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**Mauritian Offshore Financial Center: Past,
Present and Possibilities for the Future**

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University of Cape Town

EXECUTIVE SUMMARY

Government's commitment to boost the global financial business as a growth area for Mauritius lies on certain essential conditions: cleanliness of the center as a reliable jurisdiction, transparency and integrity in financial operations, a sound regulatory framework and the existence of a pool of qualified professionals, to name a few. But how far does Mauritius stand to satisfy these conditions?

Today, the global business management companies (previously called offshore companies) are facing important challenges as they are operating in an industry, which is today highly competitive and subject to scrutiny. The recent trend in Global Business Companies reflects international factors, which have adversely affected a majority of offshore jurisdictions worldwide, name the global financial markets.

Mauritius has an expanding network of double taxation treaties (more than 25) a with number of European, African and Asian countries. Such a network provides for interesting tax planning opportunities, thereby enhancing the image of the country as international tax planning center. Attractive concessions provided by those treaties include elimination of double taxation through tax credit equivalent to Mauritian Tax, reduction in withholding taxes on dividends, interest and royalties payments, exemption from capital gains tax and possible exemption on interest payments on loan.

With the OECD Report and Financial Action Task Force, new regulatory and supervisory of financial services have become an international or supervisory system whereby jurisdictions involved in financial services have to comply with international regulations set by international bodies.

With the changes in the global financial environment, Mauritius has in recent years adopted a programme of reforms to enhance its financial supervision closer to international standards and set up an integrated regulator for non-bank financial activities, the Financial Services Commission. New legislation was introduced to combat terrorism and its financing and create a new institution to investigate cases of money laundering, corruption and financial crime, the Independent Commission against Corruption (ICAC).

Despite the challenges posed by an adverse global economic environment, Mauritius has not failed to shoulder its responsibilities towards the international financial community while sustaining the country's development efforts in financial services. Mauritius has acted, in a timely and effective manner, to meet the demands for stricter and broader regulation designed to cope with new and expanded threats and mitigate the potential risks to global financial stability.

CHAPTER 1: INTRODUCTION

Mauritius is a small, open economy, making it vulnerable to external shocks. In light of ongoing trade liberalization and economic integration, a challenge facing the island is to implement appropriate structural changes to achieve higher real growth. The Mauritian government is presently aiming at developing the country into a regional financial and business center, in the aim of making the financial sector the fourth pillar of the Mauritian economy. To achieve this objective, incentives are available to foreign companies that are established in the Freeport. These companies are able to use Mauritius as a commercial bridge between Asia and Africa. The thesis reviews the current structure and status of offshore financial sector (OFC) in Mauritius and makes an estimate of what might be the cost of compliance with international standards.

This chapter gives an overview of the Mauritian economy with the objective of identifying the key variables influencing the fourth pillar of the economy.

1.1 Introduction to the Mauritian Economy

The Republic Island of Mauritius has been subject to a number of colonisation attempts, namely by the Portuguese, the Spanish, the Dutch, the French, and the British. The Portuguese discovered Mauritius at the beginning of the 16th century. It was however, the Dutch who first attempted to occupy the island between 1638 and 1710. After the Dutch, the French came in 1715, and under Mahe de Labourdonnais, slaves were imported from Madagascar and the East Coast of Africa, in order to develop sugar cane plantations. In 1810, as a consequence of the war in Europe, the British took control of the island. They freed the slaves but had to import labourers from India and China, in order to maintain the production of sugar cane. The Mauritian economy was traditionally dominated by sugar production, and its growth was highly dependent on the climatic conditions and the changes in the international price of sugar. However, since the mid-1980's, the dominance of the sugar industry in the Mauritian economy was progressively counterbalanced by the expansion of manufacturing in the Export Processing Zone (EPZ), and by the development of tourism. The authorities are committed to enhance the infrastructure so as to encourage

more investors to locate their operations in Mauritius and to make the service sector (the Offshore and Freeport) the 4th pillar of the Mauritian economy.

At its independence on March 12, 1968, Mauritius inherited a democratic parliamentary regime from the British, and is now recognised as one of the few stable democracies in Africa. On 12th March 1992, the island was proclaimed Republic while remaining a member of the British Commonwealth.

1.2 Overview of the Mauritian economy¹

An overview of the key components of the Mauritian economy, namely the country's labour market, population, standard of living and external trade & balance of payments is given in this section. A more detailed discussion of the economic sectors is provided in Section 1.3, because of its immediate relevance to the objectives of the thesis, which is to understand the future of the Mauritian Offshore Sector.

1.2.1 Population

The population of the Republic of Mauritius was estimated at 1.2 million as at end June 2001. This population is made up of descendants of successive waves of immigration, mainly from Madagascar, the East Coast of Africa, India, China and Europe. The cultural diversity of the population makes the island a unique place in the world. Most of the Mauritians are fluent in both French and English that they are bilingual. The official language is English, but French and the Creole (the local language) are also spoken. Ancestral languages such as Hindi or Mandarin are also included in the linguistics.

During the 60's, the population growth was a threat for the island. It was thought that the future of the island would be compromised if the growth was not controlled, bringing with it irreversible consequences. Therefore, a family program was put in place to reduce the number of births. The program was a success and the rapid and continued decline in the birth rate reduced the population growth. This model is still being used in many African countries.

¹ Bowman, 1991

According to a study, the age distribution of the population is as follows: 26% of the population is below 14 years of age, 68% between 15 and 64, and only 6% is above 65 years of age. Life expectancy of women is 74.04 and 66.98 for men².

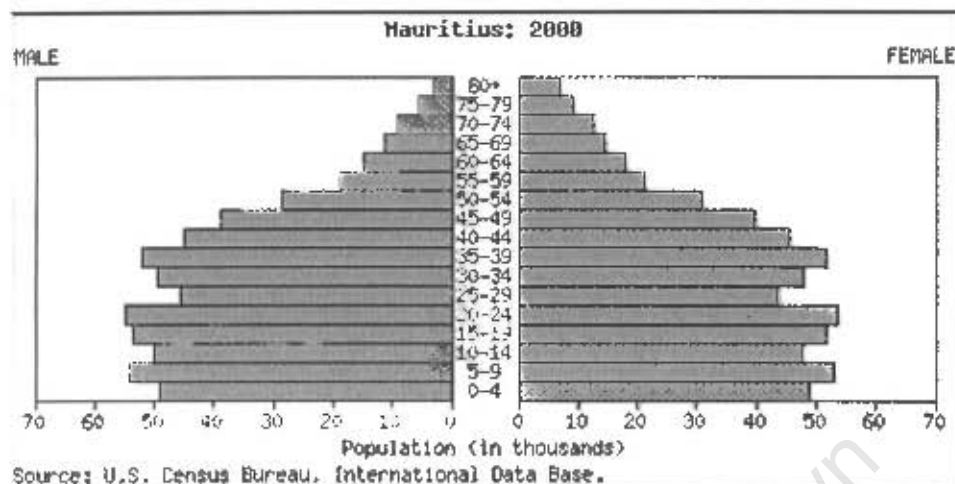


Figure 1.1 (Source: Central Bureau, International Data Base)

1.2.2 Education

The education system plays an important role in the success of the Offshore Center of the country. As a matter of fact, compared to its neighbouring countries, Mauritius has many advantages in terms of literacy rates. The level of education is a major factor in the growth of an economy. An educated workforce can be more productive.

The island has an average rate of literacy of more than 90%³. Education is officially compulsory for seven years between the ages of five and 12. Primary education begins at five years and lasts for six years. Secondary education, beginning at the age of 11, lasts for up to seven years. Primary and secondary education is available free of charge. An educational plan has been put in place for a better education system. Those students, who are weak academically, have the chance to do something that is rewarding that they can turn to industrial formation. The island's main asset is the number of young, dynamic, educated, versatile, bilingual and ready to learn people. This helps in forming people for the service

² Indian Ocean Rim Network: <http://www.iornet.org/newiornet/mauritius1.htm>

³ NATIONS SORTED BY LITERACY <http://www.tnrdowling.com/800literacy.html>

sector. Moreover, there are many graduates that are from the University of Mauritius and from abroad (United Kingdom, South Africa, India, Australia, etc).

1.2.3 Foreign Relations

The orientation of Mauritius toward other countries is influenced by its location, resources, colonial past, domestic politics, and economic imperatives. Mauritius has strong relations with Britain, France, India and since 1990, South Africa. A member of the Commonwealth, Mauritius recognised Queen Elizabeth II as head of State until it became a Republic in 1992. In addition to membership in the Organisation of African Unity (OAU), United Nation (UN), and Commonwealth, Mauritius belongs to the Non-aligned Movement. It has receives assistance from the World Bank, the International Monetary Fund (IMF), the European Development Bank, the Southern African Development Community (SADC), the Common Market for Southern and Eastern Africa (COMESA), and the Indian Ocean Commission (IOC).

1.2.4 Transport and Communication

The existing infrastructure in the island acts as an additional strength for the development of the offshore sector. The availability of information is therefore essential, and its dissemination should be possible in a quick and efficient way.

The road network is good, considering the mountainous terrain. There are a number of road projects planned or under way. The authorities are also concerned about the maintenance of the roads and are spending to keep them in good condition. The Port Louis harbour is efficient and modern. The authorities want the island to be a Commercial Regional center in the Indian Ocean.

The international airport at Plaisance, the Sir Seewoosagur Ramgoolam Airport in the South East of the island, has recently been under renovation. This is mainly because of the increasing numbers of tourists coming into the country.

Recently, IBM⁴ has chosen Mauritius for its regional headquarters and in March 2001, Infosys Technologies⁵, a huge Indian software company has invested around \$280 millions in the island. This shows the eagerness of the Mauritian authorities to be more competent in terms of better technology and infrastructure to attract more investment.

1.2.5 Standard of living

The country has succeeded in overcoming acute isolation from main export markets to develop into one of the most open economies in the world, as measured by the ratio of trade goods and non-factor services to GDP currently at 135% (The Africa Competitiveness report 2000/2001). The GDP of US\$ 3900⁶ is one of the highest in Africa and ranks Mauritius as an upper middle income economy. Income distribution has become less skewed with the Gini coefficient improving to 0.39 in 1997. According to the Human Development Index (HDI), human welfare has also improved from 0.64 in 1975 to 0.76 in 1997. Mauritius's higher ranking in the HDI than on per capita GDP in the 1999 UN World Human Development Report suggests that the country has been successful in translating economic prosperity into better lives for the Mauritians.

1.3 Economic History

At the time of its independence in 1968, Mauritius was the very prototype of a monocrop, underdeveloped country. The sugar industry has been traditionally the predominant source of revenue. The economy of Mauritius has passed through several distinct phases and, in the process, has successfully diversified from a monocrop culture highly dependent on the export of sugar into manufactured exports and tourism. Its development path has been shaped by its location; resource endowments and many factors have contributed to its success. They include strong demand for the output of the two fast growing sectors – the Export Processing Zone (EPZ) and the tourist industry – and the continuation of the sugar quota arrangement with the European Union. The new orientation of the government was to encourage the manufacture for export of those products in which labour costs were a significant proportion of the value added. Its main concern was to provide jobs for the many

⁴ Mauritius Continues On Road To IT Success, by Mandy Robinson, Tax-news.com, London 12 March 2001

⁵ IBM Chooses Mauritius For Regional Headquarters, by Amanda Banks, Tax-news.com, London 31 January 2001

⁶ http://www.mauritius-online.com/coopers/mm_politics.htm

skilled unemployed in the hope that the establishment of labour intensive activities would reduce unemployment level. The EPZ was intended to encourage the development of export-based manufacturing and a processing industry in Mauritius through local and foreign investment. Hence the creation of the EPZ in 1970.⁷ After the EPZ legislation was passed, investment, employment, and export expanded considerably. A series of endogenous factors strengthened the dynamism in the EPZ, such as sound government policies and good economic management. A favourable business climate coupled with a good combination of a stable government helped was also the strength of the Mauritian EPZ. External trade relations were also important to potential investors, as the island was not subject to quota limits in the United States and the European Union and the Lomé preferential trade arrangements provided Mauritius with a tariff preference for its exports to the EU. During the last 20 years, foreign direct investment in the EPZ sector (especially Hong Kong, France, United Kingdom, Germany and South Africa) has played an important role in the rapid structural transformation of the Mauritian economy.

Mauritius is traditionally an attractive destination for European tourists. However, it was in order to solve the problem of unemployment and to reduce the dependence on the sugar production that the Mauritian government decided to develop tourism during the 1970's and 1980's. The Mauritian government adopted the following measures to expand tourism:

- Creation of a new airport capable of handling jumbo jets,
- Acquisition of new long range planes,
- Development of direct flights from major European countries,
- Encouragement of the construction of new hotels with significant tax incentives for the developers.

As a result of the above, in the 1990's, tourism became the third most important source of foreign exchange earnings, after the EPZ and the sugar industry. In order to diversify the economy further and to attract more investments and businesses, the Mauritian government decided also to launch offshore services in 1989. The Mauritian offshore services started with banking activities and extended to a Freeport and 10 other types of non banking

⁷ Dabec, 1998

activities, including offshore fund management, royalties companies, operational headquarters, construction, securities, consultancy companies, ship management, trading, and re-invoicing. While the offshore is under the supervision of the Bank of Mauritius, the Mauritius Freeport Authority (MFA) supervises the Mauritius Freeport, and the other non-banking activities are licensed and supervised by the Mauritius Offshore Business Activities Authority (MOBAA). The MOBAA has been replaced by the Financial Services Commission (FSC), following the recommendations made by the Report on a New Regulatory Framework for the Financial Services Sector in Mauritius^{1 26/02/01}. The FSC was set up by the Financial Services Development Act 2001 and the idea of the FSC was mooted since 1995 and proposals were made for the setting up of a unified regulatory institution. After discussions, the Report on a New Regulatory Framework for the Financial Services Sector in Mauritius recommended a unified Regulatory institution, which would bring under its umbrella the functions of the Stock Exchange Commission, the Controller of Insurance and the Mauritius Offshore Business Activities Authority. The Financial Services Commission is a body to license, regulate, monitor and supervise all non-banking financial activities namely Global Business Activities (formerly offshore activities), Insurance Business and the Securities market. The concern of the Government is to move towards an enabling regulatory environment with better supervision, more transparency but at the same time, preserve the confidentiality of information.

The Mauritian government invited in 1989 some international banks to set up offshore banking units in the island. Major banks such as Barclays, Mauritius Commercial Bank, State Commercial Bank of Mauritius, Hong Kong and Shanghai Banks, and Bank of Baroda responded positively and opened up their offshore banking units. The following advantages were conferred to the economy. These were as follows:

- Complete freedom of exchange control,
- Strategic time zone location between Far Eastern markets and European financial centers,
- Concessionary income tax rates of 5% on all offshore companies,
- Ability to repatriate profits freely without other tax or levy,
- Advanced efficient telecommunication facilities to all financial markets around the world.

The Banking Act was put into place for the development of offshore services. In 1989, the Stock Exchange was established and the Stock Exchange Act 1988 established a small but thriving exchange, which is run by the Stock Exchange of Mauritius Ltd (SEM), a private limited company. The Act also established the Stock Exchange Commission (SEC), which controls and supervises stock exchange operations. Two markets are operated: the Official List and the over-the-counter market (for unlisted shares).

In 1994, there was an abolition of foreign exchange controls. There is no control on currency repatriation, and the currencies are fully convertible and market determined. Settlement can be made in foreign currency and foreign currency accounts can be opened in Mauritius. There are no capital gains taxes and no withholding tax on dividends procured from trading in officially listed companies.

It can be said that all the development that has taken place since the 1970's has helped the island to be prepared for the development of several sectors, by establishing a good economic environment for the development of the service and the financial sectors. With the creation of the offshore sector, the EPZ and the stock exchange, the Republic of Mauritius has a good framework in place for the growth of the tertiary sector.

The rest of this chapter will deal with the evolution of the economy and the way in which Mauritius has implemented different strategies for a better future. Mauritius has achieved high growth rates of output and employment over the past ten years and in 2000 the country had a Gross National Income (GNI) per capita of about US \$3859 (BOM June 2001). The island has been recognised as a Newly Industrialised Country (NIC) due to its sustained transformation from an impoverished sugar colony to that of a modern country. Economic growth has been a positive figure for the last 10 years. Inflation rates has been maintained and fell to 4.5% in 2000 (6.9% in 1999) 5. The deceleration of employment growth in 2000 resulted in an increase in the unemployment rate from 6.7% to an estimated 8.0% in 2000. This is a major issue for the authorities. While the unit labour cost is on the rise, labour productivity is on the decline. International trade has been on a constant rise. It has increased from Rs10.7 millions to Rs89.1 millions in 1998. This shows the growth in the

industrial sector. The tourism sector is one that also brings in a considerable amount of foreign currency in the island. The foreign exchange earnings from this sector increased from an annual average of Rs500 million at the beginning of the 1980's to Rs13.7 million in 1999.

1.3.1 Agricultural Sector

Given fertile soils and a climate that is conducive to good growing conditions, it is not surprising to find Mauritius is a large producer of agricultural products. What is remarkable, though is the manner in which just one crop - sugar - dominates the output of this sector to such an extent that in many respects Mauritius is a monoculture economy relying very heavily on the production and export of sugar. The natural advantages afforded to Mauritius by its climate and geographical location mean that it is a fertile and productive island leading to a dominance of economic activity by agriculture. However, its tropical climate also brings the threat of tropical storms and cyclones that can be devastating to agricultural production. The undiversified nature of agricultural production implies that the export revenues generated by the sector are highly susceptible to fluctuations in the world price of sugar creating large potential problems for the macroeconomic stability and growth of the economy. Given the occasional occurrence of freak weather such as cyclones, this is an important issue for producers and the economy as a whole. While sugar output overshadows all other agricultural products, it is not large enough to ensure that Mauritius becomes a dominant or large economy on the world market. Thus, as a price taker, it has to accept the price that the world market generates although as a signatory to the Sugar Protocol of the Lomé Agreement, Mauritius is afforded some insulation from the worst of these effects. The arrangement between the African-Caribbean-Pacific (ACP) countries and the European Economic Community (EEC) sets formal quotas and price guarantees under which sugar is exported to the EEC. The EU buys approximately 75% of the sugar produced; the United States 2% and around 5% is kept for local consumption. The rest is kept in stock in case of any deficit that may arise to satisfy the quota set by the EU. Mauritius controls around 11% of the world sugar market. Moreover, according to the Mauritius Sugar Authority, Mauritius controls more or less around 80% of the international market of special kinds of sugar. The aim is to produce 600 000 tons per annum. The foreign earnings from sugar on the Mauritian economy is illustrated by the following figure.

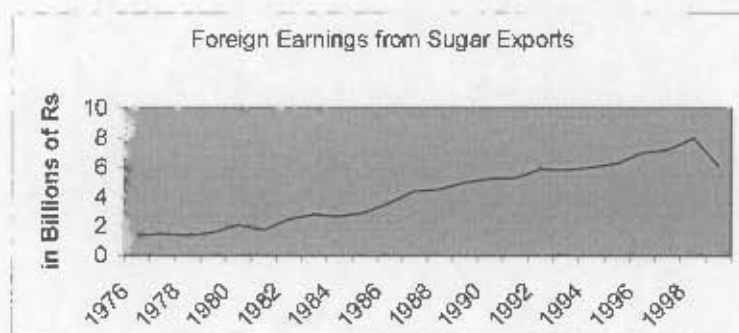


Figure 1.2 (Source : Central Statistical office)

The foreign earnings is in nominal terms and the continuous increase in foreign revenue has enabled the island to enjoy a better standard of living and encouraged the amount of imports.

1.3.2 Industrial Sector

The main long-term solution to the unemployment problem was seen to be the establishment of labour intensive industries geared to the export market. It is in this context that government, with the collaboration of the private sector, put forward a strategy for the establishment of an EPZ. The authorities put in place the Export Processing Zone Development Authority (EPZDA) and the Mauritius Export Development Industry Authority (MEDIA) which had the role of promoting the EPZ and locally produced goods. The EPZ has access to European markets via the Lomé Convention. The latter has main objective to attract investors from France, Germany, Hong Kong and Singapore.

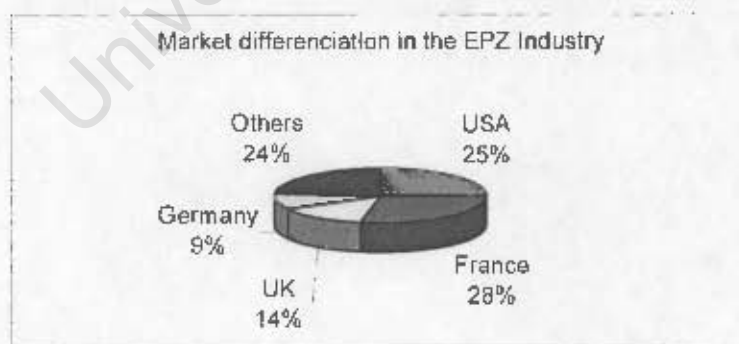


Figure 1.3 (Source: 2nd Trade policy review of Mauritius)

With the establishment of the World Trade Organisation (WTO), many steps are being taken to increase competitiveness. Better techniques are being sought for the development of new products along with more aggressive marketing strategies.

Mauritius is trying to promote better quality and product differentiation as opposed to better prices. With the emergence of countries like India, Pakistan and China, where labour is cheaper, Mauritius has no other choice but to develop new products with greater value added, and change its strategy to produce goods of better quality. In the near future, the growth in the EPZ sector seems to be positive, with the new Africa Bill, which offers access of African products to the United States.

World globalisation can be at the same time a threat and an opportunity. On the one hand, it is considered as a threat as it needs better technology, more resources and investment. On the other hand, it is an opportunity as it is a motivating factor for many economies. It challenges the economies to be stronger, competent and competitive.

The growth rate of the EPZ sector has increased drastically since the last 17 years. In 1983, its contribution to GNP was 6.5%⁸ and in 2000, its contribution had increased to 25%. EPZ exports for the year 2000 were directed mostly towards 3 major destinations, namely United States, France and United Kingdom, which represented 24.9%, 24.3% and 21.4% respectively, of total exports in 2000. As compared in 1984, where exports of the EPZ were only 30%, in 2000 EPZ exports were around 74% (BOM 2000).



Figure 1.4 (Source: 2nd Trade policy review of Mauritius)

⁸ http://www.mauritius-online.com/coopers/mtn_politics.htm

1.3.3 Tourism

From the early years of independence, when tourism development was first encouraged, through the 1980's, when both the promise and difficulties associated with tourism were more clearly seen, there has been a sustained effort to promote the selective growth of this industry. As with the EPZ, a crucial impetus for promoting tourism was job creation. The tourist industry employs around 75000 people directly and perhaps 3 times that number indirectly. Following sugar and the EPZ, tourism is the country's third major foreign exchange earner. Thus, tourism makes a significant impact on the economic life of the country.

Prior to the adjustment years, tourism was identified as a potentially lucrative industry. In the early 1980's, there was a significant fall in tourist arrivals and with this setback a careful recommendations were undertaken. The tourist infrastructure was modernised to attract more tourists to the island. Judging from the figures for 2001 recently released by the Central Statistical Office (CSO), tourism performed quite well in 2001 despite the poor global economic climate and the overall weakening in demand for travel after September 11th. A major strength of tourism in Mauritius is its orientation towards the upper end of the market, which helps it to withstand adverse external trends in the industry. Tourism today already makes a significant contribution to foreign exchange earnings, but there is also scope for further expansion if the services sector based on regional markets.

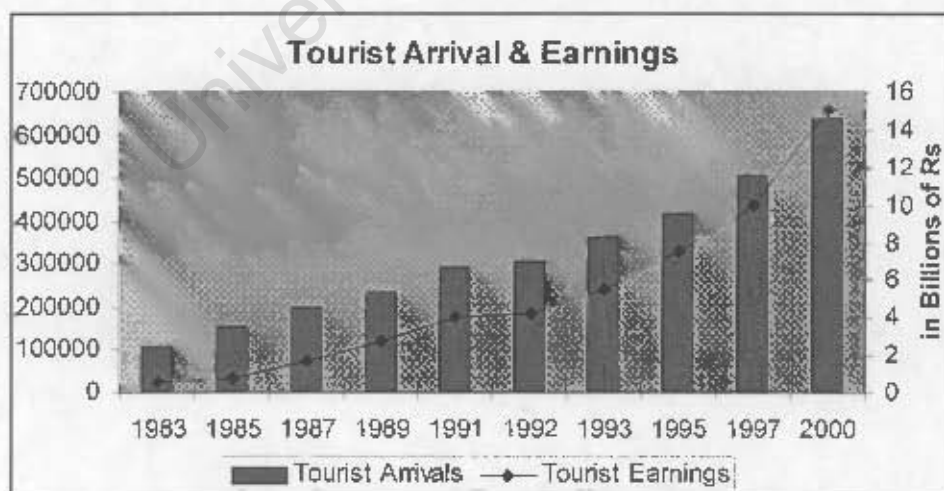


Figure 1.5 (Source: Central Statistical office)

1.3.4 The Financial Sector

Financial development has been assigned a strategic importance in economic development. This is based on the theoretical underpinning that a developed financial system would lead to gains in financial resource mobilisation and allocation and thus contribute to economic growth. Financial system development has become a key ingredient in economic stabilisation and adjustment prescribed by the World Bank and IMF. In Mauritius, financial system development has loomed large in the economic agenda even before the economy embarked upon a structural adjustment programme. However, a policy to develop the financial system began in the late 1980's. Also there has been a shift in financial system not only to serve other sectors of the economy, but also to transform Mauritius into a regional financial center with the sector becoming the 4th pillar of economic development after sugar, tourism and the EPZ. It is encouraging to note that an increasing number of offshore companies registered in Mauritius are establishing operational offices on our island. This trend reflects the determination of the authorities from the outset to develop the offshore sector as an important pillar, which will generate substance and high value-added services to the Mauritian economy. The total number of offshore entities on register has reached 10,561 as at November 1999, and includes 4,691 Offshore Companies, 5,536 International Companies, and 157 Offshore Trusts.

1.3.5 The Service Sector

The offshore sector, EPZ, insurance, etc. has brought a major contribution to the Mauritian economy. Reflecting the overall growth of the economy, value added in the services sector rose further in 2000. The "Financial Intermediation" sector, which comprises insurance and banking services registered a growth rate of 11.1% in 2000 as compared to 9.7% in 1999⁹. This improved performance was mainly attributable to the increase in profitability of offshore banks following a major expansion of their asset base.

⁹ Bank of Mauritius, 1999

Banking and Insurance

The Bank of Mauritius Ordinance 1966 provided for the establishment of the Bank of Mauritius as the country's Central Bank. The Bank started its operations on 14th August 1967 at a time when Mauritius was still a British colony. The Bank carries out all normal central banking functions. The major objectives include the conduct of monetary and exchange rate policies, which foster sustainable, non-inflationary economic growth and development. Moreover, the Bank has to ensure the stability in the financial market. It should strive to secure active and continuous co-operation from other banking institutions for an effective execution of its monetary policy. Offshore activities are also regulated and supervised by the Central Bank.

The insurance industry in Mauritius can be considered as the main institution for non-banking activities. Traditionally, it has been one of the main sources of finance for the long-term. Most insurance companies are generally privately owned, with the exception of the State Insurance Corporation of Mauritius.

The Stock Exchange

The establishment of a stock market as well as the development of other financial markets have also been used as measures of financial development. The Mauritius Stock Exchange has been in operation for slightly more than ten years. On the official market at December 1998, there were 42 listed companies with a market capitalisation of Rs45.3 billion and on the over the counter market, there were 61 companies¹⁰. Financial incentives are in place to encourage companies to list their stock, and investors get tax breaks on both dividend income and capital gains. 1993 and 1994 can be considered as the take-off years for the emerging Mauritius Stock Exchange, which almost all sectors recorded a growth rate in turnover of over 100%. In late 1994, the stock market was also opened to foreign investors, following the suspension of the foreign exchange control act. A recent development on the stock exchange is the emergence of the debenture market, which has facilitated a shift from bank borrowing by companies to direct borrowing from the public.

¹⁰ Bundoo, 1999

The Freeport

The island of Mauritius is a successful regional business base for international trade. Located ideally in the Indian Ocean off the coast of East Africa, it offers unlimited trade opportunities among the continents of Asia, Europe and Africa. Through its memberships with the *Preferential Trade Area for Eastern and Southern African States (PTA)* and the *Indian Ocean Commission (IOC)*, Mauritius offers access to a regional market of 250 million consumers and an import market valued at over US\$32 billion.

The Freeport legislation has provided for a liberal and comprehensive incentive package, advisory services and other tangible benefits for companies looking for a cost-effective storage, assemble, and redistribution location. These include:

- Exemption from tax
- Preferential rates for warehousing and storage
- Reduced port charges for all goods destined for re-export
- Exemption from customs duty, import duty and sales tax on all finished goods, machinery, equipment and materials imported into Freeport zone
- Access to offshore banking facilities
- Possibility of selling a percentage on local market
- No foreign exchange control
- 100% foreign ownership allowed

Under the *Freeport Act of 1992* the *Freeport* was established as a customs-free zone for all goods destined for re-export and on all machinery, equipment and materials imported into the Freeport zone. The Freeport carries out the following operations, namely, warehousing and storage, sorting, grading, cleaning and mixing, simple assembly and labelling and packing. According to the Mauritius Freeport Authority, French societies are planning to assemble cars in Mauritius while the Australian societies import computers from the eastern countries for re-exportation to Australia. Moreover, the goods do not physically reach the island but are only invoiced in the country to benefit from the fiscal advantages.

1.3.6 The Offshore Sector

In 1992, Mauritius became the first offshore financial center in the Southern Hemisphere. About 1500 offshore international companies have been incorporated since. Those incorporations were facilitated by the Mauritian government through the latter's ratification of the double taxation agreements with Botswana, Canada, China, France, Germany, India, Indonesia, Italy, Luxembourg, Madagascar, Malaysia, Pakistan, Singapore, South Africa, Swaziland, Sweden, United Kingdom and Zimbabwe¹¹. The offshore sector has been identified, as a great source of economic growth and the development brings along with it will also boost the economy as a whole.

Moreover, the numerous developments on the international scene, for instance, the opening of the financial sector, the globalization of markets, the emergence of regional blocs and the move towards regional integration and co-operation makes it more important for Mauritius to try and integrate itself in the international economy. This is the reason why a financial center has been established, to contribute to the development of the service sector of the country. Mauritius continues to assert itself as a regional business and financial services center. Investments from Asia (excluding India) and Africa (including the Indian Ocean islands) account for 18.5% and 18.8% respectively in terms of offshore company registration. With regards to channeling of investments in Asia and Africa, 8.2% and 12.3% of the registered offshore companies are being used for that purpose. Overall it is interesting to note that offshore business is consistently being diversified in terms of origin of investors and target investment countries. This is to show that the economy is trying to establish itself as being a strong financial center in the Indian Ocean. The authorities are committed to enhance the infrastructure support so as to encourage more investors to locate their operations in Mauritius. In terms of activity, offshore business in Mauritius is still concentrated on investment business, which includes securities and asset holding, and investment mutual funds.

In view of this development, a more modern and flexible legal system had to be established. The legislative framework caters for the wide demands of today's international business and

¹¹ http://www.mauritius-online.com/coopers/mm_politic.htm

responds to the continuous changes taking place in the business and financial services industry. The legislation has undergone constant improvements to keep pace with developments in other offshore jurisdictions and also to provide more efficient investment vehicles to investors. The reason behind is that the most successful offshore centers have known how to bring new products and change their laws according to the demands of the investors. However, the greatest dilemma that arises then is the fact that too much flexibility for the investors brings along tax evasion problems. This is one of the reasons why the Organisation for Economic Co-operation and Development (OECD) has published a report on fiscal issues. The OECD groups member countries in an organisation that provides government a setting in which to discuss and develop economic and social policy.

Developments in the Mauritian offshore sector continue to be oriented towards the establishment of activities generating substance and value-added. It is encouraging to note the increasing number of well established firms from South Africa, Europe and Asia setting up operational offices with the objective of centralizing their offshore operations in Mauritius. The range of activities carried out by these offshore companies indicates the versatility and flexibility of our jurisdiction. Assessing the full impact of the offshore sector on the Mauritian economy constitutes an important exercise in determining the value added generated in the sector. Hence it is important to try and explain where lies the Republic of Mauritius in view of the international community of offshore centers. The nature of offshore activities will be discussed along with the main aspects of such activities. This paper reviews the current structure and status of offshore financial sector of Mauritius and makes an estimate of what might be the cost of compliance with international standards.

The remainder of this paper is structured as follows: a description of services provided by offshore centers generally is given in chapter 2; a brief summary of international concerns about OFCs in the context of money laundering is given in chapter 3; an analysis of the role of the offshore sector in Mauritius in terms of composition, size and economic contribution, where a comparison with the British Virgin Islands and Seychelles is made in chapter 4. The conclusions and recommendations for further research are presented in chapter 5. The paper concludes that, under current international best practices, costs associated with this sector have increased. Thus, the prospects for significant net economic benefits from development

of this sector for new entrants in the Indian Ocean appear to be limited. Some of the background information used in this paper is included in various annexes: Annex 1 contains the list of criteria used by the Financial Action Task Force to define a noncooperative countries as of Sept 2001.

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CHAPTER 2: OFFSHORE CENTERS

2.1 Introduction

Since the French Revolution, the rich people have moved their funds into more profitable areas, in areas where they can avoid paying taxes on their capital gains. Nowadays, there are more than 50 jurisdictions that provide such advantages. With the new era of globalization since the 1990's, there has been a growing number of investment options in many emerging markets. Therefore, most businessmen are trying to maximize their incomes by investing in such countries where they can maximize their gains. Developed economies have high taxation levels and many laws, while on the other hand, those developing countries are politically and economically unstable. Therefore, most investors did not want to invest in such economies and consequently this enabled the development of offshore centers. In such cases, offshore centers are used as operational bases to satisfy the increasing demand of the investors. According to the 1994 'International Offshore and Financial Centers handbook' investment in offshore centers have increased from \$1 500 millions in 1989 to \$5 000 millions in 1995 (estimation). Moreover, it is also said that an offshore financial sector is involved in 50% of international monetary transactions.

2.2 Definition of an offshore financial center¹

"Offshore" has no precise dictionary meaning: The word simply reflects the fact that many low-tax jurisdictions are islands. Loosely, it is used to mean "outside the control of highly-taxed Western nations", although those nations could have controlled the growth of offshore jurisdictions much more tightly if they had wanted to.

¹ Offshore financial centers IMF background paper June 2000

Offshore is considered to be any jurisdiction of one's own country of residence. As an example, Canada can be considered an offshore jurisdiction for U.S.A citizens. So can The Bahamas, Switzerland or any other country that is not a U.S.A State. Likewise, the US can be considered an offshore jurisdiction for Canadians, Europeans and anyone else that is not a citizen of the U.S.A. Going offshore means nothing more than utilizing a country other than ones country of citizenship to hold one's assets and conduct one's business and financial affairs.

There is no magic or mystery surrounding offshore companies. This may sound simplistic, but an offshore company is essentially the same as any other company. Thus an offshore company can carry out the same types of business as companies incorporated in "onshore" areas. The term "offshore" refers to any place other than where the client is a resident and has his permanent residence. An offshore financial center is a jurisdiction that specifically caters for the provision of financial services to persons who do not reside in that jurisdiction. Why go offshore? This question is simply answered: to get away from "onshore". The main difference between an "onshore" and "offshore" company is that the tax rate applied by the government in the jurisdiction in which an offshore company is incorporated is either very low or zero. Moreover, some offshore companies are easier to administer and more confidential than onshore companies.

Offshore centers themselves serve a variety of different purposes for various types of individual and corporation. Not all of those purposes are legitimate. There is no question that there has been, and continues to be, inappropriate use of offshore centers by drug traffickers, terrorist organizations and racketeers, but the introduction of anti-money laundering laws in most 'advanced' offshore centers is proving to be at least as effective as anti-money laundering measures in place throughout the western world. The world's governments and economic organizations such as the OECD have had some success in preventing abuses, but laundering remains a problem in some offshore centers.

Many offshore centers are most useful in relation to a particular high tax country, e.g. the Isle of Man which is offshore to the UK. Others have specialized in particular business sectors.

All types and sizes of business take advantage of the favorable tax regimes of offshore centers. Large multi-national corporations use them as centers from which they manage their insurance and pension funds for their employees. The funds grow without being taxed, to the benefit of both the company and the employee.

2.2.1 The features of an offshore center²

They offer a low-tax regime. Offshore centers very often have no local tax or minimal income taxes. They are generally free from tax on making profits from selling assets and free from wealth tax. This is one of the main reasons they are so attractive.

The Isle of Man, and the Channel Islands of Guernsey and Jersey, for example, levy income taxes at levels lower than those prevailing in the UK. Several Caribbean jurisdictions levy income tax, but in some cases it is as low as, say, 3%³.

Having said that, most low-tax jurisdictions and even many high-tax jurisdictions are tax havens as far as non-residents are concerned, because non-residents are often exempt from the direct taxes applicable to residents

They offer, privacy and confidentiality. Due to offshore centers regulating themselves, disclosure of beneficial parties to wealth are very much restricted. This is unlike onshore centers where most information has to be submitted to a central collection house and can often be viewed by the public, e.g. company accounts must be submitted for UK public limited companies.

² Bellows, 1999

³ Suss & al, IMF Working Paper, 1988

Lack of exchange controls means that people are secure and that their money can be taken out or that more can be put in at any time. Moreover, there is minimum government intervention leading to greater confidentiality, less restrictions and less regulations.

Another feature is having political and financial stability leading to greater security that money is safe and that devaluation of currency will be unlikely to occur as currencies are generally fixed with the US Dollar or UK Sterling.

Due to the great advantages of these offshore centers, they have attracted high-level financial experts to residency and also trained local staff to high levels in the financial field. Assets held under certain structures are protected from lawsuits, judgments and/or divorce settlements.

Offshore income under certain structures accumulates tax-free, leaving more to invest. Offshore investments also accrue at a significantly faster rate than onshore due to the elimination of capital gains taxes.

All the above are the main features of offshore centers. When choosing offshore centers, there are a few factors that should be considered. These are discussed below.

2.2.2 Factors to be considered when choosing an offshore center⁴

Most offshore centers have established legal and regulatory conditions to provide the above features so what further factors should be considered when selecting an offshore finance center. The following is not a definitive list of what clients and their advisors may consider beneficial but it does cover the most important factors

a) Reputation

There are many offshore financial centers and the number has steadily increased in recent years. Many have introduced legislation and procedures to enhance business

⁴ IMF – Assessment of the Offshore Financial Sector, 2001

development. The reputation of the center can be a major factor in the decision on whether or not to use the center. Those countries, which have experienced recent economic or political problems or scandals, will find confidence in the center suffering. The more established centers often benefit if they are able to show that business has been operated without any serious incidents. The newer centers may find it more difficult to develop business until client confidence can be established.

b) Geography, and physical infrastructure

The Offshore Financial Center (OFC) must provide:

- Good communications, especially direct, and preferably non-stop, flights with easy access for clients and advisers; close to major onshore centers.
- An attractive climate and environment (stimulates interest) with good accommodation for clients and advisers and for resident expatriates.
- The same time zone as major centers (for example, Caribbean jurisdictions in the same time zone as New York; or Cyprus in same time zone as many East European cities).

c) Human infrastructure

There must be readily available expertise in banking, law, accountancy, insurance, translation, interpreting, trust administration, company administration, and clerical tasks. It is also useful if the local official language is one readily understood by the client. A strong local economy is required with; good living standard; skilled workforce; availability of back-up services; and easy work permit regulations and the absence of civil strife

d) Legal system

The local legal system will probably be common law similar to that in England, but modern and non bureaucratic. There should be good trust law and company statute law preferably drafted with offshore business in mind to include:

- Long perpetuities and accumulation periods.
- Legislation permitting limited liability partnerships

- Flexible modern company law and minimal company reporting.

The local legislature and judiciary needs to be able to operate independently and free of government interference

e) Minimal reporting.

There should be no public disclosure of beneficial ownership of companies and no central registry of trusts. Some details relating to local companies may have to be reported to the Registrar of Companies. Banking secrecy laws must be upheld to provide client and business confidentiality. This restricted reporting requirements need to be balanced against a duty to report clients who may be suspected of money laundering activities.

Offshore financial centers provide a number of legitimate and important services, that can be broadly grouped into 3 categories: (i) private investments, in which investments are managed in order to minimize potential tax liabilities and maximize protection granted under statutory confidentiality provisions; (ii) asset protection, in which the use of an international jurisdiction separate from the client's residence allows for the protection of income and assets from political, fiscal and legal risks; and (iii) estate planning in which the administration of assets is done in the most favorable legal and fiscal jurisdiction. The various types of financial institutions and vehicles that can be used for these services include international business corporations, commercial banks, insurance companies, mutual funds, and more recently, gaming companies (Higgins, J. Kevin, 2000, "Offshore Financial Services: An introduction," *The Eastern Caribbean Banker*, Vol. 2 (July), pp7-8).

The list below gives the most important or predominant vehicles through which OFCs can provide services, but is by no means meant to be exhaustive⁵.

⁵ ICSA -Introduction to the offshore business environment, 2002

- Offshore banking: Corporations or banks may open offshore banks to handle foreign exchange operations or financing needs; an individual may open an account in an offshore bank include no capital, corporate, capital gains, dividend or interest taxes, no exchange controls, and lighter supervision and reporting requirements.
- International Business Corporations (IBCs): IBCs are limited liability companies that may be used to operate businesses, or raise capital through issuing shares, bonds, or other instruments. In many OFCs the cost of setting up an IBC is minimal and they are exempt from all taxes.
- Insurance companies: Commercial operations may establish an insurance company in an OFC to manage risk and minimize taxes, or onshore insurance companies may establish an offshore company to reinsure certain risks in order to reduce reserve and capital requirements for the onshore company. The advantages of the OFC are favorable income/withholding/capital tax regimes and low reserve requirements and capital standards.
- Asset management and protection: Individuals and corporations in countries with weak economies and fragile banking systems may want to keep assets abroad to protect them against the possible collapse of the domestic currencies and banks, and free from any exchange controls; when confidentiality is desired, then an OFC is the choice for placing the assets. Individuals who face unlimited liability in the home jurisdiction may restructure the ownership of their assets through offshore trusts to protect those assets from domestic lawsuits.
- Tax planning: Multinational firms may route transactions through OFCs to minimize total taxes through transfer pricing. Individuals can make use of favorable tax regimes in, and tax treaties with, OFCs often in the form of trusts and foundations.
- Money laundering: proceeds from illegal activities such as drug trafficking, are processed through offshore centers to conceal the true source of the funds.⁶

⁶ Source: Report of the Working Group on Offshore Centers," Financial Stability Forum, April 5, 2000,

2.2.3 Characteristics of OFCs⁷

Many Offshore Financial Centers (OFC) have the following characteristics:

- Jurisdictions that have financial institutions engaged primarily in business with non-residents;
- Financial systems with external assets and liabilities out of proportion to domestic financial intermediation designed to finance domestic economies; and
- More popularly, centers which provide some or all of the following opportunities: low or zero taxation; moderate or light financial regulation, banking secrecy and anonymity.

Offshore funds are collective investment funds registered in tax havens, typically small islands in the Caribbean, Europe and Asia Pacific. The right offshore jurisdiction offers a legal regime and infrastructure which will be sensibly regulated and offer greater flexibility to the investors.

Offshore banking operations have, played a role in the recent financial crises of Latin America and Asia. In Latin America, offshore establishments were used as alternatives to domestic financial institutions that were often subject to strict prudential regulations and high reserve requirements. Moreover, tax advantages as well as political and economic uncertainty onshore fuelled the use of offshore establishments. The absence of effective consolidated supervision by onshore supervisors proved to be the most important factor in permitting the exploitation of regulatory arbitrage offered in some OFCs through the transfer of assets and liabilities between offshore establishments and parent banks onshore. In Asia (for example in Thailand), regulatory and fiscal advantages as well as lower borrowing costs, offered in some OFCs induced many Asian banks and corporations to tap international capital markets through offshore establishments. Large, undetected, and poorly accounted for offshore funds contributed to credit expansion in the region, led to increasing exposures to liquidity, foreign exchange, and credit risks, and had systemic effects on the financial systems of individual

⁷ ICSA – Introduction to the offshore business environment textbook, 2002

countries concerned. In addition, the failures of Bank of Credit and Commerce International (BCCI) and Meridian Bank have resulted in substantial damage to the banking sectors of certain smaller countries involved.

The cases of Argentina (1995), Venezuela (1994)⁸, and, more recently, Ecuador, show that a large, and, in the worst case, insolvent offshore establishment designed to escape the reach of supervisory authorities onshore may disrupt the operation of its onshore affiliated bank. In other instances, offshore establishments may become substantially larger, in terms of assets and liabilities, than affiliated banks onshore (as in the case of some private banks in Costa Rica). Because offshore banks may exploit such opportunities for regulatory arbitrage, transferred funds can be used to finance connected onshore activities—real estate and construction, for instance—further concentrating onshore risks in offshore financial centers, some of which are inadequately supervised.

The solution lies not only in better supervision in OFCs, but also in more effective consolidated supervision by home countries. Attempts to deal with it only at the OFC level are likely to lead to the movement of such business to other places, where information may be even more difficult to obtain.

Offshore activities include international tax planning, using legal mechanisms to reduce, eliminate taxes on income, wealth, profits and inheritance. However, the principal function of offshore centers is no longer to minimize current and future taxes or to avoid foreign exchange controls. They are now on the cutting edge of new corporate, investment, trust, insurance, partnership and banking legislation and are amongst the first to offer unique structures such as limited partnerships, asset protection trusts, purpose trusts and limited duration companies, while continuing to provide the only effective shield against the dangers of expropriation and sanctions.

It has been estimated that 65% of the world's hard currency is held in offshore banks and that around 40% of world trade in goods are transacted through offshore finance

⁸ <http://www.offshoreon.com>

centers. Offshore companies and offshore trusts provide you with enormous tax savings and asset protection in a legal manner if setup correctly. They can also afford the ultimate beneficial owner or promoter a certain amount of anonymity.

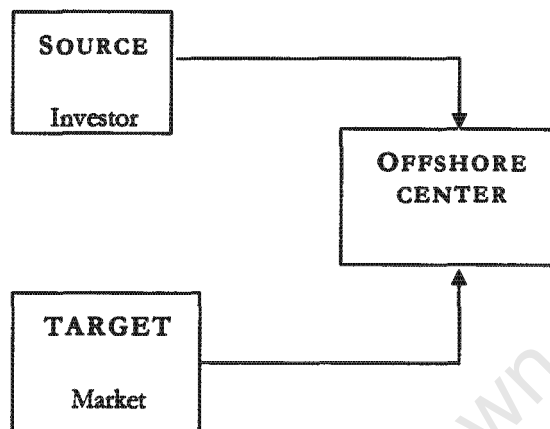


Figure 2.1 (Offshore transaction)

In simple terms, the offshore business consists of a “route” of transactions via an operational center of a country, which offers certain advantages such as a low tax rate or a no tax policy.

The subsidiary is known as offshore société and the country offering all the advantages, the offshore center. In principle, offshore activities are carried out by non-residents of the offshore center and is in foreign currency. Usually, management of the subsidiary is performed by locals.

Nowadays, there are more than 50 offshore centers established in the world, and the number increases each year. Traditionally, there are 2 categories of offshore centers:

- Centers that have absolutely no taxes charged on profits, income and capital. Such centers are commonly known as “Tax Havens”. The Cayman Island and the Bahamas are examples in this category.
- Centers that have taxes, but provide several advantages for foreign investors, for instance like having a double tax treaty (Mauritius falls into this category).

All kinds of companies take advantage of the favorable fiscal regimes of offshore centers. Multinationals use the offshore entities for insurance purposes or for pension funds for their employees. In this respect, the funds can grow without being taxed. Such companies use these entities for the restructuring of their investment to take full advantage of the fiscal regime.

There are 2 main types of investors in the offshore market:

Institutional Investors: These investors mainly live in the States, Europe and Japan. They use the jurisdiction to create offshore entities to take full advantage of the fiscal regime. The main activities include the following:

1. Financial and Banking services
2. Construction projects
3. Investment holding
4. Management of funds
5. Shipping business
6. Trade
7. etc.

Private Clients: Such investors are in search of an appropriate offshore financial center to invest their funds. An offshore trust provides an effective and legitimate means of sheltering one's assets against exchange control and risk planning. Offshore centers are chosen in respect of the taxation level, the lower it is, the more popular the center is. Confidentiality is ensured through the absence of disclosure requirements as regards the name of the beneficiary. This is of particular importance for individuals of politically unstable countries. An offshore trust may be considered as a type of insurance as it shelters one's assets against creditor's claim and protects the individual against any eventual risk (example: inheritance)

2.3 Economic effects of offshore centers⁹

Offshore centers contribute to the local and regional economies in a number of ways. First of all, an offshore center promotes integration of national capital markets, thus encouraging mobilization and allocation of savings on a regional basis. Integration of national capital markets helps to eliminate local and sectoral monopoly and stimulates the formation of savings and its pooling internationally. Location of an offshore center in a developing country stimulates the growth of financial infrastructure for a local capital market.

Most offshore centers have positive effects on local employment in such areas as banking and related financial institutions, legal, accounting and the air transportation sectors. Positive stimulus to employment and infrastructure in the offshore center has other positive spill over effects on the rest of the economy.

Offshore centers also provide additional tax revenues to host governments in the form of personal income tax on local employees, registration fees on foreign financial institutions, and stamp duties and transfer taxes on securities being traded.

2.4 Advantages of offshore financial centers

The main reasons why investors use offshore companies are as follows:

- Save tax
- Protect assets and reduce risk
- Reduce costs
- Maintain privacy
- To avoid unwarranted bureaucracy

⁹ Roussakis, 2000

Offshore investment funds are alleged to engage in trading behaviour that are different from their onshore counterparts. Because they are less moderated by tax consequences, and are subject to less supervision and regulation, the offshore funds may trade more frequently.

The regulatory and institutional environment faced by offshore funds can be quite different from onshore funds. The host countries the offshore funds typically do not collect capital gains tax. More often than not, they typically do not forward the financial information to other tax and financial authorities either, even if the ultimate owners of the funds are located elsewhere. Furthermore, the regulation on these funds in the tax havens is often less stringent than that of major industrialized countries where most of the onshore investment funds are located.

Helm¹⁰ listed seven areas in which offshore funds face fewer regulations as compared with their counterparts in the U.S. For example, offshore funds would have greater flexibility and less procedural delays in changing the nature, structure, or operation of their products, and they would face fewer investment restrictions, short-term trading limitations, capital structure requirements, governance provisions, and restrictions on performance-based fees.

As a consequence, offshore funds may trade more aggressively than onshore funds because the zero or lower capital gains tax reduces the required expected gains from them to trade. They may also engage in trading behaviours that are different from their onshore counterparts. Not having to pay capital gains tax at home and facing less supervision and regulation from home governments may induce offshore funds to trade more frequently than their onshore counterparts. In addition, investment funds that prefer to trade more actively may self-select to locate in the offshore centers.

For instance, it has been alleged that foreign portfolio investors may engage in positive feedback trading (e.g., rushing to buy when the market is booming and rushing to sell when the market is declining), and are eager to mimic each other's behaviour while

¹⁰ Helm, 1997

ignoring information about the fundamentals. There is a concern that offshore funds may be more prone to this kind of trading pattern than their onshore counterparts, either due to the nature of their investment styles or due to lower regulatory constraints they face at home. Behaviors such as these by offshore funds could exacerbate a financial crisis in a country to an extent not otherwise warranted by economic fundamentals.

Offshore tax havens preceded the modern form of offshore financial center. They were mostly of British origin designed to shelter assets from economic uncertainties in the wake of World War II. The tax haven's key product was private banking to manage the estates of rich families in a tax-free environment. The motivation for remote islands to establish such centers were economic; to create good local employment opportunities. Early pioneers were the Channel Islands of Jersey and Guernsey near the coast of Normandy, and Bermuda. According to the OECD, a "tax haven" is a jurisdiction that meets the following criteria:

- Low or no nominal tax
- Effective exchange of information
- Transparency
- Ring-fencing (where there is substantial domestic economy)

Offshore finance can be defined as the provision of financial services by banks and other agents to non-residents. The number of offshore financial centers seems to be growing by the year. Other services provided include fund management, insurance, trust business, asset protection, corporate planning and tax planning. An offshore bank in Mauritius deals exclusively with foreigners, in foreign currency (not the Mauritian Rupee).

2.5 Factors influencing the choice of offshore centers¹¹

2.5.1 Geographical Location

The geographical location is an important factor, which decides on whether the country is a suitable place for the establishment of an offshore sector.

2.5.2 Political and Economic Stability

Both political and economic stability are important factors that foreign investors should take into account while choosing their offshore center. Most investment is made with the aim of making a profit. Therefore, the stability in all its forms is an indispensable condition to guaranty such a profit. An economy that is politically unstable is unlikely to attract investors. It is essential therefore for the investors to have “faith” in the jurisdiction they are investing. This usually requires a democratic economy, where the authorities are willing to invest into the economy and make it stronger.

2.5.3 Laws of Offshore Centers

The arguments to take into account are the efficiency of a transaction in terms of the time taken to conclude a transaction, the flexibility of certain laws and the restrictions imposed. In the financial sector, it is as difficult and painstaking a task to build up confidence and reputation, as it is easy to lose them. This situation was amply demonstrated by the East Asian crisis of 1997-98, when capital left the region swiftly, the banking system was thoroughly shaken up, exchange rates of currencies swung up and down and certain governments had to reintroduce exchange controls in an attempt to stem the tide. Even today, it is as yet unclear whether East Asia has got back to where it was before the crisis of 1997 and whether the region will rise to the occasion were the world economy to turn around in the near term. Moreover, it should be said that investors look for an environment that is not too restrictive in terms of having many rules and regulations and one which provides a certain level of confidentiality. The dilemma that is faced by most offshore centers is that of having a liberal approach to meet the needs of the clients and at the same time have a good international reputation.

¹¹ <http://www.mauritius-finance.com>

Those economies that are able to balance this dilemma will succeed whereas others will not be as successful.

2.5.4 Fiscal Regime

Fiscal incentives have been a major determinant in the success of economic development. The country that offers the best fiscal incentives will attract more international investment.

2.5.5 Double Taxation Avoidance Treaties

Having a double taxation treaty acts as an additional incentive for investment. This leads to multinational corporations to route their investment in such a country.

2.5.6 Exchange control

Countries with a bureaucratic system of exchange control will find it more difficult to have an offshore financial sector. In general, investors look for economies where financial services are efficient. This is because a bureaucratic system means inefficiency and a slow down in operations.

2.5.7 Social Factors

Social factors also have an influence on investors; as such factors will directly affect the expatriates, who have to work in such an environment. The space needed for new offices affects the choice of investors. Other factors that are also taken into account: road infrastructure, availability of land for houses, schools, hospitals, cost of living, standard of living, climatic conditions and recreational facilities. Below is a table that illustrates those social factors that influence investment in the offshore sector in Mauritius.

FACTOR	SCORE
Quality of local professionals	8,6
Speed of service	8
Quality of the legal system	8
Good reputation	7,9
Good communication	7,9
Quality of regulation	7,3
Quality of investor protection	6,6
Extent of disclosure required	6,6
Quality of banking system	6,5
Language	6,4
Government costs	6,1
Quality of treaty network	6
Good access	5,1
Time zone	4,4

Source: MOBAA Report 1997

Table 2.1 (Source: MOBAA Report 1997)

It should be noted that the different offshore centers could be used for different purposes, depending on the intention of the investor. If the latter wants an investment in India, he would not use the offshore facilities of the British Isles just because the latter has a good reputation and is successful. In other words, the choice of a jurisdiction depends on the type of investment in a specific country. Another investor may choose a different jurisdiction as the advantages offered suit his needs better.

2.6 Disadvantages of OFCs

However, OFCs could bring some disadvantages, such as making small open economies and their domestic financial systems, in particular, vulnerable to sharp changes in global financial flows through the transmission of financial and banking crises. The operations of OFCs have recently come under increased scrutiny by international policy regulators, especially after the recent wave of financial crises in global markets and subsequent debate on financial restructuring, regulatory reform and institutional capacity building. The role of OFCs in money laundering has also contributed to the heightened scrutiny. The fact that transactions through OFCs have increased significantly over the last decade has made their impact non-trivial.

2.7 International concerns about OFCs

In the late 1990s, enhanced concerns of the international community and tax evasion have led to a number of concerted efforts being undertaken by various international committees. The fact that many OFCs exist in loosely defined regulatory and supervisory environments has increased the focus of policy makers and regulators on the possible role played by OFCs in the process of tax evasion and money laundering. This focus has become even more intensified since the events of September 11, 2001, as officials attempt to identify sources of terrorist financing. The two principle forums engaged in the international attack on money laundering are (1) the Financial Stability Forum (FSF) and (2) the Financial Action Task Force (FATF). Both the FSF and FATF has established criteria for identifying countries that facilitate money laundering and have proposed the imposition of sanctions. As a result, the costs of an offshore sector to an individual country have increased, reflecting the need too have appropriate supervisory and regulatory agencies. In the absence of these agencies, the risk of sanctions being opposed by the international community has increased significantly.

In April 1990, the FATF issued a report containing a set of 40 recommendations (these recommendations were revised in 1996 to take into account changes in money laundering trends; for details on the recommendations, see "Financial Action Task Force on Money Laundering, The Forty Recommendations", at www.oecd.org/fatf, which provided a set of counter measures against money laundering and are related to the criminal justice system and law enforcement; the financial system and its regulation; and international cooperation. The basic issues addressed by these recommendations ("Enhancing Contributions to Combating Money Laundering: Policy Paper," Annex II prepared by the IMF and the World Bank, April 26, 2001) relate to (i) the criminalisation of money laundering; (ii) international cooperation in investigating, prosecuting, and extraditing of crime suspects; (iii) the existence of adequate supervisory policies, practices and procedures, including "knowing your customer" rules which would shield banks from being used by criminal elements; and (iv) the international exchange of information regarding suspicious information.

In mid-2000 both the FSF and the FATF issued reports on the state of money laundering with a focus on various offshore financial centers, using various criteria to determine the degree of “cooperation” and the adequacy of legal and supervisory systems relative to international standards. However, since the FATF criteria were more straightforward in many areas than those used by the FSF, this paper deals only with the countries addressed by the FAFT in its June 2000 report, which updates as of September 2001.

In the June 2000 report¹², the FAFT evaluated 26 nonmember countries or territories using 25 criteria drawn on the basis of the 40 recommendations (see Annex 1 for the list of criteria used. For member countries, the FAFT evaluate their offshore sectors on the basis of the 40 recommendations). These criteria can be grouped into 4 main areas: (i) loopholes in financial regulations; (ii) obstacles raised by regulatory requirements; (iii) obstacles to international cooperation; and (iv) inadequate resources provided for dealing with money laundering activities and territories. Of the 26 countries initially evaluated, 15 were declared to be noncooperative (NCCT).

In general, being declared cooperative did not exclude the need to improve measures to address money laundering, e.g., legislation, supervision, regulation, but rather that the country or jurisdiction had been taking measures to address any shortcomings. The report identified detrimental rules and practices that obstructed international cooperation against money laundering.

The bulk of the reasons for Mauritius being declared uncooperative related to (i) secrecy provisions regarding institutions; (ii) lack of appropriate system for reporting suspicious transactions; (iii) inadequate legal requirements for registering business and legal entities; and (iv) the existence of obstacles to international cooperation in investigating money laundering activities. In recent years, competition for international capital has resulted in some new entrants to the offshore financial market offering broad banking secrecy as one way to attract funds away from already established OFCs. Although professional

¹² <http://www.lowtax.net/lowtax/html/jurhom.html>

secrecy in banking activities can be justified, to an extent, by the need to protect business secrets from rivals, this need cannot be allowed to take priority over the supervisory responsibilities and the investigative powers of the authorities.

2.8 Offshore Trust and offshore¹³ companies

The aim of this section of the chapter is to review the main uses of an offshore trust and offshore companies and to provide reasons for using such entities. The main problems that arise and to avoid while using these entities will also be discussed.

2.8.1 Offshore Trust

In certain countries, a trust can serve as an effective tax planning structure to pass a family business to succeeding generations. However, it is the non-tax attributes of trust structures – namely specialized control and management, flexibility and continuity that play the most important roles in business succession plans. The trust laws regulate the trustees and grant guarantees against future taxation.

How do trusts work?

The family's shares in the business are transferred to a trust and the trustee becomes the shareholder. As such, the trustee has voting power in business related issues such as the composition of legally required Board of Directors.

A management company can be set up in which family members named by the owner can be given the power to direct the trustee to vote the family's share of the business in accordance with its restrictions.

Thus the trust can provide an oversight structure for the family while also controlling the management of the business, to a large degree.

A trust may be drafted to:

¹³ This is based on the article 'Offshore trusts and offshore companies: a consumer's guide' – Professor Peter Willoughby, Deacons Graham & James, Hong Kong, Magazine Offshore Investment édition mars 1996

1. Allow for centralized control of the management of the business during the owner's lifetime.
2. Enable transfer of equity to the family business without the loss of control by the founder.
3. Provide sufficient flexibility so that it can react to unexpected events.
4. Allow for transition in case the owner becomes disabled.
5. Provide a forum to educate the family on the responsibilities of wealth.
6. Allow family members to be brought into management position on a gradual basis through the management committee structure.

Provide a mechanism to allocate ownership interests consistent with any restructuring of the business.

Why choose a trust?

Why should anyone choose a trust rather than, for instance a foundation in a suitable jurisdiction or some other legal structure?

There is rarely a clear-cut answer to this question from a purely objective point of view. The motive for choice of one rather than the other is almost invariably a strongly subjective one. It depends on the upbringing and education, the original background and surroundings. With the spreading of the offshore trust, initial inadequate structuring of trusts has occasionally resulted in later litigation. It should be borne in mind that the trust is, as a rule, a long-term solution, often providing for both an existing and a coming generation. Some of the main reasons why trusts are popular offshore entities are:

1. Transfer of family business
2. Avoid a split after death
3. Protect the weaker members
4. Protection for potential creditors
5. Protect the family fortune
6. Continuation of family affairs

With offshore trusts we do, find that they tend to be favored by what is called a high net worth individual. Also the property in question is often of a diversified nature. The assets are normally spread over more than one country and in the form of securities or property.

Where should a trust be implemented?

1. **Favorable fiscal environment:** Generally, jurisdictions such as the States, Great Britain, Australia, Canada or the Republic of Ireland do not have favorable fiscal regimes, but have good laws concerning trusts.
2. **Good professional advice:** This is of utmost importance. It takes a long time to develop a level of expertise in trusts. Having the appropriate expertise in a jurisdiction is essential.
3. **Good communication:** If the settlor and the beneficiary are in different parts of the world, there have to be able to communicate easily and efficiently with the trustees. Nowadays, a good system of communication is a must for business to be carried out effectively.
4. **Political and economic stability.**
5. **Good reputation:** Some of the most ancient jurisdictions have maintained a good reputation through a cautious supervision and regulation (Guernsey, Bermuda, Jersey, etc...). The problem with recent jurisdictions is that they do not have a good reputation and some have a bad reputation. (Example: attract investment at any cost).

2.8.2 Offshore Companies

There exist many offshore jurisdictions that provide incentives for the creation of offshore companies. At first glance, it is difficult to for a professional to decide on the basis on which a country has been chosen to be an offshore jurisdiction.

In general terms, it is possible to classify the jurisdictions offering offshore companies into 8 categories:

1. **International Companies of the Caribbean jurisdiction,** for example: Anguilla, the Bahamas, Barbados, Belize, British Virgin Isles, Cayman Isles, Nevis, etc. From all the

above, BVI is the most popular jurisdiction. However, Cayman Islands provide services at a cheaper rate, has a more lenient legislation and even provides better services.

2. The British Virgin Isles, Isle of Man, are tax-exempt jurisdictions. Jersey, Guernsey and Isle of Man have a special kind of offshore company, where the residents of those countries are considered as being non-residents and therefore benefit from the advantages of the offshore sector. A fixed annual fee is payable to benefit from this advantage.

3. International jurisdictions such as Jersey, Guernsey, Isle of Man and Gibraltar do not provide the same advantages as those international companies in the Caribbean or in the Pacific Ocean. In the European states, more emphasis is placed on taxes. The general idea is that different jurisdictions offer variable tax rates.

4. There are also those jurisdictions that are known only for specific activities (insurance, shipping or aircraft). Offshore centers such as Guernsey or Isle of Man, or the Republic of Ireland, specialize in insurance business, whereas the Bahamas, Liberia, Panama, Isle of Man are reputed for their excellent Aircraft business.

5. There are some jurisdictions that have companies that have limited liability. In this type of company, there is a kind of partnership business, where all the members/shareholders are involved in the management of the company. More specifically, it combines the favorable characteristics of a corporation and at the same time have all the advantages provided in a partnership. Such a structure allows the companies to benefit from all the fiscal advantages while at the same time have a certain level of flexibility, which is usually found in partnership businesses, while operating in a limited liability business. This type of business is possible in the Bahamas, Cayman Islands, etc.

6. Jurisdictions providing a number of double taxation treaties (Cyprus, Madeira, Mauritius)

7. Jurisdictions having advantages in terms of location (Jersey, Guernsey, Isle of Man, Cyprus, Mauritius, Panama, The Bahamas, Cayman Islands, etc).

8. Special types of companies:

(a) Companies limited by guarantee - A Guarantee company is a company limited by guarantee without a share capital with all the necessary modifications, as if the

company were a company limited by shares, and references to shareholders were references to members. In case of bankruptcy, the members pay only a certain amount.

- (b) A Hybrid company is a type of company where the responsibility of members is limited both by shares, and by guarantee. This type of company has close attributes to trusts. For example, it is possible to establish a hybrid company where the shareholders own and control the shares of the beneficiaries who are “guaranteed members”.

Having described the different categories in which offshore jurisdictions can be split up, the choice of a jurisdiction depends on the need of the potential investor. The reason may be political or more specific (example: Insurance, aircraft, shipping, etc).

Apart from the specific needs of the client, some standard factors should be taken into account, most of which have been mentioned in the offshore trust section above. Factors such as the political stability, the geographical location, good reputation, modern infrastructure or a strong commitment to prudence must be taken into account.

There are 2 types of offshore jurisdictions, those that have double taxation treaties (Cyprus, Malta, Mauritius, etc), and those that do not (Bahamas, Seychelles, Jersey, etc). Countries having the treaties are generally those that do not pay taxes on dividends and royalties that is the fiscal regime is more attractive. Countries that do not have such treaties are chosen on the grounds of an absence of taxes on incomes, and generally, a company in such a jurisdiction must pay an annual license fee.

Most of the residents of offshore jurisdictions are capable to provide bilingual or multi lingual services, however it is important that they speak English fluently as the latter is the most common language used in most of the financial centers. This insures that all the needs of the investor is understood and executed without making mistakes.

Another important factor for the choice of an offshore center is the time zone. In fact, it is possible to communicate via fax or e-mail, but it is also important for the Director of

the Management Company and the client to be able to communicate on the telephone during the same working day.

2.9 Important players in the offshore industry¹⁴

2.9.1 Switzerland

As a magnet for investments, Switzerland has historically been one of the locations in which investment funds business has developed. The service sector contributes 70% of Switzerland's economy, and much of that is the financial service. 150,000 Swiss jobs are in banking, and they are not the worst paid ones. Switzerland is said to be the world's biggest center of private banking, with more than a third of all private wealth based there. Swiss banking assets exceed three trillion Swiss francs. This has come about because of three main factors:

1. Switzerland is neutral thus, most people choose Switzerland because it has proven to be a safe haven.
2. Switzerland has made use of conservative financial policies, which have led to a rise in the value of the Swiss Franc.
3. The Swiss authorities have managed to keep the confidentiality of their clients, while at the same time have defenses against money laundering.

A member of the OECD and one of the most secure members financially, Switzerland defied the majority of members that voted for measures against unfair tax competition in December 1999. Then in April 2000 it surprisingly agreed with an OECD declaration aimed at securing information exchange in the interests of tax harmonization.

Switzerland is not an offshore jurisdiction such as the Cayman Islands, or Jersey. It is however a low-tax jurisdiction, having a series of specialized corporate forms which can be used by international investors and multinational companies to reduce their tax bills to a significant extent.

¹⁴ <http://www.goldhaven.com>

The economy in Switzerland is moderately taxed, but locals have access to the tax-privileged company forms as much as foreigners if they comply with the rules, which broadly prevent any local business operations.

Being an OECD member, Switzerland has double tax treaties with 50 other countries. The effect of the treaties for non-residents from treaty countries is that they can obtain a partial or total refund of tax held up by the Swiss paying agent.

2.9.2 Cayman Islands¹⁵

Located around 600 kms to the South of Miami, the Cayman Islands is considered to be one of the best and more attractive fiscal paradise for foreign investment. During the last 20 years, more than 50 000 companies have been established. The most important reason being the fact that capital gains and incomes are not taxable. In the Cayman Islands, there are no taxes on revenues, incomes, profits or capital gains. There has never been any tax and this absence of any tax has not been implemented but is something that came naturally.

The economy is dependent on tourism, but financial services are growing in importance. The Cayman Islands is the largest offshore financial center in the world with more than 600 banks and with deposits of around \$500 milliards.

The trust sector has been estimated to be around \$450 milliards. The islands' stock exchange is now open for business and the listing function for mutual funds and debt issues is running. The second phase of the exchange, which will allow online trading of equities, is now in the planning stage and will be brought on shortly.

An integral part of any financial center is the availability of professionals who are highly qualified in various fields. The islands have through sensible immigration policies been able to attract and maintain a very high quality of skilled persons who meet the requirements of the worldwide community.

¹⁵ Offshore Trust Yearbook, 2001

2.9.3 Cyprus¹⁶

In view of its strategic location in the Eastern part of the Mediterranean sea at the crossroads of Europe, Asia and Africa, Cyprus has since ancient times been regarded as an important international business center. It is a democratic republic, and a member of the Commonwealth. Its past historical connection with the United Kingdom has given Cyprus the advantage of an English based legal, accounting and banking systems, which have contributed to the development of the infrastructure necessary for the island's growth as a financial center.

The authorities have done their best to establish a favorable fiscal climate, while at the same time maintaining a domestic economy. The tax policies of the country triggered the rapid evolution of Cyprus. The development of the financial and banking services industry was therefore a natural consequence. There are around 50 000 offshore companies in operation in Cyprus today.

Cyprus has double taxation treaties with 27 countries, most of them being members of the Commonwealth. The existence of such treaties combined with the low tax paid by international business entities offer possibilities for international tax planning. The island is not considered as a "tax haven" by most tax jurisdictions and is thus free from reservations usually associated with tax haven operations. In contrast to tax havens, Cyprus is a tax incentive country, which offers incentives aimed at attractive foreign investment.

2.9.4 British Virgin Islands

The British Virgin Islands (BVI) is an English-speaking dependent territory of the United Kingdom, located in the Caribbean off Puerto Rico. The BVI is a politically stable territory. The population of 19,000 is of mixed European and Caribbean origin. Its economy is dependent on tourism, with financial services gaining importance. The local currency is the US dollar.

¹⁶ Offshore Trust Yearbook, 1999

The BVI introduced its outstandingly successful International Business Company (IBC) in 1984; there are now more than 300,000 IBC's, with Hong Kong and Latin America the main sources of clients. This led to the creation of around 300 000 IBC's, Hong Kong and Latin America were the principal investors. The British Virgin Islands operate essentially with pension funds, and banking activities represent only a small part of offshore revenues. IBC's are completely exempt from all income taxes, but a resident company has to pay income tax at 15%.

The OECD's Forum on harmful tax practices produced a report in 2000¹⁷, which listed 35 jurisdictions as meeting the tax haven criteria, and the BVI was one of the jurisdictions detailed in the report.

The main advantages of the BVI are that it is a reasonably cheap jurisdiction compared to its local rivals, and has quite strong professional services. The Government is responsive to the needs of business, and its legislation is mostly flexible and straightforward.

As one of the world's leading offshore domiciles, the BVI offers an attractive combination of a safe, politically stable environment, with a legislative framework with the private sector. Financial services and tourism form the main pillars of the economic growth of the British territory.

2.9.5 The Bahamas

The Bahamas became independent from the United Kingdom in 1973. Located in the Caribbean, between Florida and Haiti, the Bahamas has 700 islands and a population of 285,000.

At the beginning of the 20th century, the Bahamas became a trust and tourist jurisdiction but was relatively late in developing a financial center. The economy is

¹⁷ Harland, 1998

heavily dependent on tourism (4million visitors a year), but financial services are growing in importance. Per capita income is \$12,000, which is reasonable for the region.

Offshore banking started in 1908 and therefore is one of the oldest offshore financial sectors in the world. The Bahamas is one of the world's top ten international banking centers. The leading sector of the Bahamas is the banking sector. There are over 400 banks, which have assets to the value of \$200 billion. The country's improved legislation and regulatory structure, its highly skilled workforce, and its stable government have attracted some prestigious financial institutions from around the world. About half of the banks are incorporated locally, and more than half offer trust services. It is estimated that there is more than \$70bn of funds under management in the Bahamas, making it one of the leading jurisdictions in this respect.

In May 2000, the Bahamas' new stock exchange went live, with 2 brokers but its success has allowed for larger expansion. By June 2001, the exchange had achieved 17 listings

There is no income tax, capital gains tax, value-added tax, sales or wealth tax in the Bahamas. This acts as an incentive for all investors, hence making the Bahamas an effective financial base.

In June 2000, the Bahamas was identified by the Financial Action Task Force (FATF) as non-cooperative in the fight against global money laundering. However in June this year, the Bahamas was de-listed and this has provided an authentication of the integrity of the financial system.

The success of the financial system over the past thirty years has permitted the Bahamas to enjoy the third highest per capita income among independent states in the Western Hemisphere after the United States and Canada. Today, high levels of employment, increased home ownership, rising personal and household incomes and low interest rates have all been the good effects of this success.

(The Bahamas - Virtue Rewarded By Jeremy Hetherington-Gore)

2.9.6 Malta¹⁸

Having practically no natural resources and arable land, Malta imports most of its products. Malta is a civil jurisdiction. The authorities have however put in their efforts to create an industrial sector with high levels of technology and an appropriate infrastructure. There are several incentives that are provided to attract investment in Malta.

Most of the foreign currency comes from the industrial sector, tourism and marine transport. However, it is the revenue obtained from the financial sector that pays accounts for the deficit in the balance of payments. It was in 1988 that the authorities implemented the idea of developing a financial sector in Malta. The laws that were implemented had favorable fiscal advantages for foreign investors. Malta has relatively high tax rates but offers a fiscal regime that is advantageous to companies and individuals.

Nowadays, Malta is considered as one of the most attractive financial centers for foreign investors. The reasons for this are the fiscal advantages and the quality of the service provided. Being 60 kms South of Italy, Malta is ideally situated and is accessible to any area in Europe.

2.9.7 Luxembourg

The Luxembourg economy was dependent on steel production, but after the Second World War, the authorities managed to encourage the development of another sector - the financial sector. Tourism is also important. In Europe, Luxembourg has the second most extensive banking industry after London. The Luxembourg private banking industry is possibly Europe's biggest. The Stock Exchange specializes in collective investment funds and many of the 4,000 Luxembourg-registered funds are also listed there.

¹⁸ Offshore Trust Yearbook, 1999

According to figures released by the World Bank in May 2001, Luxembourg was the richest country in the world in 1999. Luxembourg was also listed as the wealthiest country in terms of gross national income (GNI) in 1999 at US\$ 42,930 per head.

Luxembourg is not considered as a fiscal paradise. However, the Luxembourg holding companies and the more recent investment fund, are both exempt from all taxes, making the country as attractive an 'offshore' jurisdiction. There are about 18000 such entities in Luxembourg.

Luxembourg has signed Double Tax Treaties with 32 other countries, all of which follow the OECD Model Tax Convention.

After the OECD issued its final list of offshore jurisdictions in April 2002, it made threatening noises towards Luxembourg, and is said to be considering what sanctions can be imposed on the country after its 2003 deadline for the removal of 'harmful' tax practices. This puts the country in an uncomfortable situation.

2.9.8 Liechtenstein

Liechtenstein is a constitutional monarchy, has a land area of about 160 sq km (60 sq m), a population of 32,000, and is sandwiched between Switzerland and Austria. It has a customs union and a monetary union with Switzerland. The official language is German; English and French are also spoken.

Liechtenstein was primarily an agrarian country until its economic union with Switzerland (1922 and reinforced in 1980) propelled it into rapid industrial and financial development. GDP per head is \$26,000, inflation and unemployment are below 2%. The currency is the Swiss Franc, and there are no exchange controls.

Liechtenstein offers an extremely stable and efficient business environment with modern infrastructure and excellent telecommunications. There are 35,000 of these 'offshore' entities, which provide 30% of state revenues. Liechtenstein is a relatively expensive jurisdiction. However taxation is low, even for domestic and resident individuals and companies; and it is lower still for those who are offshore or non-resident.

In addition to its fiscal advantages, Liechtenstein also benefits from its location in Central Europe, its strong and stable economy, and a strong currency (Swiss French Francs).

Liechtenstein has only one double taxation treaty with Austria.

In June 2000, Liechtenstein was identified by the FATF as a non-cooperative and harmful tax haven. The result of this is that Liechtenstein was one of fifteen tax jurisdictions placed on an FATF blacklist. Each 'harmful' tax haven has a year in which to correct its tax regulations and legislation, once it has done so the tax haven will be removed from the list. The FATF released its next annual report in June 2001, in which the organization revised its list of countries and territories deemed non-cooperative. Only four were removed from the list, including Liechtenstein. Liechtenstein was praised by the FATF for its substantial efforts to conform to forty recommendations set out by the FATF in a code of good practice governing money laundering. By mid-2002, the FATF was able to say that Liechtenstein was 'off its radar screen'.

2.9.9 Hong Kong

Hong Kong is the third largest financial center in the world (after New York and London) and the ninth strongest economy. Per capita income is higher than that of the British population, Canada or Australia. 80 of the 100 biggest international banks are represented in the territory. Since 1992, Hong Kong has a very active harbor, with more and more trading activities taking place.

Many countries consider Hong Kong an 'offshore' jurisdiction; the attitude of the Government however is that the territory is not an offshore center in the traditional sense of the word but rather a low tax area which levies tax according to the territorial principle. The tax laws of Hong Kong are extremely simple compared to other onshore jurisdictions and the fiscal advantages of operating there could be summarized as follows:

1. Tax rates are extremely low by OECD standards. Taxation case law is minimal since the low tax rate means that the costs associated with challenging a decision of the revenue authorities usually outweigh any monetary gain.
2. Taxes are levied according to the "territorial principle" meaning that taxes are only levied on income "derived from or arising in" Hong Kong and not on income outside the Territory.
3. A number of taxes that exist in most jurisdictions do not exist in Hong Kong. Thus there are no capital gains taxes, no withholding taxes, no sales taxes and no value added tax. In the long term it is intended to completely phase out stamp duty on the sale and issue of shares and securities and to reduce direct taxes further.

Being a leading insurance center in Asia, Hong Kong has attracted many of the world's top insurance companies. The insurance industry had a stock of US\$ 4.1 billion in foreign direct investment as at end-1998. Hong Kong has the largest number of authorized insurance companies in Asia. The industry has also built up a critical mass of professionals.

The economic success of Hong Kong depends largely to the liberal, 'laissez faire' non-interventionist role played by the government. The result of this liberal political attitude by the authorities has led to practically no barriers for foreign investors. In effect, according to figures published in April 2001, Hong Kong has received HK\$64 milliards in foreign direct investment during the financial year 2000, with a drastic growth compared to HK\$15 milliard in 1998 and HK\$35 milliard in 1999.

Hong Kong is at the center of economic exchanges between the Republic of China and the rest of the world and its importance is growing rapidly with the strengthening of the Chinese Republic.

CHAPTER 3: OFFSHORE OF MAURITIUS – ANALYSIS & DESCRIPTION

3.1 Introduction

It has been over a decade since offshore business was initiated in Mauritius. The start off with offshore banking paved the way for the establishment of comprehensive non-banking offshore business in 1992. The real push was given to this sector when specific legislation was introduced to allow the conduct of non-banking offshore business coupled with the complete abolition of exchange controls.

Within a relatively short period of time, Mauritius has earned recognition as being a reliable, competitive and tax efficient platform for the structuring of customers' international investments. There are approximately 20,000 offshore entities currently registered in Mauritius. Moreover, the island has emerged as a privileged route for inward investments into India, China and several African countries.

There are several factors that can explain the success of the Mauritian offshore center. These can be listed as follows:

1. Absence of exchange controls
2. Absence of capital gains tax
3. A sound banking system
4. Absence of any tax on dividends
5. Absence of any duty on transfer of shares
6. Confidentiality: information relating to offshore entities is not available to the public
7. A flexible regulatory framework
8. A low tax regime

3.2 Procedures for the incorporation of an offshore company

If an investor wants to create an offshore company in the Mauritian jurisdiction, a management company has to be contacted in the first place. A management company is specially licensed by the Financial Services Commission (FSC) to provide the essential services of company formation, administration and management.

Steps for incorporation:

1. Provide a name for the company, and to ensure that the name is valid and meets the requirements, that is it is not already in use. Generally, the investor has to suggest at least three names.
2. The investor should also give details of the main activities to be carried out by the offshore company.
3. The type of offshore entity that will be incorporated
4. The amount of capital investment is required, including the sources of funds and share capital.
5. A brief history of previous investment of the beneficial owner is required.
6. A business plan for 3 years is required. Such a business plan should include the following information:
 - The type of activities to be carried out.
 - The target market
 - The approximate turnover of the company.
7. If the client is an owner of another company, a copy of the annual reports of the last 3 years is required.
8. A Memorandum of Articles (M&A) of the incorporated company has to be provided. (Usually a management company issues the Memorandum of articles).
9. A barrister should certify that all the documents required by the FSC are correct, and then submit them all to the commission.
10. Finally, the fees have to be paid to the Management Company.

When applications are vetted by the FSC, care is taken to ensure that sufficient information about the beneficial owner or promoter is available to the Management Companies so that there is sufficient confidence that the subsequent activities do not bring Mauritius into disrepute as a financial services center.

If all the above conditions are met, a company can receive its incorporation certificate within the next 72 hours after all the documents have been submitted to the Financial Services Commission (FSC). And in less than 2 weeks, the business license is released.

3.2.1 Role of the Financial Services Commission (FSC)

The Financial Services Commission (FSC), the regulatory, licensing, monitoring and supervisory body for all non-banking activities was set up in 2001 under the Financial Services Development Act. It has taken over the functions of the previous three non-banking regulators namely, the Securities market, the Insurance Business and Global Business Activities (formerly known as offshore activities). Financial services, which were not regulated, were also brought under the review of the new legislation.

3.2.2 The Securities Market

The Stock Exchange Act 1988 established a formal stock exchange in Mauritius, operated and managed by the Stock Exchange of Mauritius (SEM), whose role is to ensure an efficient, transparent and fair securities market. However, with the setting up of the Financial Services Development Act, the functions have now been shifted to the Financial Services Commission.

3.2.3 The Insurance Business

The insurance industry constitutes the core of the non-banking financial institutions, and has grown by an average of 20% over the last 3 years. Insurance in the island is still governed by the Insurance Act of 1987, and the Insurance regulations of 1988. Under the Financial Services Development Act, the FSC has taken over the regulatory and supervisory role of the controller of insurance within the Ministry of Economic Development, Financial Services and Corporate Affairs.

3.2.4 Global Business Activities

In terms of the Financial Services Act, a qualified Global Business is defined to be any business or activity, which is carried on from within Mauritius with persons who are resident outside Mauritius and in a currency other than the Mauritian rupee. The following activities are carried out:

- Aircraft financing and leasing
- Asset management
- Consultancy services
- Financial services
- Fund management
- Trading

The Companies Act 2001 provides for a more effective, efficient and investor friendly legislative framework for the corporate sector. It also aligns the legal provisions governing domestic companies with those companies known as offshore or international companies renamed Category 1 and Category 2 Global Business companies respectively.

- Global Business Companies Category 1 (GBC1) – formerly known as offshore companies

Such companies may be set up either by direct incorporation or by registration of a branch of a company registered in a foreign jurisdiction. They are set up for the purposes of carrying out any of the approved global business activities. The key main features of the GBC1 entities are as follows:

- No prescribed minimum capital is required.

- May be a private or public company limited by shares or unlimited.
- May issue redeemable shares with disproportionate rights example voting or non-voting.
- Access to the network of Mauritius' Double Taxation Treaties.

However, GBC1 companies are not allowed to:

- Issue bearer shares or hold shares in a domestic company.
- Deal business with residents in Mauritius
- Have corporate directors.

With respect to taxation, such companies do not pay taxes on interest earned on deposits maintained in any bank in Mauritius. Moreover, there is no capital gains tax on the transfer of shares. And no taxes are to be paid on dividends, interests or other payments to non-residents. Companies holding Category 1 Global Business License are liable to taxes at a rate of 15%.

The minimum annual fees for administering a GBC1 Company are \$6000.

- Global Business Companies Category 2 (GBC2) – formerly known as international companies

Global Business Companies Category 2 is ideally suited for trading purposes, invoicing and holding of assets. In essence, it is similar to the popular British Virgin Isles type of International Business Companies. It is a cost effective, flexible and tax-exempt vehicle available to clients wishing to use Mauritius as a base for the structuring of their international investments. These entities are the most popular type of offshore entities in the island. Over 15,000 such entities are registered in the country. The key features of such entities are as follows:

- Only registered shares may be issued.

- No minimum capital is required.
- Shareholders meetings may be held in Mauritius or outside the island.

There are certain restrictions that should be mentioned and taken into account. The GBC2 Company is prohibited to deal with Mauritian residents or in the local currency. Moreover the beneficiary owner or the promoter should reside in Mauritius.

With respect to taxation, such a company is not liable to any tax in Mauritius on its income, profits and does not pay any tax on any payments effected to non-residents. This means that the GBC2 does not have access to any benefits available under the Mauritius double tax treaties network. This is the main difference between the GBC1 and GBC2.

The main functions of the Commission are as follows:

- a) Carry out investigations and take measures to suppress illegal and improper practices in the financial services sector
- b) Set rules and guidance governing the conduct of business in the financial sector
- c) Identify and take measures to prevent and eliminate investment business abuse
- d) Be responsible for the administration of the relevant Acts such as Company's Act, International Business Act
- e) Ensure the orderly administration and sound conduct of business in the financial services activities

3.3 Features of different offshore entities

3.3.1 Offshore companies

a) Background

As the financial services industry in Mauritius continues to develop strongly, innovative legislation has been enacted to further consolidate the regulatory and supervisory aspects of the financial sector. The Financial Services Development Act (FSD Act) consolidates the existing framework for regulating offshore activities in Mauritius.

b) Key features

- No minimum capital requirement except in the case of management companies, offshore banking or insurance activities.
- May be a private company or public, limited by shares or unlimited or a 'Limited Life Company'¹
- Only registered and par value shares are allowed.
- Shares may be subscribed by nominees but names of beneficial owners should be disclosed to the Authority.
- Must be managed by at least 2 directors who may not be residents in Mauritius
- Must have a resident secretary and a registered office in Mauritius

c) Taxation

Offshore companies are taxed on their chargeable income at the rate of 15%, however they can elect to be taxed at any rate higher than 15% under the Finance Act 1988. All offshore companies are exempted from any exchange control and local taxes.

d) Double taxation

Offshore companies can benefit from the advantages of the double taxation treaties in Mauritius. However, to take full advantage of the treaties, the offshore companies should be established in the country.

e) Confidentiality

The FSC has to see to it that the confidentiality of the offshore companies be maintained and respected at all times. The names of the beneficial owner, the shareholders or any person having an interest in the company should not be divulged.

f) Fees payable to the FSC

Processing fee: US \$ 500

Annual license fee: US \$ 1 500

3.3.2 International Companies**a) Background**

The international company provides for greater confidentiality. They are ideally suited for trading purposes, invoicing, international contracts or the holding of assets. This type of company is governed by the Companies Act 2001. It is tax exempt and therefore cannot benefit from double taxation relief under the tax treaties.

b) Key features

- No minimum capital requirement
- Shares may be redeemed or brought back
- Shareholders may be both individual and body corporate
- No need to file audited reports with the Registrar of International Companies
- May be set up either by direct incorporation or by way of continuation.
- May be structured as a guarantee company, a hybrid company or as a limited life company

c) Restrictions

- Offer professional services in any investment fund
- Deal with Mauritians or in the local currency
- Own any interest in immovable property situated in Mauritius
- Hold shares, bonds or debentures in another local company
- Have as beneficial owner of its shares a person resident in Mauritius
- Carry on any banking and insurance business

d) Continuation / Migration

- Possibility of migrating out to another jurisdiction
- Possibility of conversion to an offshore company (and vice-versa)

e) Fees payable to the Registrar of International Companies

- Incorporation fee: Min US \$ 100 Max US\$ 300¹
- Annual license fee: Min US \$ 100 Max US\$ 300
- Continuation fee: US \$ 300

3.3.3 Offshore trusts²**a) Background**

A trust, a concept originating from English Law, describes a relationship whereby one person (called the settlor) transfers property to another (the trustee) for the latter to hold and manage for the benefit of a category of people (the beneficiary) or to fulfil a purpose. Offshore trusts are governed by the Offshore Trust Act 1992. The act permits the establishment of different types of trusts:

- Protective trusts
- Charitable trust
- Foreign trusts
- Commercial trusts

b) Key features

- The settlor may choose the proper law that will govern the trust
- The duration of the trust is limited to 100 years (except for charitable trust)
- The trustee or settlor may be the beneficiaries of the trust
- Confidentiality of the investors is maintained
- The settlor may appoint a protector and establish a memorandum of wishes

¹ Where authorised capital exceeds \$100 000 or consists of no par value shares

² Offshore Trust Yearbook, 1999

c) Conditions

- Settlor : for a trust to be validly constituted under the Act:
 - The settlor shall not at any time in the trusts duration be a resident in Mauritius
 - At all times there has to be a trustee resident in Mauritius
 - The trust shall not include any movable and immovable property in Mauritius or any account in Mauritian Rupee in a domestic bank

- Trustee :
 - The custodian trustee may be a firm or a body corporate
 - The number of trustees shall not be less than 2, unless administered by a body corporate
 - Unless stated in the contract, the trustee cannot delegate his responsibilities

- Beneficiary :
 - The beneficiary has to be identifiable by name (By reference to a class or relationship with another person, at the time of the creation of the trust)
 - A settlor or trustee of a trust may also be a beneficiary but shall not be the sole beneficiary of the trust

- Protector :
 - A protector may be appointed to supervise the trustees and to ensure that the trust is administered in accordance with the settlor's wishes as expressed in the Memorandum of Wishes
 - The protector may also be a settlor, a trustee or a beneficiary of the trust but he is not regarded as a trustee

d) Taxation

- A non-resident offshore trust and its non-resident beneficiaries are exempt from tax in Mauritius. A trust makes an election to be non-resident by filing a declaration of non-residence with the FSC; where no declaration is filed, the trust is deemed to be a resident for Mauritius tax purposes.

- Capital gains are tax exempt in Mauritius. The double taxation avoidance agreements that Mauritius has concluded with foreign states grant to Mauritius the taxing right with respect to capital gains realized upon disposal of securities held by a Mauritian resident in the treaty partner country.
- An offshore trust is taxed at the rate of 15% on income.

e) Fees payable to the FSC

The cost for set up of a trust is US\$ 2500 payable to the FSC.

3.3.4 Protected Cell Companies

a) Background

The Protected Cell Company Act (PCC) 1999 provides for a new type of offshore vehicle. It can be used to carry out offshore business activities in the fields of insurance and investment funds.

The PCC is a relatively rare structure only to be found in a few jurisdictions and is one of the features attracting interest in our country. A PCC is made up of separate and distinct “cells”, the assets and liabilities of each cell being legally segregated from those of other cells. A PCC protects one cell from contagion from others.

b) Key features

- No minimum capital requirement is imposed for the PCC and each cell. However, on a case to case basis, depending on the nature of the business, the FSC may prescribe certain capital requirements.
- A PCC can have an unlimited number of cells.
- A PCC offers flexibility in the allocation of capital between the core and individual cells
- A PCC is required to submit annual audited accounts to the FSC
- The PCC is the only entity liable to pay tax
- Dividends are paid in respect of cells' shares by according to profits of the cell concerned

3.3.5 Captive insurance

a) Background

The offshore activities of the insurance industry are regulated by the FSD Act 2001. A captive insurance company must obtain a licence to conduct captive business. The latter were introduced because the conventional insurance industry could not meet financial needs of major insurance corporations.

b) Types of captives permissible

- *Captive General Insurance Business :*

- Minimum Paid up capital : US \$100 000

A captive insurance company is an insurance company that has been set up to provide coverage at a lower cost than available by going through the general insurance market. The company's stock is controlled by one group of related interests so as to provide coverage for their business operations.

- Minimum capital for general insurance business : US\$100 000
- Minimum capital for long term insurance business : US\$250 000
- Minimum paid up capital for captive general and long term insurance business : US\$350 000

- *Reinsurance:*

Generally, captive insurance companies are required to be reinsured in excess of reasonable and prudent retention levels unless the Commission is satisfied that the captive has access to sufficient security without the need for reinsurance.

- Minimum paid up capital : US \$300 000

3.3.6 Offshore banks

a) Background

Offshore banks resident in Mauritius are authorized to carry out all kind of banking activities with non-residents of Mauritius in foreign currency (that is all other currency other than the Mauritian Rupee). There are 14 offshore banks in the country.

b) Regulation

The Banking Act 1988 regulates all the activities of offshore banks in the country. The Bank of Mauritius carries out the regulation and the supervision, which is the Central Bank of the island.

c) Requirements for the incorporation of an offshore bank

- Offshore banking activities can not be undertaken without an Offshore Banking License issued by the Central Bank
- An offshore bank can be established as a branch, or locally incorporated subsidiary, or a joint venture
- An offshore bank has a maintenance if a minimum capital of at least Rs100million or any equivalent amount of freely convertible currency
- A certain level of net free assets to be determined by the Bank of Mauritius must be kept in each bank

d) Services

- Accounts in different currencies
- Fund administration
- International portfolio management
- Money transfer
- Financial advice
- Trusteeship
- Forward rate agreements, exchange of money at spot and forward rates
- Etc

e) Confidentiality

The Banking Act 1988 guarantees the confidentiality on all information on clients. Giving out any information is allowed only under the orders of the Supreme Court of the country, for example because of money laundering, drug trafficking, or the sale of arms.

f) Taxation

Like offshore companies, an offshore bank has to pay taxes at the rate of 15%, but is exempt of exchange control, local taxes and other fiscal charges.

g) Fees payable to the Registrar of Companies

Incorporation fee :Min US \$ 100 Max US\$ 300

Annual license fee :Min US \$ 100 Max US\$ 300

Continuation fee :US\$ 300

3.4 Double Taxation Treaties

This section will deal with double taxation treaties and the way in which an offshore company can take advantages of such treaties.

One of the main reasons why an investor chooses to invest in an offshore financial center is the fiscal advantage involved. Being tax exempt or having a tax incentive is a stimulus for most investors willing to invest in an offshore jurisdiction.

A general overview of the double taxation treaty will first be discussed and how a company can make use of such a treaty to enhance their image as an international tax planning company will be illustrated. Finally the advantages of having such treaties in Mauritius will be discussed.

3.4.1 Mechanism of the double taxation treaty³

Double taxation can be defined as the levy of taxes on income / capital in the hands of the same tax payer in more than one country in respect of the same income or capital for the same period. Tax treaties serve the purpose of providing full protection to tax payers against double taxation and thus prevent the discouragement which double taxation may provide in the free flow of international trade and international investment. Moreover, such treaties generally contain provisions for mutual exchange of information. The aim of these treaties is the avoidance of double taxation of income

³ Financial Services Promotion Agency – Mauritius Double Tax treaties Comparative study – July 2002

earned in any of the two contracting countries. Under these treaties either a credit is allowed in a contracting country in respect of tax levied by the other state on the same income or such income is exempt from tax. Thus a taxpayer does not pay more than the higher of the two rates or he is not taxed twice on the same income.

Double, or multiple, taxation occurs when on the subject of tax equal or similar tax is applied. In international relations it happens when income or property is taxed in two or more countries at the same time. There are several causes for the occurrence of double taxation; all of them result from the clash of two or more legal tax systems of different states in the chapters defining tax relevance and income that the state considers as taxable in its own territory.

Double taxation of one income is undesirable as it lowers the clear profit and demotivates businessmen and companies from doing business in other countries. Double taxation works against the effort of governments to support their citizens' and companies' business activities abroad and to try to tempt foreign investors to start business there. Tax questions become an important aspect of the final results of negotiations in these contacts. These are the reasons why countries are trying to eliminate the influence of double taxation through tools of international law. To prevent double taxation, several methods and their different forms are used, they can work as one-sided measures defined directly in the tax system of the individual state, or as a part of two-sided, or many-sided international double taxation treaties.

What follows is an example to explain the mechanism of a treaty?

	<i>W/out permanent establishment</i>	<i>With permanent establishment, W/out double taxation treaty</i>	<i>With permanent establishment, With double taxation treaty</i>
Gross profit in Y	5,000,000	5,000,000	5,000,000
Taxation in Y	0	1,000,000	2,000,000
Taxation in X ($0.3 \times 5,000,000$)	1,500,000	1,500,000	1,500,000
Tax credit (taxed in Y @ 20%)	0	0	(1,000,000)
Tax payable to X	1,500,000	1,500,000	500,000
Total fiscal charges	1,500,000	2,500,000	1,500,000

Table 3.1 (Mechanism of a treaty)

If there is no treaty between country X and Y, an offshore company incorporated in jurisdiction X, resident of Y, will be taxed in X. If the country exports some products to Y, no problems will arise as the company does not have a stable establishment in Y and therefore will not be taxed in country Y. However, if the company wants to have its own market in Y, that is selling its products in Y, the company will be considered as being resident in Y. At the end of the financial year, the company will have to pay its taxes, because of its establishment in X on the income and profits earned in Y. If there is no double taxation treaty between the 2 countries, the company will for instance be taxed at the rate of 30% on gross profit. But however, if a treaty is in place, the tax regime is different. The tax is 30% of the gross profit after subtracting all payments effected in country Y.

3.4.2 Advantages of double taxation treaties

The advantages offered by the treaty can be illustrated using the following example:

A non-resident of Indian origin (NRI) owns an offshore entity in Mauritius. Under the old regime, an offshore company could choose its tax rate (between 0%-30%), and assuming it has decided to pay a rate of 20%. The NRI conducts business via a stable

establishment in India and its profit is 100. Suppose that profits are taxed at the rate of 15% in India (because of the stable establishment), therefore 15 is paid in India. In Mauritius, the tax rate is 20%, therefore 20 is payable in Mauritius. However, because of the existence of the double taxation treaty between the 2 countries, and due to the fact that 15 has already been paid in India, only 5 has to be paid in Mauritius. Now assuming that the NRI stays in the United Kingdom, where tax rates are 25%. The NRI has to show his profits as 100-20, which is the gross profit subtracting the taxes already paid, as opposed to 80. Once again, the double taxation treaty is used and instead of paying 20 (80×0.25), the investor will pay only 5 (15 in India, 5 in Mauritius and 5 in Great Britain, which is a total of 25). If the NRI did not use the offshore jurisdiction, and therefore not used the treaty, he would have paid 35 in taxes (15 in India and 20 in Great Britain and therefore been taxed twice on the same revenue earned) instead of 25.

Although the Mauritian jurisdiction is tax exempt, the company has chosen to pay 20% on the income generated from offshore activities. The underlying reason is to create a bond between India and the United Kingdom and thus to be able to benefit from the double taxation treaty that exist between the Republic of Mauritius and Great Britain and Mauritius and India. However, the law that allowed offshore companies to choose a tax rate between 0% and 30% has changed since 2000, and from now on, all offshore entities have to pay a fixed tax rate of 15%.

3.4.3 The double taxation treaty between India and Mauritius⁴

Mauritius has double taxation agreements with various countries including France, United Kingdom, Malaysia, South Africa, Germany, Zimbabwe, Sweden, India, China, Pakistan, Namibia, Swaziland, Italy, Madagascar, Singapore, Botswana, Luxembourg, Sri Lanka, Indonesia, Thailand, Oman, Kuwait, Belgium, Mozambique, Nepal and Cyprus. Double taxation treaties have been negotiated by Mauritius with various other countries and are awaiting ratification. In order to benefit from the treaties, the Companies holding a Category 1 Global Business License must obtain a Tax Residence Certificate. Certain requirements need to be fulfilled before such certificate is granted such as the

⁴ Double Taxation Agreement with India 1983

need to have at least a number of Directors resident in Mauritius, local secretary and auditor.

This section will deal with the double taxation treaty of Mauritius with India. The treaty was signed on the 28th August 1982. In the last few years, Mauritius has been quite popular with foreign investors for routing investment in India because of the favourable terms of the Double Taxation Avoidance Agreement (DTAA) between India and Mauritius as well as the favourable tax and related legislation in Mauritius.

Under section 2 of the Income Tax Act, a company incorporated in Mauritius has to be a resident of Mauritius, and for the same reason, so has to be an offshore company.

The main rule for being classified as a resident of the Republic of Mauritius so as to benefit from the double taxation treaty is found in Article 4 of the treaty:

Article 4 stipulates that resident of Mauritius is any person who under the laws of the State, is liable to taxation by reason of his domicile, residence or management. Therefore, to be classified as a resident under the treaty, an offshore company has to pay taxes in Mauritius and this is because it is managed in Mauritius. Generally, the following 5 criteria are important:

- Have at least 2 Mauritian residents in the management committee
- At all times have a resident secretary and auditor
- An account with a Mauritian offshore bank
- At all times have a registered office in Mauritius
- General meetings must be held in Mauritius

If these rules are not met, an offshore company is not resident and therefore can not benefit from the advantages of the double taxation treaty. The advantage of being a resident in Mauritius is that the tax rate is lower than if it were resident in India.

Example: A non Indian resident (NRI), incorporating an offshore holding in Mauritius can benefit from the following advantages:

- If the company holds less than 10% of shares in an Indian company, 15% of the gross amount of the dividends are paid instead of 25%
- If the company holds more than 10% of the shares in an Indian company, 5% of the gross amount of the dividends are paid instead of 15%

A permanent establishment is a fixed place where the business matters are carried out wholly or partially.

The term permanent establishment includes:

1. A place of management
2. A branch
3. An office
4. A factory
5. A workshop
6. A warehouse, in relation to as person providing storage facilities for others
7. A mine, an oil or gas well, a quarry or any other place of extraction of natural resources
8. A farm, plantation or other place where agricultural, forestry, plantation or related activities are carried on
9. A building site or construction or supervisory activities, where business activity carries for a period of more than 9 months.

However, it excludes:

1. The use of facilities solely for the purpose of storage or display of merchandise
2. The maintenance of a stock of goods belonging to the enterprise only for the purpose of processing by another enterprise
3. The maintenance of a fixed place of business solely for the following purposes:
 - Advertising

- Supply of information
- Scientific research

The income of a Mauritian company is not taxable in Mauritius, unless if the company deals with a company in India via a permanent establishment in India. If the Mauritian Company carries out business via a permanent establishment, the profits of the company are taxable in India.

Dividends are those sums payable as profit of joint stock companies – benefit from the shares held. When a company is resident in Mauritius and gains profits from India, the authorities in India can not impose that dividends be paid to the company, unless for the following cases:

- These dividends are payable to an Indian resident
- If the company gaining the dividend is connected to the permanent establishment in India

Figure 3.1 illustrates how investor X invests directly in country A. In so doing, the dividends are taxed at the rate of 25% in India.

Dividend	100
Tax rate (25%)	<u>25</u>
Dividend after tax	75

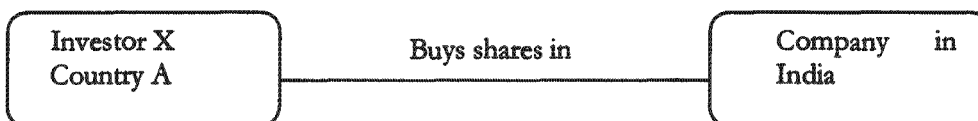


Figure 3.1 (Direct investment)

Figure 3.2 shows an alternative for the same investment. The investor has incorporated an offshore company in Mauritius. Therefore, the company will benefit from the double taxation treaty between India and Mauritius. In respect to this treaty, if the company holds more than 10% of the shares of the company, dividends are taxed at 5%, and if holdings are less than 10%, the tax is 15%.

Case 1: The holding company holds less than 10% of the shares

Dividends	100
Deduction Fee (15%)	<u>15</u>
Dividend after tax	85

Case 2: The holding company holds more than 10% of the actions

Dividends	100
Deduction Fee (5%)	5
Dividend after tax	95

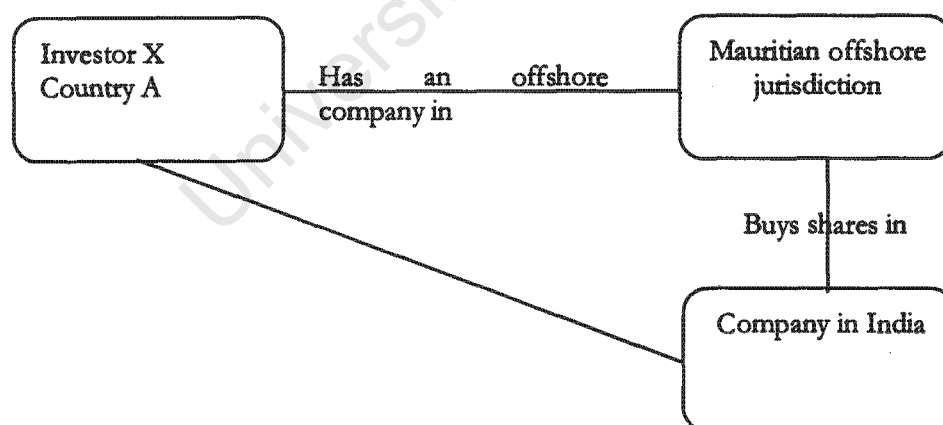


Figure 3.2 (Investment using an offshore center)

Offshore investment in India

Suppose, an Offshore Company realized capital gains on disposal of investments in India. In article 13 of India/Mauritius Double Taxation Agreement, capital gains are taxable only in the country where the seller resides. Therefore, such gains by the Offshore Company will be tax exempt, as Mauritius does not tax capital gains.

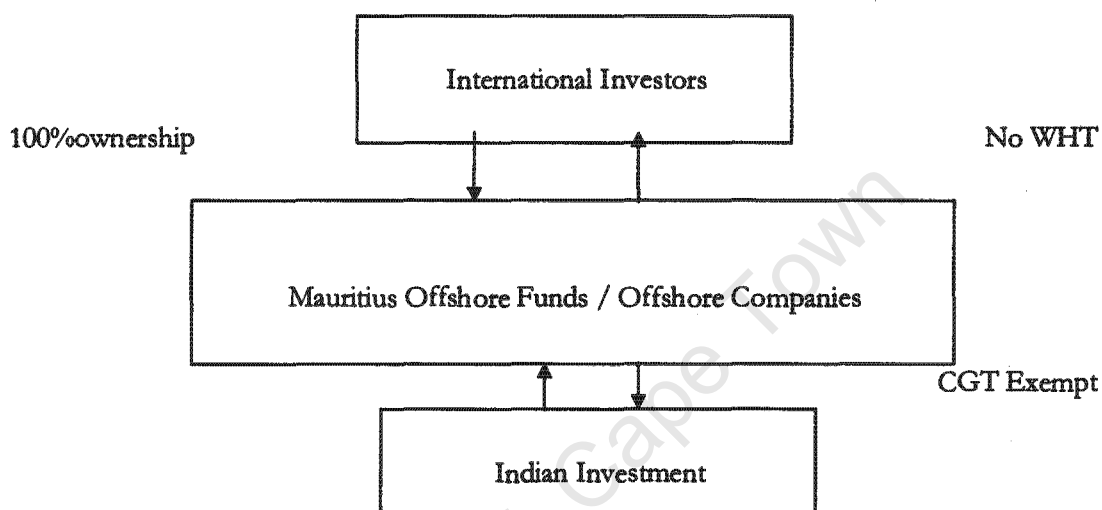


Figure 3.3 (Indian structuring – portfolio investment)

3.4.4 Using the double taxation treaty and offshore companies

Offshore jurisdictions and the double taxation treaties, as explained above, play an important role in attracting investors to invest in these jurisdictions.

The following examples illustrate the advantages of the treaty:

Example 1: Global Business Company Category 1 invests in A

GBC1 received dividend income from A	100
No Withholding Tax (WHT) in A on dividend	0
Chargeable income of GBC1 in Mauritius	100

Mauritius tax at 15%	15
Credit for foreign tax	Nil
Deemed credit for foreign tax (80%*15%)	12
Net tax burden in Mauritius	3

Example 2: GBC1 invests in country B

Received interest income	100
WHT paid in source country at 15%	15
Chargeable income in Mauritius	100
Mauritius tax liability at 15%	15
Credit tax suffered in source country	(15)
Net tax liability in Mauritius	NIL

GBC1 derives income from countries C and D

	<i>Country C</i>	<i>Country D</i>
Income received	100	200
WHT in source countries	10	25

Chargeable income in Mauritius $(100 + 200) = 300$

Mauritius tax at 15% $(0.15 \times 300) = 45$

a) Credit for foreign tax = 35

b) Deemed credit @ 90% of the Mauritian 15% tax $(0.9 \times 45) = 40.5$

Under a) net tax liability in Mauritius is $45 - 35 = 10$

Under b) net tax liability in Mauritius is $45 - 40.5 = 4.5$

Using this illustration, the GBC1 opts for b)

3.5 Regulation in the offshore world

This section deals with the need of control of clients, the consequences of inadequate control and the manner in which control is carried out in the Republic of Mauritius. This section will also describe the various type of fraudulent activities in the offshore sector and ways to combat these frauds.

3.5.1 Confidentiality and criminal activities

The starting point for any exchange of information between the authorities is the fact that information supplied by the investor or taxpayer to the authorities is confidential. However, some investors use this factor as an incentive for performing criminal activities. It is for this simple reason that all the information gathered should be thoroughly checked by the authorities. Pressure from the OECD on offshore jurisdictions is great so as to reduce such activities to a minimum (drug trafficking). This is where there should be a good understanding between the role of the private sector and the authorities.

3.5.2 Responsibilities

It is the private sector of the offshore financial sector that should ensure that all activities are legal. It is their job to detect any criminal activity in the offshore sector.

A typical example to illustrate the responsibility of the bank in terms of control is as follows. Before, bankers were only concerned about the amount of money deposited and loans made out. Nowadays, however, this information is not their only concern. When a new account is being created, it is their duty to see to it that all the proper documentation has been gathered. Moreover, all banking institutions have the duty to write up a special report for any unusual and suspicious transactions. In the event that

the reports are not written up, there is a severe penalty as a consequence. And the most common of them all is the tarnishing of the bank's image and reputation.

If all parties in the offshore sector undertake their responsibilities in the regulation of the investors by controlling all the activities, it would be near impossible for any criminal activity to take place without being detected. Regulation and control does not mean a constant interference into the business of all investors, but seeing to it that all laws are respected.

For instance, a bank, which deals with an offshore company account, should be suspicious when a big amount of money is transferred to and from different accounts unrelated to offshore activities. Moreover, when unusual amounts are dealt with the authorities should be careful.

3.5.3 Bad control – the responsible party?

Generally, there is more than one jurisdiction involved in money laundering and criminal activities. This is an example of who is responsible to detect such activities:

An individual residing in country X carries out a transaction of money laundering from X to a bank with a good reputation in country Y, taking into account that the bank account of country Y is under the name of an offshore company incorporated in jurisdiction Z.

1. The authorities of country X should have detected the criminal activity. The authorities in X can in their defense state that it is impossible to detect all criminal activities that take place in the country.
2. The banking institution in country Y should shoulder the responsibility of having all the statutory records of the clients comprising the clients details at the time when opening an account. And they also have the responsibility to detect all unusual and suspicious transactions. However, the bank can state that all the requirements were met for opening an account.

3. Jurisdiction Z is also responsible in the crime in some way for having let the offshore company operate. However, it can also deny the blame by stating that the client had all the required information and the latter was thoroughly checked before accepting him to open up an offshore company.

With this example, it can be seen that money laundering is a problem and no individual would like to take responsibility of its consequences. Therefore, as a measure against money laundering, better cooperation among the authorities in different countries is essential.

3.5.4 Characteristics of a regulated offshore jurisdiction

An offshore jurisdiction, which is well known and reputed, is one, which has the appropriate regulation in place.

The foundations for a good jurisdiction are based on:

1. Appropriate legislation
2. Develop a legal system which is effective and efficient
3. Competent authorities
4. Qualified individuals
5. Well equipped offices, with the appropriate technology
6. Good relationship between the authorities and the private sector
7. Well established objectives of the government
8. A set of standards for all professionals

3.5.5 Inadequate regulation leading to frauds

All services provided in offshore jurisdictions differ from each other in terms of quality. Most people try to find the “perfect” offshore center, but often do not find one. Having the right amount of regulation is the best policy to attract investors. Having a flexible regulation is generally undesirable as the laws are not well defined and may lead to corruption and frauds. On the other hand, having a rigid regulation is also a drawback as it acts as a disincentive for investment. Therefore, the lawmakers and the regulatory

body in each jurisdiction should see it to that the laws are neither too flexible nor too rigid. In fact, there should be a good 'trade-off' between the two types of regulations.

3.5.6 Control procedures

In Mauritius, the way in which a certain control is kept on the various clients is by keeping a record of all the following information before the incorporation of an offshore company:

1. Name of applicant
2. Passport number
3. Nationality of the applicant
4. Occupation + status of the applicant in society
5. Name of the company
6. Address of the company, mailing address (if different), Telephone and fax numbers
7. Name of local representative
8. Copy of the Memorandum of Articles
9. Business activities to be carried out
10. Each director, secretary, shareholder has to provide the following information:
 - a Last name
 - b First name
 - c Nationality
 - d Passport number
 - e Occupation
 - f Permanent address
 - g Telephone and Fax numbers
 - h A letter from a barrister, an accountant, a banker confirming all the above information

3.6 Detecting frauds

One of the main problems, which play against the reputation of offshore centers, is money laundering, drug abuse, terrorism or any other criminal activities.

Money laundering is the process of disguising the source of the proceeds of crime. It is the process that conceals the true source of funds in order to use it freely. The main instruments of money laundering are cashier's cheques, travellers cheques and wire transfers. The key objectives of money laundering are:

- Disguise source of property
- Disguise identity
- Conceal fact of ownership of property
- Retain an element of control of property
- Benefit from property

The stages of money laundering are as follows:

1. Placement - physically placing bulk cash proceeds
2. Layering – separate fund from criminal activity from the origins through layers of complex financial transactions
3. Integration – provide a legitimate transaction for dirty money. Thus funds become integral of the mainstream economy

3.6.1 How to detect fraudulent activities?

As mentioned, the client has to provide all the necessary information for the incorporation of an offshore company. Moreover, special attention should be made to all the following transactions:

- Payments of unusual amounts
- A deposit in cash by an individual or a company whereas the transactions are usually carried out in checks
- An increase in the amount of cash deposits of a client without any apparent cause, especially if the same amount is then transferred in a short time period to another account to a location not usually used by the client
- Clients from countries where drug trafficking is common
- Transfer of important amounts in cash towards unusual locations

- Crediting the bank account with a big sum of money but all in small notes, particularly if in foreign currency
- The use of a bank account of a client by a huge number of people without any valid reason
- A number of amendments to the Memorandum of Articles

3.6.2 What can authorities do?

In fact, the governments can do very little acting by themselves. International financial crime is one of the negative manifestations of globalization. No individual government has sufficient power or reach to control these illegal activities. Co-operation among governments and jurisdictions is the prerequisite to managing this aspect of globalization, just as it is the prerequisite for managing other aspects of globalization such as trade, investment and capital flows. Responsible stewardship of the global financial system requires a co-coordinated international effort to counter international money laundering and corruption, and tax abuse. The taxation aspects of this effort are critical, not only because international tax evasion is serious in itself, but also because it is often combined with other international criminal activities. The steps that can be taken to prevent money laundering are as follows:

- Implement the Basle principles
- Implement principles and appropriate laws and practice
- Train staff in connection with this issue
- Know your customer procedures
- Co-operation with law enforcement agencies like ICAC
- Satisfactory audit trail

3.6.3 Consequences of a fraud in Mauritius

If a fraud were detected in Mauritius, this would cause a lot of damage to its reputation. Firstly, the Financial Intelligent Unit and the Management Company would have to explain to the authorities why they were incapable of detecting the fraud. In Mauritius, it is the Financial Intelligent Unit (FIU) that is the central agency responsible for receiving, requesting, analyzing and disseminating to the supervisory authority information concerning suspected proceeds of crime and money laundering offences. The main purposes of the FIU are:

- Collect, process, analyze and interpret all information disclosed to it
- Inform, advise and cooperate with the supervisory authority
- Supervise and enforce compliance by banks and financial institutions
- Provide assistance in the investigation or prosecution of money laundering offences to overseas countries

Any person may be convicted of a money laundering offence has to bear the following penalty. The penalty is a fine not exceeding 2million rupees and to penal servitude for a term not exceeding 10 years. Moreover, any property belonging to the individual may be forfeited.

A case of fraud can be detrimental to the reputation of the island, even if it is an isolated case. Existing clients may decide to change jurisdictions for their investment and potential investors would think twice before investing in Mauritius as this may affect their own reputation. It is therefore highly recommended that the offshore sector in general including management companies, the Financial Services Commission, offshore companies and the Financial Intelligence Unit to do its share of regulation to preserve the reputation of Mauritius as being an international financial center providing a business image of substance.

3.7 Corporate Governance

Corporate governance is a matter, which has become the major preoccupation of many nations worldwide as its impact on a nation's economy, health, development and social progress cannot leave policy makers indifferent.

The OECD defines CG as "the system by which business corporations and directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the Board, managers and stakeholders and spells out the rules and procedures for making decision on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance".

3.7.1 Corporate Governance in Mauritius

For some years now, CG has been very high on agenda of the Mauritian government. The CG framework in Mauritius needed to be strengthened to make it fairer and more transparent with the objective of ensuring that the public retains its faith in the free market system. It is considered that good CG is a means of achieving a sustainable regime of economic and social objectives.

Thus, the fundamental principles of good governance – accountability, transparency, responsibility, fair treatment, meritocracy, management disciplines, and fight against corruption needs to be ingrained in all public and private organizations. In this respect, government has amongst other initiatives to impose CG regime in Mauritius, establish a committee on CG in September 2001.

The terms of reference of the committee are to strengthen the competitiveness of companies in the global market. The work of the committee has been directed at:

- (i) raising awareness on the significance of CG
- (ii) forging consensus on concepts and methods of CG and

- (iii) developing and implementing action plans in collaboration with all stakeholders

Companies in Mauritius will have to find the leadership and management competence to integrate the universe with the local in their corporate governance culture and performance in such a way that it adds to the profitability and strategic purpose of the enterprise.

3.8 Advantages of the offshore sector in Mauritius⁵

Offshore companies in Mauritius are ideal for the following purposes. *This list is however not exhaustive.*

1. To hold shares and to have total control in those shares in confidentiality and privacy.
2. To have a security against future demands, bankruptcy and any creditors.
3. Financing and planning of real estate using trusts protectors, with all long term gains to be earned by the beneficiary alone, without having to pay any taxes on such incomes, no taxes on succession or on capital gains. A Mauritian company can act as a financing company to fulfill the functions of fund management within and between companies, for example, for financial loans or funds for the running of everyday business. The payment of interests to the financing company is tax deductible, therefore decreasing the total fiscal charges. The double taxation treaty in Mauritius reduces or eliminates totally all taxes on royalties earned.
4. Holding property (example illustrated below)

The most common scenario is investment, which deal with the transfer of technologies, license fees and royalties. Royalties and license fees can be assigned to a Mauritian company. The property can include software programmes, technical knowledge or copyrights. The company can in turn then associate itself with other companies, which are interested in these fields. Generally, payments of royalties are expenses that are deductible in the country of origin and are subject to a tax at the rate

⁵ Financial Services Promotion Agency, Mauritius

of 1,5% after deducting all expenses in Mauritius. The double taxation treaties that Mauritius has with 26 countries reduce or completely eliminate the deduction fee on any gain of royalties.

5. Consulting services
6. International trade (example illustrated below)
7. Leasing of equipment and of property (example below)
8. Real estate agency business

A Mauritian company can own property in any country, apart from Mauritius, but can own a building in the beneficial owner's place of origin. The structure of property via an offshore company can reduce taxes on capital gains and succession taxes. The beneficiary of the offshore company can sell some of his shares only instead of the property itself. Therefore, since the legal property of the company has not changed, there is no fiscal charge to be paid in the jurisdiction where the company is found. All the gains on the sale of the shares of the Mauritian offshore company are tax-exempt.

9. Investment and holding companies (example illustrated below)
10. Minimize fiscal exposure by planning all revenues and using the double taxation treaty of Mauritius.

This is a list that briefly shows the advantages of the Mauritian offshore sector of Mauritius:

- Sound domestic economic base is quickly establishing itself as a premier international business center in the Indian Ocean
- Political stability with a democratic Parliament system
- Time zone advantage: business can be done with European countries at mid-day and the States in the afternoon
- A strong and diversified economy with the sugar industry well established and the EPZ growing, and the authorities are promoting the financial services sector as the 4th pillar of the economy
- A well educated workforce, with a bilingual population, tourism
- In the Global Competitiveness Report by the World Economic Forum, Mauritius was placed 1st in the African continent in 1998 and 1999. The Institutional Investor

Country Credit Rating placed Mauritius 41st out of the 136 countries analyzed and 1st in the African continent. The Republic of Mauritius is also one of the African countries to have less corruption

- Confidentiality is guaranteed for all those dealing between the banks and clients unless they are operating against the laws
- A jurisdiction that is set to implement the 40 recommendations of Financial Action Task Force (FATF) to combat money laundering
- Frequent flights towards African countries, Europe and Asia
- Telecommunication: The telecommunication facilities are equipped with a fibre optic communication
- Member of several regional organizations such as the Southern Africa Development Community, Indian Ocean Rim-Association for Regional Cooperation (IOR-ARC), Common Market for Eastern and Southern Africa (COMESA)
- No exchange control regulation: The operations of offshore institutions in Mauritius are completely free from exchange control regulation when dealing with non-residents. Mauritius liberal exchange control policy allows offshore companies to freely move foreign currency funds into and out of Mauritius
- Mauritius has ratified 26 treaties with Europe, Asia and Africa³

³ <http://www.lowtax.net/lowtax/html/jmu2tax.html>

Table 3.2: (Mauritius Tax Treaty Network)⁶

Year	Country	Dividends (%)	(a) Interest (%)	Royalties (%)	(b) PE if building site lasts more than (months)	
1978	1990	Germany	5/15(d)	(g)	15	6
1981	1987	United Kingdom	15	(g)	15	6
1992	1992	Zimbabwe	10/20(d)	10/ 0 (g)+	15	6
1993	1993	Malaysia	5/15(c)	15	15	6
1994	1994	Switzerland	5	5	10	6
1990	1995	Italy	5/15(d)	(g)	15	6
1994	1995	Pakistan	10	10	12.5	6 in any 12
1995	1996	Singapore	0	0	0	9
1995	1996	Luxembourg	5/10(e)	0	0	6
1996	1997	Sri Lanka	10/15(e)	10	10	6
1996	1998	Indonesia	5/10(h)	10	10	6
1997	1998	Thailand	10	10/ 15 (f)	5/ 15	6
1995	1999	Belgium	5/10(c)	10/ 0 (g)	0	6
1995	*	Russia	10(f)	0	0	12
1999	1999	Nepal	5/10 (i)	10/ 15 (h)	15	6 in any 12
2000	2000	Nepal	5/10 (i)	10/ 15 (h)	15	6 in any 12

- (a) Dividends derived from Mauritius by non-resident companies are tax-free.
 (b) Royalties paid by offshore companies to non-residents are tax-free.
 (c) Lower rate applies to companies holding at least 10% of capital.
 (d) Lower rate applies to companies holding at least 25% of capital.
 (e) 5% in the case of an investment of at least US\$500,000.
 (f) Interest taxed at source or entry according to local law. 0% if paid by any bank carrying on a bona fide banking business. However, there is no withholding tax in Mauritius on interests paid by an offshore company.
 (g) Lower rate applies to companies holding at least 20% of capital.
 (h) Lower rate applies if paid to any bank carrying on a bona fide banking business.
 (i) Lower rate applies to companies holding at least 15% of capital.

*Taxies awaiting signature: Bangladesh, Malawi, Costa, Yemen and Uganda.
 Taxies being negotiated: Canada, Greece, Portugal, Vietnam, Zambia and Czech Republic.*

⁶ http://www.dcdm-ela.sncs.com/mu@consult/p_news/news/rct_00.htm#JTAs

3.9 Offshore structure models⁷

3.9.1 Leasing model

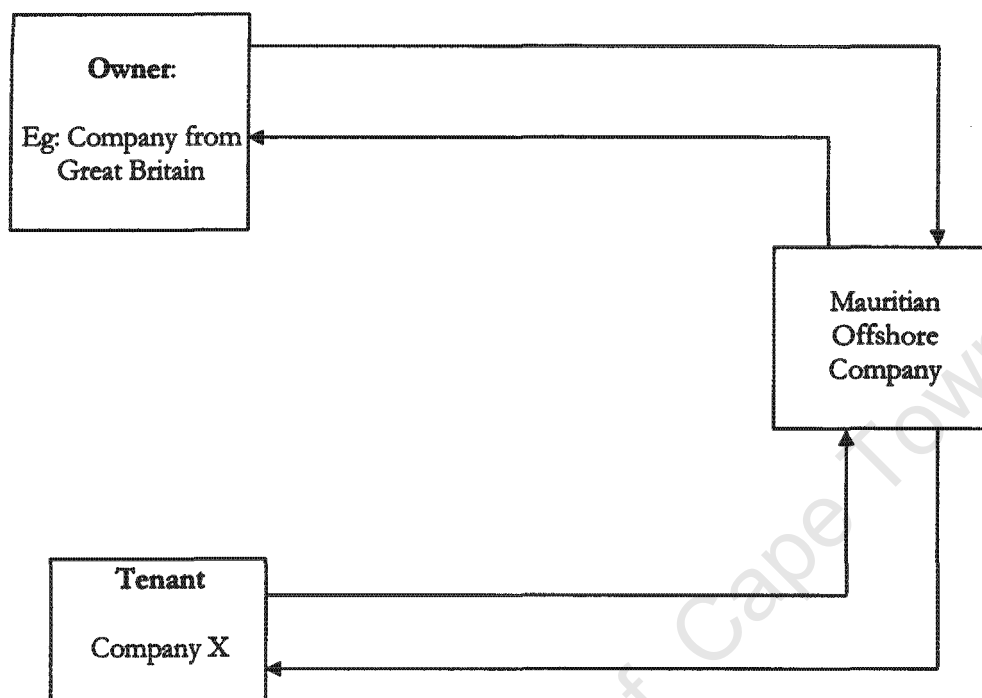


Figure 3.4 (Leasing model)

In the first offshore structure model as illustrated in *Figure 3.4*, if a British company is involved in the renting or leasing of equipment from a foreign company (X), the British company should go through a Mauritian offshore company to do so. The British company should have a leasing contract with the Mauritian Company, and the latter in turn will re-rent or re-lease the equipment to company X at a higher price.

The revenue of the British company is lower than the revenue of the Mauritian offshore company. Therefore, some of the business of Company X will not be taxed in Great Britain, but only in Mauritius, where the credit tax is not higher than 1.5% taking into account the fiscal credit abroad.

⁷ Financial Services Promotion Agency, 2000

Payment by X to Mauritius	100
Payment by Mauritius to G.B	<u>25</u> – taxable in GB
Profit	<u>75</u> (taxable at the rate of only 1.5% in Mauritius)

3.9.2 The property and rights offshore structure model

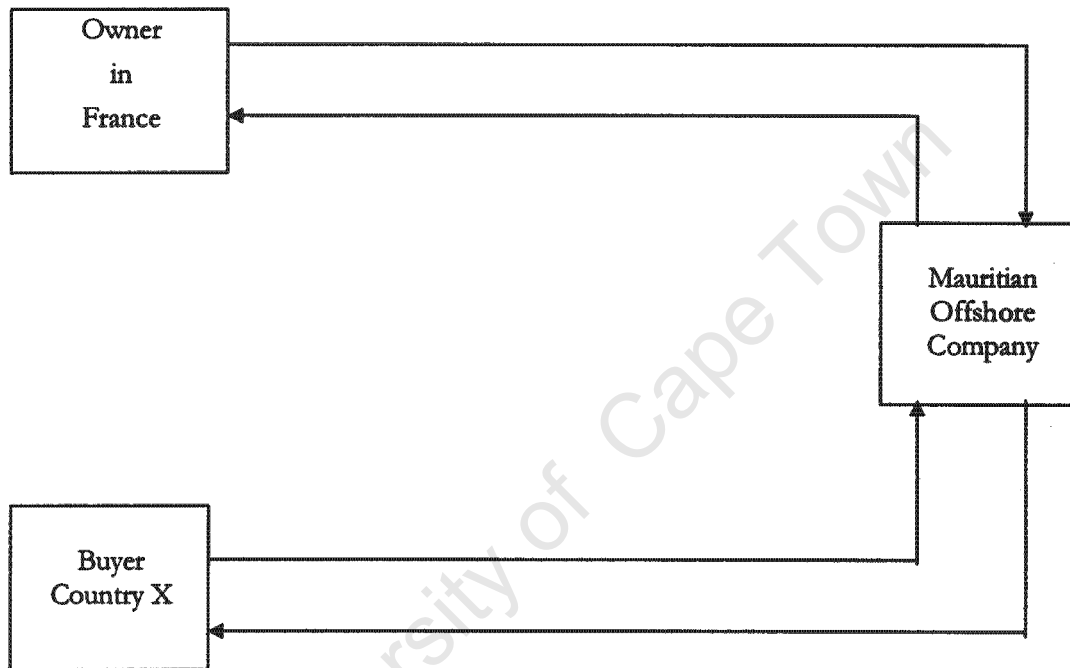


Figure 3.5 (Property and rights)

Figure 3.5 illustrates the offshore structure model of property and rights. The owner of the rights, the person who receives income or revenue from the buyer in country X, can create an offshore company in Mauritius.

The owner has to forego the rights to the offshore company at a reasonable rate, but at a lower rate than what the offshore company would receive from the buyer of country X. The offshore company is the one which will receive all income from X. A large part of the revenue is generated by the offshore company, where tax paid is lower than if it

were paid in total directly to the owner in France. Therefore, the fiscal gains are obtained in France.

Sale of rights from France to Mauritius 100 - taxable in France
 Sale of rights from Mauritius to X 200
 Profits that are not taxable in France,
 But in Mauritius at a rate of 1.5% 100

3.9.3 International Trade – Invoicing – Freeport offshore structure model

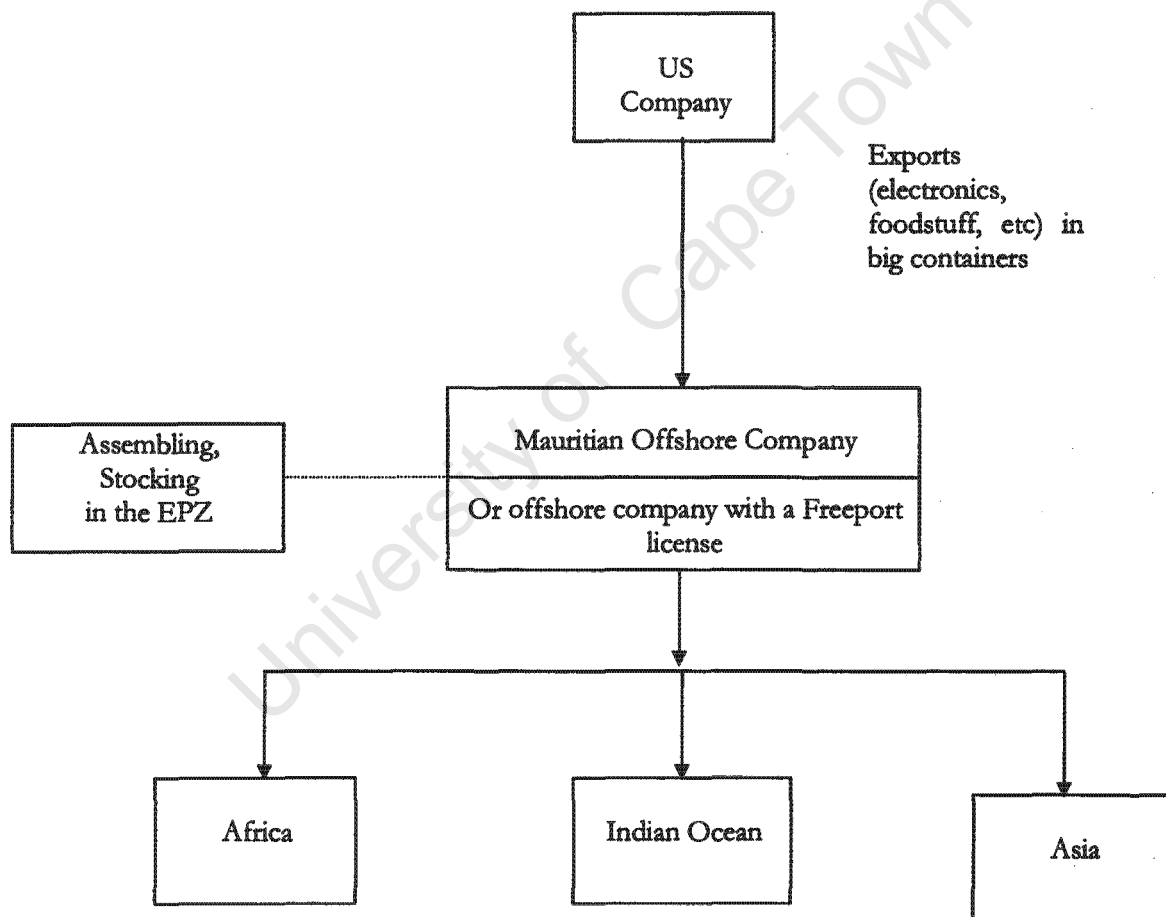


Figure 3.6 (International trade)

An American company involved in international trade can use the Mauritian offshore center as a platform for the distribution of its goods or services, so as to benefit from the 'transfer pricing' mechanism. Therefore, the revenues, which would normally be taxable in the United States of America, are taxable in Mauritius, where the tax rate is lower.

The offshore company could also obtain a Freeport license to operate in the EPZ in Mauritius, where activities such as assembling, stockage, minor processing or e-commerce can take place. Such a service proves to be beneficial before being re-exported. Companies that have a Freeport license have the following incentives:

- No corporate tax is payable
- Dividends are non taxable
- Complete exemption from payment of customs duty and sales tax on machinery, equipment or any materials imported into a Freeport zone.

The offshore company can also invoice the company when there is a purchase of property in one country and sale in another.

As an example, the Mauritian offshore financial center has recently been used by a group of companies for exports, where services such as cargo and transport facilities are available in the region of India and Africa.

3.9.4 Investment and Holding Company offshore model structure

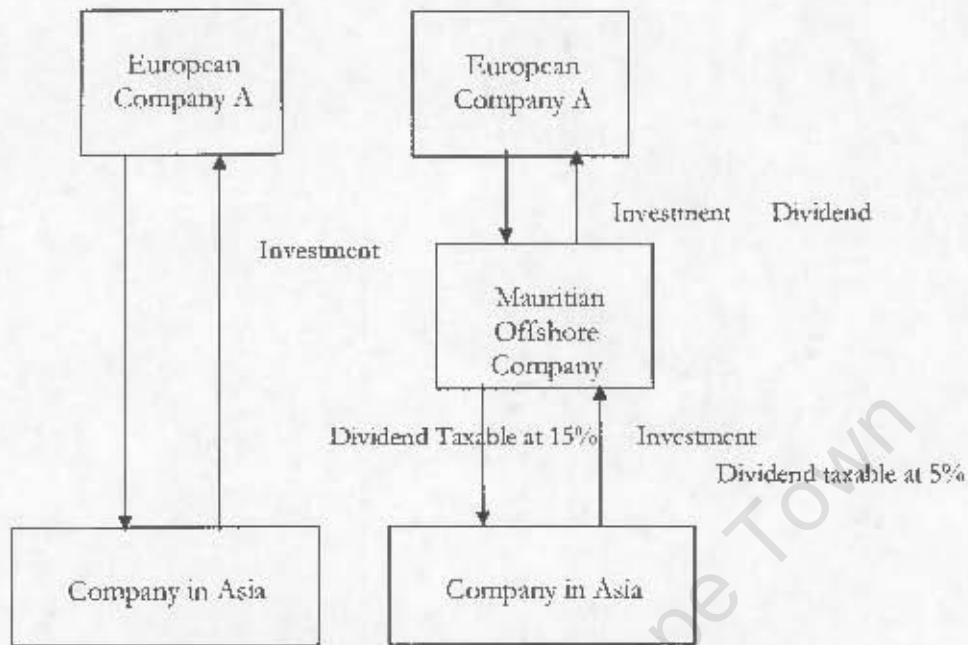


Figure 3.7 (Investment and Holding company)

As illustrated in *Figure 3.7*, a European investment company, which invests abroad, can increase its profits by going through a Mauritian offshore company. Companies based across Europe, the States or Australia frequently use the Mauritian jurisdiction for investments in shares or specific projects in Asia, for instance in India, China Indonesia or in the African continent.

Numerical example of a holding company using a double taxation treaty

European Company investing directly in Asia (100%)

European Company investing in Asia via an offshore company in Mauritius (100%)

		<u>Asian Company</u>	No proof of tax payments	Proof of tax payments
Profit before tax	1000	Profit before tax	1000	1000
Tax @ 30%	300	Tax @ 30%	-300	-300
	<u>700</u>		<u>700</u>	<u>700</u>
Dividend	700	Dividend	700	700
Deduction fee @15%	-105	Deduction fee @ 5%	35	-35
Received by the European Company	595	Received in Mauritius	665	665
		<u>Mauritius</u>		
		Dividend received	665	665
		Fiscal credit	335	335
		Total	<u>1000</u>	<u>1000</u>
		Tax in Mauritius 15%	150	150
		Fiscal credit 90% of 150	-135	.
		335 Limit of fiscal amount		-150
		Net tax payable	15	Nil
		Revenue	665	665
		Tax in Mauritius	15	Nil
		Dividend	650	665
		Deduction fee	0	0
		Dividend received by the European Company	<u>650</u>	<u>665</u>

3.10 Description of target and origin of investment in Mauritius

It is interesting to note the trend in global business entities since its first few days of existence until today. The trend shows the determination of the Mauritian authorities to make the financial sector the 4th pillar of the economy. The total number of entities registered at December 2001 was 18,769 as opposed to 14 in December 1992.

Evolution of global business entities in Mauritius (1992 – 2001)

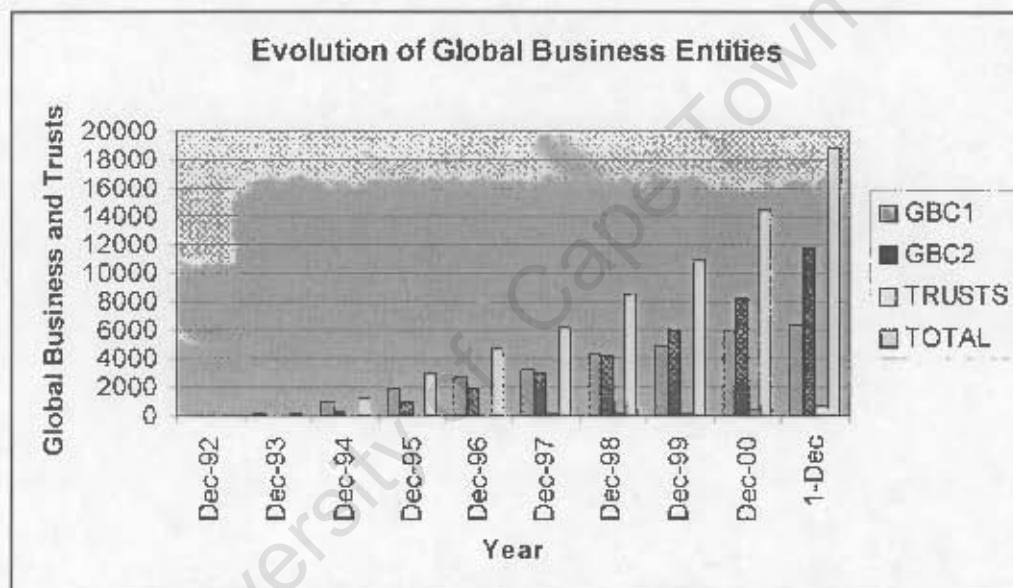


Figure 3.8 (Source: Financial Services Commission 2002)

It can be seen that the number of trusts and global business entities both global business category 1 and 2 have been on the rise. In 1992, there were no global business category 2 entities and only 4 trusts. In December, the figures were 11,730 and 670 respectively. These figures are a proof to illustrate the growth in the financial sector of Mauritius.

India remains the main market of investors using the Mauritian offshore jurisdiction. However, it is interesting to note that India, which was the main and greatest target

market in the first stages of the offshore development, has only 54% of incorporated companies as opposed to 67% in 1997.

The evolution of the origin of investment indicates a change in the tendency in the industry. In the first years of the offshore sector of the island, most of the investment in India originated from American, British and Arab investors. Such investment are on a decline along the years, and most of the investment nowadays comes from South Africa, India and Indonesian and such investment is on the rise as can be shown graphically.

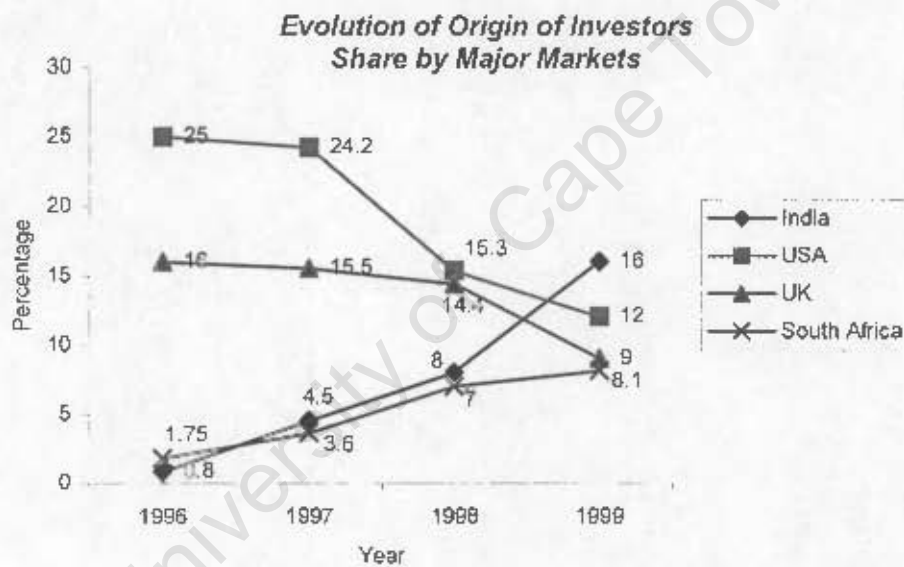


Figure 3.9 (Source: MOBAA annual report 1999)

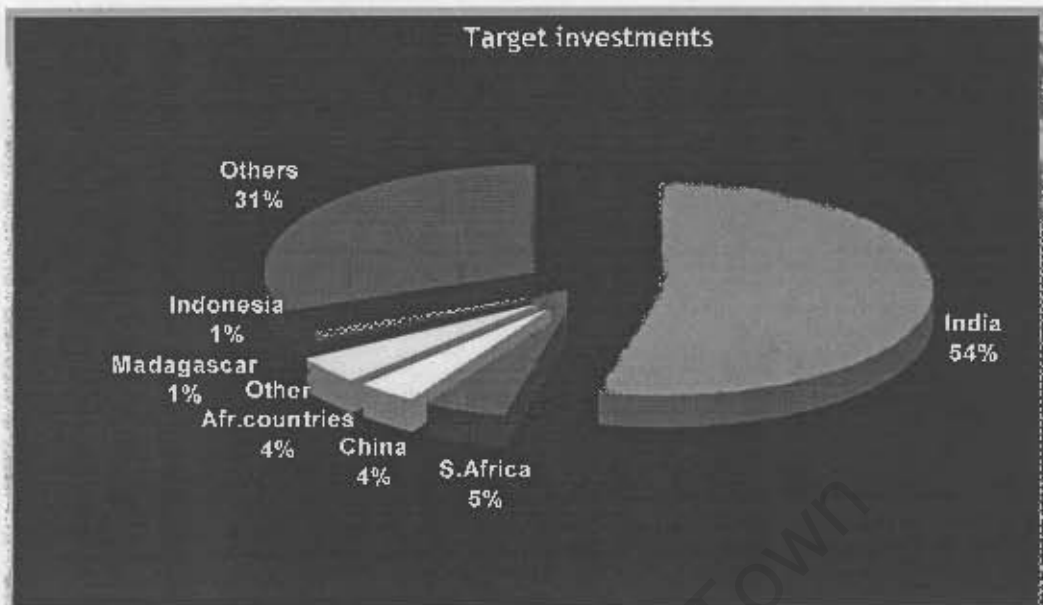
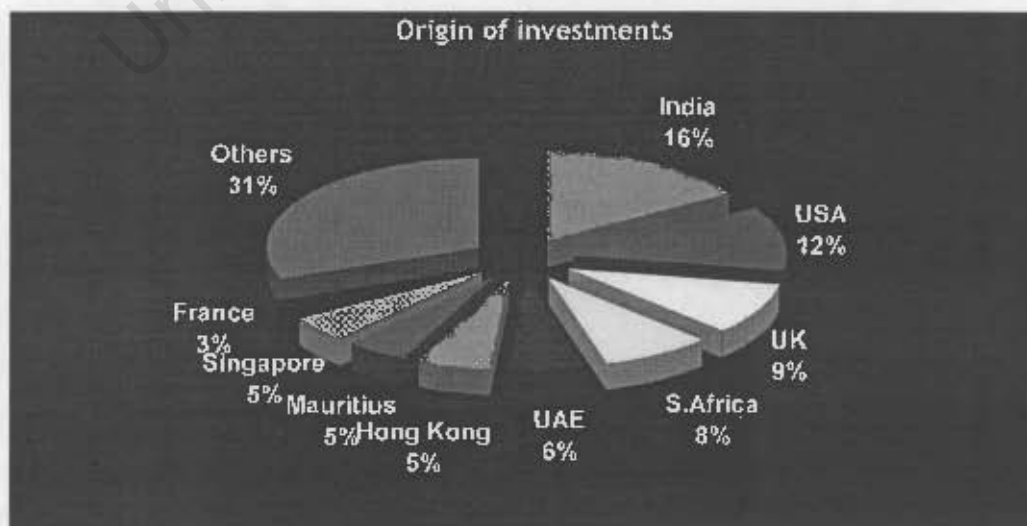


Figure 3.10 (Source: MOBAA annual report 1999)

As illustrated from *Figure 3.10*, the diversification of investment towards South Africa, China and other African countries is maintained. Mauritian Offshore companies are becoming very popular among the other islands in the Indian Ocean, specifically Madagascar and Reunion Island. In the case of the origin of investment, the beneficial owners come from India, the States, Great Britain, Africa, South Africa, Hong Kong, Indonesia and Singapore.

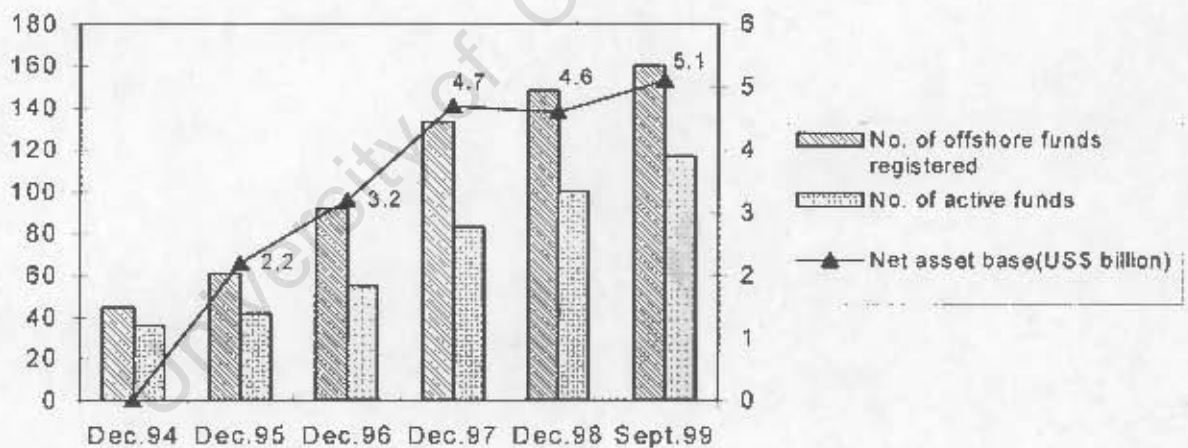


An interesting feature of the Mauritian offshore center is its structure for all investment to and from India. This shows the special 'rapport' that the 2 countries have.

Another important feature to note is the relocation of offshore companies from other offshore jurisdictions. In 1999, the re-location of offshore operations towards Mauritius, from European and the Caribbean jurisdictions amounted to 5.4% and 2.8% respectively in terms of incorporated companies.

Offshore funds have grown at a stable pace, with 164 funds incorporated till November 1999. 127 active funds had a net asset base exceeding \$5.1 milliard. Most of the incorporated funds have been structured in a way to be able to invest in Indian companies.

Progression of Offshore Funds



Graph 3.1 (Source: MOBAA Annual Report 1999)

3.11 Position of Mauritius in relation to the OECD report on fiscal practices⁸

In 1998, the Organization for Economic Co-operation and Development OECD published a report entitled "*Harmful Tax Competition: An emerging Global Issue*", with the aim of countering "harmful tax practices". Initially, the OECD identified 47 jurisdictions as having "tax havens" features. These jurisdictions were to submit information on their fiscal regimes, which were associated with "tax havens". According to the International Fiscal Association, a tax haven is any country, which by features in its tax law attracts the attention of tax planners. They are those countries, which levy very low taxes at all, at least on certain categories of income and profits. There are several requirements of a tax haven:

1. Political stability
2. Good communication
3. No exchange control restrictions on foreign persons
4. Good commercial and corporate laws
5. Good professional services
6. Confidentiality of transactions

In June 2000, the OECD published a report on "*Progress in Identifying Harmful Tax Practices*". This report includes a list of potentially harmful preferential tax regimes in member countries, the harmful features of which are to be eliminated by April 2003. The final list contains of 35 jurisdictions. Six jurisdictions including Mauritius have made commitments to eliminate harmful tax practices by the end of 2005 and as a result have been removed from the initial list.

The OECD has been promoting a global tax harmonization initiative in an attempt to create a tax cartel of high tax nations, which are for the most part European based. Their efforts have been targeted at low tax and no tax financial centers, which have been

⁸ Towards Global Tax Co-operation : Report to the 2000 ministerial council meeting and recommendations by the committee on fiscal affairs - Progress in identifying and Eliminating Harmful Tax Practices

threatened with sanctions if they do not comply with certain conditions, set out by the OECD.

Under the terms of the report of 1998, key factors that can assist in identifying harmful preferential tax regimes are as follows:

1. No or nominal effective tax rates
2. Lack of effective exchange of information
3. Lack of transparency
4. Attracting investment without substantial meaning

The Republic of Mauritius has at all times denied the fact that its tax practices are not harmful and that it is not a tax haven. However, it has decided to cooperate with the OECD. In this context, as published on 19 June 2000⁹, Mauritius has set the pace for the following:

1. Eliminate all harmful tax practices by the end of 2005
2. Meet the international requirements of transparency
3. Exchange of information
4. Be competitive in a fair manner

Due to its rigid set of regulations in respect of combating money laundering in the offshore sector, Mauritius has been praised by the United Nations¹⁰. The Economic Crime and Anti-Money Laundering reinforce the existing legislation in the prevention and the fight against money laundering.

At the July 1989 economic summit in Paris, the group of Seven countries set up the Financial Action Task Force (FATF), whose brief is to prevent banks and financial institutions from laundering the proceeds of criminal activities – in particular, sales of

⁹ <http://www.oecd.org/dataoecd/14/14/2471111.pdf> Advance Commitment Letter Mauritius

¹⁰ www.unhcr.org/refugees/1998/01/43c1c1c1.html: UN Praises Mauritius for diligent regulation of its Offshore Sector - 'Financial Havens, Banking Secrecy and Money Laundering' published in 1998

controlled substances, organized criminal activities, and manipulation of markets by insiders. The FAFT, which has 28 member countries and governments, primarily from the industrial world, encourages countries to make money laundering a criminal activity in itself. It also seeks to strengthen international cooperation between criminal investigations agencies and the judiciaries in different countries. The FATF has become increasingly concerned over the misuse of financial institutions on a global basis for criminal purposes and put in place a number of recommendations. In response to these recommendations, most financial centers have tightened their procedures in the hope of discouraging criminal procedures and providing early detection of any attempts to launder the proceeds of criminal activity. On 14 February 2000, the FATF published a report on non-cooperative countries. The report main aim was to identify those jurisdictions, which were plainly uncooperative, partly cooperative and non-cooperative. The report list 25 procedures to identify those jurisdictions that failed to cooperate with respect to the introduction of effective anti-money laundering regimes.

In this report, there is a list of uncooperative countries: Mauritius has been excluded from this list in light of the implementation of the Economic Crime and Anti-Money Laundering Act 2000 by the parliament on 13 June 2000.

In conclusion to this section, Mauritius has done great efforts to cooperate to international norms in the exchange of information of clients in the offshore sector, helping the country to prevent money laundering while at the same time preserve its good reputation.

3.12 Regional perspectives

Situated in the Indian Ocean, the Republic of Mauritius is the gateway to Eastern and Southern Africa and Asia. To enhance this position, Mauritius has entered into various bilateral and multilateral trade and economic agreements. By integrating our economy into regional blocs, necessary economies of scale to attract foreign investment can be achieved. One of the most important trade agreements is the ACP/EU Cooperation where Mauritius is a signatory to the Lomé Convention.

The active role played by Mauritius in various organisations encompassing the Indian Ocean Commission (IOC), the Common Market for Eastern and Southern Africa (COMESA), the Southern African Development Community (SADC) or the Indian Ocean Rim Association for Regional Cooperation (IOR-ARC) are testimony to these efforts.

3.12.1 COMESA

Mauritius is a founding member of the COMESA, which was established in 1994 to replace the Preferential Trade Area for Eastern and Southern African States (PTA). It comprises of 20 member countries.

Under the regional bloc, goods produced in the island can benefit from this preferential custom duty equivalent to 10% of the normal duty charged on imports from other member countries provided the goods meet certain requirements. Trade between member states of the COMESA and Mauritius has increased from \$47 millions to around \$159 millions in 1998¹¹.

3.12.2 SADC

The SADC (Southern African Development Community) groups 14 member states¹². One of the most active regional groupings, the SADC was established in 1992. The main

¹¹ <http://www.comesa.int/statistic/statmtr3.htm>

¹² Angola, Botswana, Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe.

objective of this regional bloc is to allow the free movement of capital, labor, goods and services. Each member has the responsibility to coordinate sectors on behalf of the others. For instance, Mauritius holds the responsibility for coordinating the tourism sector within the SADC. The SADC Trade Protocol commits all 14 members to create a free trade area by 2005.

3.12.3 IOR-ARC¹³

Established in 1997, the IOR-ARC aims to create a common ground for regional economic cooperation with a view to promoting sustained growth and development of the region. The IOR-ARC currently has 18 member countries.

¹³ <http://www.ile-maurice.com/>

CHAPTER 4: COMPARISON OF THE THREE CENTERS

4.1 Introduction

After having analyzed the Offshore Sector in Mauritius and its importance to the general economy, the next step is to compare different Offshore Centers. For the purposes of this thesis, The British Virgin Isles (BVI) and The Seychelles are discussed. The BVI has been chosen as it is one of the main OFC's and Seychelles as it can be in direct competition with Mauritius, being its neighbor in the Indian Ocean.

4.2 The British Virgin Islands¹

The British Virgin Islands (BVI) lies in the eastern Caribbean made up of 36 islands, dependent on Great Britain. The islands are well known as a stop over point in Europe, but also known for being a refuge for the pirates. A very popular name is Sir Henry Morgan, known for hating not only the Spanish, but also any taxes and fiscal controls.

4.2.1 Economy – Broad overview

As one of the worlds leading offshore corporate domiciles, the BVI offers an attractive combination of a safe, politically stable environment, with a legislative framework developed in close consultation with the private sector. Financial services and tourism form the twin pillars of this British territory's economic policy. The British Virgin Islands seem to have got as close to being a perfect 'private' offshore international financial centre as can be imagined. For 25 years the Government has welcomed offshore business, and has created a world-standard regulatory structure to avoid money-laundering and other criminal activity. The other sector of less importance is construction.

4.2.2 Development of the offshore centre of the BVI

The BVI have an excellent business infrastructure with good telecommunications; this coupled with the widespread use of the English language and a legal system largely based on English law makes

¹ Offshore Finance Yearbook, 1999

the island a very convenient and effective business base. The very large numbers of offshore companies, trusts, insurers and mutual funds on the islands are supported by a well-developed and diverse professional services sector.

Although there are two other types of company available, Resident and non-resident companies, the most important is the International Business Company (IBC). This type of company was introduced under the International Business Companies Act 1984 especially aimed at the offshore industry. The only restrictions are that an IBC cannot carry on business with residents of the BVI (apart from dealings with professional firms/banks or other IBC's) and cannot own property in the BVI. During the first year of existence of the IBC Act 1984, only 253 companies were created. The BVI were already an offshore jurisdiction before the effect of this Act. In fact, it had several double treaty agreements with Japan and Switzerland. However, the real growth occurred in 1988, when the BVI invested in the right field at the right time. At that time, Panama, the traditional offshore centre was politically unstable, and as there was doubt about the future of Hong Kong, more investors moved their funds to the British Virgin Islands. The final result was the investment in trusts in BVI. This was good publicity for the islands and this in turn attracted more investors.

The laws of 1984 for international companies allowed foreign companies based in the BVI to benefit from the different fiscal advantages, with a minimal risk of devaluation of the currency like the US dollar. By the end of 1997, more than 250,000 companies were created and the fees generated were a fairly big amount.

In 1994, in view of diversification, the authorities of the BVI imposed a new law on captive insurance. In 1996, there were more than 116 captive insurance companies. In 1996, a new law was enacted for all investment in pensions. The BVI introduced its outstandingly successful International Business Company (IBC) in 1984; there are now more than 300,000 IBC's, with Hong Kong and Latin America the main sources of clients.

4.2.3 Legal System

The Islands are a dependent territory of the British Crown, and a member of the Commonwealth. The legal system is based on English Common Law. The Queen of England is the Chief of State

who is represented by a Governor appointed by the Crown. The islands are largely self-governing since the 1967 Constitution and to a limited extent rely on UK statutes on international matters

4.2.4 Communication

There are direct flights everyday between the islands and the States. Moreover, there are “cargos” available on a regular basis. Telephone, telex and fax services are also of the latest technology. Courier services are equally important for the development of the financial sector and services such as DHL, FedEx, etc are available.

4.2.5 Stable Territory

From a political point of view, the BVI have a very good political base. For internal affairs, the BVI take full responsibility of all aspects, and the Great Britain have responsibility to see to it that all other political decisions are made and accepted by the latter.

4.2.6 Infrastructure

The development of the BVI into a strong financial centre has led to a different quality of life of the population. Many big international firms are represented in the BVI, providing a large range of services in banking, financial, legal and accountancy fields. These firms have both good reputations along with a qualified workforce, which is an excellent combination for success.

However, despite a qualified local population, the BVI acknowledge the fact that foreign expertise is necessary to maintain the level of the international financial centre. In order to work in the BVI, a work permit is needed and the government is open to provide such permits, as this is beneficial for the economy as a whole.

Although the BVI have and attract many expatriates who are competent and highly qualified, the authorities have invested in providing education to its people. Nowadays, as a consequence, the rate of literacy in the islands exceeds 98%, which is the highest rate in the world.

In collaboration with the private sector, the authorities have also provided incentives for the formation of the population in the financial field. The government provides subsidies for students and also for those people willing to work abroad so as gather experience which will benefit the financial sector of the economy. The BVI is a reasonably cheap jurisdiction compared to its local

rivals, and has quite strong professional services. The Government is responsive to the needs of business, and its legislation is mostly flexible and straightforward.

4.2.7 Strategic position

With its geographical location and being 4 hours behind GMT (therefore well placed in terms of time zone) the BVI is in a strategic position to offer its services to financial markets such as Europe, States and Asia. The territory is easily accessible by air and sea and all courier services provide delivery between the BVI and other big financial centres within one day for the States and two days for the Europe region and the rest of the world.

4.2.8 Partnership between the public and private sector

In addition to belonging to the Great Britain, the BVI offer some features that help them be more competitive in comparison to their competitors.

The adaptability of the International Business Company has led to its current status as one of the preferred vehicles of choice world-wide for an enormous range of activities. The BVI have shown their real potential to offer financial services with the implementation of the IBC Act 1984. The implementation of the Act was carried out with close collaboration with the private sector. Since then, the authorities have followed a routine as to check all new law that are implemented with the private sector. With such interaction between the private and public sector, the BVI have managed to provide a stable political base along with attractive conditions in the financial sector which have led to the following:

1. Simple incorporation procedures and efficient service
2. Flexible and user-friendly legislation
3. Rate of taxation 0 for offshore entities; the rate is lower for entities in BVI; no taxes on income earned or capital gains
4. Level of privacy and confidentiality is at a maximum
5. Competitive costs

The government and the private sector have decided to continue work together to maintain the solid base of the islands. This is important as it helps BVI remain competitive internationally.

4.2.9 Legislation of the British Virgin Isles

The regulatory system of the BVI is backed by the English legal system and common law. There are many laws that have been enacted that cover a large range of financial services such as insurance, trusts, banking operations etc.

The legislation has been designed in such a way so as to protect the confidentiality of the clients and to have an efficient and effective offshore industry both domestically and internationally. Domestically, the authorities have the responsibility to check that the laws are respected by implementing some supervision. From an international point of view, the BVI has to cooperate with international organisations to see to combat criminal activities. The territory has consistently shown a determination to counter any and all forms of money laundering and has had a Proceeds of Criminal Conduct Act since January 1998.

In respect to the offshore industry, the British Virgin Islands operate under the following acts:

1. International Business Companies Act, 1984
2. Banks and Trust Companies Act, 1990
3. Company Management Act, 1990
4. Trustee Ordinance including the Trustee Amendment Act, 1993
5. Insurance Act, 1994
6. Partnership Act, 1996
7. Mutual Funds Act, 1996
8. Criminal Conduct Act, 1997

These offshore acts are generally considered among the most advanced in the world, and are most frequently used in other offshore jurisdictions.

Advantages of BVI

1. Politically stable
2. Excellent communications
3. Shelf companies available

4. Reserved company names available
5. Fast incorporation service
6. No exchange control
7. No disclosures necessary
8. Legal system based on UK common law
9. No requirement to show registered office on letterheads
10. IBC's not subject to taxation if no activity in the BVI

The financial services industry in the British Virgin Islands can fairly be described as a runaway success, particularly in recent years. More than 300,000 companies are incorporated in the BVI, with 40,000 added in 1997 alone. This flood of new registration largely reflected the reunification of Hong Kong with Mainland China, and may not be sustained. However, there is no doubt that the BVI is an attractive offshore destination, offering stability, high levels of privacy, good reputation, flexible legislation, English language etc.

4.3 Seychelles²

The Seychelles are a group of 115 islands located in the Indian Ocean. The largest island is Mahé, which contains the capital, Victoria. These islands were inhabited until the 17th century and since have been occupied by the English and French. Great Britain gave them their independence in 1976 and they have until today known economic success and be politically stable. The Seychelles Islands are now a Republic and is a member of the Commonwealth.

4.3.1 Economy – Broad Overview

Since independence, the country has experienced reasonably equitable economic growth and there has been significant progress in social conditions, which compare favourably with those of the upper-income countries. The main economic activities are tourism and fishing. Tourism employs 30 percent of the labour force and accounts for more than 70 percent of export earnings.

The country has managed to keep the inflation rate at a reasonable level, and in 1995, the CPI decreased to 1.28%³, after the authorities took measures to lower the prices of basic foodstuff,

² <http://www.siba.net/Pages/siba.htm>

services, and tax rates. The Seychelles has been listed in the 1998 edition of the Guinness book of records as the country having the lowest rate of inflation. During the last 12 years, the economy has experienced a growth of around 4-6% annually.

The economy of Seychelles essentially depends on tourism, but the financial sector is gaining importance, due to the establishment of Seychelles International Business Authority (SIBA). SIBA is a body corporate for licensing and regulating primary offshore activities. Moreover, the law that regulates offshore banking in the Seychelles incorporates the necessary flexibility to encourage substantial growth in the offshore sector.

Tax treatment of the offshore banking is equivalent to that prevalent in some of the most reputable offshore jurisdictions. For example, corporation tax, withholding tax, tax on dividends and interests and exchange control are non-existent.

The recently released *UNDP Human Development Report 2002* has Seychelles ranked amongst a select group of 53 countries with high human development. Seychelles is the only African country that falls in the "High Human Development Index Category" with an index of 0.811. Norway, which occupies first position, has an index of 0.942. Seychelles has a literacy rate of 88%, and GDP per capita is US\$ 12,208.

The economy was dependent mainly on one or two sectors, and therefore was vulnerable to all external shocks. In recent years the government has encouraged foreign investment in order to upgrade hotels and other services. At the same time, the government has moved to reduce the dependence on tourism by promoting the development of farming, fishing, and small-scale manufacturing. New laws were put in place, which would allow the growth of these sectors.

The SIBA was formed in February 1995 as a body for regulating the offshore industry. The SIBA is an independent corporate body to manage the Seychelles International Trade Zone (SITZ), to administer the International Company Act (1994) and International Trust Act (1994). The SIBA has as main functions to monitor, supervise and co-ordinate all the activities of the offshore industry,

³ <http://www.siba.net/Pages/siba.htm>

including the subscription of all International Business Companies. In fact, it is one of the fastest Registrars in the world, providing incorporation within one day.

The authorities are negotiating several double taxation avoidance agreements to promote the offshore industry. Agreements that are in progress to be signed are with Tunisia, Cyprus, Mauritius and India. Such treaties combined with low tax rates and a favourable political and economic climate for investors are good incentives to make Seychelles a well-known offshore jurisdiction.

In 1996, the Economic Development Act (EDA) was enacted. The latter created an outrage in the international business world, as the Act permitted all investment higher than \$10 millions in the Seychelles, to benefit certain privileges and legal assistance. Therefore, this Act was more harmful than beneficial to the offshore industry as it promoted the country as a centre, which would go to any means to be successful.

The Seychelles offshore industry continues to make remarkable progress as government prepares the final stages for the enactment of key legislation that will not only mark its entry into more sophisticated tax planning work, but also provide practitioners with a wider variety of entities to work with. The introduction of the Companies (Special Licenses) Act in particular will provide a resident corporate structure that is capable of taking full advantage of the growing network of double taxation agreements, which now includes a treaty with South Africa. The Act provides for a license issued to a domestic company engaged in an approved activity affording it to a certain measure of confidentiality and tax concessions and access to DTA benefits. The Act must comply with the provisions of the Companies Act (1972) and is therefore more transparent than the traditional IBC.

Following the positive reviews of the IMF, FATF and OECD of the regulatory framework, there is little doubt as to the credibility of Seychelles as an emerging jurisdiction, which has met all the requirements for a reputable well-regulated centre. With the new legislation on the verge of being enacted, discussions have now begun on the first draft of the Corporate and Trustee Services Providers legislation, designed to ensure that all offshore service providers are licensed and regulated in accordance with international standards.

The good news for management companies is that the new legislation, which has already seen the admission of foreign lawyers to perform offshore work, is that licensees will be able to avail of a

number of proposed concessions, designed to make Seychelles even more attractive for qualified professionals and firms.

4.3.2 Political Stability

Seychelles has had a multi-party system with the adoption of a new constitution in 1992. Since then, three multi-party elections took place in 1993, 1998 and 2001. All three elections were won by the Seychelles People's Progressive Front (SPPF) led by President France Albert Rene.

4.3.3 Communication

The Seychelles airport is one of the most modern and efficient in the Indian Ocean. There are direct flights between Europe, Africa and the Seychelles.

'Cable and Wireless Seychelles' provide telecommunications services a subsidiary of the 'Cable and Wireless London' company. In general the telephone system is an effective one.

4.3.4 International Relations

The Seychelles is a member of the International Monetary Fund and World Bank. In 1992 the country became a member of the Multilateral Investment Guarantee Agency (MIGA), which protects investors from expropriation. The Seychelles is also a member of the Commonwealth and a member of the United Nation and all the closely related organisations (UNESCO, UNDP, etc).

The Seychelles has also signed several international conventions. The Seychelles made an application to rejoin the World Trade Organisation and is a member of the Common Eastern and South African Market (COMESA) and the South African Development Community (SADC).

4.3.5 Legislation

The offshore financial sector of the Seychelles economy has been fostered and encouraged by the government over the last twenty years, and as a result, has been steadily developing, with recent, well formed legislation now in place for:

- International Business Companies Act, 1994
- International Trusts Act, 1994
- Seychelles International Trade Zone Act, 1994

- Seychelles International Business Act, 1995
- Financial Institutions Act, 1995
- Insurance Act, 1995
- Anti-Money Laundering Act, 1996

The financial sector is regulated by the Offshore Banking Department of the Central Bank, and at present there are five licensed foreign banks, and two domestic banks established in the Seychelles.

This jurisdiction operates a territorial taxation system, meaning that only income earned in Seychelles is taxed (at rates of up to 40%), and although there are import duties to be paid, these have been reduced substantially in recent years, which combined with the large number of investment incentives for incoming investors, means that the Seychelles are an attractive option. There are no exchange controls.

In order to obtain residence in the Seychelles, an individual must either be able to demonstrate sufficient resources to support themselves and their dependants, or must obtain a Gainful Occupation Permit (GOP) from the government. A GOP must be applied for by the prospective employer, and although it acts as permission for both residence and employment, there is a cost of SR18,000 per person, per year. A reduced rate is sometimes available for investors approved under the Investment Promotion Act, but there is usually quite a low limit on how many foreign nationals can be employed by any one company.

It is important to note that the laws, which are enacted in the Caribbean, in particular the Bahamas and the British Virgin Isles are similar to those in the Seychelles. For instance, the IBC Act of the Bahamas resembles the IBC Act of the Seychelles, whereas the Trust Act of the Seychelles is a combination of several laws, which are in place in the Caribbean.

Advantages of Seychelles

- Politically stable
- Excellent communications
- Bearer shares permitted
- Shelf companies available
- Not highlighted by OECD

- Fast incorporation service
- No exchange control
- No disclosures necessary
- First year's annual fees due on anniversary of incorporation
- IBC's not subject to local taxation if no activity in the Seychelles

4.4 Comparison of the three centers

4.4.1 Advantages to the shareholders

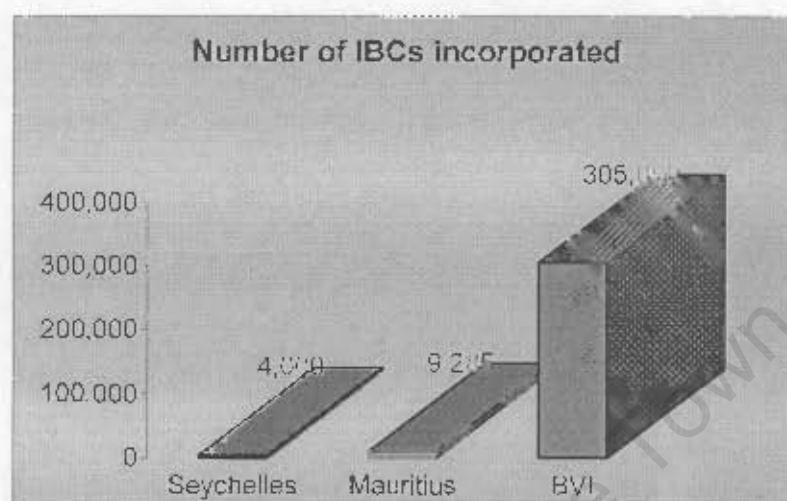
In most of the jurisdictions where an IBC can be established, it is exempt from any local taxes. This acts as an incentive for the non-residents (as a reminder: IBCs cannot deal with residents of the jurisdiction) to invest in such centers. Often, the only payable tax is the annual fee paid on incorporation.

In most of the countries, the shareholders are exempt from:

- Taxes on income and revenues
- Capital gain tax
- Company tax
- Inheritance tax
- Exchange control
- Etc

The figure below illustrates the number of IBCs incorporated which shows clearly the popularity of OFCs because of its many advantages.

Figure 4.1: Number of incorporated IBC in each jurisdiction⁴



⁴ Sources: For the Seychelles and the BVI: *Offshore Investment* magazine March 1999
For Mauritius: FSC (Oct 2002)

4.4.2 Differences between the 3 Offshore Financial Centers⁵

	<i>British Virgin Isles</i>	<i>Mauritius</i>	<i>Seychelles</i>
<i>Commercial Laws</i>	International Business Companies Ordinance 1984	International Companies Act 1994	International Companies Act 1994
<i>Minimum Capital</i>	No minimum	No minimum	No minimum, and the capital can be in any currency
<i>Incorporation Fees</i>	US\$ 500	US\$ 500	US\$ 100-2000
<i>Cost of incorporation</i>	If capital < US\$ 50 000 --> US\$ 300 If capital > US\$ 50 000 --> US\$ 1000	If capital < US\$ 100 000 --> US\$ 100 If capital > US\$ 100 000 --> US\$ 300	If capital < US\$ 5 000 --> US\$ 100 If US\$ 5 000 < capital < US\$ 50 000 --> US\$ 300 If capital > US\$ 50 000 --> US\$ 1 000
<i>Annual Fees payable</i>	If capital < US\$ 50 000 --> US\$ 300 If capital > US\$ 50 000 --> US\$ 1000	If capital < US\$ 100 000 --> US\$ 100 If capital > US\$ 100 000 --> US\$ 300	If capital < US\$ 5 000 --> US\$ 100 If US\$ 5 000 < capital < US\$ 50 000 --> US\$ 300 If capital > US\$ 50 000 --> US\$ 1 000 But these amounts are fixed for a lifetime
<i>Taxation Rate</i>	0%	0%	0%
<i>Who can register?</i>	Local agent for incorporation	Local agent for incorporation	Local agent for incorporation
<i>Time taken</i>	24h Max	24h Max	24h Max
<i>Minimum number of members</i>	1	1	1
<i>Office</i>	Has to be in the BVI	In Mauritius	In Seychelles
<i>Directors and secretaries</i>	Min 1 director	Min 1 director	Directors and secretaries should not be resident in Seychelles
<i>Meetings</i>	Anywhere	Anywhere	Anywhere
<i>Annual audited accounts</i>	No	No	No
<i>Exchange control</i>	No	No	No
<i>Number of companies</i>	305 000	4 000	3 500

Table 4.1: The main differences between Mauritius, BVI and Seychelles

⁵ Offshore Investment – Mars 1999 ‘Company formation survey : the seven year itch’

In comparison to the 2 jurisdictions, Mauritius is known for its offshore companies. However, this does not mean that IBC in the island are not as interesting as those of BVI or Seychelles. From the table, it can be seen that there are many similarities. The main difference lies in the reputation of the offshore financial centre.

In general, the 3 jurisdictions have similar laws, as they have to constantly modify their laws to remain competitive on the IBC market. The British Virgin Isles have a certain advantage over the Seychelles and Mauritius as it is one of the oldest offshore jurisdictions and has a very good reputation among the investors' worldwide. The Republic of Mauritius and the Seychelles are both very "new and young" jurisdiction and are in the process of growing and they are still on the 'learning curve'.

4.4.3 Double taxation treaties

The British Virgin Isles have double taxation treaties with Great Britain, Japan and Switzerland. The advantages of such treaties are applicable only for companies residing in the BVI, which have to be companies in the Companies Act. Since most companies in BVI are International Business Companies or trusts, most of the investors do not enjoy the benefits of the double taxation treaties.

The Seychelles has negotiated a treaty with South Africa. Why South Africa? The choice of South Africa, with its tremendous potential development tailored offshore investment products is especially significant in the light of the recent entry force of the Double taxation agreement avoidance treaty with Seychelles. It is the ideal platform for the launching of the second phase of the Seychelles offshore industry. More recently, in April 2001, Seychelles signed a treaty with Thailand. Since, the authorities believe that such treaties are of great importance for the development of the offshore industry and to make Seychelles more competitive, they are negotiating other treaties with Tunisia, Mauritius and India.

As mentioned in the preceding chapter, Mauritius has a large double taxation treaty network. Most of the investors use the Mauritian offshore centre because of these treaties. It is for this reason, that Mauritius has acquired a reputation of being a "DTA

jurisdiction". In fact, the main reason behind the success of the offshore sector is the 26 treaties it has with so many countries (especially the treaty with India).

Among the 3 jurisdictions, Mauritius provides international fiscal planning due to the DTA, whereas the other 2 centers are mostly used for specific investment with the International Business Companies.

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CHAPTER 5: CONCLUSION

Mauritius, on the eve of independence in 1968, was essentially a mono-crop economy based on sugar production. In the early 1970s, Mauritius set out to diversify its economy by encouraging the establishment of export-oriented companies within its Export Processing Zone (EPZ). In the early 1980s, government launched a comprehensive adjustment programme aimed at fostering economic development through export-led industrialization, agricultural diversification and expansion of the tourist industry. The manufacturing sector, which has spearheaded economic development since 1990, has now outweighed the sugar industry as the main pillar of the economy.

The Mauritian economy pulled itself from stagnation and embarked on a path of self-sustaining growth as from the 1970's. Since then it has steadily maintained an average real GDP growth rate of about 5% per annum for the past three decades. Its per capita GDP rose steadily. More importantly, the economy has undergone significant transformation from a monocrop economy to an industrializing economy with a well-developed manufacturing sector and a fast expanding services sector which includes tourism, offshore banking, offshore business and a newly established Freeport.

The success of the Mauritian economy is a result of a strong commitment to democratic principles coupled with political stability, good governance, clear policy orientation, consistency in the management of the economy and a staunch belief in free enterprise. Mauritius has a long-standing tradition of open dialogue between the public and private sectors, within a well-structured framework, through which regular meetings are held with the country's economic players to discuss major issues confronting the country. The government sees its role as a facilitator and supporter of the private sector and it seeks to provide an enabling environment for businesses to grow and prosper. There are 2 types of offshore jurisdictions, those having a double taxation treaty (Cyprus, Malta, Mauritius, etc), and those that do not (The Bahamas, Seychelles, Jersey,

etc). Those investors wanting to take advantage of the double taxation agreements, to lower the amount of tax paid, have to invest in such jurisdictions that have such treaties. This lowers the amount of taxes paid on dividends and royalties.

Mauritius depends heavily on tourism or is moving from a predominantly agriculture base and is looking to other means of diversifying their economies. To this end, offshore financial sectors are attractive to Mauritius in this context. This sector has been viewed as a growing industry with the potential to provide significant growth in developing economies; it is being seen as being able to generate large revenues without large investments in physical infrastructure. Under current international standards, these views are no longer widely held. There are certain stigmas associated with offshore centers to the extent that they are perceived to be involved in money laundering or other illegal activities.

The more established centers have been able to generate significant amounts of revenues and employment. These economies, such as BVI, the Cayman Islands, have also developed relatively strong and extensive legislative and regulatory frameworks to address these sectors. However, even in these countries additional measures have been required by the various international organizations looking into the problems of money laundering. For the new entrants to this sector, the benefits are not so clear-cut. Additional work should focus on refining the measurement of the benefits and costs¹.

In Mauritius, the scope of measuring the contributions, or value-added, of the OFC to the economy encompasses fees paid to government and registered agents, rental of office space, wages paid to local workers, utilities and other military services.)

During the 1980's and early 1990's, a large part of funds transiting via the offshore jurisdictions were concentrated only in a few offshore (Switzerland, Cayman Islands, the

¹ One approach used in the measurement of traditional commercial banking output that may be of interest is the value-added approach, which explicitly uses all operating costs, such as labor and capital to model inputs (see Berger and Humphrey (1990). This method was partially applied to make a crude assessment of the contribution of the OFCs to the respective economies, with the value-added or income defined as:

$$\text{Value added} = \text{gross output} - \text{intermediate consumption} = \text{operating surplus} + \text{employee compensation} + \text{depreciation}$$

British Virgin Islands, Hong Kong, etc). However, since a couple of years a couple of countries offer certain fiscal advantages and therefore the competition between the various jurisdictions has increased. The offshore centers have to offer more flexible laws and regulation to attract more investors. The investors are interested in the quality of the services provided and the level of technology in the country.

There is no doubt that since the creation of the MOBAA (now the FSC) that the offshore sector has known a considerable growth. In fact, before 1992, the offshore companies did not have the appropriate framework to succeed, the promotion of the jurisdiction was done via offshore banks and in turn this led to a loss of credibility. The authorities also found it difficult to identify the potential target markets and the variety of goods and services that were available on the markets to the investors was limited (between 1990 and 1992 only 6 offshore companies were created). It was for this reason that in June 1992 the Mauritius Offshore Business Activities Authority was established (MOBAA). The legal framework has been reviewed and has become more flexible, allowing the development of new products. Since, the offshore sector of the island has grown dramatically.

All the different factors elaborated in the previous chapters, particularly the strategic position of the island, the bilingual languages spoken and the economic development of the island are essential factors to the success of the offshore sector. The major problem faced by Mauritius is the fact that is far from the most important players in the offshore world. Therefore, to fill in the gap, the appropriate technology should be in place to be able to allow Mauritius to be closer to international markets.

However, the legal aspects should not be ignored. In view of all the recent measures taken by Mauritius to abide by international standards on fiscal practices, it can be said that the country has more credibility. In fact, the reputation of an offshore centre is one of the most important features in the choice of a jurisdiction. If the island can maintain a good reputation and a good base of professional services in the legal and financial fields, there is no reason why the Republic of Mauritius would not be one of the well-known offshore jurisdictions in the world.

There has been a growth in the total offshore entities registered in Mauritius. As at December 2001, there were 18,769 registered entities, including 6,369 Global Business Category I, 11,730 Global Business Category II and 670 trusts. Comparing to the figures in 1996, where the total number of registered offshore companies was 4500, it can be seen that in less than 5 years, the number has increased more than 350%!

India has always been a very popular destination by the investors who route their investment via Mauritius. However, there has been a slight decrease in this investment level, and this shows that the authorities do not want to place "all their eggs in one basket", that is they are willing to diversify and not be too dependant on one country only. In fact, if the double taxation agreement between India and Mauritius were to have certain changes, this could have a negative impact on the Mauritian jurisdiction. This is the main reason why Mauritius has to ratify new treaties on a constant basis, to attract new investors and diversify the destination of investment.

Comparing Mauritius to the British Virgin Islands and the Seychelles, it can be said that the legal framework in all 3 jurisdictions is quite similar, but Mauritius is more specialized in offshore companies (which can benefit from the double taxation treaties). On the other hand, the other 2 have more International Business Companies, which are used for specific investment purposes.

In comparison with the Seychelles, it can be said that the Republic of Mauritius has a better reputation and because of the negative consequences of the Economic Development Act of Seychelles, this has led to a slower economic growth in the offshore sector. It should be said that Mauritius has a long way ahead to achieve the same reputation as that of the of the British Virgin Islands, as the latter is constantly innovating, creating new products, new technology in order to find news ways to attract investment.

Regional economic integration is part of the economic policy to achieve sustainable economic growth by aligning Mauritius to the increasingly competitive and integrated world economy. Regional cooperation is all the more important, given its geographical

isolation from major markets. By integrating itself to regional blocs such as COMESA, SADC and IOR-ARC, necessary economies of scale to attract foreign direct investment can be achieved by Mauritius.

The increased competition resulting from more entrants into this activity implies greater product differentiation or price reductions (lower fees or enhanced services). However, one of the major competitive factors (increased secrecy) is no longer a viable option. All in all, in light of the higher costs associated with an offshore sector and thus, the net gains limited, country authorities will need to evaluate carefully a decision to establish, or to expand any existing, offshore sector.

In conclusion, it could be said that the offshore sector of Mauritius has a promising future, and this can be proven by the fact that although its small size, the country is one of the most important in the region. Moreover, Mauritius is the biggest investor in India (in 1999 investment in India via Mauritius exceeded \$4.6 milliards). However according to me, before becoming an important player in the offshore industry, Mauritius has a long way to go, because for instance the island does not have a large base of professionals to attract investors. But with the development of the economy, there are many more qualified people having tertiary education who can help the country attain a certain level.

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ANNEX I¹

GENERAL FRAMEWORK OF THE RECOMMENDATIONS

Recommendation 1

Each country should take immediate steps to ratify and to implement fully, the 1988 United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention)

Recommendation 2

Financial institution secrecy laws should be conceived so as not to inhibit implementation of these recommendations.

Recommendation 3

An effective money laundering enforcement program should include increased multilateral co-operation and mutual legal assistance in money laundering investigations and prosecutions and extradition in money laundering cases, where possible.

ROLE OF NATIONAL LEGAL SYSTEMS IN COMBATING MONEY LAUNDERING

Scope of the Criminal Offence of Money Laundering

Recommendation 4

Each country should take such measures as may be necessary, including legislative ones, to enable it to criminalise money laundering as set forth in the Vienna Convention. Each country should extend the offence of drug money laundering to one based on serious offences. Each country would determine which serious crimes would be designated as money laundering predicate offences.

Recommendation 5

As provided in the Vienna Convention, the offence of money laundering should apply at least to knowing money laundering activity, including the concept that knowledge may be inferred from objective factual circumstances.

Recommendation 6

Where possible, corporations themselves - not only their employees - should be subject to criminal liability.

Provisional Measures and Confiscation

Recommendation 7

Countries should adopt measures similar to those set forth in the Vienna Convention, as may be necessary, including legislative ones, to enable their competent authorities to confiscate property

¹ Financial Action Task Force on Money Laundering, "The forty recommendations" at www.oecd.org/fatf

laundered, proceeds from, instrumentalities used in or intended for use in the commission of any money laundering offence, or property of corresponding value, without prejudicing the rights of bona fide third parties.

Such measures should include the authority to : 1) identify, trace and evaluate property which is subject to confiscation; 2) carry out provisional measures, such as freezing and seizing, to prevent any dealing, transfer or disposal of such property; and 3) take any appropriate investigative measures.

In addition to confiscation and criminal sanctions, countries also should consider monetary and civil penalties, and/or proceedings including civil proceedings, to void contracts entered into by parties, where parties knew or should have known that as a result of the contract, the State would be prejudiced in its ability to recover financial claims, e.g. through confiscation or collection of fines and penalties.

ROLE OF THE FINANCIAL SYSTEM IN COMBATING MONEY LAUNDERING

Recommendation 8

Recommendations 10 to 29 should apply not only to banks, but also to non-bank financial institutions. Even for those non-bank financial institutions which are not subject to a formal prudential supervisory regime in all countries, for example bureaux de change, governments should ensure that these institutions are subject to the same anti-money laundering laws or regulations as all other financial institutions and that these laws or regulations are implemented effectively.

Recommendation 9

The appropriate national authorities should consider applying Recommendations 10 to 21 and 23 to the conduct of financial activities as a commercial undertaking by businesses or professions which are not financial institutions, where such conduct is allowed or not prohibited. Financial activities include, but are not limited to, those listed in the attached annex. It is left to each country to decide whether special situations should be defined where the application of anti-money laundering measures is not necessary, for example, when a financial activity is carried out on an occasional or limited basis.

Customer Identification and Record-keeping Rules

Recommendation 10

Financial institutions should not keep anonymous accounts or accounts in obviously fictitious names: they should be required (by law, by regulations, by agreements between supervisory authorities and financial institutions or by self-regulatory agreements among financial institutions) to identify, on the basis of an official or other reliable identifying document, and record the identity of their clients, either occasional or usual, when establishing business relations or conducting transactions (in particular opening of accounts or passbooks, entering into fiduciary transactions, renting of safe deposit boxes, performing large cash transactions).

In order to fulfill identification requirements concerning legal entities, financial institutions should, when necessary, take measures:

- i. to verify the legal existence and structure of the customer by obtaining either from a public register or from the customer or both, proof of incorporation, including information

- concerning the customer's name, legal form, address, directors and provisions regulating the power to bind the entity.
- ii. to verify that any person purporting to act on behalf of the customer is so authorised and identify that person.

Recommendation 11

Financial institutions should take reasonable measures to obtain information about the true identity of the persons on whose behalf an account is opened or a transaction conducted if there are any doubts as to whether these clients or customers are acting on their own behalf, for example, in the case of domiciliary companies (i.e. institutions, corporations, foundations, trusts, etc. that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located).

Recommendation 12

Financial institutions should maintain, for at least five years, all necessary records on transactions, both domestic or international, to enable them to comply swiftly with information requests from the competent authorities. Such records must be sufficient to permit reconstruction of individual transactions (including the amounts and types of currency involved if any) so as to provide, if necessary, evidence for prosecution of criminal behaviour.

Financial institutions should keep records on customer identification (e.g. copies or records of official identification documents like passports, identity cards, driving licenses or similar documents), account files and business correspondence for at least five years after the account is closed.

These documents should be available to domestic competent authorities in the context of relevant criminal prosecutions and investigations.

Recommendation 13

Countries should pay special attention to money laundering threats inherent in new or developing technologies that might favour anonymity, and take measures, if needed, to prevent their use in money laundering schemes.

Increased Dillgence of Financial institutions

Recommendation 14

Financial institutions should pay special attention to all complex, unusual large transactions, and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. The background and purpose of such transactions should, as far as possible, be examined, the findings established in writing, and be available to help supervisors, auditors and law enforcement agencies.

Recommendation 15

If financial institutions suspect that funds stem from a criminal activity, they should be required to report promptly their suspicions to the competent authorities.

Recommendation 16

Financial institutions, their directors, officers and employees should be protected by legal provisions from criminal or civil liability for breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision, if they report

their suspicions in good faith to the competent authorities, even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred.

Recommendation 17

Financial institutions, their directors, officers and employees, should not, or, where appropriate, should not be allowed to, warn their customers when information relating to them is being reported to the competent authorities.

Recommendation 18

Financial institutions reporting their suspicions should comply with instructions from the competent authorities.

Recommendation 19

Financial institutions should develop programs against money laundering. These programs should include, as a minimum :

- i. the development of internal policies, procedures and controls, including the designation of compliance officers at management level, and adequate screening procedures to ensure high standards when hiring employees;
- ii. an ongoing employee training programme;
- iii. an audit function to test the system.

Measures to Cope with the Problem of Countries with No or Insufficient Anti-Money Laundering Measures

Recommendation 20

Financial institutions should ensure that the principles mentioned above are also applied to branches and majority owned subsidiaries located abroad, especially in countries which do not or insufficiently apply these Recommendations, to the extent that local applicable laws and regulations permit. When local applicable laws and regulations prohibit this implementation, competent authorities in the country of the mother institution should be informed by the financial institutions that they cannot apply these Recommendations.

Recommendation 21

Financial institutions should give special attention to business relations and transactions with persons, including companies and financial institutions, from countries which do not or insufficiently apply these Recommendations. Whenever these transactions have no apparent economic or visible lawful purpose, their background and purpose should, as far as possible, be examined, the findings established in writing, and be available to help supervisors, auditors and law enforcement agencies.

Other Measures to Avoid Money Laundering

Recommendation 22

Countries should consider implementing feasible measures to detect or monitor the physical cross-border transportation of cash and bearer negotiable instruments, subject to strict safeguards to ensure proper use of information and without impeding in any way the freedom of

capital

movements.

Recommendation 23

Countries should consider the feasibility and utility of a system where banks and other financial institutions and intermediaries would report all domestic and international currency transactions above a fixed amount, to a national central agency with a computerised data base, available to competent authorities for use in money laundering cases, subject to strict safeguards to ensure proper use of the information.

Recommendation 24

Countries should further encourage in general the development of modern and secure techniques of money management, including increased use of checks, payment cards, direct deposit of salary checks, and book entry recording of securities, as a means to encourage the replacement of cash transfers

Recommendation 25

Countries should take notice of the potential for abuse of shell corporations by money launderers and should consider whether additional measures are required to prevent unlawful use of such entities.

Implementation and Role of Regulatory and Other Administrative Authorities

Recommendation 26

The competent authorities supervising banks or other financial institutions or intermediaries, or other competent authorities, should ensure that the supervised institutions have adequate programs to guard against money laundering. These authorities should co-operate and lend expertise spontaneously or on request with other domestic judicial or law enforcement authorities in money laundering investigations and prosecutions.

Recommendation 27

Competent authorities should be designated to ensure an effective implementation of all these Recommendations, through administrative supervision and regulation, in other professions dealing with cash as defined by each country.

Recommendation 28

The competent authorities should establish guidelines which will assist financial institutions in detecting suspicious patterns of behaviour by their customers. It is understood that such guidelines must develop over time, and will never be exhaustive. It is further understood that such guidelines will primarily serve as an educational tool for financial institutions' personnel.

Recommendation 29

The competent authorities regulating or supervising financial institutions should take the necessary legal or regulatory measures to guard against control or acquisition of a significant participation in financial institutions by criminals or their confederates.

STRENGTHENING OF INTERNATIONAL CO-OPERATION

Administrative Co-operation

Exchange of general information

Recommendation 30

National administrations should consider recording, at least in the aggregate, international flows of cash in whatever currency, so that estimates can be made of cash flows and reflows from various sources abroad, when this is combined with central bank information. Such information should be made available to the International Monetary Fund and the Bank for International Settlements to facilitate international studies.

Recommendation 31

International competent authorities, perhaps Interpol and the World Customs Organisation, should be given responsibility for gathering and disseminating information to competent authorities about the latest developments in money laundering and money laundering techniques. Central banks and bank regulators could do the same on their network. National authorities in various spheres, in consultation with trade associations, could then disseminate this to financial institutions in individual countries.

Exchange of information relating to suspicious transactions

Recommendation 32

Each country should make efforts to improve a spontaneous or "upon request" international information exchange relating to suspicious transactions, persons and corporations involved in those transactions between competent authorities. Strict safeguards should be established to ensure that this exchange of information is consistent with national and international provisions on privacy and data protection.

Other Forms of Co-operation

Basis and means for co-operation in confiscation, mutual assistance and extradition

Recommendation 33

Countries should try to ensure, on a bilateral or multilateral basis, that different knowledge standards in national definitions - i.e. different standards concerning the intentional element of the infraction - do not affect the ability or willingness of countries to provide each other with mutual legal assistance.

Recommendation 34

International co-operation should be supported by a network of bilateral and multilateral agreements and arrangements based on generally shared legal concepts with the aim of providing practical measures to affect the widest possible range of mutual assistance.

Recommendation 35

Countries should be encouraged to ratify and implement relevant international conventions on money laundering such as the 1990 Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime.

Focus of improved mutual assistance on money laundering issues

Recommendation 36

Co-operative investigations among countries' appropriate competent authorities should be encouraged. One valid and effective investigative technique in this respect is controlled delivery related to assets known or suspected to be the proceeds of crime. Countries are encouraged to support this technique, where possible.

Recommendation 37

There should be procedures for mutual assistance in criminal matters regarding the use of compulsory measures including the production of records by financial institutions and other persons, the search of persons and premises, seizure and obtaining of evidence for use in money laundering investigations and prosecutions and in related actions in foreign jurisdictions.

Recommendation 38

There should be authority to take expeditious action in response to requests by foreign countries to identify, freeze, seize and confiscate proceeds or other property of corresponding value to such proceeds, based on money laundering or the crimes underlying the laundering activity. There should also be arrangements for coordinating seizure and confiscation proceedings which may include the sharing of confiscated assets.

Recommendation 39

To avoid conflicts of jurisdiction, consideration should be given to devising and applying mechanisms for determining the best venue for prosecution of defendants in the interests of justice in cases that are subject to prosecution in more than one country. Similarly, there should be arrangements for coordinating seizure and confiscation proceedings which may include the sharing of confiscated assets.

Recommendation 40

Countries should have procedures in place to extradite, where possible, individuals charged with a money laundering offence or related offences. With respect to its national legal system, each country should recognise money laundering as an extraditable offence. Subject to their legal frameworks, countries may consider simplifying extradition by allowing direct transmission of extradition requests between appropriate ministries, extraditing persons based only on warrants of arrests or judgements, extraditing their nationals, and/or introducing a simplified extradition of consenting persons who waive formal extradition proceedings