

Transfer Pricing in Mauritius and the Case for a Proper Legal Framework

Beebeejaun A*

Department of Law, University of Mauritius, Reduit, Mauritius

Abstract

This paper aims to analyze the general anti-avoidance legislative provisions of the Mauritius Income Tax Act. In doing so, the importance of certainty in law regarding tax matters will be highlighted, and the need for an appropriate legal framework to combat transfer pricing abuses in Mauritius will be discussed. In the absence of data on transfer pricing in Mauritius, direct and indirect interactions with key stakeholders have been carried out in order to find out the current situation of transfer pricing in the country.

Keywords: Legal provision; Regulation; Demarcation

Introduction

At present, there is no rule, regulation or legal provision that exists to prohibit or restrict transfer pricing practices in Mauritius and thus, there is no clear line of demarcation of the extent to which taxpayers are able to exercise their right to avoid tax through transfer pricing. In addition, the few Mauritian court cases on the issue of tax avoidance have expressed the difficulty involved in distinguishing between permissible and impermissible tax avoidance in Mauritius. Permissible and impermissible tax avoidance in Mauritius.

Tax avoidance is viewed by some as effective in securing the tax benefits sought while it is also a continuum that stretches from permissible tax avoidance to impermissible tax avoidance. The main difference between permissible and impermissible tax avoidance is that the former is legal while the latter is illegal, although both are considered to be immoral practices.

The legality of tax avoidance in Mauritius

To deal with issues caused by impermissible tax avoidance, the legislator has included some anti-avoidance provisions in Part VII of the Income Tax of Mauritius, Act No. 16 of 1995, more precisely from Sections 84 to 90. The main purpose behind the anti-avoidance provision is to reject tax avoidance arrangements that are found to be abusive and therefore allowing some other forms of permissible tax avoidance. A taxpayer who gets caught under Part VII of the Mauritius Income Tax Act is subjected to corrective measures only in the form of payment of the amount of tax that would have been due in the absence of the avoidance arrangement but the consequences set out in the same section do not result in any disincentive to the taxpayer that would ensure the prevention of the occurrence of such type of anti-avoidance practices in the future.

It is important to highlight that Mauritius law does not explicitly refer to the terms permissible or impermissible tax avoidance. The distinction has been made by legislator to categorize certain acts that may or may not fall within the ambit of the law. Impermissible tax avoidance refers to practices that are the target of anti-avoidance rules and must be struck down in the courts if successfully challenged and therefore does not result in the avoidance of tax. On the other hand, permissible tax avoidance can be defined as the act of taking legally permissible steps to limit one's tax liability. In the absence of Mauritius case laws on the subject, reference has been made to case law precedents in UK since Mauritius Income Tax Act has been largely inspired from UK laws, and it is a matter of practice for Mauritius courts to refer to UK case laws in the circumstance. For instance, the case of *Craven*

(*Inspector of Taxes*) v. *White* [1], the court decided that if the law states that a company in the Isle of Man is immune from taxation and a taxpayer transfers his assets to an Isle of Man company, the taxpayer will enjoy the tax immunity because Parliament intends that the immunity be enjoyed, unless a provision to the contrary is present.

Kujinga argues that the ability to engage in permissible tax avoidance is backed by the right of the taxpayer to avoid tax, which is further given judicial recognition by courts in a number of countries. In this regard, Lord Tomlin stated in the case of *IRC v. Duke of Westminster* [2] that a taxpayer is entitled to order his affairs in such a manner that the tax attaching under the relevant Acts is less than it would otherwise be, and if the result is secured, then any of the Commissioners of Inland Revenue or the other tax payers cannot force for an increased tax to be paid by the taxpayer in question. Contrary to this concept, according to the *Ralph Report*, impermissible tax avoidance exists where there is a misuse or abuse of the law that is often driven by the exploitation of structural loopholes in the law to achieve tax outcomes that were not intended by parliament but also includes the manipulation of the law and a focus on the form and legal effect rather than substance [3]. Similarly, the case of *Matrix Securities Ltd v. Inland Revenue Commissioners* [4] highlights that every tax avoidance scheme involves a trick and pretense, but if the scheme is carried out with a view to reduce or postpone a tax liability without any business purpose apart from the avoidance of tax on the taxable transaction, then the scheme is described as artificial. Following this reasoning, Lord Templeman described impermissible tax avoidance in the case of *Craven (Inspector of Taxes) v. White* as an artificial tax avoidance scheme. Consequently, there is common consensus that the elements of impermissible tax avoidance involve a lack of business purpose, the existence of artificial schemes that abuse the tax laws to obtain tax benefits accompanied by the absence of economic or commercial substance and that there is no prospect of a substantial pre-tax profit. The latter implies that where there is no significant tax benefit, the transaction will not be concluded because it would result in a loss. This is illustrated by the case of *Moodie v Inland Revenue Commissioners*

*Corresponding author: Beebeejaun A, Department of Law, University of Mauritius, Reduit, Mauritius, Tel: +230 403 7400; E-mail: a.beebeejaun@uom.ac.mu

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and another and related appeal whereby the taxpayer had incurred only the expense associated with the implementation of an avoidance scheme [5]. Lord Templeman struck down the scheme by advancing that there was no commercial justification behind the scheme in that it was not implemented to achieve any business objective, and also there was no expectation of profit from the scheme itself.

Some other features of impermissible tax avoidance practices are the presence of tax-indifferent or accommodating parties. The presence of multiple parties such as foreign persons, foundations, trusts and pension funds in transactions that should ideally involve fewer parties may raise suspicion. Similarly, transactions that have complex and multiple steps are widely seen as indicative of impermissible tax avoidance, which on closer analysis, may be shown unnecessary in normal business and are probably necessitated by the need to fulfil certain formalities to obtain tax benefits. Other methods of impermissible tax avoidance involve the manipulation of discrepancies and discontinuities in the tax system and tax arbitrage in order to exploit inconsistencies and discontinuities to obtain tax advantage.

From the above and viewed from a Mauritian law perspective, it is clear that the legality attached to the broad concept of tax avoidance is questionable due to the absence of clear demarcation lines between permissible and impermissible practices in the tax legislations. An attempt to differentiate the two is to assess the allowable deductible provisions against the anti-avoidance provisions of the Income Tax Act. Part III Sub-Part B and Part IV Sub-Part B of the Income Tax Act 1995 provide for instances of permissible tax avoidance through deductions from income obtained from employment and from trade respectively that are allowed by the legislation. In order to avoid the system of tax to frustrate trade and employment, the legislator has tried to adopt a lenient approach to allow for the deduction of some expenses from income that are directly linked with the same trade or employment [6]. For deductions in connection with employment income, the revenue authorities are however strict in interpreting Section 17(1) of the Income Tax Act by requiring the expenditure to be wholly, exclusively and necessarily incurred by the taxpayer in performing the duties of an office or employment. Similarly, for deductible expenses incurred in the course of business or trade, it is imperative to prove that the expenditure is incurred exclusively in the production of gross income. These forms of tax avoidance are legal since there is no violation of law, however, engaging in some other practices of tax avoidance that are set out in Part VII of the Income Tax Act is impermissible because it not only contradicts the provisions of the Income Tax Act but also results in revenue losses to the revenue authorities thereby growing disrespect for the tax system and the law.

The general anti-avoidance rules for impermissible tax avoidance in Mauritius

As mentioned in the last section, some expenditures incurred exclusively in the production of income are tax deductible, however, Section 84 of the Income Tax Act relates to the anti-avoidance provision of business income that prohibits the deduction of interest paid by the company on debentures issued to the company's shareholders, and rather reclassifies the payment as a dividend to the shareholders, in which case, the payment is not tax deductible. Similarly, the anti-avoidance provisions also apply for the personal income of an individual. For instance, section 86A of the Income Tax Act provides that where the benefit made by a company to any shareholder or a relative of the latter exceed the payment, the benefit shall be deemed to form part of the taxable income of the shareholder or the relative of the latter.

Sections 85, 86 and 87 of the Income Tax Act set out anti-avoidance provisions with regards to excessive payment or remuneration made to directors, employees or any other person, and empowers the director general of the Mauritius Revenue Authority to assess whether the remuneration, salary, share of profits, management expenses or other income payable is beyond the amount that is deemed to be reasonable. It is imperative to note that the legislation is silent on the definition of 'reasonable' and no guidance or Mauritian case law has been issued on this matter yet. The determination of the excess payment is left entirely on the discretion of the director general and the amount of excess is not deemed to be an allowable deduction but instead is treated as income or benefit derived by the recipient of the payment. Another anti-avoidance provision lies in section 88 of the said Act which empowers the director general to determine the amount of an adequate rent where a property that is jointly owned, or in undivided ownership or by a *société* that is being leased to a relative of any of those persons or any associate of the *société* and the lease makes no provision for the payment of rent or the rent is not an appropriate figure for the property under the lease.

The last section 90 of Part VII of the Income Tax Act lays down the basic requirements that must be satisfied before an avoidance arrangement other than the ones elaborated above, can be said to an impermissible tax avoidance scheme such as the presence of a tax benefit from the structuring, the manner in which the transaction was entered, the form and substance of the transaction, the change in financial position, the presence of rights or obligations that are beyond arm's length principle between independent parties in similar transactions. Once the criteria are established, the director general is entitled to assess the tax liability of the relevant person in the manner in which the director general considers appropriate to counteract the tax benefit obtained. However, several contentions have been recorded against the manner in which the director general determines the tax liability attributable to the relevant tax avoidance arrangement. The case of *BH Industries (Mauritius) Ltd v. The Assessment Review Committee (ARC)* concerns an appeal regarding the decision of the ARC that has maintained the decision of the director general of the MRA regarding a revision of the chargeable income of BH Industries [7].

To better dive in the subject, it is vital to illustrate the facts surrounding the case and the grounds on which the director general has categorized the transaction as one intending to avoid tax. Following the assessment of the books and accounts of BH Industries, the director general was of the opinion that the transactions effected between BH Industries and BH Exports Ltd being a Freeport company having the same shareholders and directors as BH Industries, for the purpose of exporting the products overseas, have no commercial purpose other than the avoidance of a tax liability. Therefore, BH Industries was required to account the export in its own books and transactions effected by BH Exports were disregarded in accordance with Section 90 of the Income Tax Act. The director general then ordered for a revised assessment of income tax payable. The ARC also agreed with the decision of the director general and concluded that the setting up of BH Exports Ltd, the sale of all the garments manufactured by BH Industries to the former and the expenditures incurred by BH Industries to BH Exports in the form of management fees was designed to solely or predominantly obtain a tax benefit for the appellant. Counsel for the appellant tried to refute the allegations by referring to the concept of transfer pricing between related parties and that the MRA should have determined the arm's length prices of the transactions between BH Industries and BH Exports instead of determining the absence of commercial purpose between the two companies. The case is the only one in existence in Mauritius that refers to the terms "transfer pricing"

as put forward by neither counsel for the appellant, yet neither the Supreme Court in its judgment nor counsel for the respondent in his defense have elaborated on transfer pricing. However, emphasis was made on the link between the facts of the case and the power of the director general to determine if a transaction is carried out to solely to obtain tax benefit. In this regard, Section 90 of the Income Tax Act was referred to in order to justify the director general of the MRA's findings, mainly:

- (1) BH Industries was initially exempt from tax but when the law was changed, it became liable to tax and consequently, BH Exports being a related party of BH Industries in the sense that they have the same shareholders and directors, was set up in the freeport to be exempt from tax.
- (2) BH Exports was making substantial profits whereas BH Industries was consecutively declaring losses over several years. In addition, BH Exports had no full time employee and was paying BH Industries a management fee for expenses incurred by the latter.
- (3) The issue of capital to BH Exports has not been paid by the shareholders.
- (4) All the importation, storing, factory overheads, packaging, marketing and transportation were solely done by BH Industries while BH Exports was in charge of selling the appellant's products. Nevertheless, the sales representative responsible for all the marketing was still employed by BH Industries.
- (5) Goods produced by BH Industries were sold to BH Exports who in turn exported them via the Freeport.

Based on the above, the Supreme Court of Mauritius upheld the decision of the director general of the MRA and the ARC, and held that the particular transaction between related parties involve the establishment of an artificial device in the form of BH Exports that has been designed for the appellant to obtain a tax benefit. As seen, in the absence of specific rules on transfer pricing practices, the general rules of Section 90 of the Income Tax Act are referred to and the director general then uses his powers to determine whether the anti-avoidance transaction is abusive or not.

The Relationship between FDI, MNEs and Transfer Pricing

As part of globalization, MNEs have significantly expanded their international operations mainly through foreign direct investment (FDI) [8]. Easson [9] explains that FDI can take any of the following three forms:

- The establishment of a new enterprise in an overseas country, either as a branch or as a subsidiary;
- The expansion of an existing overseas branch or subsidiary; and
- The acquisition of a foreign business enterprise or its assets.

Over several decades, economists have tried to provide a conceptual framework to explain the reasons behind the existence of MNEs and as to what leads to their foreign investment decisions. Researches have been focused on looking for reasonable explanations behind the successful operations of MNEs in countries that are foreign to them and how the MNEs are succeeding to hold a grip on the local market of an unfamiliar territory. Hymer [10] and Buckley [11] argue that

it is market imperfections that enable MNEs to obtain monopolistic advantages. In other words, to compete successfully with local firms in the host environment, MNEs exploit certain specific advantages not possessed by their local competitors, and such market imperfections offer MNEs compensating advantages that exceed the disadvantages of being in a foreign country. Dunning [12] has further developed the theory of market imperfections and emphasizes on the essential features of the advantages that MNEs possess, mainly the ownership, location and internalization benefits.

Dunning's [12] theoretical framework sets out the determinants as to why foreign investors invest abroad, one amongst which is the "Eclectic Paradigm" [13]. This particular theory categorises investment determinants into three main types, being Ownership (O), Location (L), Internalization (I), and together, the OLI framework. Foreign investors usually look for the effective Ownership advantage prior to investing their capital. For instance, ownership of rights, assets, intellectual property or other intangible assets encourage a foreign enterprise to implant itself in the host country because of the advantage to be treated as a domestic firm and hence, to have access to and exploit resources that are available to the foreigner in its capacity as owner of the respective assets. The Location advantage, on the other hand, refers to particularities in the host country's natural endowments, cultural factors, strategic advantages through intangible assets or other types of benefits that make the chosen country an attractive site. The Internalization advantage emanates from exploiting imperfections in external markets, including taking benefit of low transaction costs or benefit from reduction of state-generated imperfections such as tariffs, quotas, other barriers to trade as well as subsidies [14]. Further to the OLI theory, driving forces of FDI can also be identified through policy and non-policy factors [15]. Policy factors, as the name suggests, refers to governmental intervention to implement measures favorable to attract FDI including, inter alia, low corporate tax rates, reduction in trade barriers, improved infrastructure in terms of road and communication networks. Non-policy factors refer to determinants which are outside human control, for instance, the market size of the host country, resources endowments, political and economic stability, climatic conditions amongst others. On the same line of reasoning, Fernandez-Arias [16] and Montiel [17] have presented a two-fold categorization for FDI driving forces, being the push and the pull factors. Pull factors are the characteristics of the FDI host country that helps to induce foreign investments in terms of a stable political and economic stability, favorable climatic conditions and proper legislative measures whereas push factors relate to repellant characteristics that reduce the attractiveness of the host country as a recipient of FDI.

Various studies have been undertaken by several scholars to confirm the direct link between the aforesaid driving forces or determinants, and FDI. For instance, a research study carried out by Musila and Sigue concluded that FDI in Africa is highly reliant on the level of infrastructure prevailing in the host country [18]. A further study by Reiter et al. [19] found the positive relationship between FDI flows and good quality labor, while factors such as poor governance, foreign ownership restrictions and strict repatriation of profits policies are all found to be deterrents of FDI [20]. In an attempt to clarifying the rules underlying foreign investment, countries have begun to conclude bilateral investment treaties with the primary motives to provide security to foreign investors and to put in place favorable terms of trade so as to make the host country more attractive to FDI. It can therefore be concluded that FDI occurs as a response to both natural and unnatural market imperfections. In short, FDI is determined by the need to internalize a firm-specific advantage to overcome market

imperfections which as a response, has greatly increased the number of MNEs situated in foreign countries.

Li argues that a substantial part of international trade comprises of high volumes of intercompany sales or commercial transactions between parent companies and their foreign affiliates such as transfers of goods, services, intangible property or the use thereof, intercompany financing and licensing. In addition to that, there are numerous forms of internal charges associated to related party transactions such as management fees, royalties, service charges, franchise, rents, licensing fees and interest [21]. Such substantial amount of intercompany transactions has huge tax implications for both the MNEs and the revenue authorities of the countries in which they operate since manipulations in transfer prices for internal transactions could have the potential for saving large amount of tax payments for the MNEs on one hand but on the other hand, this could deny tax revenues to the government concerned. Consequently, countries hosting MNEs have to be on their safeguards to counter actual or suspected transfer pricing maneuvers.

Mauritius and Transfer Pricing

Ever since the opening of the economy of Mauritius to the rest of the world since 1968 after the independence of the country, the island has stopped being a monocarp economy and has diversified into various range of activities ranging from tourism, textile to the financial services sector. The improved network and logistic facilities as well as the proper legal and regulatory framework have further encouraged foreign investors to transact with Mauritius or set up their businesses or a branch thereof in the country.

Further to the ease of doing business in Mauritius, it has been witnessed that multinationals engaged in various spheres of activities are setting up their offices in Mauritius ranging from fast food chains, accounting firms, legal and solicitor firms, tourist operators, enterprises specialized in business process outsourcing. The activities of such locally based MNEs comprise of high volume of intercompany sales or commercial transactions between parent companies and their affiliates, or between subsidiaries. It is to be noted that the majority of the multinationals have the goal of profit maximization that would result in cash flows to stakeholders directly involved in the operation of such enterprises. Consequently, revenue authorities in other countries have intensified their monitoring and enquiry of multinational transfer pricing in related party transactions in order to counter abusive price fixing behaviors that may lead to a loss in tax revenues of government. In this respect, Dunning and Rugman [8] admits that a major challenge facing MNEs today lies in the effective management of international transfer prices. To investigate on the said challenge in the Mauritius context, some locally domiciled MNEs have been contacted for the purpose of understanding how companies make international transfer pricing decisions and the conditions that influence such decisions.

In addition to the above, for the purpose of analyzing the issues of transfer pricing from the perspective of the tax and regulatory authorities in Mauritius, some officials from different institutions such as the Mauritius Revenue Authority, Ministry of Foreign Affairs, Regional Integration and International Trade and the Ministry of Finance and Economic Development have been approached by personal contact and interviews have been conducted in this respect.

Interview results of transfer pricing monitoring in Mauritius

While no formal rules and regulations on transfer pricing exist in Mauritius, it becomes vital to analyse the extent to which the government

and the relevant regulatory bodies monitor transfer pricing abuses in the wake of the mushrooming of MNEs in the island. To this end, the findings will be presented according to the order in which the interview questions were asked. The purpose of obtaining this qualitative evidence is to have an in-depth and on-site investigation of transfer pricing practices in Mauritius and to enquire on the effectiveness of the authorities' approaches to combat the challenges faced in terms of tax avoidance through transfer pricing abuses.

What is the extent of transfer pricing abuse in Mauritius at present? In the interviews reported in this paper, all of the government officers and those employed by the Mauritius Revenue Authority have expressed deep concerns over the fact that MNEs based in Mauritius are not actually paying their fair share of taxes in the country. The tax officials argue that the main indicator of transfer pricing abuse has been the persistent losses reported by multinationals while contradictorily, their operations are expanding. One particular interviewee's comments included the following:

"Multinationals based in Mauritius rely heavily on imported inputs including plant and machinery, raw materials, intermediate products and some of them engineer losses by importing from their overseas affiliates at a high price and exporting the end products to their associates abroad at low prices. Tax avoidance through transfer pricing is becoming all more pressing especially due to the opening up of the Mauritius economy which attracts MNEs. The issue is becoming more pressing in the services industry for instance, Action Aid exposed how Illovo used an artificial structure in Mauritius to shift millions of dollars through transfer pricing to its Mauritius Company that has no permanent employees. Others are also following suit but the cases are left either unexamined or unreported."

Another concern expressed by an officer of the local government is the reluctance of the regulatory and tax bodies to adopt strict transfer pricing scrutiny. This is mainly because the government is undertaking various endeavors to provide an attractive investment climate and environment for foreign investors and having strict transfer pricing audits will be likely to create the fear of inducing a capital flight. From the government's perspective, it has been seen that the losses of corporate income taxes collected from MNEs can be compensated by a significant increase in FDI. The reasoning behind is that foreign investment will lead to increases in other forms of revenues such as VAT and other forms of taxes such as land transfer tax, stamp duties, custom duties, other types of income such as governmental and regulatory fees, licensing and renewal fees amongst others. FDI also caters for the social welfare of the local economy since it brings job creation and hence, taxes on employment income make up for the losses on corporate income taxes further to transfer pricing practices.

Nevertheless, although the MRA has not paid much attention to transfer pricing issues in the past, it has now begun to challenge MNEs on the issue of fixing of prices. In this respect, one particular tax official's verbatim comments included the following:

"Although the enactment of the arm's length provision was made in 1995 which is applicable for trade between related parties, the revenue authority was not giving much consideration to the determination of prices involved in dealings by MNEs since there was the fear that the imposition of tight control monitoring may impede foreign investment in the country. The central objective has been to attract foreign investments rather than to collect tax revenues from MNEs. However, the alleged reputation of Mauritius as being a tax haven has raised concerns over issues of tax avoidance. At present, there is a committee at the level

of the MRA comprised of eight tax officers who are equipped with the responsibility of auditing intra group transactions of each Mauritius domiciled multinationals, and to consider the determination of arm's length prices in dealings that appear to be suspicious. In other words, the committee has been established as a watchdog for Section 75 of the Income Tax Act."

Apart from prices of goods and services in intra-group dealings, some interviewees have expressed concerns over the growing trend of tax avoidance through thin capitalization of Mauritius subsidiaries of MNEs. One official noted that:

"It has been witnessed that foreign investors in the global business sector do not inject sufficient capital in their subsidiaries established in Mauritius, as a result of which the latter have to borrow from the parent company for their operations. This can be used as a technique to avoid paying taxes in Mauritius by paying huge sums of interest money further to the loan amount especially in the absence of thin capitalization rules in the country."

The interviewees' responses conclude that the costs of transfer pricing abuses are tax losses, monopolized markets, negative impact on balance of foreign exchange, thereby causing unfair advantage of MNEs over domestic competitors. Hence, this calls for a proper legal framework to regulate transfer pricing issues in Mauritius.

Circumstances under which the MRA initiate audits: A particular query from the interview questions is based on the main indicators that are areas of concern regarding transfer pricing abuses. While there is no specific set of rules to identify high risk MNEs, the tax officials state that MRA refers to the following circumstances as triggering factors that requires check for compliance with arm's length principle under the Section 75 of the Mauritius Income Tax Act for related party transactions:

1. Production and executive functions are controlled by affiliated enterprises
2. Huge amount of internal fees transferred between associated enterprises
3. Prolonged periods of losses (usually for more than 2 consecutive years)
4. Large volume of transactions with associated enterprises established in tax havens
5. Unreasonable expenses paid to affiliated enterprises
6. Fluctuating profit patterns with frequent interchanging of profits and losses without reasonable justifications
7. Payment of high rate of interests further to borrowing from the parent company
8. Lower profit margin than enterprises in the same industry
9. The main circumstance commonly considered as the most significant area of concern is those MNEs whose production and operational decisions are controlled by associated enterprises. In this respect, one tax official stated that:

"We are more likely to scrutinize those MNEs who receive raw materials from the overseas parent or the parent company controls the sales of finished products. In such a case, there is a greater risk that purchases are overpriced and sales are underpriced, that is why; the MRA is devoting increasing resources to audit such sorts of transactions."

Definition of related party transactions and transfer pricing methods:

Interviewees from governmental and tax authorities were asked about their understanding of the term "related party transactions". In the absence of formal legal definition, the MRA considers the term as a four-fold classification of transactions between related parties being the purchases and sales, transfers and use of tangible assets, the transfers and use of intangible assets, financing and provision of services. The interviewees were asked to express their concern regarding transfer pricing abuses in four types of related party transactions. Responses include situations where:

1. MNEs based in Mauritius provide services to associated enterprises free of charge or with reasonably low fees,
2. A multinational pays excessive fees for services provided by affiliated companies,
3. A multinational makes excessive payments to an overseas affiliate for importing materials, machinery or equipment,
4. A Mauritius based MNE underprices its sales or exports of finished products to overseas associates.

As a basis for an arm's length price, the MRA is likely to use fees for similar services used between independent parties. It is to be noted that the term "related party" is construed and interpreted in the same line as the term "related company" that is defined under Section 2(2) of the Mauritius Companies Act as follows:

Interpretation:

In this Act, a company is related to another company where:

- (a) The other company is its holding company or subsidiary;
- (b) More than half of the issued shares of the company, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital, is held by the other company and companies related to that other company (whether directly or indirectly, but other than in a fiduciary capacity);
- (c) More than half of the issued shares, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital, is held by members of the other company (whether directly or indirectly, but other than in a fiduciary capacity);
- (d) The businesses of the companies have been so carried on that the separate business of each company or a substantial part of it, is not readily identifiable; or
- (e) There is another company to which both companies are related.

Once a transaction between related parties that appears to be dubious has been identified, the MRA will proceed with an office desk auditing by reviewing the books and accounts of the Mauritius enterprise and all such other information as provided by the taxpayer. Specific attention is given to the profit margin, sales revenue, costs and expenditures, interest rates, the valuation of intangible property. An assessment is thereafter carried out to examine the extent to which such figures are reasonable. If such amounts appear to have been manipulated, the MRA then proceed with a field auditing by designating a tax team to visit the office premises of the company in question. An on-the-spot inspection is carried out which includes an examination of the vouchers, contracts, factory, number of machinery, materials and other documents. Interviews may also be carried out

with key officials of the company. It is to be noted that the office desk audit and the on field audit team comprise of eight tax officials who are selected on a random basis at the level of the MRA itself.

On the question regarding the actions plan taken by the MRA if the audit concludes that prices are not at arm's length, the tax official states that:

"If the tax auditors are sure that the related party transactions are not conducted in an arm's length manner, the MRA will adjust the taxable income using any one of the range of methods namely, comparable uncontrolled price method, the resale price method, the cost plus mark-up method, the comparable profit method, the profit split method or the transactional net margin method to align with the provisions of Section 75(2) of the Income Tax Act."

Further to interactions with some other officers of the MRA, it has been noticed that of the various methods, the cost-plus method is most often applied. As quoted by one tax official:

"In applying the cost-plus method, we usually use the cost of the product for both accounting and income tax purposes, and then apply an appropriate mark-up to arrive at an arm's length price."

The interviewees consider the cost-plus method to be most straightforward since it is simple to administer and is not complicated, and data is more readily available for this pricing method. The mark-up amount is derived from transactions between unrelated parties. However, in practice, an agreement is agreed upon between the MRA and the taxpayer under audit to negotiate a mutually acceptable pricing.

Up to now, the interviewees have confirmed that no disagreement has arisen as to the adjustments made to the taxable income by the MRA. However, neither the laws of Mauritius nor the internal procedures of the MRA have established the appropriate procedures in case the taxpayer does not agree with transfer pricing adjustments. In addition, no penalties have been imposed on those taxpayers that do not pay tax on the adjusted amount of taxable income or for failing to make a payment according to the due date set by the MRA on an amount resulting from a transfer pricing adjustment. Although no contention has been received from taxpayers on adjustment of taxable profit by the MRA yet, a preventive system needs to be catered for by way of legislating and regularizing the manner in which transfer pricing audits are carried out and setting out the appropriate procedures in case of opposition from the taxpayer. A punitive system of penalty needs to be also established for failure to pay, or late payment of taxes on the adjusted taxable income.

Advance pricing agreement (APA): The interviewees were given a brief explanation on APA and their opinions were sought as to whether an APA is an advantage or not. While it is known that APAs are not provided for in Mauritius laws and regulations, the interviewees are well acquainted with the concept of APA. The tax officials have confirmed that up to date, the MRA has not entered into an APA with any taxpayer. They acknowledge that an APA provides the following benefits:

1. Agreeing in advance on the arm's length pricing or pricing methodology brings certainty with respect to the tax liability for the taxpayer and tax income for the tax authority.
2. The threat for a transfer pricing or tax audit is minimized if all the parties concerned by the APA have properly followed the terms of the agreement.

3. An APA is likely to reduce the costs of administration and also frees scarce resources for the tax authority.

Overall, an APA is a win-win situation for all the stakeholders involved. However, the tax officials have also expressed concerns over the functioning of the APA mainly the fact that some MNEs may not be interested in participating in APA programs. The reasons explained by the interviewees are as follows:

1. Not all MNEs warrant an APA since sometimes, some multinationals may be too small in size to conclude an APA.
2. In countries like Mauritius where no formal APA procedures exist, such agreements once established are difficult to monitor and may not be as efficient as expected because of lack of expertise of personnel involved.
3. The drafting and finalizing of an APA is time consuming, and for the tax authority, an APA program may place strain on its limited resources as the process of initiating and negotiating an APA will divert resources earmarked for other purposes.
4. In the absence of formal rules concerning APA or proper guidelines issued by the MRA, there will be much ambiguity on mechanisms to apply for an APA and on the information that is required for this exercise.

Factors constraining international transfer pricing monitoring in Mauritius: Researches have concluded that developing countries are more vulnerable to transfer pricing manipulations due to lack of knowledge and know-how on the subject matter [22-24]. Apart from ignorance of the local population of transfer pricing matters, the interview results have set out some practical difficulties encountered by the tax authority in Mauritius that have a negative impact on revenue collection and that constrain transfer pricing monitoring.

One main area of concern raised by the tax officials is the absence of information exchange with foreign tax bodies and a lack of a proper transfer pricing computerized information system. One interviewee stated that:

"The reluctance of foreign fiscal bodies to provide information about transfer pricing and financial data about foreign companies poses problems for us to determine pricing and income adjustments in cases where goods or raw materials are transacted between associated enterprises."

It is the particular information gap that makes transfer pricing monitoring difficult and the tax officials are of the view that by having bilateral or multilateral agreements regulating the coordination and exchange of information about transfer pricing, the foreign tax authorities will be in a better position to collaborate with the Mauritius Revenue Authority. In addition, one interviewee has proposed that an alternative to solve the information exchange problem will be to develop an effective computerized information-sharing network for tax administration. However, one must consider the costs of development and maintenance of the network and the willingness of tax bodies to trust the system and to make use of. Other setbacks identified are the lack of well-trained personnel to conduct transfer pricing audits. It is only recently that the MRA has put in place tax audit teams comprised of eight staff to investigate on pricing of goods and services between related parties. However, the team has not received any briefing or training which deters the staff to undertake large scale audits or to adopt sophisticated techniques in tax audits.

During the interviews, the most often cited issue for transfer pricing monitoring is a lack of well-defined transfer pricing legislation and regulation. One tax official advances that:

“The absence of transfer pricing rules or guidelines makes it difficult for the MRA to deal with transfer pricing issues due to the lack of enforcement powers. In addition, there is no penalty on taxpayers who practice abusive transfer pricing and given the legality of the concept in Mauritius, the Mauritius government is losing enormously in terms of tax revenues and the reputation of the country as a tax haven is on the rise due to the lack of proper rules and framework.”

The interviewees are of the view that in order to enhance transfer pricing monitoring in Mauritius, it is vital that a formal tax legislation about transfer pricing be put in place and that the Income Tax Act be amended to set out clear procedures for dealing with transfer pricing manipulations. The tax officers advance that as the volume of MNEs doing business in Mauritius continues to grow, it is important for the MRA to intensify their investigations of related party transactions to prevent the loss of tax revenues. Some notable recommendations have been put forward by the interviews, some of which are set out below:

1. To establish an international exchange network for the transmission of routine information with foreign tax authorities including financial data from foreign affiliated companies.
2. The MRA may establish transfer pricing related software that will facilitate the collection of comparable information to help the MRA make income or profits adjustments.
3. Training needs to be given to tax officials on transfer pricing. This can be done by an exchange of delegations of tax authorities from developed countries to Mauritius during a specific training period.
4. It is imperative to provide for both a corrective and a preventive system of transfer pricing abuses. Laws need to be enacted in respect of transfer pricing and penalties need to be imposed on taxpayers that practice abusive transfer pricing methods.

Results from questionnaires sent out to MNEs in Mauritius

Coupled with the analysis of the interview results of officers from the MRA, this part will also present the results of the questionnaire survey regarding the determination of transfer prices and the factors that influence such decisions, generated from forty (40) respondents forming part of the executive bodies of some Mauritius domiciled MNEs engaged in various fields of activities field ranging from the services sector, tourism industry, fast food chains, transport industry and the textile sector. The questionnaire was sent out to forty respondents out of which a response rate of 50% is obtained. The questionnaire comprises of six closed-ended questions and of two open-ended questions.

The survey results conclude that none of the respondent firms has been the target of transfer pricing audit and the majority of the MNEs are involved in the food chain and services industry. It has been noted that in selecting the most appropriate transfer pricing method by multinational companies, compliance with tax laws and regulations was perceived by 80% of the respondent firms as the most important variable in transfer pricing decisions. Other factors considered “very important” included the competitive position of the company, the overall profit of the company to the multinational group and performance evaluation. Variables that are deemed to be of moderate importance by the respondents are the maintenance of cash flows, good relations with host government, price controls of host

government, existence of local partner, transfer pricing audits, political and social pressure. The majority (51%) of the respondents classified the restrictions on repatriation of income” factor as of no importance at all.

Previous studies such as Burns [25] and Chan and Chow [26] corroborate the results of the survey which shows that both legal and tax variables are important considerations to take into account when selecting pricing strategies. In this line, Al-Eryani et al. [27] finds that companies that are concerned with following the legal requirements use the market-based methods by taking either the full market price or the adjusted market price when determining the transfer prices. The variable “overall profit of the company to the multinational group” that is somehow associated to “performance evaluation” is also given high ratings by the respondent firms which is in line with the findings of Caves (1996), concluding that in designing transfer pricing systems, local managers are likely to seek to balance the interests of the overall profit to that of the group. The said author explains the reasoning behind this consideration is that an arbitrary shifting of profits from a foreign subsidiary in order to enhance the overall corporate profitability of the group, may affect the profitability of that subsidiary which in turn impact negatively on the performance of the subsidiary managers. Some managers of foreign subsidiaries have a stronger motive to establish good profit records since this is a measure of their performance appraisal. Therefore, as Li mentions, they would not want to fix prices that have the effect of reducing the profits of their own companies.

On the other hand, the respondents have no particular concern for the variable “restrictions on repatriation of income” since firstly the Mauritius government does not impose restrictions on foreign subsidiaries against the repatriation of their share of profits to their parent or affiliated firms abroad, secondly, there is no foreign exchange control in Mauritius, and finally, there is no withholding tax in Mauritius on remittances of dividends, interests and royalties. Therefore, this factor has no importance to MNEs based in Mauritius when determining transfer prices between related parties. Amongst the factors that are classified as being of moderate importance, the variable “competitive position of the subsidiary” is given fairly high ratings amongst the other variables in the same category ranking. The opening up of the Mauritius economy to the rest of the world in addition to various endeavors of the Mauritius government to help local businesses mushroom and expand, have engendered a competitive commercial environment in the country. Hence, the competitive position of the Mauritius-based MNE is regarded as a vital variable by the respondents as well as their group’s counterparts. Chan and Chow [26] argue that MNEs are often at a disadvantage when implementing their enterprises in other countries since they are unfamiliar with such countries’ local market conditions. To compete with local firms, MNEs therefore exploit certain specific advantages that are not enjoyed by their local competitors. In this way, MNEs use transfer pricing mechanism to enhance their subsidiaries’ competitive position in the local market to redress the balance. For example, to penetrate the local market, the foreign parent company may charge its Mauritius affiliated company below market prices that will in turn boost profitability of the subsidiary and hence, it will be able to offer its products at competitive prices.

Conclusion

International transfer pricing abuses may be tackled by sophisticated tax rules and regulations, however, literatures suggest that to deal with the issue, highly qualified and experienced tax experts

are needed [28]. It has been noted from the above that developing countries like Mauritius find it difficult to deal with the problem due to lack of laws, regulatory powers, administrative expertise and technical knowhow. Sometimes, international transfer pricing abuses are not even detected on the local front since the Mauritius government does not possess the necessary resources to control and monitor the fixing of prices between related parties effectively. The interactions with key stakeholders in Mauritius have demonstrated that there is a dire need for the country to adopt strict transfer pricing rules and a proper regulatory framework for transfer pricing monitoring due to the increasing number of MNEs being located in Mauritius. Failure to remedy the situation will undeniably amount not only to a loss in tax revenues of the Mauritius government but also, the reputation of Mauritius as a tax haven will continue to raise concerns over issues of tax avoidance in the international sphere.

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