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A Passage to India: Investing in India through Mauritius and Cyprus

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Over the past few years there has been a significant increase in hedge fund investment in Indian securities. Properly structured, such investments may enjoy significant additional tax advantages if made through entities domiciled in certain offshore jurisdictions such as Mauritius or Cyprus. In particular, Mauritius, an independent republic located in the Indian Ocean, provides significant tax benefits for certain investments in India. The purpose of this article is to summarize certain principal features related to investing in India through Mauritius and, to a lesser degree, Cyprus.

Tax Benefits of Investing in India through Mauritius

From a U.S. or Indian regulatory perspective, there is sufficient choice of jurisdictions where a fund may be organized. However, location may affect a fund's tax liability. Mauritius offers fund managers the ability to trade in Indian shares and derivatives with significant tax benefits over other jurisdictions. These tax benefits are considerable as Indian tax liability can range from 20%-42%.

Investing in Mauritius (Mauritius Based Fund) is most useful if the fund is established specifically to invest in India and other countries with whom Mauritius has business connections and intended for investors to invest in this specific fund. Unlike Mauritius, investing through Cyprus requires local control and management unlike Mauritius which, for e.g., allows bank directives to be signed by U.S. resident directors.

Mauritius currently has a 15% tax rate, which is reduced by a maximum of 80% deemed tax credit. Therefore, Mauritius will impose an effective rate of no more than 3% of profits for funds with a Mauritius tax residency certificate. Although India has a 20% capital gains tax, the double tax avoidance agreement between Mauritius and India imposes no capital gains tax. Underlying tax credits further reduce tax liability.

For example, if an Indian issuer earns $100 in profits per share and pays 40% tax on such profits in India, $60 remains. If $10 is distributed as a dividend, the company has to pay $1 as dividend distribution tax in India. If the $10 dividend is paid to a shareholder resident in Mauritius, the dividend received will be subject to a further 3% tax in Mauritius. However, the $1 dividend distribution tax paid by the issuer in India would be credited to the shareholder and if it is greater than the tax due in Mauritius, no additional tax is due in India or Mauritius by a shareholder resident in Mauritius.

How to Set Up a Fund in Mauritius

Investment funds must obtain a Mauritius tax residency certificate to benefit from the India-Mauritius double tax avoidance agreement. To obtain this certificate, a fund needs to show a legal presence in Mauritius which can be established by incorporation and management in Mauritius.

Pending the introduction of specific legislation for collective investment schemes, the Mauritius Financial Services Commission (FSC) has adopted "best industry" practices from long established jurisdictions for regulating investment business. Mauritian regulators adopted corporate laws from the best of various legal regimes. Mauritian corporate law is based on English law, its limited liability company law is based on Delaware legislation, and its protected cell company structure is based on Bermuda law. Mauritius also allows entities organized under foreign law to continue their existence under Mauritian law but does not permit off-the-shelf companies.

Two basic structures can be used for investing in Mauritius. The first is a fund established in Mauritius (Mauritius Based Fund). This structure is most useful if the fund is established specifically to invest in India and other countries with whom Mauritius has business connections and intended for investors to invest in this specific fund. Alternatively, one may establish a sub-account of a non-Mauritius Based Fund in order to invest a portion of a fund's assets in India without including any direct investors.

Mauritius Based Fund

Mauritius Based Funds are global funds registered with the FSC. Such funds are commonly structured as companies incorporated under the Companies Act 2001 and hold Category 1 Global Business Licences under the Financial Services Development Act 2001. This structure is referred to as an "Investment Company."

An Investment Company may take the form of a close-ended company with a fixed share capital. Investors cannot call for their shares to be redeemed at net asset value (NAV) by the company but the company may be listed on the stock exchange to prevent lock-in.

Registration Requirements

An Investment Company must be approved by the FSC before it commences business. The FSC may issue an approval in principle to enable all charter documents to be prepared and the company to be incorporated.

Local Administration

The FSC prefers the administration of the fund to be in Mauritius. A Mauritius Based Fund may retain an investment adviser outside of Mauritius and may execute management decisions in relation to investment and disinvestment overseas. Also, foreign intermediaries may participate in the placing and redemption operations as distributors or nominees.

Prospectus and Reports

Investment funds operating from Mauritius must prepare and file a prospectus with the FSC. In addition, an unaudited half-year report, an audited annual report and quarterly reports must be submitted to the FSC. The FSC may also request additional information and has the right to inspect the fund's books and records.

Alternative Sub-Account

An alternative to a full-blown Mauritius Based Fund, a hedge fund can establish a subsidiary limited liability company in Mauritius as an Investment Company. Such a subsidiary will become a sub-account, or a client, of a foreign institutional investor (FII) license holder in India. A hedge fund's prime broker will likely have an FII license. The fund would then become the FII's client for trading in India. The fund manager would give trading orders to the FII, essentially making the FII the account manager. Under this structure the FII would assume most of the regulatory risk and reporting obligations which in India can be quite significant and are rapidly changing.

A sub-account must also be approved by the FSC. A certificate of compliance must be filed with the FSC to ensure that the fund's service providers are fit and proper persons.

The same financial reports and requirements applicable to audited financials of Mauritius Based Funds apply to sub-accounts. These reports must be audited by local auditors and filed with the FSC.

Cyprus as an Alternative for Fixed Income

Hedge funds investing in certain Indian fixed income instruments may want to consider establishing a subsidiary in Cyprus as an alternative to Mauritius. Cyprus and India have a double tax avoidance treaty which eliminates tax in India on interest and eliminates all tax in Cyprus. However, no treaty relief is applicable to convertible securities.

Unlike Mauritius, investing through Cyprus requires local control and management unlike Mauritius which, for e.g., allows bank directives to be signed by U.S. resident directors.

Singapore as an Alternative

Singapore has also become a fashionable domicile for establishing entities to invest in India but may not be appropriate for hedge funds because the new double tax avoidance treaty between India and Singapore is only relevant if the fund has more than just a legal presence in Singapore.

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