

Funds Hotline

October 23, 2013

PURSUIT OF SUBSTANCE IN MAURITIUS AND WHAT IT MEANS FOR INDIA-FOCUSED FUNDS

- Financial Services Commission enhances substance requirements for obtaining Category 1 Global Business Licence (GBL-1); sets deadline of January 1, 2015 for compliance with the new substance requirements.
- Additional substance requirements include having appropriately qualified directors who are resident in Mauritius and exhibit an application of mind while considering matters.

INTRODUCTION

The Financial Services Commission ("FSC") of Mauritius recently revised the *Guide to Global Business* ("Guide")¹ to enhance the level of substance required to be demonstrated by Mauritius based entities for holding a Category 1 Global Business Licence ("GBL-1")².

This development is important since it is necessary for a company to obtain a GBL-1 to be eligible to apply for a Tax Residence Certificate ("TRC") which itself is a necessary pre-condition for a company to qualify for treaty benefits under the India-Mauritius Double Taxation Avoidance Agreement ("Treaty").

The *Communique* issued by the FSC on September 4, 2013 has prescribed a deadline of January 1, 2015 on all companies holding GBL-1 for compliance with the amended Guide.

LEVEL OF SUBSTANCE EXPECTED TO BE DEMONSTRATED

For a company seeking / holding GBL-1, in addition to the existing requirements of maintaining its principal bank account and its books of accounts in Mauritius and having at least two local directors on its Board, FSC shall consider certain additional conditions with effect from January 1, 2015. These include having office premises in Mauritius, holding assets of at least USD 100,000 in Mauritius, employing at least one person resident in Mauritius, agreeing to resolve disputes arising out of the constitution of the entity by way of arbitration in Mauritius, listing in Mauritius or meeting a 'reasonable' expenditure test.

Though several additional thresholds have been prescribed, satisfaction of even one of the criteria should suffice in demonstrating that the company is 'controlled and managed' from Mauritius. Further, the amendments also provides for 'borrowed substance' where a criterion being met by any one entity in a group would suffice for all the entities within the defined group structure.

The revised rules of substance as introduced also require the resident directors to meet certain standards of governance including committing required levels of time, attention and independent exercise of mind. This seems to be in line with the emerging jurisprudence which suggests that the threshold of fiduciaries to be met by the directors is shifting from "sustained or systematic failure to exercise oversight" to "making reasonable and proportionate efforts commensurate with the situations".

FSC's approach seems to be in line with other jurisdictions like Singapore and Luxembourg that expect a level of substance from a resident company beyond being just the jurisdiction of its incorporation.

WHAT HAS THE FSC PRESCRIBED?

The FSC has revised the list of guidelines that it considers relevant while determining whether a company is being managed and controlled from Mauritius for the purpose of issuing / renewing a GBL-1 through amendments to Section 3 of Chapter 4 of the Guide. These revisions are:

1. Resident director qualifications: Before the amendment, a company holding GBL-1 was required to have at least two resident directors of sufficient caliber to exercise independence of mind and judgment. While these requirements have been retained, there is now an additional requirement for the Mauritius resident directors to be "appropriately qualified".
2. Administration of closed-end funds and collective investment schemes: The FSC has introduced a fresh requirement that a company seeking GBL-1 which is a collective investment scheme or a close-end fund or an external pension scheme must be administered from Mauritius.

Mandatory parameters: In addition to these, a GBL-1 will have to continue to fulfill the other criteria, being: (i) maintaining its principal bank account in Mauritius at all times; (ii) keeping and maintaining its accounting records at its registered office in Mauritius at all times; (iii) preparing its statutory financial statements having them audited in Mauritius; and (iv) providing for meetings' of directors to include at least two Mauritius resident directors.

Mauritius resident director requirements: The amended Guide also mentions that the Mauritius resident directors will have to comply with the requirements of Circular Letter (CL280313) issued by the FSC ("**Circular**")³. The Circular summarizes duties and obligations of directors of Mauritius companies. In this regard, the FSC will consider

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'Qualification and experience'⁴, 'Independence of mind'⁵, 'Judgment'⁶ and 'Time Commitment'⁷ of the Mauritius resident directors of a company holding GBL-1.

Secondary tests for determining place of control and management: The FSC has also enumerated a separate set of tests in addition to the primary tests above to determine whether the conduct of business is managed and controlled in Mauritius for the purpose of issuing / renewing a GBL-1. A company seeking / holding GBL-1 or a related company⁸ will have to fulfill only one of the following requirements in addition to satisfying each of the primary tests:

1. Office Premises: The company has or shall have office premises in Mauritius.
2. Full-time employee: The company employs or shall employ at least one Mauritius resident at an administrative / technical level on a full time basis.
3. Arbitration: The constitution of the company contains a clause whereby all disputes arising out of the constitution shall be resolved by way of arbitration in Mauritius.
4. Non-cash Assets: The company holds or is expected to hold assets within the next twelve (12) months (excluding cash held in bank accounts or shares/interests in another company holding GBL-1) which are worth at least USD 100,000 in Mauritius.
5. Listed shares: The shares of the company are listed on a securities exchange licensed by the FSC.
6. Annual expenditure: The company has or is expected to have a yearly expenditure in Mauritius which can be reasonably expected from any similar company which is controlled and managed from Mauritius.

The Guide specifically states that where a company relies on yearly expenditure to demonstrate economic substance, the burden will be on the company to satisfy the FSC that its level of yearly expenditure in Mauritius is reasonable. The FSC will judge the level of expenditure in the light of the circumstances of each case. Among other factors, regard will be given to type of activity of the company, its average turnover, the country(ies) in which it is conducting business, the value of its net assets and the industry average.

ANALYSIS

On certain conditions being met, the Treaty exempts a resident of Mauritius from Indian tax on gains derived from the sale of shares in an Indian company. This coupled with other factors, have led to Mauritius emerging as a favorite destination for overseas investments into India (currently accounting for about 40 % of total foreign inflows into India).

In early 2012, the Government of India introduced a statutory General Anti-Avoidance Rules ("GAAR")⁹ regime. Among other things, GAAR extended the power of the tax authorities to disregard transactions if they amounted to an "impermissible avoidance arrangement", i.e. an arrangement entered into with the main purpose of obtaining a tax benefit. The amendments by the FSC to the Guide could be viewed as an effort to build a substance requirement under the domestic law of Mauritius, thereby make it easier to pass the commercial substance test under GAAR. In fact, one of the substance requirements introduced by the FSC (maintaining reasonable yearly expenditure) is similar to annual expenditure test¹⁰ under the India-Singapore Double Taxation Avoidance Agreement.

The FSC requires companies to comply with the new standards by January 1, 2015 - a few months ahead of the currently scheduled kick-off for GAAR i.e. April 1, 2015. In this context, it will be interesting to see how GAAR will interact with the Treaty especially since eligibility for benefits under the Treaty has itself become subject to the FSC's new economic substance standards. It is reported that the Treaty is currently being renegotiated and it is possible that certain substance requirements may be introduced. A Limitation of Benefits (LoB) article is also being discussed.

The prescribed expectations from fund directors require that directors should exhibit that there was application of mind when considering different proposals before it. The decision making process will also play a pivotal role in determining the substance of the fund from an Indian tax perspective as India moves away from the principle of "form over substance" in favour of the doctrine of "substance over form" post April 1, 2015.

In this regard, a recommendation would be that board meetings should be followed by accurately recorded minutes. The minutes of board meetings should be able to demonstrate how the decisions of the company were arrived at and the resolutions thereon passed. The minutes should reflect that the directors were aware of the issues that were being discussed. Clearly, a 'boilerplate' approach would not work. Further, the non-delegable functions for the directors to discharge on an on-going basis require action 'between' board meetings and not 'during' board meetings only.

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You can direct your queries or comments to the authors

¹ The Guide to Global Business has been issued by the Board of the FSC under section 7(1)(a) of the Financial Services Act, 2007.

² Section 71(4) of the Financial Services Act, 2007 provides that the FSC may consider any such matters when determining whether a company holding GBL-1 is managed and controlled in Mauritius.

³ Circular Letter dated March 28, 2013 issued by the Financial Services Commission.

⁴ The Mauritius resident director must have relevant qualification and experience to exercise sufficient care, diligence and skills for good conduct of the business.

⁵ The Mauritius resident director must act with integrity, freedom of mind, without any influence, interest or relationship that might impair his professional judgment or objectivity.

⁶ The Mauritius resident director must provide impartial and good judgment.

⁷ A Mauritius resident director serving on multiple boards must ensure that sufficient time is given to the affairs of each company in which he/she is a director.

⁸ Section 3.4 of the Guide provides that a company shall be deemed to have satisfied section 3.3 if a related company satisfies one of the criteria mentioned in section 3.3. The Guide also clarifies that a related company refers to a subsidiary, fellow subsidiary, a parent company or any other company within the same group structure.

⁹ S.95, Income Tax Act, 1961.

¹⁰ Article 3 of the 2005 Protocol to the India-Singapore DTAA provides that a company resident in Singapore shall be deemed not to be a shell or conduit if its annual operational expenditure is at least SGD 200,000 per year in the two years preceding the transfer of shares giving rise to capital gains.

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