile comparing the ITA and the VAT Act with the Companies Act. The latter Act states that a company and the persons controlling it are separate. Consequently, creditors have to exercise caution when dealing with companies; the risks and benefits of lending should be weighed properly to ensure that they do not suffer in case of liquidation and bankruptcy.

However, the situation is different as regards the revenue laws. As specified above, the 'agent' of a company is responsible to pay any income tax due by a company and any VAT due is payable by the 'principal officer' of a company. This can be exemplified by the case **Jayram Chiniah v. The Commissioner of Income Tax** whereby an inscription of privilege was taken on the property of the shareholder/director of the company Chiniah & Sons Ltd on ground that he was the 'principal officer' of the company. In fact, Mr Chiniah held 99 out of the 100 issued shares and he and his wife were directors of the company. He denied that they 'took active part in the management of the company' but could not prove who managed the company if not them. Consequently, the Privy Council held that that Mr Chiniah was the 'principal officer' of the company and steps were taken by the revenue authority to have the personal property of the shareholder inscribed. Even if the Privy Council or Supreme Court did not conclude on the basis that the Director had used the company's fund for personal expenses, it could be deduced that, as principal officer, he had control over the mentioned fund.

The agents, who have control over the fund of a company, are thus liable to pay any tax due by the company and if the tax is not paid, enforcement actions can be taken. In practice, these enforcement actions usually include the following:

i. The recovery of debt by way of an attachment as provided in the Attachment Act;

ii. A direction issued to the Passport and Immigration Office to prevent the director as agent of the company, from leaving Mauritius; and

True it is, the concept of limited liability exists but in cases of VAT and income tax, if an inscription of privilege is taken on the property of the shareholder, it implies that the personal assets of the latter may also be exposed.

Revisiting Transfer Pricing Guidelines following BEPS

Mr. Faisal Oozeerally
Section Head,
Large Taxpayers Dept.

The last four years has witnessed major and radical changes in transfer pricing guidelines and rules. It all started with the initial request made by the G20 to the Organisation for Economic Cooperation and Development (OECD) to analyse and examine the extent and causes of base erosion and profit shifting (BEPS). The OECD report on BEPS which was presented to the G20 Finance Ministers at their meeting in Moscow in February 2013 acknowledged a positive reception.

The OECD has therefore set out an Action Plan on BEPS consisting of 15 actions to carry out the mandate of the G20. Four out of the fifteen actions are in relation to transfer pricing namely Actions 8,9,10 and 13.

Action 8 assures that transfer pricing outcomes are in line with value creation with respect to intangibles. It is set out in the OECD guidelines and consists of four sections providing guidance on:

a. Identifying intangibles

b. Ownership of intangibles and transactions involving development, acquisition, enhancement, maintenance, protection and exploitation of intangibles (DAEMPE)

c. Transactions involving the use or transfer of intangibles

d. Supplemental guidance for determining arm's length conditions in cases involving intangibles

Actions 9 and 10 equally assure that transfer pricing outcome are in line with value creation but with respect to risks and capital and other high risks respectively.

Actions 8 to 10 of the BEPS Action Plan therefore aim to ensure that the allocation of profits is correctly aligned with the economic activity that produced the profits. It places more reliance on the factual control of functions and risk and the capacity to bear risk. It also limits the possibility of shifting risks from one related company to the other simply through contract when in substance, the underlying risk has not been transferred.

Action 13, however, is on transfer pricing documentation and it sets out a standardised three-tiered approach which include:

a. A master file setting out the general information about the Multinational Enterprise (MNE) group

"There are no mistakes so great as that of being always right"
Samuel Butler

b. A local file referring specifically to material transactions of the MNE group members resident in the local jurisdictions and setting out the transfer pricing methodology

c. A country by country (CbC) report containing certain information relating to the global allocation among taxing jurisdictions of the MNE group income and tax paid. This is only applicable to MNE having global revenue exceeding Eur 750M.

While the international environment on transfer pricing is constantly changing, it is apposite to consider its development in Mauritius. The first legislation on transfer pricing in Mauritius goes back to 1974. Infact, section 43 of the then Income Tax Act (Income Tax Act 1974) which is an anti avoidance of tax provision requires the carrying of any business or other income earnings activities between related parties to be at arm's length.

In those days where cross border transactions were not that preponderant as it is today and the financial sector was in an embryonic stage, transfer pricing issues arose essentially in profitable entities trying to shift profit to loss making related entities or to those entities enjoying tax holiday or paying taxes at a lower income tax rate.

In the mid 1990, with the development of the financial sector and the advent of a new tax legislation, the transfer pricing legislation was revisited. The anti-avoidance provisions of the new Income Tax Act (Income Tax Act 1995) contains a single sub section {S 90(1)(f)} which requires transaction to be at arm's length. Concurrently, under the "International Aspects of Taxation", a new section has found its way under the heading "Application of arm's length test". This new section of the Income Tax Act which is similar to the one in the Income Tax Act 1974 now contains a subsection which empowers the minister to make regulations for purpose of the arm's length test. This subsection which caters for a secondary legislation is yet to be enacted and may well take on board the transfer pricing guidelines.

Transfer pricing issues are complex, poses a number of challenges especially for smaller tax administration like that of Mauritius. However, transfer pricing rules are essential for countries in order to protect their tax base and counteracting profit shifting. Mauritius apart from protecting its tax base is also concerned with Action 13 as it is a signatory of the Multilateral Competent Authority Agreement which require the exchange of the CbC Reports

The Listing Process that haunts every Financial Centre

"If a man does not know what port he is steering for, no wind is favorable to him."
Seneca

Mrs. Yamini Rangasamy
Section Head,
Large Taxpayers Dept.

In December 2017, the European Union (EU) Commission published a list of non-cooperative tax jurisdictions based on tax good governance criteria. 92 jurisdictions were screened and 17 of them appeared on the 'blacklist' but Mauritius was not part of them! Instead, we were placed on the EU "watchlist" as a result of having committed to amend or abolish our preferential tax regimes to remove any deficiencies by 31 December 2019.

The EU blacklist is like a death shadow cast over a jurisdiction. It is intended to 'name and shame' non-EU jurisdictions in order to coerce them to change their tax systems so as to comply with international standards. Ending up on that list could only mean doom and gloom! Not only would exporters face nightmares when their goods enter the European ports but the jurisdiction would have to deal with a series of defensive measures both in the tax and non-tax area.

Thus, EU taxpayers using structures or arrangements involving blacklisted jurisdictions or dealing with entities in those jurisdictions would face a greater likelihood of being audited by tax administrations of the respective European States. Those tax authorities could apply withholding tax measures or other defensive measures such as denying deductions to the taxpayer. Moreover, International Financial Institutions, such as the European Investment Bank and various Development Financial Institutions, are prevented from channeling EU funds through blacklisted jurisdictions. The above measures, if applied would lead to a slow death of the blacklisted jurisdiction's financial centre and eventually cripple its whole economy.

As a member of the Inclusive Framework, Mauritius has committed to implement the minimum standards under the Base Erosion and Profit Shifting (BEPS) project. Fully aware of the consequences of failing to deliver on our commitments taken with the EU and the Organisation for Economic Cooperation and Development (OECD), necessary reforms were brought to clear all our preferential tax regimes at the level of the Forum on Harmful Tax Practices (FHTP). The deemed foreign tax credit (DFTC) regime associated with the Global Business Category 1 licence and Segment B banking activities together with the Global Business Category 2 licence were abolished. As a replacement of the DFTC, a partial exemption system linked to enhanced substantial activities requirements was introduced on specified types of income. The partial exemption system was made available to any type of company whether it holds a Global Business licence or not, thus ensuring that there is no ring-fencing issue. Additional substance requirements were built into the captive insurance regime. The Freeport regime, on the other hand, became out of scope of FHTP work following removal of all geographically mobile activities such as global trading from the list of permitted activities. Mauritius also came up with a new banking regime that satisfied all the criteria set by the FHTP. When the October 2018 FHTP Progress report was published, it was found that all our preferential tax regimes met the FHTP standards!

The sense of joy was short-lived as the EU soon turned around informing us that they have stricter rules than the FHTP. All along, we were given to understand that the EU would rely on FHTP's work. What we discovered was that they had chosen to piggyback on the work of the FHTP and to develop their own rules. Thus, they were also concerned with manufacturing activities in the Freeport and concluded that there was an absence of laid down criteria for substance and that the regime was ring-fenced since the 3 % tax rate was applicable only to exported goods. To address EU's concerns, the Income Tax Act was amended to impose tax at 3% on income derived from goods manufactured in the Freeport zone and sold on the local market and to lay down the substantial activities requirements.

The way the EU deals with ring-fencing is also different. Whereas the OECD looks only at de jure ring-fencing (whether the legal provisions confer benefits mostly to non-residents), the EU also probes into de facto ring-fencing (whether in practice, the regime benefits mostly non-residents). Taking into account de facto ring-fencing is unfair since it is likely to discriminate against small countries with high levels of foreign direct investment like Mauritius. We nevertheless battled our way to demonstrate to the EU that based on the previous year's statistics, the partial exemption system is expected to benefit an equal number of domestic companies and companies in the global business.

Unfortunately, the EU review process is carried out in a unilateral way. Non-EU members are not part of the conversation when their regimes are tabled for discussion and run the risk of being part of the menu! There is also a clear attempt to impose non-minimum standards under the BEPS project by the EU. We resisted the proposal to introduce capping of interest deductions as recommended under BEPS Action 4 on the ground that the EU does not impose such a rule on its members. We were less fortunate as regards the Controlled Foreign Company (CFC) rule as it is a requirement for EU members under the EU Anti-tax avoidance Directive (ATAD).

While the OECD has a staged process for review and clears a jurisdiction if its legal framework is in place, the EU adopts a combined approach and also evaluates the monitoring mechanism in place for substance during the review process. Mauritius was thus requested to reinforce its existing substance requirements in the case of outsourcing. After having ticked all the boxes, Mauritius was placed on the EU white list in 2019.

In May 2020, Mauritius was moved once again to the EU grey list simply because the EU has moving goalposts. It decided out of the blue that its listing process should also consider countries which present strategic AML/CFT deficiencies. Although Mauritius has developed an action plan with the Financial Action Task Force (FATF), it satisfies 35 out of 40 elements and is actively working to clear the 5 remaining deficiencies. The timeline set by the EU for Mauritius to demonstrate practical implementation of the measures appears too short. One can only hope that the EU has mercy on small economies like Mauritius that are already being crippled by the effects of COVID-19, and that an extension be granted to enable us to show our good faith!

Controlled Foreign Companies (CFC)

Mr. Rajarshi Harnamsing
Officer,
Large Taxpayers Dept.

After the newly gained momentum through BEPS Action 3 final report and the newly enacted European secondary law, the Anti-Tax Avoidance Directive, CFC rules has become the superstar puzzle of the global business and finance sector in Mauritius. Despite not being a minimum standard, Mauritius has to introduce CFC rules to avoid being blacklisted by the European Union (EU).

CFC rules are regarded by the EU as an appropriate anti-abuse measure to tackle tax planning opportunities in respect of preferential tax regimes such as the Mauritian Partial Exemption system. At the time the EU code of conduct group was reviewing the Mauritius Preferential tax regimes, it identified deficiencies with regards to the Partial Exemption system under the specific criterion of substance. The EU Informed Mauritius that despite having domestic anti-abuse provisions, Mauritius did not have any rule in its legislation which aimed at preventing the erosion of other countries tax base. In addition, Mauritius initially was not in favour of CFC rules or a switchover clause. As such, to avoid the inclusion of Mauritius in the EU list of non-cooperative jurisdictions for tax purposes (Blacklist), CFC rules has to be introduced. With the introduction of the CFC rules, Mauritius demonstrated its commitment to ensure that our partial exemption regime is consistent with the EU tax good governance standard.

CFC rule was introduced through Section 26 of the Finance (Miscellaneous Provisions) Act 2019 by adding Section 90A in the Income Tax Act (ITA). CFCs are companies that are found outside Mauritius but are owned and controlled by a Mauritian resident. Section 90A of the ITA empowers the MRA to tax non-distributed income of a CFC if it arises from non-genuine transactions with a view to obtain a tax benefit.

For any year, the CFC rule does not apply under any of the following instances:

i. The accounting profit is less than EUR 750,000 and non-trading income is not more than EUR 75,000.

ii. The accounting profit is less than 10% of its operating costs; for this purpose, operating cost does not include the cost of goods sold outside the country of residence and payments to associated enterprises.

iii. The tax rate in the country of residence of the CFC is more than 50 per cent of the Mauritian tax rate.

Section 90A of the Act provides that a CFC is a company which is not resident in Mauritius and in which more than 50 per cent of its total participation rights are held directly or indirectly by the Mauritian resident company. The shareholding of associated enterprises including a permanent establishment is considered to determine the 50 per cent threshold. The Regulations provide that the income to be included in the tax base of the Mauritian resident company is limited to amounts generated through assets and risks linked to significant people functions carried out by the controlling company. The amount that is taxed under the CFC rule reduces the subsequent taxable dividend income from the CFC, irrespective of the fact that the CFC may be resident in a country with which Mauritius has a tax treaty.

How would one distinguish the transactions or schemes covered by the General Anti Avoidance Rule (GAAR) in section 90 of the Income Tax Act (ITA) and the transactions or schemes covered by the CFC rules in section 90A of the ITA?

Whilst the GAAR under section 90 of the ITA concerns transactions or schemes aimed at avoiding tax that should have been due in Mauritius, the CFC rules would concern schemes involving Mauritius but aimed at eroding other countries' tax bases.

Even though CFC rules vary widely around the world, the general rule is that entities that are located in countries with low or no taxes and generated mostly passive income with little economic substance will be subject to CFC rules. Strict CFC rules have been adopted mostly by developed countries like the US, UK, Japan, Italy, France amongst others. The likely impact of CFC rule on the global business sector and offshore business in Mauritius still remains to be assessed given the difficult economic situation post the covid-19 pandemic.

INTERVIEW

Mario Hannelas

Director,
Large Taxpayers Dept.

Mr. Mario Hannelas, also has under his mandate the responsibility to oversee the International Taxation Section (ITS).

In January 2017, the Government of Mauritius designated Mr. Hannelas to sign the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (CbC MCAA) to enable the exchange of CbC reports from Mauritius. Automatic exchange of information has started in the year 2015 in Mauritius under the Foreign Account Tax Compliance Act (FATCA) followed by the OECD Common Reporting Standard (CRS) in 2018. The introduction of FATCA and CRS in Mauritius has required a significant mobilisation of resources in the industry as well as for the MRA.

In this context, for the benefit of our readers, may I ask you, what is CbC reporting and whether the exchange of CbC reports will require as much resources as with FATCA and CRS?

CbC Reporting is part of Action 13 BEPS Action Plan. In October 2015, the OECD/G20 published the Transfer Pricing Documentation and Country-by-Country Reporting Action 13 Final Report (the "BEPS Action 13 Final Report"). The BEPS Action 13 Final Report recognised that enhancing transparency for tax administrations is an essential part of tackling the BEPS problem.

CbC Reporting requires large multinational enterprises ("MNE") to file a CbC Report that will provide a breakdown of the amount of revenue, profits, taxes and other indicators of economic activities for each tax jurisdiction in which the MNE group does business. Unlike FATCA and CRS which require reporting on all financial accounts information, CbC Reporting only applies to MNE groups with annual consolidated group revenue of €750 million or more in the preceding fiscal year ("MNE Groups"). For this reason and the fact that we have gained experience through the implementation of FATCA and CRS, it will be relatively easy to implement CbC Reporting with our existing resources.

Mauritius does not have many MNEs headquartered in the country. Do you think we should implement BEPS Action 13 from Mauritius?

CbC reporting is a minimum standard under the Base Erosion and Profit Shifting (BEPS). As a member of the inclusive Framework, Mauritius is required to exchange information under BEPS Action 13. Even if the MNE is not headquartered in Mauritius, its subsidiary will still have to notify the MRA where it has filed its CbC report. Furthermore, in case the ultimate parent company is unable to file CbC report in its jurisdiction for reasons such as absence of legal and administrative framework, the OECD has mechanisms in place to allow other jurisdictions to require the filing of CbC Reports through surrogate company. That is, there is a possibility for MNE groups to elect an entity as a surrogate parent in a country that has the legislation in place. That surrogate parent would provide the CbC reports to its country of tax residence, the tax administration of which will disseminate the information through automatic exchange of information. It is worth noting that many offshore companies holding GBC licences are part of MNE groups and in the Mauritian context, it is expected that filing of CbC reports will be done by GBCs mostly.

CbC Reporting is an exchange of sensitive information. What conditions must be satisfied before MRA automatically exchanges CbC reports with other tax jurisdictions?

Similar to all types of AEOI, the MRA had to ensure that the domestic legislation provides for the reporting requirements by the concerned entities and this has been taken care of by means of regulations. Tax administrations must have the Administrative and IT capacity to obtain, process, send and use the information. The Information System Department in collaboration with the International Taxation Section have closely worked together to ensure that this pillar has been met. Of utmost importance is confidentiality and data safeguards to protect information received from stakeholders and from other tax authorities. Questionnaires have been filled and Mauritius did not receive any recommendation in this area. Also, countries must have the international agreements in place which is the legal basis for exchange. Mauritius has signed the Convention on Mutual Administrative Assistance in Tax Matters on 23 June 2015 and the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (CbC MCAA) in January 2017 enabling the exchange of CbC reports from Mauritius.

> CbC Reporting will give tax administrations a global picture of the operations of MNE Groups. Tax authorities can then use this information to perform only high-level transfer pricing risk assessments and to evaluate other BEPS-related risks.

Can the Country-by-Country information be used to issue a transfer pricing assessments by tax administrations? What is the risk that frivolous assessments will be raised on the basis of information collected?

CbC Reporting will give tax administrations a global picture of the operations of MNE Groups. Tax authorities can then use this information to perform only high-level transfer pricing risk assessments and to evaluate other BEPS-related risks. The MRA has issued the "Guidelines for the Appropriate Use of Information contained in CbC Reports" detailing the extent to which information received in CbC reports may be used by tax administrations and the consequences of non-compliance.

Do you agree that the scope of the minimum standard should be expanded to include the master and local filing requirements and that the level of the consolidated group revenue threshold should be reduced?

This issue has been raised several times at international level. We are not agreeable to expand the minimum standard to include local and master filing requirements.

The master file (MF) is a document which contains high level information about the global business operations and transfer pricing policy of an MNE group. The local File (LF) provides more detailed information and analysis about the local entity's intercompany transactions. The information provided in the LF would typically supplement the information in the MF and would include a detailed description of; the management structure of the local entity; related party transactions entered in the year; copies of related material intercompany agreements concluded by the local entity; application of TP methodology; and financial information of the local entity.

We are of the opinion that if some countries want to have those detailed information, these countries may request for such information in their domestic legislation instead of expanding the scope of the minimum standard.

With respect to the threshold, at this stage, it is too early to determine whether to reduce the threshold or not. We should allow two/three reporting to be done and see the volume of information it represents. Lowering of consolidated group revenue threshold might be burdensome for developing countries like Mauritius.

Can you state the current Position of the MRA in terms of CbC reporting?

The CbC regulations for Mauritius has been proclaimed in February 2018 thereby requiring concerned MNEs and their constituent entities to file CbC Reports/notification for fiscal years beginning on or after 01 July 2018.

The MRA has developed a CbCR portal which can be accessed on its website since July 2019 and constituent entities in Mauritius have already started filing notifications with the MRA.

"A good head and a good heart are always a formidable combination"
Nelson Mandela

Interview by
Ms. Vishma Chiniah,
Officer, Large Taxpayers Dept.

Directional Testing

Mrs. Wardah Hosenbux
Officer,
Large Taxpayers Dept.

***'Every debit should have a corresponding credit'*- this is the basic concept most commonly used in the accounting world. Although nowadays auditors use advanced techniques to check the accuracy of figures and disclosures within a set of financial statements, the double entry system remains one of the most important base of auditing. One related auditing technique is directional testing.**

Directional testing is a methodology developed in the early 1980s and is based on double entry bookkeeping: when recording a transaction, both the debit and credit entry should correspond. Hence, when the totals of the trial balance's debits and credits agree and all the debit entries have been verified and found to have been properly made, it is likely that all the corresponding credit entries are also accurate. Testing only in one 'direction' thus automatically indicates overall correctness and increases audit efficiency.

Being a straightforward approach, directional testing may guide tax auditors to the most risky areas and trace misstatements such that any undeclared income or hidden expenses may be identified.

Testing for overstatement and understatement

Directional testing implies that:

- By testing debits (assets and expenses) directly for overstatement, the corresponding credits (liabilities and income) are tested indirectly for overstatement and
- By testing credits (liabilities and income) directly for understatement, the corresponding debits (assets and expenses) are tested indirectly for understatement

In other words, when tests are carried out in one direction, misstatement in the opposite direction is automatically tested.

Directional testing allows the testing of:

i. Debits for overstatement and credits for understatement or

ii. Debits for understatement and credits for overstatement

The 'rule of thumb' is, however, the former test (debits for overstatement and credits for understatement), which addresses most of the issues faced by the tax compliance departments when conducting audit. In other words, this test will allow tax auditors to detect whether taxpayers are either overstating their expenses or understating their income or both so as to reduce their tax liabilities.

"Don't leave inferences to be drawn when evidence can be presented"
Richard Wright

1. Test for overstatement of expenses

When testing for overstatement, auditors have to work backwards from the ledger to the source documents. That is, the source of the expenses must be traced to ensure that fictitious amounts have not been introduced in the accounts with a view to reduce the profit. Hence, assertions such as 'occurrence' and 'measurement' are used to verify if expenses claimed have in fact been incurred.

While testing for the overstatement of expenses, any overstatement of liabilities is also indirectly detected. Some examples are given in table 1 below:

Direct Test	Indirect Test
Overstatement of:	**Possible overstatement of:**
Purchases	Trade payables/ Cash/ Bank
Main expenses	Other payables/bank overdraft
Rent	Other payables/bank overdraft
Interest payable	Other payables/bank overdraft

Some of the direct tests are usually carried out through vouching:

- Verification of a sample of purchase invoices
- Verification of a sample of invoices of main expenses
- Analysis of the payroll of the business to ensure the correctness of wages and salaries
- Analysis of the contract of employment of directors to confirm their emoluments
- Analysis of documentary evidences in respect of legal and professional fees
- Analysis of agreements in respect of rent payable
- Confirmation of interest payable through certificate of interest from banks/creditors

It is to be noted that, in addition to the correctness of the amount of expenses, tax auditors need to ensure that same have been incurred exclusively for business purposes and hence non-allowable expenses are disallowed accordingly.

2. Test for understatement of income

As opposed to overstatement, when testing for understatement, auditors have to work from the source documents and move forward towards the financial statements. Understatement occurs when a transaction occurs but is omitted from the books. Therefore, the test aims at checking whether all transactions have been recorded to ensure completeness. Such omission usually arises in the case of income whereby revenue is earned but is not declared by the taxpayer such that the resulting profit generated is lower and hence less tax becomes payable.

As shown in table 2 below, when testing for understatement of income, any understatement of assets is indirectly detected:

Direct Test	Indirect Test
Understatement of:	**Possible understatement of:**
Turnover	Trade receivables/Cash/ Bank
Dividend income	Investment
Rental income	Other receivables/Cash/ Bank
Interest income	Other receivables/Cash/ Bank

Some of the direct tests that can be undertaken are:

- Verification of a sample of customers' orders
- Verification of a sample of goods despatched notes
- Verification of a sample of bank statements
- Verification of sample of invoices (copies)
- Verification of a sample of receipts
- Verification of dividend vouchers
- Analysis of rent agreements
- Analysis of interest certificate

Directional Testing *Cont'd*

Example

Tax audit normally involves the verification of underlying records and source documents. Below is an example showing how turnover can be ascertained through vouching of invoices.

The income tax return of company A for the Year of Assessment 2015/2016 (Income Year ended 31 December 2015) is under examination. The listing of sales amounting to Rs 20m declared in the return has been requested by an officer from the audit department and same has been provided by the taxpayer as follows:

Client Name	Amount (Rs)
A Ltd	100,000
B Ltd	50,000
C Ltd	250,000
D Ltd	1,000,000
E Ltd	10,000,000
F Ltd	600,000
G Ltd	300,000
H Ltd	2,000,000
I Ltd	700,000
J Ltd	60,000
K Ltd	150,000
L Ltd	3,700,000
M Ltd	340,000
N Ltd	750,000
	20,000,000

Sales to E Ltd being the major transaction, the audit officer requested for a further listing in respect of Rs 10m. The company submitted the following:

Sales to E Ltd- Year ended 31 December 2015		
Date	Invoice No.	Amount (Rs)
10.01.2015	7910	1,000,000
02.02.2015	7921	500,000
15.03.2015	7950	500,000
20.04.2015	7961	1,000,000
30.04.2015	7966	200,000
01.08.2015	7971	1,000,000
10.09.2015	7980	800,000
25.09.2015	7982	2,000,000
14.11.2015	7989	500,000
01.12.2015	7991	500,000
10.12.2015	7992	1,000,000
20.12.2015	7995	1,000,000
		10,000,000

To trace the sales transaction recorded in the books to the original source document, the audit officer then selected a sample of 4 invoices (Nos: 7950, 7971, 7982 and 7992) amounting to Rs 4.5m from the above listing. Upon verification of invoice number 7950, the following is noted: the correct client name and date are recorded but the invoice amount is Rs 600,000. The company's accountant is queried about this discrepancy but no concrete answer could be provided; he simply stated that this could be attributed to a mistake.

This discrepancy indicates that the company understated its sales from E Ltd by 20% [(600,000-500,000)/500,000]. Consequently, there is a possibility that sales to other clients might also have been understated. An extrapolation is thus required to adjust the overall sales level by 20%. The audit officer will therefore increase turnover of the company from Rs 20m to Rs 24m.

Third Party Information

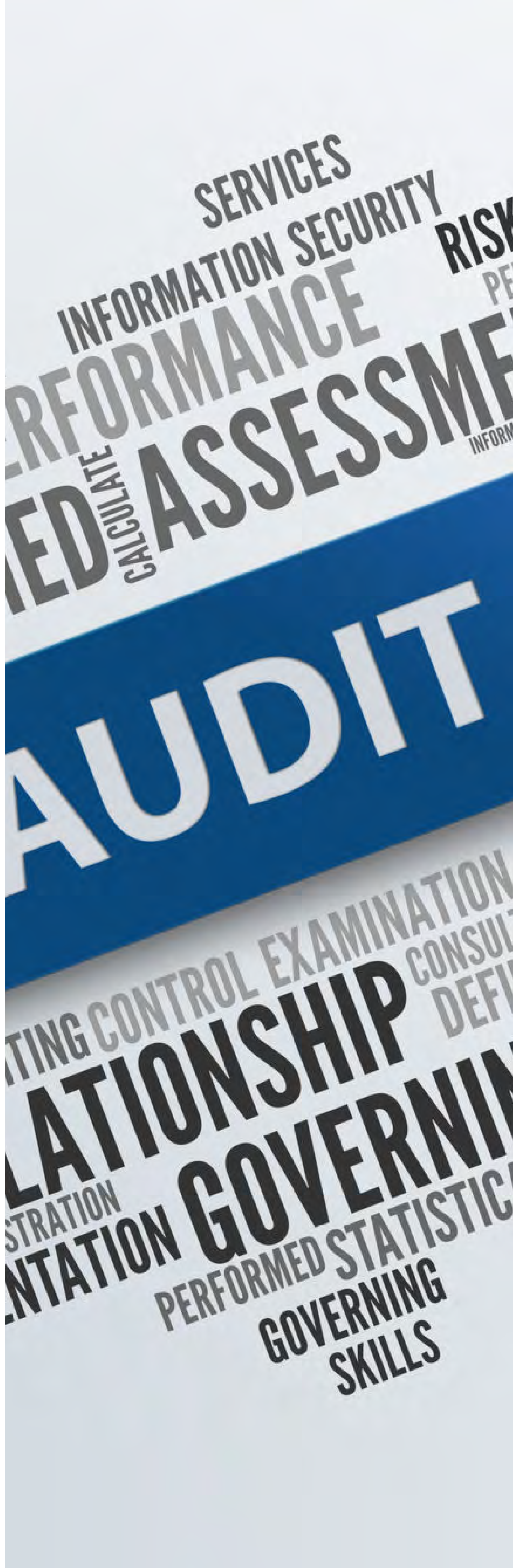
Income declared by taxpayers is also cross checked with third parties through circularisation or information already available. For instance, to test for any understatement of income by a particular contractor, data available as regards "payment made to contractors" is verified to ensure that the income declared by the contractor corresponds to the sum of all payments made by different firms and individuals.

Similarly, to test for overstatement of expenses, the "payment made to contractors" is analysed to verify whether the amount expensed by the company in its accounts corresponds to the payments received by particular contractors.

Conclusion

It is worth mentioning that the above analysis has been geared towards taxation. However, in most circumstances, auditors usually test for overstatement of income and understatement of expenses given the fact that companies tend to inflate profit with a view to attract investors and bankers. Such window dressing is hence tested by auditors through directional testing.

As far as Revenue department is concerned, the main objective of tax audit is to ensure the correctness of the declaration made by the taxpayer in his tax returns. This can be achieved objectively through directional testing which allows the identification of any overstatement of expenses and/or understatement of income. This methodology proves to be helpful to tax auditors since it avoids duplication of tasks and thus reduces audit inefficiencies.



Tax Treatment of Directors Fees

Mrs. Kirtee Heeramun
Technical Officer,
Medium and Small Taxpayers Dept.

Unlike "Employees" of a company who are employed by the management team, "Directors" are appointed at the Annual General Meeting (AGM) by the shareholders of a company. Directors are responsible for determining the policies and strategic direction of a company as well as for the preparation of annual reports on the affairs of the company In consideration to the functions carried out as directors, they get remunerated accordingly.

Although there is a difference in the mode of appointment of an employee and a director, both are liable to income tax. In the present article, we are going to deal with different aspects of taxation of directors.

The Companies Act 2001 defines a director as a member of the board of a company, responsible for "managing, directing and supervising the management of, the business and affairs of the company." A company's board includes both executive and non-executive directors.

Section 159 of the Companies Act 2001 recommends that the directors of a company should be remunerated for their services rendered. Remuneration may consist of salary, director's fees, or use of a company's property and may or may not be tied to company profits.

The term 'director fee' is not defined in the Income Tax Act (ITA). It should therefore be given the normal commercial meaning. Director fees are reward for services rendered as a member of the board of directors of a company. These include, but are not limited to, retainer fees, board meeting fees, and chairman fees.

Directors may also be paid for all travelling, hotel and other expenses properly incurred by them in attending any meetings of the Board or in connection with the business of the company. However, such payments will not be liable to tax if they constitute reimbursement of expenses incurred by the director in the performance of his duties. .

Director fees and Tax Implications

Director fees have tax implications on both the company (i.e. the party paying the fees) and the directors (i.e. the party receiving the fees).

Director fees are allowable deductions for the company, to the extent that the fees have been incurred for the production of the company's gross income. On the other hand, such fees form part of the emoluments of a director and are therefore taxable in the hands of the director.

Director fees and Tax under PAYE

Under section 2 (b) (i) of the ITA, emoluments include:

"a remuneration to the holder of any office and fees payable to the director of a company"

Section 93 of the ITA reads as follows:

(1) Every employer shall, at the time the emoluments are received by or made available to an employee, withhold income tax from the emoluments of that employee.

(1A) The remuneration earned by a director of a company shall, notwithstanding subsection (1), be deemed to have been received by the director in the income year in which such remuneration is charged in the income statement referred to in section 217(1)(b) of the Companies Act, of the company.

Director's fees meet the definition of emoluments in section 2 of the ITA and therefore, such fees will be subject to withholding tax under the PAYE system as required by section 93 (1) of the ITA.

Whereas PAYE normally applies at the time emoluments are received by or made available to an employee, the remuneration earned by a director of a company is, by virtue of section93(1A) of the ITA, subjected to withholding tax under PAYE at the time the director fees are charged in the income statement of the company even if such fees have not yet been received by or made available to the director.

Section 96 of the ITA stipulates the rate at which director fees are subject to PAYE:

"Delegating work works, provided the one delegating, works too!"
Robert Half

"Where any fees are payable by a company to any of its directors, tax shall be withheld from the fees of the director at the rate of 15% of those fees"

All employers are expected to withhold tax under the PAYE system from the emoluments of their employees. However, it is not mandatory to withhold tax from the emoluments of all employees. The law prescribes a threshold. Employees drawing monthly emoluments not exceeding one-thirteenth of the Category A of Income Exemption Threshold (currently Rs 23,077 (1/13 * 300,000)) are classified as exempt employees and thus not affected by the PAYE system .

However, in the case of a director, the situation is different. Where any fees, irrespective of the amount, are payable to a director of a company, tax at the flat rate of 15% is applicable on such fees. For instance, even if a director derives only Rs 8,000 as director fees in a month, the tax to be withheld for that month on account of those fees is 15% of Rs 8,000, i.e. Rs 1,200.

Fees payable to a non-resident director of a company which is resident in Mauritius are also subject to PAYE at the flat rate of 15%. The amount of tax so withheld is the final amount of tax payable on those fees by the director.

A director may either be an employee of the company (executive director) or may be appointed as a non-executive director. Director fees payable to a non-executive director are taxable at the flat rate of 15%. For example, Mr John acts as Non-Executive Director for Company A and receives director fees of Rs 8,000 in a month from Company

Tax Treatment of Directors Fees *Cont'd*

A for attending board meetings. In this case, the onus to withhold PAYE on the fees lies on Company A. The latter will apply a flat rate of 15% on such fees.

However, where a director is an employee of the company and receives BOTH emoluments (including fringe benefits) and fees, he shall be treated as any other employee for PAYE purposes, and the director's fees should be aggregated with the emoluments he derives as an employee.

Example:

If a director is paid Rs 8,000 as fees and Rs 250,000 as salary in a month, the tax to be withheld for that month will be as follows:

	Rs
Salary	250,000
Director fees	8,000
Total emoluments	**258,000**
Less IET (1/13 * 300,000) (Assuming the Director does not have any dependent in that income year)	(23,079)
Chargeable income	**234,921**
PAYE (15%)	**35,238**

Director fees paid by a GBC2 entity

According to item 6 of Sub-Part C to the Second Schedule of the ITA, the following payments made by a company holding a Category 2 Global Business License (GBC 2) are exempt from income tax:

"Interest, rents, royalties, compensations and other amounts paid by a company holding a Category 2 Global Business Licence or a special purpose fund established under the Financial Services Act 2007 to a non-resident"

Questions arose as to whether director fees formed part of the 'other amounts' mentioned above and are therefore exempt from income tax. Legal advice was sought in the matter and it was confirmed that the exemption would apply to payments of similar nature to interest, rents and royalties and not to director's fees. Office Circular No. 5 dated 04 May 2015 has also clarified that director fees payable by GBC2 companies is subject to withholding tax under PAYE.

Fees paid to non-resident directors

Section 74 of the ITA stipulates the following:

"……*Income derived from Mauritius shall include –*

(a) emoluments derived from any office or employment, the duties of which are performed wholly or mainly in Mauritius, whether such emoluments are received in Mauritius or not;

(aa) directors' fees and any other similar payments derived by any person in his capacity as a member of the board of directors of a company which is resident in Mauritius, whether the services are performed in, or from outside, Mauritius"

Subject to section 74 (aa), fees payable to a non-resident director of a company which is resident in Mauritius are subject to PAYE at the rate of 15%.

Previously, a person had to be physically present in a country to provide services as a director. However, with the advent of new technologies, this is no longer required. Board meetings can be effectively delivered through tele-conference or video-conference from any place where there is telephone or internet coverage. The director may hold an office, either physically or virtually, and may thus exercise his decisions and management through this office as authorised under section 158 of the Companies Act 2001.

Thus, director's fees payable in the above situations will also attract tax under PAYE.

However, if the non-resident director performs services from outside Mauritius for the company and is remunerated for such services, the remuneration, to the extent it is not director's fees, will not be subject to PAYE as it is not income derived from Mauritius in accordance with section 74 (1)(a) of the ITA.

It has been noted that in order to avoid tax under PAYE system, companies, especially those operating in the Global Business sector, have the tendency to treat the entire sum payable to a non-resident director as emoluments. A contract of employment between the company and the non-resident director may also be produced to present the latter as an employee.

However, it is inconceivable that the non-resident director has not derived any fees in his capacity as a director. In such case, directorship fees – fees payable to management companies for the provision of resident directors - may be used as a benchmark to determine the amount of the directors fees.

In some cases, it has been noted that the non-resident director also provides consultancy services from outside Mauritius to the company in return for a fee. In such cases, a copy of the consultancy agreement and invoices issued by the directors of the company can be requested to ascertain whether the consultancy services performed by the directors 'go beyond the normal expected roles and responsibilities of a director'. Only then the consultancy fee may not be subject to PAYE system.

Where the director fee is lumped in the consultancy fee, an apportionment will have to be made. Once again, directorship fees incurred by the company may be used as a benchmark.

Directorship fees v/s Director fees

It is important to distinguish between directorship fees payable to management companies and director fees which are payable directly to the directors of a company. The recipients are different in each case.

For a company to operate as a GBL 1, the Financial Services Commission requires that company to have at least two resident directors, as representative of the companies. Normally, it is the management companies which provide the GBL 1 entities with directors. In exchange of this service, the management companies charge a fee which they term as directorship fee. Since the fee is treated as income in the books of the management companies, it is not subject to PAYE as the fee is not paid to individual directors

Value Added Tax (VAT)

Under the VAT Act, supply of services to a non-resident is a zero-rated supply. Global business companies (GBC companies) deal mainly with non-residents. For VAT purposes, supplies made by management companies to GBC companies are treated as zero-rated supplies because it is as if the management companies are supplying the services to the non-residents, through the GBC companies. This is the rationale behind item 6 (b) (i) to the Fifth Schedule of the VAT Act which reads as follows:

"The supply of services by a holder of a management licence under the Financial Services Development Act to corporations holding a Category 1 Global Business Licence or a Category 2 Global Business Licence."

In accordance with the above provision of the VAT Act, directorship services provided by management companies to GBL 1 companies are also zero-rated supplies.

Conclusion

I have tried, through this article, to shed light on the different types of directors fees and their tax treatment, and I hope that this would be useful whenever they have to deal with this issue.

Determining Corporate Tax Residence

Ms. Amira Mamoojee
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The world is referred to as a global village mainly with the advent of rapid communication. Companies operate simultaneously in several jurisdictions. Revenue authorities face a challenge as to where a company should be liable to tax. Some companies use aggressive tax planning schemes to avoid paying tax in the jurisdiction where it is due. It thus becomes important to determine where a company is resident for income tax purposes.

The residence status of a company is determined based on:

- its place of incorporation or
- its place of central control and management/ place of effective management.

As shown in the table below, the definition of residence varies across jurisdictions.

Country	Definition of 'Residence'
South Africa	It is incorporated or has its place of effective management in South Africa.
India	It is an Indian company; or the control and management of its affairs is situated wholly in India. Changed with effect from 01 April 2016: It is an Indian company; or its place of effective management is in India.
France	It is incorporated under French commercial laws.
UK	It is incorporated in the UK or, its central management and control are exercised in the UK.
Singapore	The control and management of whose business is exercised in Singapore.
China	It is incorporated in China or it is incorporated elsewhere but has the place of effective management in China.
Australia	It is incorporated in Australia or although not incorporated in Australia it carries on business in Australia and has either: its central management and control in Australia; its voting power controlled by shareholders who are residents of Australia.
Germany	Its place of incorporation or its main place of management is in Germany.
Russia	It is incorporated in Russia.
Canada	Its central management and control is exercised in Canada or it is incorporated in Canada.
Cyprus	Its management and control are exercised in Cyprus.
Luxembourg	Companies have their legal seat or central administration in Luxembourg.
Netherlands	Its place of effective management is in Netherlands.
Switzerland	Its legal domicile (registered office) or place of effective management is located in Switzerland.

A company was considered to be tax resident in Mauritius in the Income Tax Ordinance 1950 when the control and management of its business was exercised in Mauritius. After independence, with the promulgation of the Income Tax Act 1974, a new criteria was added to the definition of tax residence such that a company is considered to be resident if "it is incorporated" or "has its central management and control" in Mauritius. The new Income Tax Act 1995 maintained the same definition of tax residence as in the penultimate legislation. The common criteria in the above three legislations is about central control and management in Mauritius. Having said this, a foreign company which is incorporated in a country other than Mauritius is resident in Mauritius if it is centrally managed and controlled in Mauritius. However, a company incorporated in Mauritius is treated as non-resident if it has its central management and control outside Mauritius.

The place of incorporation is a factual issue and there would be hardly any dispute about its interpretation. However, same cannot be said about 'centrally managed and controlled'. Some pointers regarding the meaning of 'central management and control', derived from case law, are listed below:

- The highest level of decision making.
- The place where decisions about the strategic policy and direction of a company are taken. These decisions will depend on the nature of the business and may include, for example, the acquisition/ disposal decisions, the capital investment decisions and extension or restriction of the company's scope of activity, among others.

It is not the exercise of powers vested in the shareholders in general meeting, the day to day management or the actual carrying on of a business that would be the only criterion for the determination of 'central management and control'

Since the term "central management and control" has not been defined in the Income Tax Act 1995, it would be interesting to examine some leading court cases so as to understand the precise meaning of the term.

1. **Calcutta Jute Mills Company, Limited v/s Henry Nicholson (Surveyor of taxes) 1876 (1 TC 83)**

The company was incorporated on 16 April 1872 and was managed by a board consisting of not less than five directors. One of the directors was resident in Calcutta, India and the others in United Kingdom.

It had a spinning factory and was manufacturing Jute at Ishera, near Calcutta. All raw materials were purchased in India itself. After the manufacturing process, products were sold wholly in India. In an agreement, it was constituted that the managing agents are in India and they have the entire control of the business. The company thus contended that it was resident in India.

The company had no office or other place of business in UK though for the purpose of registration, its address is in London, which was in fact the office of one of the directors. Board meetings were held in London. All the company's books of accounts, papers, money and other documents were kept, received and dealt with by the management in India. The directors received a proportion of the profits realised in India by way of dividend.

Since the company was managed by its board of directors in UK, it was held that the company was resident in UK because its control and management was there.

2. **The Cesena Sulphur Company, Limited v/s Henry Nicholson 1876 (I TC 88)**

An English company carried on its trade in the Kingdom of Italy. It was engaged in the business of sulphur mining and manufacturers or merchants at Cesena in Italy.

The company was registered in Italy but was managed by a board of eight directors, holding their meetings at the registered office of the company in England. Two or three members of the board were resident in Italy, one of them was the Managing Director of the company and resided at Cesena.

Determining Corporate Tax Residence *Cont'd*

All the operations of the company were wholly carried on at Cesena where the profits were earned but the Italian members of the board were in constant correspondence with their co-directors resident in France and England who meet at the English registered office. Transcripts and copies of the company's books of accounts were sent to London but all the original books of accounts and all its money were kept in Italy.

However the administrative part of the business would be carried on at the place from which the orders came, from which all the directions flowed and where the appointments were made, where the money was received and where the dividends were payable which were in London.

Hence the company was held to be resident in England and thus liable to British taxation.

Following the above two cases one important case went up to the House of Lords for a decision. A summary of the case is given below:-

3. **De Beers consolidated Mines, Limited v/s Howe (Surveyor of Taxes) 1906 (5 TC 198)**

The company was engaged in diamond mining and its registered office was in South Africa. Even the head office was in South Africa.

Extraction of diamond was effected in South Africa. Statutory meetings of shareholders were also conducted in South Africa.

The contention of the company was that it is tax resident in South Africa.

The key factor was that the board meetings were held in London and the House of Lords determined that the company had its control and management in England. Thus the company was resident and taxable in UK.

The case of De Beers has become of paramount importance in determining the central management and control whenever similar cases arise. The ratio decidendi of the case is reproduced below:

"The head office (of De Beers) is formally in Kimberley (South Africa), and the general meetings have always been held there. Also the profits have been made out of diamonds raised in South Africa and sold under annual contracts to a syndicate for delivery in South Africa upon terms of division of profits realised on resale between the company and the syndicate. And the annual contracts contain provisions for regulating the market in order to realise the best profits on resale. Further, some of the directors and life governors live in South Africa and there are directors' meetings at Kimberley as well as in London. But it is clearly established that the majority of directors and life governors live in England, that the directors meetings in London are the meetings where the real control is always exercised in practically all the important business of the company except the mining operations. London has always controlled the negotiation of the contracts with the diamond syndicates, has determined policy in the disposal of diamonds and other assets, the working and development of mines, the application of profits, and the appointment of directors. London has also always controlled matters that require to be determined by the majority of all the directors, which include all questions of expenditure except wages, materials and, such-like at the mines, and a limited sum which may be spent by the directors at Kimberley."

More than 100 years after the judgement in De Beers, a landmark case has been ruled by the court in Australia which also has in its law the term "central management and control". The Judgement in **Bywater Investments LTD and others v/s Commissioner of taxation**, delivered on 11 December 2015 may be considered to be a departure from the principles laid down in De Beers.

4. **Bywater Investments Ltd and others v/s Commissioner of taxation**

The Australian case involved 4 companies viz

i. Bywater Investment Ltd (Bywater)

ii. Chemical Trustee Ltd (Chemical Trustee)

iii. Derrin Brothers Property Ltd (Derrin Brother)

iv. Hua Wang Bank Berhad (Hua Wang)

All the above companies were incorporated outside Australia and their ultimate holding entity were 2 companies in Cayman Island. Mr Peter Borgas who was resident in Switzerland was the only shareholder of the companies in Cayman Island. Mr Peter Borgas was a director in all the companies. It was contended on behalf of the appellant that Mr Borgas as director was responsible for the "Central management and control of the companies. As such, they were not resident in Australia. The Tax Authority contended that:

- an accountant based in Sydney, Australia called Vanda Gould who had all the powers to appoint directors was the one who was taking all strategic decisions; and
- Mr Peter Borgas in Switzerland, was only implementing the decision of Vanda Gould who was the real decision maker.

In this case it was ruled that the real decision taking was made from Australia and not in Switzerland by Peter Borgas. As such, the companies were considered to be resident in Australia and were taxable there.

From the above Australian case, it is confirmed that a company may be resident in more than one country, that is it may have more than one place of management, but it can have only one place of effective management (POEM) at any time, where decisions are regularly and predominantly made.

POEM is the place where key management and commercial decisions that are necessary for the conduct of a business are in substance made, as defined in paragraph 24 of the commentary on Article 4 of the OECD model tax convention.

Furthermore, the South African Revenue Services (SARS) issued a new interpretation (Note 6 Issue 2 dated 03 November 2015) which provides guidance on the interpretation and application of the term "POEM" in determining the tax residence of a company.

The note underlines that there are multiple facts, involving multiple locations and from those, it is necessary to determine a single dominant place where effective management is located. The POEM test is one of substance over form which requires the identification of those persons in a company who actually "**call the shots**" and exercise "**realistic positive management**". The POEM must be determined by ascertaining what are and who makes the key management and commercial decisions for the conduct of the company's business as a whole and where those decisions are in substance actually made.

The note further elaborates on the location of a company's head office, the board, the board's delegation of its authority to a committee consisting of key members of senior management, the impact of modernization and global travel on POEM and the role of shareholder in decision making where it may usurp the power of a director and influence the POEM.

Did you Know?

Export of goods: Companies engaged in export of goods shall be liable to tax at the rate of 3% on the chargeable income attributable to that export.

Determining Corporate Tax Residence *Cont'd*

Moreover, India issued guidelines in January 2017 on POEM which aim to target companies that are created for retaining income outside India though the management and control is located in India. The guidelines provide that a POEM determination is based on whether or not a company is engaged in "active business outside India" (ABOI).

According to the guidelines, 'a company is said to be engaged in ABOI if the passive income is not more than 50% of its total income; and

i. less than 50% of its total assets are situated in India;

ii. less than 50% of its total number of employees are situated in India or are resident in India; and

iii. the payroll expenses incurred for such employees is less than 50% of its total payroll expenditure.

Also some guiding principles mentioned for determining POEM in India are: the location of the board meetings where key and commercial decisions necessary for conducting the business as a whole are made, the board delegation of its authority to one or more committee and the location of a company's head office. Nowadays, the use of modern technology and the decisions made by shareholders greatly impact the POEM.

On a global perspective, Mauritius has concluded tax treaties with various countries, which follow both the OECD and UN Model. Article 4 of the tax treaties deals with 'Resident', where the term resident of a contracting state is defined and it is mentioned that when a company is a resident of both contracting states then it shall be deemed to be resident only in the State in which its place of effective management is situated.

In May 2015, following the renegotiation of the South African tax treaty with Mauritius as regards dual residence, paragraph 3 of Article 4 of the 2014 OECD model was adopted. At the same time, a Memorandum of Understanding (MoU) was signed between the Mauritius Revenue Authority (MRA) and the South African Revenue Service laying down the factors to be taken into account when applying the provision of Article 4(3) of the treaty. These factors are listed below and have been borrowed from the commentary of Article 4(3) of the OECD model:

a. where the meetings of the person's board of directors or equivalent body are usually held;

b. where the Chief Executive Officer and other senior executives usually carry on their activities;

c. where the senior day to day management is carried on;

d. where the headquarters are located;

e. which country's laws govern the legal status of the person;

f. where its accounting records are kept;

g. any other factors listed in paragraph 24.1 of the 2014 OECD commentary as may be amended by OECD/BEPS Action 6 final report; and

h. any other factors that may be identified and agreed upon by the competent authorities in determining the residency of the person.

To conclude, it is clear from case law that 'central management and control' or POEM is usually exercised by the persons who are in control of the entire business and make all important decisions of the company, who may be the director, a board of directors or the shareholder. The place from where these decisions are being taken is important. A company may be carrying on its business in a particular country but where are the orders and directions for running the business coming from, who controls and who are financing that business are the questions that needs to be asked. Hence, the company will be resident where the real decision makers are located. However, as seen in the case Bywater Investments Ltd, a company may be managed at different places but it can have only one place of effective management, where the final decisions are being taken, which will determine the residency of that company.

IFRS 15 - Revenue from Contracts with Customers

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Revenue is a very important item, whether for shareholders, potential investors and even for tax auditors. This figure will set the tone on the tax to be levied. Since the accounting profit is the starting point for calculation of chargeable income and the accounts are prepared based on International Financial Reporting Standard ("IFRS"), it is mandatory for the tax auditors to understand clearly how the revenue figure is computed and the relevant standards used in its calculation. IFRS 15 has brought major changes and any change in the pattern of revenue recognition will have a direct impact on taxation.

Nowadays, transactions do not consist of mere buying and selling of goods but the complexity of today's transactions has rendered the existing standards obsolete. IFRS 15 has thus emerged to address the weaknesses under those standards and also to bring in a suitable model which bridge the gap between IFRS and US GAAP. It supersedes all revenue recognition standards including IAS 18 Revenue and IAS 11 Construction Contracts and aligns with the revenue recognition requirements under US GAAP. IFRS 15 was issued in May 2014 and it is effective for periods beginning on or after 1 January 2018.

The impact of IFRS 15 shall be minimal for straightforward and clear-cut transactions such as buying and selling of goods. It will affect mostly long term service contracts and bundled contracts of "products and services" where it can result in changes either to the amount and/or to the timing of revenue recognized. Consequently sectors like software development, real estate, telecommunication services, construction, power and utility entities, automotive industry and industries dealing in long term contracts will mostly be affected.

1	Identify the contract (s) with a customer
2	Identify the performance obligations in the contract
3	Determine the transaction price
4	Allocate the transaction price to the performance obligations in the contract
5	Recognise revenue when (or as) the entity satisfies a performance obligation

While under IAS 18 transfer of goods and services was based on transfer of risks and rewards, under IFRS 15 transfer is based upon transfer of control. Let us take the example of a software licence sold to a customer where the vendor needs to provide an access code to enable access to the software. The vendor shall recognise revenue only when the access code has been made available to the customer, even though the licence period could have started at an earlier date. This is because even though the customer is in possession of the software licence, the customer does not have control over same without the access code. Therefore, while conducting a tax audit, it may be found that the company has delivered the licence to a customer and received the proceeds but no revenue recognised. This may be perceived as an underestimation of revenue. In reality as per IFRS 15 there has not been transfer of control since the access code has not been delivered yet and hence revenue has not been recognised.

Furthermore, IFRS 15 requires entities to recognise revenue when a performance obligation has been satisfied. For instance in the automotive industry many companies provide free maintenance services upon sale of cars. Let's assume a car company whose year-end is 31 December sells a car to a client on 3 January 2018 for Rs 800,000 and gives the client free maintenance for a period of 3 years. The maintenance service for 1 year is worth Rs 5,000.

Previously, the company would have recognised the whole amount of Rs 800,000 as revenue for the year ended 31 December 2018. However under IFRS 15, it would be incorrect to recognise Rs 800,000 as revenue for that period. IFRS 15 would require the company to identify the "sale of the car" and "maintenance" as separate performance obligations. Therefore, the maintenance service will have to be recognised over a period of three years as and when performance obligations are satisfied as shown in the table below.

Year End	31 Dec 2018	31 Dec 2019	31 Dec 2020
Maintenance	5,000	5,000	5,000
Sale of car	785,000		
Total	**790,000**	**5,000**	**5,000**

"Most of the important things in the world have been accomplished by people who have kept on trying where there seemed to be no hope at all"
Dale Carnegie

The revenue to be recognised as at the year ended 31 December 2018 shall be Rs 785,000 for sale of car and Rs 5,000 for maintenance. The remaining revenue of Rs 10,000 for maintenance is to be recognised as follows:

Year End 31 December 2019: Rs 5,000

Year End 31 December 2020: Rs 5,000

While auditing the period 31 December 2018, the tax auditor will find that the company has invoiced Rs 800,000 and has received Rs 800,000 in its bank account but recorded only Rs 790,000 as revenue.

IFRS 15 is seen as a revolutionary change in revenue recognition.

For tax purposes, IFRS 15 may result in timing difference which may also impact on deferred tax. Revenue recognised as per the new standard may not necessarily match the invoiced amount and money received. It is therefore mandatory for tax auditors to understand how the mechanism operates before auditing sectors which are affected by this new standard so that they do not reach a wrong conclusion.

Apportionment of Input Tax

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Brief overview of credit for input tax

Before going into the detailed analysis, let me explain briefly the meaning of input tax and the rule governing its allowability. Input tax means, in relation to a taxable person, VAT charged to him on the supply of goods or services and VAT paid on importations which, in both cases, have to be used in the course or furtherance of his business. Only input tax allowable under section 21 of the VAT Act can be taken as credit by a registered person. Credit for input tax is not allowable on items specified in section 21(2) of the VAT Act. Moreover, a credit for input tax will not be allowed if it is not supported by proper VAT invoices or Customs import declarations.

A credit for input tax must be taken only once in the return for the taxable period in which it was incurred. Where credit for any input tax has not been taken in the taxable period in which it ought to have been taken, a registered person may take such credit within a period of 36 months of the date the input tax ought to have been taken.

The issue

Under section 21 of the VAT Act, a registered person can claim as credit against his output tax in any taxable period, the amount of input tax allowable to him during that period. A person who makes only taxable supplies/sales (standard & zero rated) is entitled to deduct all the input tax incurred for the purposes of making those supplies. However, a person who makes both taxable supplies and exempt supplies is not entitled to the full input tax credit for that period. Where the input tax is directly attributable to the taxable supplies, he is entitled to the whole amount of such input tax. No claim can be made in respect of input tax directly attributable to exempt supplies. Where the input tax is attributable to both the taxable supplies and the exempt supplies, he has to apportion the input tax attributable to both taxable supplies and exempt supplies. The apportionment must be fair and reasonable.

Applicable laws

The analysis below is based on the provision of section 21(3) of the VAT Act and Section 8A of the VAT Regulations. Section 21(3) of the VAT Act describes the manner in which input tax should normally be apportioned whereas Section 8A of the VAT Regulations provides that where a taxpayer is disadvantaged by the normal method of apportionment of input tax, the Director-General can approve an Alternative Basis of Apportionment.

How does apportionment arise?

As mentioned above, the method of apportionment is provided under section 21(3) of the VAT Act. This method provides that where a registered person uses taxable goods and services to make both taxable supplies and exempt supplies, credit for input tax is allowed in the proportion of the value of taxable supplies to total turnover on the basis of:

i. in the case of a new business, the estimated figures for the current accounting year; or

ii. in any other case, the actual figures for the previous accounting year.

A registered person who has apportioned input tax using this method has to adjust the amount of input tax taken at the end of his accounting year, based on actual figures for sales for the year. He has to make an adjustment in his return for the taxable period immediately following the end of that accounting year.

The normal method of apportionment can be illustrated by means of the following example:

XYZ Ltd deals in both taxable supplies and exempt supplies. It started its operations on 1 July 2019 and its expected turnover for the twelve months ending 30 June 2020 was as follows:

Expected Annual Turnover

Nature of supply	Value (Rs)	VAT (Rs)
Standard rated	7,000,000	1,050,000
Exempt	3,000,000	Nil
Total	**10,000,000**	**1,050,000**

The company incurred input tax attributable to both taxable supplies and exempt supplies for the quarter ended 30 September 2019 as follows:

Input tax for quarter ended 30 September 2019

Expenses:	Value (Rs)	VAT (Rs)
Directly attributable to exempt supplies	60,000	9,000
Directly attributable to taxable supplies	80,000	12,000
Attributable to both taxable & exempt supplies:		
Rent	*150,000*	*22,500*
Telephone	*30,000*	*4,500*
Administrative expenses	*250,000*	*37,500*
Other expenses	*300,000*	*45,000*
Total		**109,500**

Allowable input tax for quarter ended 30 September 2019 would be calculated as follows-

i. <u>Input tax in respect of both taxable supplies and exempt supplies</u>

Apportionment Formula= A X B/C, where

A= total amount of input tax in the taxable period attributable to both taxable supplies and exempt supplies

B=Estimated value of taxable supplies for the current year without VAT (new business)

C= total expected value of all supplies (excluding VAT) during the current year including exempt supplies.

Allowable input tax for quarter ended 30 September 2019 would be:

A X B/C = 109,500 X 7,000,000/10,000,000= Rs76,650

ii. <u>Input tax directly attributable to taxable supplies- Rs 12,000</u>

Total allowable input tax for December 2015 - Rs 76,650 +12,000 =Rs 88,650

End of Year Adjustment

Assuming that the input tax attributable to both taxable supplies and exempt supplies for the year ended 30June 2020 was Rs 820,000.

In that respect, input tax allowable and taken by taxpayer, based on estimated annual turnover, would be:

820,000 x 7,000,000/10,000,000 = Rs 574,000

Apportionment of Input Tax

Cont'd

Now, suppose the actual sales for the year ended 30 June 2020 were as follows

Actual Turnover for the year

Nature of supply	Value (Rs)	VAT (Rs)
Standard rated	9,000,000	1,350,000
Exempt	3,000,000	Nil
Total	**12,000,000**	**1,350,000**

Based on the above annual turnover, input tax attributable to taxable supplies would be –

820,000 x 9,000,000/12,000,000 = Rs 615,000.

Company XYZ Ltd has claimed less input tax in respect of the supplies attributable to both taxable supplies and exempt supplies for the year for an amount of Rs 41,000 (615,000 – 574,000).

It will be entitled to make an adjustment as input tax claimable in its return for July 2020 for the amount of input tax under-claimed.

However, had the input tax actually claimed by XYZ Co Ltd in the returns been more than the input tax calculated on the basis of the actual turnover for the accounting year, XYZ Co Ltd must adjust its return with the excess amount claimed as tax charged.

Alternative basis of apportionment of input tax

Where a registered person claim that the normal method of apportionment of input tax is not fair and reasonable given the nature of his business, he may apply to the Director-General to use an alternative basis of apportionment.

The application in support of the alternative basis should state the following:

i. The reasons why the normal method of apportionment is not fair and reasonable;

ii. The description of the alternative basis of apportionment; and

iii. Any other information that may be required by MRA.

ILLUSTRATION

__Illustration (i)__

Consider an Insurance company having a ten-storeyed building. Income, to the tune of Rs28m is derived from insurance activities the office of which is located on the ground floor. The remaining nine floors are leased in return for rental income. Annual rental income amounts to Rs 4.5m (9 x Rs500,000).

During the year, the company incurred input tax on repairs and maintenance costs (including refurbishment and cleaning) and utilities of the building in the sum of Rs350 000.

Since the input tax incurred on the abovementioned costs relates to the overall business activities, that is to produce both taxable and exempt supplies, it is subject to apportionment in order to determine the amount of allowable input tax.

On the basis of turnover, out of the amount of Rs350,000, input VAT deductible would amount to Rs48,300 (13.8% x 350,000) only and the difference of Rs301,700 would not be allowable to the company. In the circumstance, the company considers that basis to be unfair.

The entity applies to the Director General to consider an alternative method of apportionment on basis of floor area of the building.

Did you Know?

Exempt income: Any expenditure which is incurred in the production of income which is exempt income is not allowable for tax purposes.

Apportionment calculation:

Normal method (Turnover):	Deductible proportion	Input Tax
Value of taxable supplies =4.5m/32.5m x 100	13.8 %	48,300
Alternative basis (Floor Area): 9/10 =	90%	315,000

In the present case, the alternative method of apportionment based on the floor area occupied will be more favourable to the entity than the standard method.

The deductible proportion of 90% under the alternative method better reflects the economic use of the overheads and is more accurate than the normal method.

Although there is no prescribed method in the VAT Act to determine the proportion, the rule is that the result must be fair and reasonable. The majority part of the building (90%) is being used to generate taxable supplies and only 10% is being used to make exempt supplies. Therefore, it appears unfair to use the normal method in this situation.

Illustration (ii)

Another sector where often application to use an alternative basis of apportionment is the construction sector. Suppose a developer employs a contractor to construct a new building which contains commercial units on the ground floor with residential flats above for sale. The construction of the whole building is taxable at the standard rate. However, the sale of the commercial part is standard rated, while the sale of the residential element is exempt. The developer has to apportion the VAT on construction between the taxable and exempt elements of the building. And here the developers often find the Normal Method of Apportionment inappropriate and not fair and reasonable. They then apply to the Director General for an alternative basis with reference to floor space, costs, value or any other method which provides a fair and reasonable result. The alternative method proposed should be adopted only after approval given by the Director General.

Conditions for alternative basis of apportionment

The Director-General, having regard to the nature of the business, and is satisfied that the normal basis of apportionment would not give a fair and reasonable apportionment of input tax, he may, by notice in writing, approve such alternative basis on such conditions as are specified in section 8A(5) of VAT Regulations. These conditions are reproduced below:

a. the approved alternative basis of apportionment shall take effect as from the beginning of the accounting period of the registered person following the date of the approval;

b. the registered person shall maintain appropriate records so that the alternative basis of apportionment can be readily verified by the Director-General;

c. where changes in the circumstances of the business no longer render the alternative basis fair and reasonable, the registered person shall, not later than one month after the occurrence of these circumstances, notify the Director-General in writing;

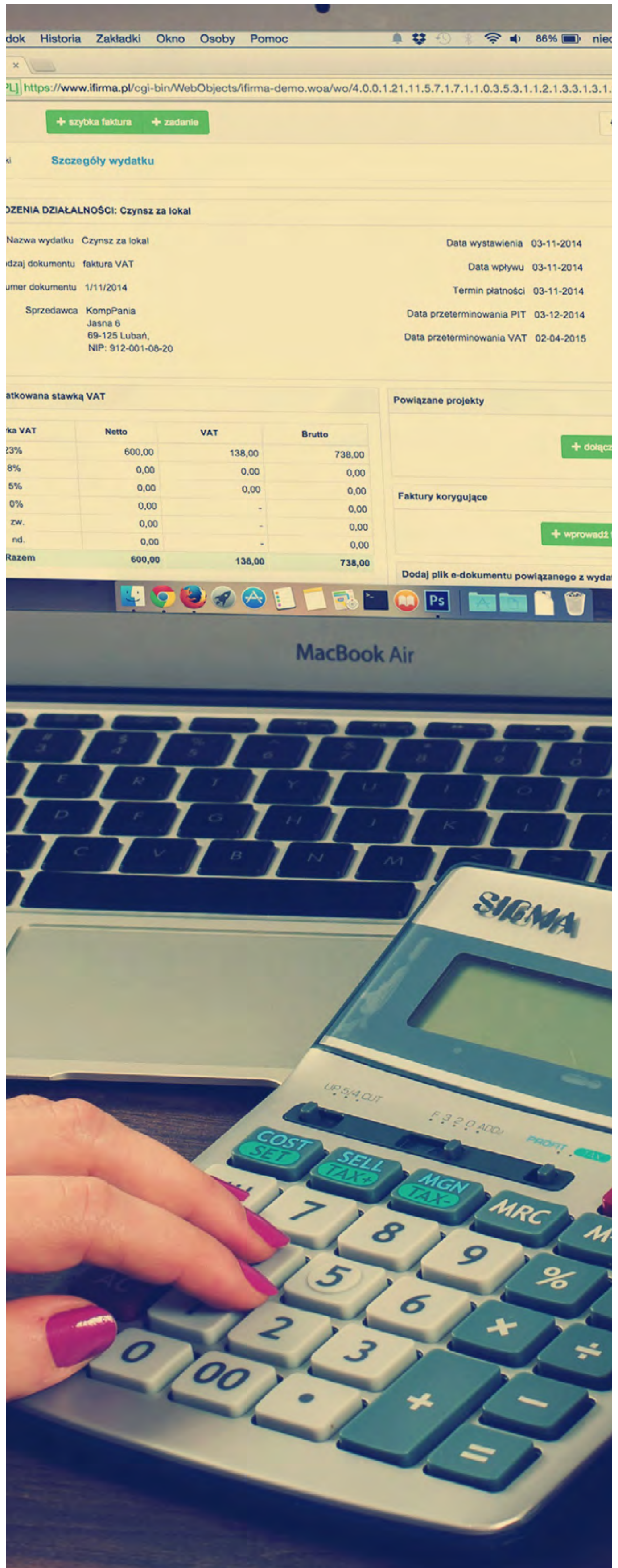
d. the registered person shall continue to apply the alternative basis of apportionment until such time as the Director-General otherwise notifies the person in writing.

Apportionment of Input Tax

Cont'd

Conclusion

Credit for input tax is a key element in the operation of the VAT mechanism, and can be at the same time a major risk area in our tax system. However, we have a responsibility to ensure that the registered person does not take undue advantage of the system by crediting more input tax than that to which he is entitled. Where the registered person deals in both taxable and exempt supplies, apportionment must be in accordance with the provisions of the VAT Act. We have to be vigilant in certain sectors where substantial amount of input tax is involved and for which repayments are claimed. For example in the property development sector where a registered person is engaged in both taxable and exempt supplies, he often applies for the alternative basis of apportionment. We should ascertain that the proposed Alternative Basis of Apportionment is justified and will really entitle the taxpayer to a fair and reasonable apportionment of input tax in relation to his project.



Did You Know?

Subject	Relevant Information
Appeal to ARC	With effect from 01 September 2018, an additional 5% of the amount of tax assessed will be payable when applying before the ARC.
Tax Holiday	A five-year tax holiday is introduced for a company setting up an e-commerce platform provided the company is incorporated in Mauritius before 30 June 2025.
Presumptive Tax on small enterprise	Companies engaged in agriculture, fishing, manufacturing or trading of goods and having annual turnover not exceeding Rs10 million have the option to pay 1% of their turnover as a final income tax on business income.
Annual allowance	Capital expenditure incurred on plant or machinery not exceeding Rs60,000 or less will attract 100% annual allowance in the year of acquisition.
Zero-rated supply	The transport fares of passengers travelling by light rail is zero rated for VAT purposes.
Tax band of 10%	The reduced income tax rate of 10% will continue to apply for employees whose annual net income in the income year does not exceed Rs700,000.
Partial exemption	The 80% partial exemption regime is applicable to all companies incorporated in Mauritius deriving dividend or interest income, whether local or foreign sourced. The benefit is subject to the prescribed substance requirements.
Export of goods	Companies engaged in export of goods shall be liable to tax at the rate of 3% on the chargeable income attributable to that export.
Taxation of foreign artist	Final tax in the form of tax deduction at source at the rate of 10% is applicable in respect of fees paid to a non-resident entertainer or sportsperson.
VAT deregistration	Where the return for the last taxable period of a VAT registered person shows an excess of input tax over output tax, the excess of input tax over output tax shall not be refundable upon cancellation of registration.

Automatic Exchange of Information (AEOI)

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The automatic exchange of information(AEOI) under the Common Reporting Standard (CRS) involves the systematic and periodic transmission of "bulk" taxpayer information by the source country to the residence country concerning various categories of income (e.g. account balance or value, dividends, interest, royalties, salaries, pensions, etc.).

AEOI is now up and running and is a powerful tool to improve tax compliance is. This represents a significant step forward in international cooperation on tax transparency, ushering in a new era where the automatic exchange of financial information for tax purposes is the norm.

The first exchange of information under CRS took place last year. Financial Institutions had until the 31st August 2018 to submit their reports to the MRA while the MRA had up to the 30th September 2018 to send those reports to jurisdictions wishing to exchange with Mauritius. The exercise proved to be a successful one. Prior to exchange of information, Mauritius had to ensure that the four main building blocks described below are in place:

1. **Domestic legislation**

   To enable the implementation of the CRS, the Income Tax Act has been amended accordingly. It requires Financial Institutions to establish, maintain and document CRS due diligence procedures and to provide the MRA with information in respect of reportable accounts. CRS Regulations which contain detailed information about due diligence rules have also been gazetted.

2. **Administrative capacity**

   The MRA had to ensure that it had the required technical and administrative capacity to properly manage information being sent as well as information received from partner jurisdictions. The Information Systems Department with the support of the International Taxation Section developed the necessary platforms on the MRA Website to allow Financial Institutions to register with the MRA and to submit their CRS Reports. We also ensured that we had the necessary IT infrastructure in place to receive and send data through the Common Transmission System (CTS) developed by the OECD.

3. **International agreements**

   In October 2014, Mauritius signed the Multilateral Competent Authority Agreement (MCAA) which provides for automatic exchange of information with other Competent Authorities. In June 2015, Mauritius also signed the Convention on Mutual Administrative Assistance in Tax Matters (the Convention) developed by the OECD. This enables Mauritius to exchange information automatically on a reciprocal basis with all those jurisdictions that have signed the Convention.

4. **Confidentiality and data safeguards**

   Confidentiality of taxpayer information is a fundamental cornerstone for the proper implementation of CRS. An expert panel of the Global Forum on Transparency and Exchange of Information for Tax Purposes has on the basis of an assessment concluded that the level of confidentiality and data safeguards in place at the MRA is of the required standard.

   Mauritius has in fact been able to exchange information with Participating Jurisdictions for the past two consecutive years because it has robust data safeguard and security systems in place.

The domestic legal framework of Mauritius has been subject to a peer review process by the AEOI working group to ensure that all the key elements of the AEOI Standard are reflected therein. After the exercise Mauritius received recommendations on particular issues and was asked to take remedial actions to address those recommendations.

One recommendation related to the absence of anti-abuse provisions in our CRS legislative framework. This provision is essential in the implementation of CRS as it will prevent the development of schemes to avoid complying with CRS. Another recommendation received was as regards the imposition of administrative penalties for non-compliance. Administrative penalties have to be included so as to ensure a high compliance rate. The MRA therefore had to amend the current CRS Regulations to include those provisions. The amendments have been gazetted in May 2019. This means that administrative penalties can now be imposed in cases of non-compliance with the CRS Regulations.

"Pleasure in the job puts perfection in the work"
Aristotle

The MRA has also developed a compliance strategy and will conduct compliance checks with Financial

diligence procedures are being followed to identify reportable accounts.

The aim of this exercise is to ensure that complete and accurate information has been reported by the FIs. This is an essential component of the successful implementation of CRS and has been included as a core requirement in the Terms of Reference(TOR) for the peer review of the AEOI Standard. The two other core requirements of the TOR are that jurisdictions should exchange the information effectively in practice, in a timely manner, including by sorting, preparing, validating and transmitting it in accordance with the AEOI Standard and proper confidentiality and data safeguards have to be in place.

It is also worthwhile noting that the EU listing process has set as a Future criterion that a jurisdiction should possess at least a "Largely Compliant" rating by the Global Forum with respect to the Automatic Exchange of Information under the Common Reporting Standard. Achieving this rating is essential to show that Mauritius as a Financial Centre not only has all the legal requirements in place in terms of tax transparency and exchange of information but that the practical implementation of AEOI is a success.

NIT – Minimum Wage Special Allowance

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Negative Income Tax (NIT) is a system forming part of the welfare state where an individual in the low income bracket receives an allowance from the state if his income is below a pre-defined threshold. The idea of NIT is believed to have originated from the American economist, Milton Friedman in the early sixties. He advocates in his 1962 book, Capitalism and Freedom, the payment of NIT by the state as an improvement of the welfare state. This proposal found a number of academic champions including Robert Lampman (1965,1968) of the University of Wisconsin and the late Joseph Pechman and was brought to the attention of the US government policy planners in 1965.

In Mauritius, NIT has been introduced in July 2017 following legislative changes brought to the Income Tax Act 1995. The purpose of NIT is to provide for a direct financial support to individuals of the lower income group.

Every individual who is a Mauritian citizen deriving a basic wage of up to Rs 9,900 is entitled to NIT whether from full-time or part-time employment. The individual is required to work for a minimum of 24 hours during at least 3 days in a week. Payment of NIT is made on the basis of the basic wage declared by the employer in his monthly National Pension Fund (NPF) return. To benefit from NIT, the individual's total monthly emoluments excluding travelling, end-of-year bonus, annuity and pension including basic retirement pension should not exceed Rs 20, 000 rupees. Additionally, the net yearly income of the individual or his spouse, excluding any dividend and interest should not exceed Rs 390, 000 rupees and the individual and his employer should both be compliant with their contributions to the NPF and the National Savings Fund (NSF).

The responsibility to pay NIT has been entrusted to the MRA and the monthly allowance payable is as shown in the table below.

Individual deriving the following basic wage in a month	Allowance (Rs)
Less or equal to Rs 5,000	1,000
Between Rs 5,001 and Rs 7,000	800
Between Rs 7,001 and Rs 9,000	500
Between Rs 9,001 and Rs 9,750	250
Between Rs 9,751 and Rs 9,900	100

In January 2018, the government introduced the national minimum wage. Every employer, other than an export enterprise, is required to pay full-time employees a monthly national minimum basic wage of Rs 8,140 plus an additional remuneration of Rs 360, that is, a total of Rs 8,500 monthly. Where the employer is an export enterprise, the monthly national minimum basic wage payable is Rs 8,140 inclusive of the additional remuneration of Rs 360.

The government has also decided to top-up the basic wage of all full-time employees, through a Special Allowance, so that all full-time employees have an income of at least Rs 9,000. The Special Allowance is the difference between the employee's monthly basic wage and Rs 9,000. The MRA has been entrusted with the responsibility to pay the Special Allowance.

In January 2019, employees have been provided with a salary compensation of Rs 400. In order to maintain the Special Allowance that the employees were already deriving, the basis on which the Special Allowance is payable has been increased from Rs 9,000 to Rs 9,400. For employees taking up employment as from 01 January 2019, the basis for the calculation remained at Rs 9,000 such that the new employees will derive Special Allowance to a maximum of Rs 100 unless such employee is employed by an export enterprise, in which case, the maximum allowance payable is Rs 460.

An employee is entitled to either NIT or Special Allowance, but not both. As these two allowances may be different, one may be more beneficial to the employee. In order avoid the employee from making a choice based on complex calculations, the MRA effects monthly payment NIT or Special Allowance on the basis of the allowance which is more beneficial to the employee. Taking the example of a full-time employee deriving a monthly basic wage of Rs 8,600, he is entitled to either NIT of Rs 500 or Special Allowance of Rs 400. The MRA will automatically pay the NIT of Rs 500.

The MRA has been paying NIT for the months of July 2017 to December 2017 and NIT or Special Allowance, as applicable, for January 2018 onwards by crediting the employee's bank account. In order to benefit from NIT or Special Allowance, employees are required to communicate their bank account details to their employers for onward submission to the MRA.

The MRA pays NIT/Special Allowance to over 65,000 employees per month for a total amount of over Rs 37 million. The number of employees having benefited from NIT/Special Allowance to date exceeds 100,000. It has been noted that a number of employees entitled to the allowance have not provided their bank account and are not benefiting from the allowance. Employees deriving a monthly basic wage of up to Rs 9,900 are requested to provide their bank accounts as stated above. Alternatively, they may call at the MRA customer service where there is a special desk for NIT/Special Allowance issues.

The payment of NIT and Special Allowance has contributed to making the tax and welfare support systems in Mauritius fairer and more equitable. Individuals in the highest income groups pay income tax at the rate of 15% plus a Solidarity Levy of 5%. Individuals not forming part of the "high income group" pay income tax at the rate of 15% and those earning less than Rs 650,000 yearly pays tax at the rate of 10%. Individuals earning less than Rs 305,000 annually do not pay any tax. Those individuals with a basic wage of up to Rs 9,900 monthly, not only do not pay tax, but they are also entitled to a direct financial support from Government through the Negative Income Tax or a Special Allowance. Reducing the disposable income of individuals in the high income bracket through taxes and increasing that of low income earners through NIT or Special Allowance helps in receding inequality in the distribution of income and creating a fairer society. The MRA is privileged to be the key player in both ends.

Taxation of the Gambling Industry

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This article is about the taxation aspects concerning the three types of electro-mechanical devices that are defined under the Gambling Regulatory Authority Act (GRA Act). These are:

- **Gaming machine**
- **Limited Payout Machine; and**
- **Amusement machine**

The layperson is often confused about their differences. From a regulatory and tax perspective, it is essential to understand their core differences. The Gambling Regulatory Authority (GRA) is more concerned with their licensing and regulatory aspects. In contrast, the Mauritius Revenue Authority (MRA) is only concerned with the taxation issues as the Director-General of the MRA is responsible for the administration of the taxes levied under the Act. The impact of other tax legislations will also depend on whether the operation of these machines is a gambling activity or not.

Does the playing of the machine consist of a gambling activity?

To determine whether an activity is classified as gambling, we need to consider the definition of gambling. We have reproduced below, the definition per the GRA Act and also, the general dictionary meaning of gambling.

Per the Gambling Regulatory Authority Act "gambling."

a. *means paying or staking consideration, directly or indirectly, on the outcome of something with a view to winning money when the outcome depends wholly or partly on chance; and*

b. *includes –*

   i. *playing any casino game, gaming house game or on any gaming machine or limited payout machine;*

   ii. *pool betting; and*

   iii. *betting, paying, or staking consideration on the outcome of any event or contingency;*

Dictionary meaning

The Oxford dictionary defines gambling as "the activity of playing games of chance for money and of betting on horses, etc."

"I walk slowly, but I never walk backward"
Abraham Lincoln

Gaming machine

A gaming machine, as it is defined under the GRA Act, is produced below.

"gaming machine" means an electro-mechanical or other device which, on insertion of a coin, banknote, electronic credit, token or similar object or on payment of any other consideration, is available to be played or operated and the playing or operation of which, by reason of the skill of the player or operator or through an element of chance or both, may deliver, or entitle the person playing or operating the machine, or any other person, to receive, cash, cheques, credit, electronic credits, debits, tokens, tickets or prizes, and includes a machine –

a. which produces a random combination of symbols on reels; or

b. on which a player is able to play roulette, bingo, twenty-one, blackjack, chemin de fer, baccarat, poker, Chinese roulette, keno or on horseracing or games of similar type, but does not include an amusement machine or limited payout machine;

The operation of a gaming machine is a gambling activity as a player stakes consideration to play on it to win money, and the outcomes depend on an element of chance. The GRA issues licences for the operations of gaming machines only to a holder of a casino license, a hotel-casino and a holder of a gaming house-A license.

Limited payout machine (LPM)

A Limited Payout Machine, as it is defined under the GRA Act, is produced below.

"limited payout machine" means an electro-mechanical machine or other device which complies with such technical standards as may be prescribed and which, on insertion of a coin, banknote, electronic credit, token or similar object or on payment of any other consideration, enables a person to play a game approved by the Authority, whereby the person, by reason of skill, or through an element of chance or both, receives electronic credits, tokens or tickets which are exchangeable in return for prizes and which are limited to –

a. one opportunity or more to play a further game;

b. electronic credits, tokens or tickets for one or more cash prizes with a combined retail monetary value not exceeding 5,000 rupees or such other amount as may be prescribed; or

c. cash equivalent to the amount the person inserts in the machine;

The operation of a limited payout machine is a gambling activity as a player stakes consideration to play on it to win money, and the outcomes depend on an element of chance. Compared to a gaming machine, an LPM is on the softer side in the gambling scale than a gaming machine, which is a form of hard gambling. The amount of money that can be lost or won in a moment is much higher when playing a gaming machine than when playing on an LPM. You will note that in the definition of LPM, there is a maximum amount (Rs 5,000) that can be won per game whereas, in respect of gaming machines, there is no such threshold. The definition also comprises of other conditions such as compliance with technical standards. Such conditions are for regulatory purposes. The prescribed standard a limited payout machine has to comply with is the Mauritius Standard Bureau standard MS182 of 2013 and to GN17 of 2014.

Taxation of the Gambling Industry *Cont'd*

Amusement machine

An amusement machine, as defined under the GRA Act, is produced below.

"amusement machine" means an electro-mechanical or other device which, on insertion of a coin, banknote, electronic credit, token or similar object or on payment of any other consideration, enables any person to play a game whereby the person, by reason of skill or of skill coupled with an element of chance, may win a prize which is limited to -

a. more than one opportunity to play a further game;

b. one or more non-cash prizes with a combined retail monetary value not exceeding 500 rupees or such other amount as may be prescribed;

c. tickets or tokens redeemable for one or more non-cash prizes with a combined retail monetary value not exceeding 500 rupees or such other amount as may be prescribed; or

d. cash equivalent to the amount the player inserts in the machine to play;

The operation of an amusement machine does not fall under the definition of gambling: a player does not play the device with an intent to win money. No cash prize is payable, and the outcome of gameplays depends on the skill of the player. It is not determined purely on an element of chance.

Before the amendments brought to the GRA Act by the Finance (Miscellaneous Provisions) Act 2017, an operator of an amusement machine was not required to obtain a license from the Gambling Regulatory Authority. He only needed a local authority license, and he was not subject to any gaming tax.

Many persons holding a local authority license for the operation of amusement machines were engaged in the illegal operation of non-compliant LPMs/gaming machines.

Amusement machines

Taxation aspects

The taxation aspects in relation to income tax, value-added tax and gaming tax for each type of machine are discussed below.

Income tax

Gaming machine, LPM & Amusement machine

Any operator will be subject to income tax on his chargeable profit. This was not always the case. Before October 2011, the income of gaming operators (casinos and gaming houses) were exempt from income tax.

However, in the case of a player, his winnings do not constitute an income. They are therefore not subject to income tax.

Tax on "winnings" - (Section 111(O) of the Income Tax Act

Gaming machine

A player of a gaming machine may be subject to a 10% tax on "winnings" under Section 111(O) of the Income Tax Act. The responsibility to account for this tax lies on the operator and is only applicable if the player's cumulative "winnings" over 24 hours exceed Rs 100,000.

Note:

- The 24 hour cut-off time is 10.00 a.m.
- The tax base value is the total cumulative amount of "winnings" and not limited to the excess amount over the Rs 100,000 threshold.
- "Winnings" is defined as "any amount paid out in money" which implies that a tax may be payable even in a loss-making situation.

Value-added tax

Gaming machine & Limited payout machine

The operations of gaming machines and LPM do not constitute a supply under the Value-added Tax Act. These are gambling activities. Consequently, no input tax can be claimed by the operator in respect of any VAT paid on the purchase of his machines.

Amusement machine

Since the activity of playing on an amusement machine does not fall under the definition of gambling, it constitutes a "supply of service" under the Value Added Tax Act. In the circumstances, the operator must consider registering for VAT if his turnover of taxable supplies is likely to exceed the compulsory registration threshold of Rs 6 Million.

The taxable supply of an amusement machine operator is the gross turnover before the deduction of the cost of prizes distributed as winnings.

With regards to input tax, the operator may claim it as a credit against his output tax subject to the provisions under Section 21 of the Value Added Tax Act.

Gaming tax

Gaming machines

Casinos and gaming house operators of gaming machines are subject to a monthly gaming tax of 35% of their gross takings derived from their gaming machines (please see Part I of the Fifth Schedule to the GRA Act). Hotel casinos pay a gaming tax of 20%.

Gaming machines

Limited payout machines

A limited payout machine operator pays a monthly gaming tax of 10% of his gross takings or Rs 500,000, whichever is the higher.

Amusement machine

An amusement machine operator pays a fixed monthly gaming tax amounting to Rs 5,000 irrespective of the number of machines he operates.

Gambling levy

Additionally, a gaming machine/LPM operator is subject to a gambling levy of 2% of his gross gambling yield. No levy is payable by an amusement machine operator.

The Multilateral Instrument Quo Vadis?

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Mauritius signed on 5 July 2017 the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting also commonly known as the Multilateral Instrument (MLI).

Mauritius did not form part of the first cohort countries to sign the MLI (On 7 June 2017). However, in view of the sea change in International Taxation Policy, Mauritius could not afford to stay on the sidelines. Needful was done weeks later and as a signatory of the MLI, Mauritius later became an associate of the Inclusive Framework (IF) and therefore committed, by that process, to implement the four minimum standards under the Base Erosion and Profit Shifting (BEPS) project. These are the commitments to abolish harmful tax practices (action 5), to prevent the granting of tax treaty benefits inappropriate circumstances (action 6), to do country by country reporting (action 13), and to improve effectiveness of dispute resolution mechanism (action 14) but also to include the new preamble in all tax treaties. In 2017, Mauritius listed23 tax treaties as covered tax agreement under the MLI. The tax treaty with India was excluded,justifiably so, as the Protocol with India had been renegotiated in July 2016.

In October 2019, Mauritius enacted the Income Tax (BEPS) Regulations 2019. The MLI is now part of our law.

The features of the regulations are as follows: -

Regulation 2 provides for the definition of 'BEPS' and that of the MLI.

Regulation 3 stipulates that the MLI shall apply to reservations and notifications which Mauritius has made. The list of reservations and notifications are set out in the second schedule to the regulations.

Regulations 5 and 6 provides that the MLI applies to the list of Covered Tax Agreement and to those added after the date of ratification.

Minimum Standards

In so far as Mauritius is concerned the minimum standard include the following: -

- The preamble – This text will now be into all our tax treaties.
- The Principle Purpose Test – The rule to prevent treaty abuse: -

'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.'

How effective would be the PPT? Will it introduce more uncertainty?

At the last meeting of Working Party 1 on tax conventions and related questions/MLI issues (held last October 2019), it was reported that 89 countries adopted the PPT. In a few recent treaties negotiated by Mauritius (for example the ones with Kenya and Angola) the Parties have adopted the PPT as the minimum standard to address treaty abuse. It is a matter of time for stakeholders to witness how this will work. The PPT is a treaty General Anti Avoidance Rule (GAAR) and it will be for the national cohorts to interpret same. This is not to underplay the role of the Conference of Parties (COP) provided for by Article 31(3) of the MLI: -

As Raphael Holzinger puts it in an article entitled "the Relevance of the Conference of the Parties for the Interpretation and Amendment of the MLI" published in the OECD Multilateral Instrument for Tax Treaties.

Analysis and Effects – Ed by Lang et Al – (2018) The relevance of the COP will be limited to the following: -

- With regard to interpretational issues, the decision of the conference of the parties could be seen only as an agreement of interpretation of an expert opinion, which are only one aspect or the entire interpretation process, as other grammatical, systematic, teleological and historical arguments must be considered, as well.
- Regarding amendments, the decision of the conference of the parties cannot bind parties that do not consent. Accordingly, it is questionable to what extent amendments will be carried out at all.

As for Mauritius, being part of the Inclusive Framework and having now listed all of its tax treaties except the one with India, the effects of the MLI will soon be felt.

**Mr Ramloll is currently Deputy Solicitor General at The Attorney General's Office. The views expressed in this Article are entirely his own.*

The Impact of the MLI on the Mauritian DTAA Network

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Domestic tax base erosion and profit shifting has been identified as a problem affecting all countries in the world. It arises because multinational enterprises exploit unintended gaps and mismatches between different countries' tax systems to shift profits to locations where there is little or no overall corporate tax being paid.

To tackle this problem, the G20 and the Organisation for Economic Cooperation and Development (OECD) developed 15 action points to address Base Erosion and Profit Shifting (BEPS) in a comprehensive manner, and set deadlines to implement those actions, many of which cannot be tackled without amending bilateral tax treaties.

Given the sheer number of treaties in effect across the Globe (over 3,500), implementing these changes on a bilateral basis would take years, if not decades. Recognising that the OECD/G20 BEPS package includes tax-treaty related measures to address certain hybrid mismatch arrangements, prevent treaty abuse, address artificial avoidance of permanent establishment status and improve dispute resolution, the need was felt to consider an innovative way to implement the measures resulting from this work. Action 15 of the BEPS Action Plan provides for the development of a Multilateral Instrument (MLI).

What is the MLI?

The MLI is an instrument that modifies all Covered Tax Agreements in a fast and effective manner to implement BEPS treaty related measures by including two of the four BEPS minimum standards countering treaty abuse (Action 6) and improving dispute resolution mechanisms (Action 14) together with other measures to improve tax treaties. It does not function in the same way as an amending protocol to a single existing tax treaty. Instead, the MLI is applied alongside existing bilateral tax treaties, modifying their application in order to implement the tax treaty-related BEPS measures. It also enables countries to go through only one ratification procedure in their parliament in order to modify their whole treaty network rather than seek separate ratification of amendments for each bilateral tax treaty. The MLI which is a Convention allows for different forms of flexibility through a system of reservations and notifications of choices.

MLI position of Mauritius

Mauritius signed the MLI on 5 July 2017 and has ratified it in October 2019. 44 of its 45 DTAAs have been listed as Covered Tax Agreements (CTA) and Mauritius has opted for the minimum standards of the MLI relating to Treaty Abuse and Mutual Agreement Procedure. Arbitration is what investors are increasingly looking for since they get assurance that if ever a mutual agreement procedure case cannot be resolved between 2 Competent Authorities, there will be no deadlock since the arbitration process kicks in. Mauritius has thus signed up to Arbitration.

The minimum standards under the MLI

Article 6 of the MLI is devoted to the granting of treaty benefits in inappropriate circumstances. At a minimum, countries are expected to include an express statement in the title and preamble of their tax treaties that the common intention 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 is achieved by adding the following words in the 'Preamble' of all tax treaties:

> Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions.

In addition to the above text, Mauritius had an option to choose between the Principal Purpose Test (PPT), the Simplified Limitation of Benefits (LOB) clause, or a US-style detailed LOB.

The general policy of the LOB rule is that treaty entitlement should not typically be granted in the case of triangular arrangements. Only in bona fide situations, intermediaries would qualify as residents entitled to treaty benefits as opposed to 'mere conduits'. There will be a series of tests that individuals and companies or other legal entities will have to undergo to be entitled to certain or all treaty benefits. Mauritius is of the view that the LOB is too restrictive as it tends to exclude from the scope of the DTAA virtually all businesses except companies that are listed on a recognised stock exchange. Thus, a DTAA with an LOB clause would defeat the purpose of attracting the much needed foreign direct investment.

On the other hand, the PPT is a powerful tool to counteract abusive use of DTAAs and this is widely recognised by the OECD. For this reason, Mauritius has opted for the PPT which is a subjective test that is based on an assessment of the intentions of each arrangement or transaction. Under the PPT, once a benefit for a taxpayer has been identified, it would not be granted if, given a consideration of all the relevant facts and circumstances, the obtaining of the benefit was one of the principal purposes of the arrangement or transaction that resulted, directly or indirectly, in that benefit. As a result, the intentions of a taxpayer are the essential elements that give rise to the application of the PPT and this is difficult to prove in practice. Moreover, taxes are one of the most important costs and any reasonable and diligent investor will take into account the tax effect of its business decisions. The PPT carries a high degree of uncertainty since it is linked to the subjectivity of the taxman. It is essential for

The Impact of the MLI on the Mauritian DTAA Network

Cont'd

the OECD to identify best practices and develop a framework for the application of the PPT rule as soon as possible so as to prevent an overzealous inspector of taxes from invoking the PPT rule without having carefully looked at all the facts and circumstances of the case.

Article 25 of our treaties provides a mechanism, independent from the ordinary legal remedies available under domestic law, through which differences or difficulties regarding the interpretation or application of the Convention are resolved on a mutually-agreed basis – the Mutual Agreement Procedure (MAP). By amending our treaties with Article 16 of the MLI, Mauritius ensures a full implementation of treaty obligations related to MAP and the timely resolution of MAP cases within an average period of 24 months. The main change that is brought to Article 25 of our treaties is that taxpayers are allowed to present their case to the competent authority of **either Contracting Jurisdiction** within three years.

Concluding Note

The MLI will enter into force on 1 February 2020 for Mauritius and will only amend a DTAA if our treaty partner has signed the MLI and has listed its treaty with Mauritius as a Covered Tax Agreement. From the MRA's side, what remains to be done is the preparation of consolidated or synthesised texts and also the re-negotiation of existing DTAAs not covered under the MLI through bilateral negotiations. It can be expected that some of our treaty partners will call for a review of the sharing of taxing rights and the inclusion of provisions which are not minimum standards under the MLI. Challenging times lie ahead. But then, we do not grow when things are easy. We only grow when we face challenges. Instead of running away from the challenges, Mauritius will be able to run over them!

NPF/NSF From a Tax Audit Perspective

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Following amendments brought under the Business Facilitation Act 2017, the MRA has been entrusted the function of collection of contributions/payments to the National Pension Fund (NPF), National Savings Fund (NSF), HRDC Training Levy and Recycling Fee.

As from 1st January 2018, employers are required to submit all returns and effect payments in respect of NPF/NSF contributions to the Director-General of the MRA. Submission date is same as for PAYE Vouchers, that is, by the 20th of each subsequent month.

A tax audit normally includes expenditure testing; and wages and salaries may represent a material component of total business expenses. While auditing wages and salaries for PAYE audit purposes, it is now imperative to verify whether the company is complying with NPF, NSF and Levy legislations.

The audit of NPF/ NSF is two fold:

1. Based on wages and salaries claimed in Income tax returns and after an analysis of the payroll, the correct amount of NPF/NSF contributions that ought to be made by employers in respect of pensionable employees could be determined.
2. Based on contributions made we may have an insight on whether the wages and salaries or any other staff cost have been overstated with a view to reduce profitability of the company and hence reduce the tax payable..

No contribution is payable in respect of:

a. An employee who has not attained the age of 18;

b. An employee who has attained the final retirement age (70 years); and

c. A non-Mauritian citizen employee of an export manufacturing enterprise in respect of his first 2 years of employment.

NPF is calculated on Basic wage only excluding traveling, end of year bonus or any other fringe benefits. Any 'Fee' payable to a person, for e.g Directors Fee, Management Fee, does not attract contribution of NPF and NSF. Rates applicable depend on the category of employment in which a person is working for e.g whether in sugar industry, public servant or employees in private sector etc. Rates are available from the First Schedule of National Pensions Act (NPA). It should also be noted that the NPF and NSF rates are applicable on basic wage up to a maximum basic wage ceiling. The ceiling is available from the Fifth Schedule of NPA.

Persons voluntarily insured

Where a person, for example a self-employed or a non-employed person makes an application in the prescribed manner and further to approval, that person shall become an insured person and may make monthly contributions in multiple of Rs 5, not below Rs 170 and not exceeding Rs 990.

Surcharge on late payment of contributions

Where an employer fails, within the prescribed time, to pay to the Director-General the whole or part of any contributions payable, he shall pay a surcharge at the rate of 5% for each month or part of the month during which any contributions remained unpaid up to a maximum of 100%. No surcharge on NPF and NSF is applicable where it is less than Rs 50.

Surcharge on late submission of returns

Where an employer other than a person who employs an employee in domestic service fails to submit return within the due date, he shall be liable:

a. in the case of a monthly return, a surcharge of one per cent of the total contributions payable under section 17 or 200 rupees, whichever is the lesser, for every day provided that the total amount of surcharge shall:

i. not exceed the total amount of contributions payable or 20,000 rupees, whichever is the lesser; and

ii. be not less than 500 rupees

b. in the case of an annual return, a surcharge of 5,000 rupees or 500 rupees for every day until t he return for that year is submitted whichever is the higher provided that the total surcharge shall not exceed 50,000 rupees.

Exemption from payment of Surcharge

- **Under S 45A (3):** The Minister may exempt from payment of the surcharge –

a. any person who under any enactment in force enjoys immunity from payment of penalties;

b. any religious or charitable institutions;

c. such cases as may be prescribed in **National Pensions (Exemption from Payment of Surcharge) Regulations 1981**

- **Under S 45A (5):** A person who employs an employee in domestic service is exempted from surcharge on late submission

NPF/NSF - FROM A TAX AUDIT PERSPECTIVE *Cont'd*

Keeping of books and records

According to section 45H of the NPA,

1. Every employer shall keep, in respect of every employee in his employment, records, whether electronic or otherwise, of –
   a. The name, occupation, NIC number and date of birth of the employee;
   b. The insurable wage or salary paid to the employee; and
   c. Where applicable, the date on which the employee has informed him of his concurrent employment pursuant to section 17(2B)(a).
2. Every employee shall affix his signature or thumbprint in the register.
3. A National Pensions Officer or an officer may request an employer to produce and submit a certified copy of the records referred to subsection (1), or the Register or similar records.

ISSUE OF CLAIMS PER Section 34A of NPA: Liability for payment of contributions

If our tax audit shows an underpayment of NPF/NSF contributions, we may issue a claim based on the provisions of section 34A of the NPA. However, before processing a claim, we should ensure that, details on employees such as the name and NID of the employees are available so that their NPF account may be credited with the contributions due.

Where an employer has not adhered to the legal obligation for NPF, NSF and Levy contributions, the following options may be considered:

- To disallow wages and salaries claimed per income tax returns as documentary evidence is not available in support of the expense claimed;
- If in the course of the audit, the person submits evidence on wages and salaries, and the expenditure claimed is reasonable, justified and supported by full details of employees, the expense will be allowed and the claim in respect to NPF/NSF and Levy will be made.
- Any other case to be dealt with on a case to case basis.

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