



## Mauritius- A hub for investment in China

With key changes from Chinese tax reforms, Mauritius with its beneficial Double Taxation Avoidance Agreement (DTAA) with China has a favourable chance to become a hub for both inbound and outbound investment from China. The three main drivers of Mauritius becoming a centre of choice for investment in China are:

- 1) Unified enterprise income-tax law
- 2) Capital gains tax
- 3) Withholding Tax on Dividends

### 1) Unified Enterprise Income-Tax Law

Under new unified enterprise income tax law, a company that makes decisions of operations in China or effectively manages operations there could potentially be qualified as a tax resident even if the company is not incorporated in China. Such companies may end up paying 25% tax on world wide income. DTAA access, such as the Mauritius/China DTAA provides, may be important to help protect foreign companies that invest in China from such taxation.

Companies incorporated in jurisdictions such as BVI, which has no DTAA protection, may choose to migrate to a jurisdiction like Mauritius in order to obtain the protection that a DTAA can potentially provide. The investment vehicle to use would be a GBL1 Company incorporated in Mauritius which has access to DTAA.

We at DTOS Ltd. want our clients to invest with a maximum of safety. The new China tax law also adds a provision found in an increasing number of countries' tax laws. This is a general anti-avoidance rule (GAAR). We will work with our clients to document valid commercial reasons for investing into China through Mauritius to minimize the tax risk that this GAAR creates. We recommend that existing Mauritius companies now review their documentation regarding commercial support against the application of GAAR.

### 2) Capital Gains tax

Under the current China domestic law effective through the end of 2007, the PRC imposes a concessionary 10% withholding tax (WHT) on capital gains realized by a foreign investor on disposition of an equity interest in a Chinese entity. Should the concessionary WHT rate cease to be continued when the new unified enterprise income tax law becomes effective 1st January 2008, the WHT rate will be increased to 20%.

The Mauritius/China DTAA provides beneficial treatment to Mauritius companies. Under the present DTAA, the PRC may not impose any WHT on capital gains realized on the disposition of PRC entities unless the assets of the PRC entity consists directly or indirectly principally of immovable property situated in the PRC. Under the new protocol which becomes effective on 1<sup>st</sup> January 2008, this benefit would be restricted to Mauritius companies owning less than 25% of the equity of the PRC entity being sold.

For companies incorporated in non treaty jurisdictions, the PRC currently impose a 10% WHT on the capital gains realized from the disposition of any interest in a PRC entity. (This rate could rise to 20% should the 10% concessionary WHT rate cease to be continued when the new enterprise income tax law becomes effective on 1st January 2008.) A GBL1 Company incorporated in Mauritius would benefit from the DTAA and would provide a beneficial exit strategy to foreign investors. Investors now owning PRC entities through non-treaty protected countries should consider migrating to Mauritius.

#### Features of GBL1:

- ✓ Benefit from DTAA
- ✓ Max Tax of 3%
- ✓ Gain from underlying tax and tax sparing provisions

Many Mauritius companies now own 25% or more in the equity of PRC entities. Such companies should review their situations and consider taking tax planning actions prior to the 1st January 2008 effective date of the protocol. Such planning actions, with reasonable commercial supporting, could protect appreciation through the current time from taxation in China. It may also be possible to structure ownership so that the capital gains exemption in the DTAA continues to apply. Please contact us at DTOS Ltd. to discuss options.

### 3) Withholding tax on Dividends

A major benefit of the Mauritius/China DTAA is the favourable dividend withholding tax rate (WHT) of 5%.

In the past, the Chinese authorities have exempted dividends paid by foreign investment enterprises to a foreign parent company from any withholding tax. The new Chinese tax law provides for withholding tax on dividends of 20% to be levied on foreign investment enterprises from 1<sup>st</sup> January 2008. According to our sources, due to the sustained pressure of the WTO and a move in China to undertake serious tax reforms under the changing economic environment especially for the requirement of balancing foreign exchange flow, the days of the current exemption are numbered. It is expected, even the withholding tax for dividend will not be levied at 20% as of in the new law, a 10% withholding rate will likely become effective from 1<sup>st</sup> January 2008.

#### Features of GBL2:

- ✓ Tax Exempt
- ✓ No Audit required
- ✓ Cost effective

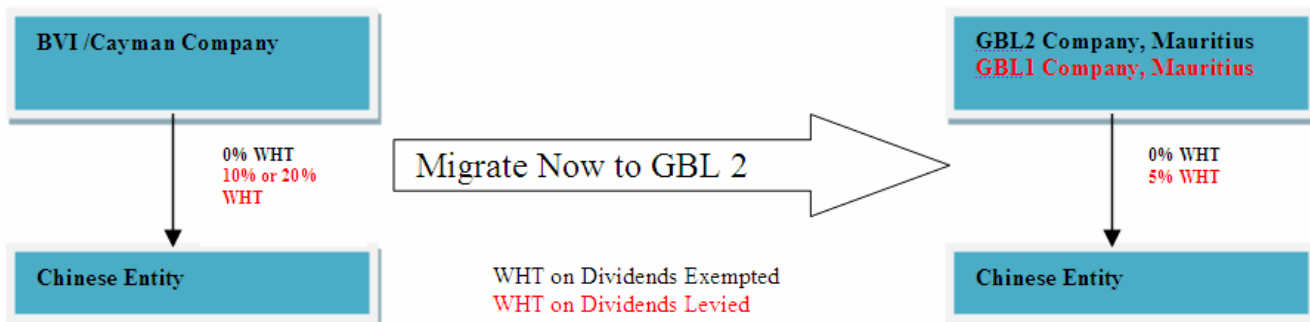
Owing to the past exemption from dividend WHT, many foreign investors have used BVI and other zero tax jurisdictions to incorporate holding companies for their PRC entities. These foreign jurisdictions (BVI, Cayman Islands, etc.) do not enjoy any DTAA with China.

If the exemption is eliminated, a WHT of 10% or 20% on dividends is likely to be levied. If this occurs, then all the foreign investment enterprises that repatriate dividends to their parent companies would have to withhold taxes in China.

The Mauritius/China DTAA has a very beneficial provision that fixes the maximum rate of WHT on dividends at 5%. If the WHT is applied, all foreign investment enterprises in China domiciled in Mauritius would gain from this favourable WHT rate of 5%.

We must point out that the Mauritius/China DTAA is very much superior to some other treaties favourable for Chinese investment. Under the Mauritius/China DTAA, **ALL** dividends will receive the 5% benefit. Under many treaties (e.g. the newly signed Singapore DTAA and the new Hong Kong arrangement effective this year), the 5% rate is only available to beneficial owners that are companies owning 25% or more of the capital of the company paying the dividend. Where this 25% ownership level is not met, a 10% withholding rate will typically apply.

All is not lost for existing holding companies incorporated in non treaty countries like BVI. Mauritius law provides for in-bound migration of companies incorporated in foreign jurisdictions. Using this clause in Mauritian law, it may be beneficial for current BVI and other companies incorporated in foreign jurisdictions to migrate to Mauritius as a GBL2 Company (or GBL1 Company). GBL2 is a tax exempt vehicle in Mauritius with similar features as a BVI enterprise. Once the China dividend WHT is applied from 1<sup>st</sup> January 2008, GBL2 companies can be converted into GBL1 Companies in Mauritius. The GBL1 Company form is a tax beneficial entity as this company can benefit from the provisions of the DTAA between China and Mauritius. Though a GBL1 Company is taxable at 15% in Mauritius, the actual tax liability is maximum of 3% due to an automatic presumed foreign tax credit of 80%. Moreover, in case actual taxes paid by the Chinese Company are more than 12%, that excess can further reduce the tax liability of a GBL1 Company in Mauritius. In addition, there is no withholding tax on dividends and interest paid by a Mauritius company to its shareholders.



The combination of the above factors makes incorporation in and migration of holding entities to Mauritius a natural choice for many foreign investors. Whether a new company is to be formed or an existing BVI or other non-treaty company is to be moved into Mauritius, the legal processes for company formation and migration are very simple and straightforward with well defined rules and procedures.

### **Migration of Companies incorporated outside of Mauritius.**

A company incorporated under the laws of any country other than Mauritius, may, where it is authorised by the laws of that country, apply to the Authorities to be registered as, and continue as, a company in Mauritius as if it had been incorporated in Mauritius under the Companies Act 2001.

The Registrar of companies will issue a certificate of incorporation by continuation in Mauritius and the company will be treated as if it had always existed in Mauritius. Should the legal aspect of the re-registration be recognized by the relevant Chinese authorities and there also be reasonable commercial support, there might be no tax consequences in China as it is merely a reorganisation of an existing company with the assets not being sold or otherwise transferred.

After becoming a Mauritius company and tax resident, the company can benefit from the many DTAA's that Mauritius has ratified with many countries, including China.

### **Other Opportunities**

Currently, investments by foreign entities in listed stocks on the A market is still not allowed in China. When this market opens up, with the 25% limit, investment funds (that normally invest less than 25% in a single stock) can set up Mauritius companies or migrate existing companies to Mauritius to benefit from the capital gains tax exemption and also benefit from the lower dividends withholding tax rate.

## **DTOS Ltd.**

DTOS Ltd. is a leading provider of set-up and administration services of various types of global business license companies in Mauritius. DTOS Ltd. can also help in setting up trusts and migration of companies. Should you need any such services you may email us at [info@dtos-mu.com](mailto:info@dtos-mu.com) or [bd@dtos-mu.com](mailto:bd@dtos-mu.com).

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