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A: Group approach and separate entity approach in domestic and international tax law

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Mauritius

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Summary and conclusions

Tax-resident companies established in Mauritius are regulated by the Mauritius Revenue Authority (MRA) and operate in a harmonised tax environment. Under the Income Tax Act of 1995 (ITA) of Mauritius, a company is tax resident if it is incorporated under the laws of Mauritius or it has its central management and control in Mauritius. The standard headline tax rate is 15% and this is applied uniformly to all companies. However, tax incentives are available to companies, which will reduce their effective tax rate. Chargeable income is the tax-adjusted profit on which the tax liability is calculated. The rationale behind adjusting the profit before tax is to eliminate the effects of accounting entries such as provisions which are based on International Financial Reporting Standards and amend the profit with existing tax rules specified in the ITA.

Sociétés, as defined in the ITA, are not liable to income tax. The associates (ultimate beneficiaries) of the société are liable to income tax on their share of profits which have been distributed or deemed to have been distributed during the accounting year in concern. Whereas a non-resident société shall be liable to corporate tax at the rate of 15% of its chargeable income.

Both individual shareholders and corporate shareholders are exempt from tax on receipt of dividend from a resident company. However, following the amendment in the Solidarity Levy which is effective as from 1 July 2020, resident individual shareholders will be taxed on the excess income if their total leviable income exceeds MUR three million per annum. Leviable income comprises the chargeable income and dividend paid to the individual shareholder. Thus, the dividend paid by the domestic company which was previously exempted from income tax will now be partially or fully taxed up to a maximum rate of 25%.

For non-resident shareholders, the tax treatment of the dividend is dependent on the country of residence which will be applicable.

In contrast, corporate shareholders will always be exempted from income tax on the dividends received from local companies.

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In Mauritius, each company is taxed on a stand-alone basis. Thus, each entity is required to calculate its tax liability and file its corporate tax return separately. There is no group taxation regime in the ITA of Mauritius .[3]

Under section 90 of the ITA, provisions for anti-avoidance have been made to address aggressive tax planning to reduce, avoid or defer tax liability. Mauritius introduced the CFC rule in 2019 and it came into effect in respect of the year of assessment commencing on 1 July 2020. A CFC, under the ambit of section 90A of the ITA, is defined as a company which is not resident in Mauritius and in which more than 50 per cent of its total participation rights are held directly or indirectly by the resident company or together with its associated enterprises and includes a permanent establishment of the resident company. The CFC rule is designed to prevent a parent company from artificially moving its profits abroad to a controlled subsidiary in a country with a more favourable or lower tax rate.

With the ongoing work of the OECD/G20 Inclusive Framework on BEPS on taxation issues around the world, Mauritius has a propensity toward changes. Rules are being implemented to deviate fundamentally from the taxation of each separate entity by developing rules for the allocation of group profits and by determining a group's effective tax burden. In Mauritius, there is no legislation for a cross-border group tax approach. Each entity is subject to corporate tax on a stand-alone basis. Nevertheless, the taxation of local branches differs from that of subsidiaries.

Even though there is a need for consolidation at the parent level in Mauritius, income tax is levied at 15% on the parent company only. However, as mentioned above, foreign source dividend, among other specific income, may be subject to partial exemption of 80% provided the company fulfils the prescribed conditions.

On the other hand, a company incorporated in Mauritius that has branches in another jurisdiction will need to consolidate and pay tax at the rate of 15% in Mauritius.

There is no transfer pricing legislation in Mauritius. The domestic legislation only provides for the arm's length principle for any transactions between related parties. Moreover, there is no thin capitalisation requirement in Mauritius.

There is no restriction on outbound payment but a withholding tax is applicable on interest payments, management fees, rental fees, etc. There are no anti-hybrid rules in Mauritius.

Mauritius signed the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (CbC MCAA) in January 2017 and the CbCR Regulation was proclaimed on 22 February 2018 to be effective for the accounting years beginning on or after 1 July 2018.

The government of Mauritius has implemented a new tax in the form of VAT on digital services provided by non-residents in Mauritius. The standard rate of VAT on the supply of digital services is 15% on providers of digital or electronic services via the internet in Mauritius.

3 See the case law of *Robert Le Maire Intergraph Co V The Director General MRA* (2011 – Supreme Court) –ANNEX 1.

Part One: Separate entity approach and group approach in domestic law

1.1. General overview

The tax regime of Mauritius has been established in order to encourage investment and allow resident and non-resident companies to grow exponentially in a harmonised tax environment which is rigorously regulated by the MRA. The domestic corporate tax regime consists of different types of taxes, such as corporate tax, corporate social responsibility, and tax deduction at source, among others. The tax year commonly known in tax jargon as year of assessment is the year in which a company or individual is liable to income tax. For an individual, the year of assessment starts from 1 July of a year and ends on 30 June of the succeeding year. The accounting year and year of assessment of a company may differ, as companies can choose any end date of their accounting year provided it does not exceed 12 months. However, a newly incorporated company may draw its financial accounts up to 18 months from its date of incorporation. Every resident company is entitled to a period of six months from the end of their balance sheet date within which they should file their corporate tax return as provided in the ITA of Mauritius. A resident company is an entity incorporated in Mauritius or has its central management and control in Mauritius.

The standard headline tax rate in Mauritius is 15% and it is applied uniformly to all companies. However, both residents and non-resident companies are entitled to fiscal incentives such as partial exemption and tax holidays which will ultimately lower the effective tax rate. Resident companies other than Global Business Licensees are liable to corporate social responsibility which is calculated as an additional 2% of their chargeable income of previous year of assessment. Chargeable income is the tax-adjusted profit on which the tax liability is calculated. The rationale behind adjusting the profit before tax is to eliminate the effects of accounting entries such as provisions which are based on International Financial Reporting Standards and amend the profit with existing tax rules specified in the ITA.

On the other hand, sociétés, as defined in the ITA, are not liable to income tax. Instead, the associates (ultimate beneficiaries) of the société are liable to income tax on their share of profits which have been distributed or deemed to have been distributed during the accounting year in concern. Whereas a non-resident société shall be liable to corporate tax at the rate of 15% of its chargeable income.

A société, as defined in the ITA, includes:

(i) limited partnerships;
(ii) sociétés commerciales;
(iii) limited liability partnerships;
(iv) joint ventures; and
(v) sociétés or partnerships incorporated under the laws of a foreign country.

1.2. General system of inter-company transactions outside special group taxation regimes

Both individual shareholders and corporate shareholders are exempt from tax on receipt of dividends from a resident company. However, for non-resident shareholders, the tax treatment of the dividend is dependent on the country of residence that is applicable. One of the main reasons is to encourage investors to fund the local companies and promote investment in Mauritius.

However, following the amendment in the Solidarity Levy, which is effective as from 1 July 2020, resident individual shareholders will be taxed on the excess income if their total leviable income exceeds MUR three million. Leviable income comprises the chargeable income and dividend paid to the individual shareholder. Thus, indirectly the dividend paid by the domestic company which was previously exempted from income tax will now be partially or fully taxed up to a maximum rate of 25%.

In contrast, in the case of corporate shareholders, they will always be exempted from income tax on the dividends received from local companies. Therefore, this may result in tax planning and optimisation of tax liability arising on the dividend income.

There is no capital gains tax or transfer pricing regulations in Mauritius. However, there is a provision of arm's length test in the ITA but it does not contain an accurate definition of the arm's length principle. In the absence of this definition in the ITA, the definition of the OECD is used instead. In the eventuality that the MRA is not satisfied with the transaction, it will therefore be revised at arm's length as deemed appropriate by the latter.

1.3. Group taxation regime

Pursuant to the Companies Act 2001, every parent company which has one or more subsidiaries as at its balance sheet date shall prepare consolidated financial statements in accordance with International Financial Reporting Standards which shall be presented in Mauritian rupees or any other currency which has obtained approval from the Companies Division. Nevertheless, provisions in the Companies Act 2004 stipulate that group financial statements are not required if the company is itself a wholly owned subsidiary or is a virtually wholly owned subsidiary of any company incorporated in Mauritius and its parent has obtained the approval of the owners of the minority interest.

In Mauritius, all the companies are taxed on a stand-alone basis. Thus, each entity is required to calculate its tax liability and file its corporate tax return separately. There is no group taxation regime in the ITA.[4]

1.4. Change of control rules

A resident company which has a loss adjusted for tax in a year of assessment may carry forward such loss to be offset against taxable profits in the following years. However, the loss may be carried forward up to five subsequent years after which the loss will be lapsed in full.

Where a company acquires another entity or there is a merger where the companies are in the manufacturing sector, the unrelieved loss of the acquiree may be transferred to the acquirer and the loss is deemed to take place in the year of acquisition provided conditions such as safeguarding employment or other terms and conditions stated by the Minister are satisfied. The acquirer is entitled to use the loss brought forward from the acquiree to set off against its taxable income. The loss transferred may be carried forward up to five years from the date of the acquisition.

4 See the case law of *Robert Le Maire Intergraph Co V Mauritius Revenue Authority* (Supreme Court).

However, if more than 50% of the number of employees is made redundant before the end of three years from the date of the takeover or merger, the unrelieved loss transferred shall no longer be available to carry forward and the amount to be deducted shall be equivalent to the gross income (except exempt income) of the acquirer in the year in which the employees are made redundant.

Moreover, if there is a change of more than 50% in the voting rights of a manufacturing company or in a company facing financial constraints, the unrelieved loss of those entities may be transferred to the new shareholder. The acquirer may carry forward the losses up to five years from the date of change in shareholding provided that the terms and conditions imposed by the Minister are satisfied. There is no group relief loss in Mauritius.

1.5. Relevance of belonging to a group/control in other contexts

Anti-avoidance provisions are incorporated in the Mauritius Income Tax Act where the MRA is empowered to lift the corporate veil of questionable practice of tax planning in certain circumstances. Thin capitalisation is an example of tax avoidance which is practiced by many entities. In Mauritius, interest on debentures issued by reference of shares to shareholders is deemed to be dividend payment to the latter and is not tax deductible. Furthermore, where a related person of the director or the shareholder of the company is awarded a contract to perform services for that company and the remuneration paid is excessive compared to the rates in the open market, the Director-General of the MRA may revise the remuneration as he deemed reasonable.

Moreover, any excess amount paid in respect of the management fees will not be allowed as an expense for computing of the chargeable income of the company. Any transaction as deemed by the Director-General to be designed to reduce the tax liability of the company or to obtain any other tax benefit, the expense in relation to that transaction may not be allowed in computing the chargeable income or any other means deemed as appropriate by the Director-General to counterbalance the effect of such transaction.

As stated above, thin capitalisation is being practiced by many companies. In order to counter-effect any excessive interest charged is revised to arm's length. However, though there is an arm's length test provision in the ITA, further guidance is required on its applicability.

Mauritius has already implemented the recommendation of the Forum of Harmful Tax Practices in its Finance Act 2019 by abolishing the deemed foreign tax credit and is continuously working closely with the OECD to mitigate the questionable practices of tax planning.

Part Two: Separate entity approach and group approach in cross-border situations

2.1. Treatment of branches

Unlike in the United States[5] and the United Kingdom,[6] in Mauritius, a foreign company, under the ambit of the Companies Act 2001, is defined as a body incorporated outside Mauritius and it is required to register with the Registrar only if it has a place of business in Mauritius or is carrying on business in Mauritius including:
(i) foreign companies establishing or using a share transfer office or a share registration office in Mauritius; or
(ii) administering, managing, or dealing with property in Mauritius as an agent, or personal representative, or trustee and whether through its employees or an agent or in any other manner.

This structure is commonly known as a branch, and it is treated for most purposes as a Mauritius-incorporated company. A branch must have a registered office address where the correspondences, bank statements, constitutive and other administrative documents are kept; and it must appoint two authorized representatives who are resident in Mauritius and who would be answerable for doing such acts, matters and things as are required to be done by the branch.
However, a foreign company will not be held to be carrying on business in Mauritius if it:
(i) is or becomes a party to a legal proceeding or settles a legal proceeding or a claim or dispute;
(ii) holds meetings of its directors or shareholders or carries on other activities concerning its internal affairs;
(iii) maintains a bank account;
(iv) effects a sale of property through an independent contractor;
(v) solicits or procures an order that becomes a binding contract only if the order is accepted outside Mauritius;
(vi) creates evidence of a debt or creates a charge on property;
(vii) secures or collects any of its debts or enforces its rights in relation to securities relating to those debts;
(viii) conducts an isolated transaction that is completed within a period of 31 days, not being one of a number of similar transactions repeated from time to time; or
(ix) invests its funds or holds property.

2.1.1. Branches of foreign companies located in Mauritius

Some states apply a higher rate of tax on foreign companies with a permanent establishment or branch in their state.[7] The branch will be taxed in its country of incorporation on its

5 For US domestic tax purposes, the "check-the-box" regulations allow an entity to elect its status as a single entity or transparent entity.
6 For UK tax purposes, the HMRC set out guidance in the form of a list of questions aiming to help the classification of an entity as a corporate body or a transparent body.
7 For example, in the US, a 30% on after-tax net profit, additional to "normal" tax, is applied to foreign companies.

consolidated accounts which will include profit or loss from the Mauritius branch. In Mauritius, we do not have the concept of additional branch profit tax. Under the Double Tax Treaty Agreement concluded by Mauritius,[8] a branch is classified under a permanent establishment, following a territorial tax approach for branches, the latter is taxed on the profit derived from Mauritius at the rate of 15% in Mauritius.

The taxable income of a branch of a foreign company is computed in the same way as that of a resident company. However, a branch may not claim a deduction for interest or royalties paid to its foreign head office. It may deduct management expenses charged to it by a foreign head office provided the charge is reasonable having regard to the nature and extent of the management services rendered. The management fees paid to the foreign company are subject to a withholding tax of 10%, though the distribution of profit from the domestic branches is not subject to withholding tax.

2.1.2. *Foreign branches of Mauritian companies*

On the other hand, a company incorporated in Mauritius, having branches in another jurisdiction, will need to consolidate and pay tax at the rate of 15% in Mauritius. Under the current tax regime, if the Mauritian company is incorporated as a Global Business Company (GBL), it will be entitled to a deemed foreign tax credit of 80% of the income tax liability.[9] In the instance that the profit of the branch is already taxed in the other jurisdiction, a credit is allowed to the tune of the tax paid abroad against Mauritius tax chargeable in respect of the profit of that branch. The credit shall be limited to Mauritius tax liability. Any excess credit shall neither be able to be carried forward nor carried back nor refunded and therefore wasted.

Credit is also provided for any tax withheld against and limited to the Mauritian tax liability.

2.2. Treatment of foreign subsidiaries

A subsidiary is a company incorporated in Mauritius where its parent company –
- controls the composition of the board of the company;
- is in a position to exercise, or control the exercise of, more than one-half the maximum number of votes that can be exercised at a meeting of the company;
- holds more than one-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; or
- is entitled to receive more than one-half of every dividend paid on shares issued by the company, other than shares that carry no right to participate beyond a specified amount in a distribution of either profits or capital.

8 So far, Mauritius has concluded 45 tax treaties and is party to a series of treaties under negotiation.

9 The current tax regime for GBL 1 is in a transition period and will not be applicable as from June 2021. In the future, the deemed foreign tax credit will be abolished and specific income streams from foreign source, such as dividends and interest income, among others, will be subject to a partial exemption of 80% provided the company satisfies the prescribed conditions.

2.2.1. *Mauritian subsidiaries held by a foreign parent*

Similar to a branch, a subsidiary pays tax in Mauritius at the rate of 15%. However, unlike a branch, a subsidiary can deduct interest and royalties from its taxable income. And these interest and royalties are subject to withholding tax of 15% and 10% respectively.

On the other hand, from the point of view of a Mauritian subsidiary, the distribution of dividend is not subject to any additional tax. Also, a dividend distribution is only feasible after a solvency test.[10]

2.2.2. *Foreign subsidiaries held by a Mauritian parent*

Even though there is a need for consolidation at the parent level in Mauritius, income tax is levied at 15% on the parent company only on a stand-alone basis. However, as mentioned above, any dividend received from a foreign source will be subject to partial exemption of 80% provided the company fulfils the prescribed conditions.

The domestic legislation of Mauritius also provides for underlying foreign tax credit. Where a dividend is paid by the foreign subsidiary to the Mauritian parent company, provided the latter owns directly or indirectly not less than five per cent of the share capital of the subsidiary company, the credit allowed shall, in addition to any foreign tax charged on the dividend, whether directly or by deduction, include foreign tax charged on the income out of which the dividend was paid.

The Mauritian parent company is not required to pay tax on the consolidated figures of its foreign subsidiary, as there is no group tax legislation in Mauritius.

2.3. Transfer pricing rules

There is no transfer pricing legislation in Mauritius. The domestic legislation only provides for the arm's length principle for any transactions between related parties. Moreover, there is no thin capitalisation requirement in Mauritius.

2.4. Controlled foreign entity (CFC) regime

In its final Base Erosion and Profit Shifting (BEPS) Action 3 report, the OECD recommended jurisdictions to implement a CFC rule designed to prevent a parent company from artificially moving its profits abroad to a controlled subsidiary in a country with a more favourable or lower tax rate. The recommendations in the final report on BEPS Action 3 on CFC rules were in the form of six building blocks, covering definition of a CFC; CFC exemptions and threshold requirements; definition of income; computation of income; attribution of income and prevention and elimination of double taxation. These recommendations have been implemented in the Mauritian CFC rules during the budget speech of the Finance

[10] A company satisfies the solvency test if (i) the company is able to pay its debts as they become due in the normal course of business and (ii) the value of the company's assets is greater than the sum of the value of its liabilities and the company's stated capital.

Minister in 2019 and it came into operation in respect of the year of assessment commencing on 1 July 2020.

Further, CFC rules are regarded by the European Union (EU) as an appropriate anti-abuse measure to tackle tax-planning opportunities in respect of regime such as the Mauritian partial exemption regime. With the introduction of the CFC rules, Mauritius has also addressed the deficiencies identified by the EU Code of Conduct Group with regards to the partial exemption system under the specific criterion of substance.

A CFC, under the ambit of the ITA, is defined as a company which is not resident in Mauritius and in which more than 50% of its total participation rights are held directly or indirectly by the resident company or together with its associated enterprises and includes a permanent establishment of the resident company.

An associated enterprise is defined as an entity in which the resident company holds directly or indirectly a participation in terms of voting rights or capital ownership of 25% or more or is entitled to receive 25% or more of the profits of that entity.

It also includes an individual or entity which holds directly or indirectly a participation in terms of voting rights or capital ownership in the resident company of 25% or more or is entitled to receive 25% or more of the profits of the resident company. Where an individual or entity holds directly or indirectly a participation of 25% or more in the resident company and one or more entities, all the entities concerned, including the resident company, will also be regarded as associated enterprises.

Where a Mauritius tax-resident company carries on business through a CFC and the MRA considers that the non-distributed income of the CFC arises from non-genuine arrangements[11] which have been put in place for the essential purpose of obtaining a tax benefit,[12] that income will be deemed to form part of the chargeable income of the resident company.

The income to be included in the chargeable income of the company shall be limited to amounts generated through assets and risks which are linked to significant people functions carried out by the controlling company and the attribution of such income should be calculated in accordance with the arm's length principle. The income to be included in the chargeable income of the resident company will be calculated in proportion to the resident company's participation in the CFC and the income will be included in the tax return of the resident company in respect of the income year in which the tax year of the CFC ends.

2.4.1. *CFC exemption conditions*

The CFC rule will not be applied to a CFC where in an income year if:

(i) accounting profits are not more than EUR 750,000, and non-trading income is not more than EUR 75,000;

(ii) accounting profits amount to less than 10% of its operating costs[13] for the tax period;

[11] An arrangement or a series thereof shall be regarded as non-genuine to the extent that the controlled foreign company would not own the assets or would not have undertaken the risks which generate all, or part of, its income if it were not controlled by a company where the significant people's functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income.

[12] See s. 90 – "tax benefit" means the avoidance or postponement of the liability to pay income tax or the reduction in the amount thereof.

[13] The operating costs must not include the cost of goods sold outside the country where the entity is resident for tax purposes and payments to associated enterprises.

(iii) the tax rate in the country of residence of the CFC is more than 50% of the tax rate in Mauritius.

2.4.2. *Computation of income*

The net income of a CFC in respect of its tax year shall be:
(i) an amount equal to its taxable income determined in accordance with the ITA as if the CFC had been a taxpayer, and tax resident for the purposes of the definition of 'gross income' under the ITA;
(ii) determined in the currency used by the CFC for the purpose of its financial reporting.[14]

2.4.3. *Elimination of double taxation*

A credit of the tax paid by the CFC will be allowed against the tax liability of the resident company in the same manner as credit is allowed in respect of foreign tax paid.

And the undistributed income taxed at the level of Mauritius (through CFC rules) shall be deducted from the chargeable income of the resident company when the actual distribution is made.

Whilst the existing general anti-avoidance rules under the ITA cover transactions aimed at avoiding tax that should have been due in Mauritius, the CFC rules would cover schemes involving Mauritius but aimed at eroding other countries' tax bases.

However, the treatment of tax losses of a CFC has not been prescribed. This appears to be an oversight that should be addressed as soon as possible, unless it is clarified that the relevant portion of the tax loss can be utilized by the Mauritian resident company. The suggested approach, as per BEPS Action 3, is to allow CFC losses to be utilized against CFC profits to prevent manipulation of tax losses.

With the introduction of the CFC rules, Mauritius has implemented the recommendations of the OECD on BEPS Action 3 and has demonstrated its commitment to ensure the tax regime is consistent with EU's tax good governance standards.

2.5. Outbound payment

There is no restriction for payment to non-resident companies; however, a withholding tax is applicable as follows:
(i) Interest payable by corporate taxpayers to non-residents: 15%
(ii) Royalties payable to a non-resident: 15%
(iii) Rent payable to a non-resident: 10%
(iv) Payment of management fees to a non-resident: 10%
(v) Payment of fees for services rendered in Mauritius: 10%

[14] For the purpose of determining the amount to be included in the income of the company during any year of assessment, the net income of the CFC shall be converted into Mauritius currency by applying the average exchange rate between Mauritius currency and the other currency for that year of assessment.

Reduced rates may also apply under double tax treaties.

The above-mentioned payment is tax deductible for a resident company except for the following:

(i) Management fees: In case that the management fees are excessive, the MRA may disallow the excessive part and allow a reasonable amount as expense.
(ii) Interest payable: The MRA may refuse to allow a deduction on expenditure incurred as interest where it is satisfied that:
    (a) the interest is payable to a non-resident which is not chargeable to tax on the amount of the interest; or
    (b) the interest is not likely to be paid in cash within a reasonable time.

Moreover, the domestic law provides that only interest expenditure in respect of capital employed exclusively in the production of gross income is deductible for tax purposes.

The above restriction forms part of the anti-avoidance rules in Mauritius domestic legislation.

There are no anti-hybrid rules in Mauritius.

2.6. Country-by country reporting (CbCR)

Mauritius signed the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (CbC MCAA) in January 2017 and the CbCR Regulation was proclaimed on 22 February 2018 to be effective for the accounting years beginning on or after 1 July 2018.

The regulations apply to multinational enterprises (MNE) groups whose consolidated group revenue is at least EUR 750 million (approx. MUR 30 billion) and where the MNE group has two or more enterprises which are tax residents in different jurisdictions.

The exchange of CbC reports is aimed to provide tax administrations in different jurisdictions with adequate and reliable information to conduct an efficient and robust transfer pricing risk assessment analysis.

A CbC report should be filed in Mauritius when:

(i) the MNE group's ultimate parent entity (UPE) is a tax resident in Mauritius; or
(ii) the MNE group nominates an entity which is tax resident in Mauritius as the surrogate parent entity (SPE).

The SPE is an entity of the MNE group that has been appointed by the MNE group as the sole substitute for the UPE to file the CbC report. The CbC report should be filed in Mauritius not later than 12 months from the last day of the accounting year of the MNE group, where applicable.

The CbC report format set out by the MRA is similar to that proposed by the OECD under BEPS Action 13 and consists of three tables:

(a) Table 1 – Overview of group income, taxes and business activities by tax jurisdictions;
(b) Table 2 – Overview of the constituent entities of the MNE group; and
(c) Table 3 – Any additional relevant information.

Failure to comply with the regulations shall entail a fine not exceeding MUR 5,000 and imprisonment not exceeding a term of six months.[15]

2.7. Digital tax services

The government of Mauritius has implemented a new tax in the form of VAT on digital services provided by non-residents in Mauritius. The standard rate of VAT on the supply of digital services is 15%. The tax is imposed on providers of digital or electronic services via the internet in Mauritius. The objective behind imposing the VAT on digital services provided in Mauritius is to level the playing field between the resident and non-resident providers of digital services via the internet.

ANNEX 1 –

ROBERT LE MARIE INTERGRAPH LTEE v THE DIRECTOR-GENERAL, MAURITIUS REVENUE AUTHORITY

2011 SCJ 17
Record No. 103009

IN THE SUPREME COURT OF MAURITIUS

In the matter of:

Robert Le Maire Intergraph Ltée

Appellant

versus

The Director-General, Mauritius Revenue Authority

Respondent

JUDGMENT

This is an appeal by way of case stated against the determination of the Assessment Review Committee (ARC) maintaining the decision of the then Commissioner of Income Tax, now represented by the Director-General, Mauritius Revenue Authority who had raised assessment on the applicant for the years of assessment 2001/02 to 2004/05.

The appellant which owns a number of subsidiary companies in Mauritius, and four subsidiary companies in Réunion Island through an 'offshore' company, Heidelberg Océan Indien Limitée, had during the assessment year, taken loans and overdrafts from various banking institutions to "invest" in those subsidiaries as well as in the appellant company

15 See s. 124 of the Income Tax Act and regulations 23C of the Income Tax Regulations.

itself. The loans granted by the appellant to its subsidiaries were interest free except in one case where interest has been charged and which was reflected in that company's accounts.

Pursuant to section 19 of the Income Tax Act, the appellant had claimed deduction for the interests it had paid on those loans and overdrafts to the banking institutions for the above- mentioned assessment years. The then Commissioner of Income Tax had in his assessment for those years, disallowed the interests deducted by the appellant.

The appellant lodged objection before the ARC but the latter maintained the assessment made by the respondent on the ground that the capital was not exclusively employed in the production of gross income but was lent to subsidiaries which did not produce any income to the appellant.

Being dissatisfied with the finding of the ARC, the appellant has now appealed on the following 6 grounds:

1. *"The Committee has erred in law in reaching the conclusion that the appellant had to show positively how the loans taken by the applicant were necessary for the production of income of the applicant.* ***(sic)***

2. *The Committee has erred in law by failing to recognize the concept of groups of companies and by finding that there is absolutely no evidence as to how the appellant which is a different legal entity from each of its subsidiaries will derive income from the loans made to its subsidiaries.*
3. *The Committee has erred in law by failing to address the issue that the current anti-avoidance provisions in section 19 of the Income Tax Act cannot be extended to disallow interest on loans taken by a parent company and granted to a subsidiary company.*
4. *The Committee has erred in law in finding that section 26 of the Income Tax Act applied to the parent company of a group of companies.*
5. *The Committee has erred in finding that even if ultimately the appellant may benefit from the 'investment' made in the subsidiaries, it would be in the nature of dividends and thus exempt income.*
6. *The Committee has erred in law in finding that the loans taken by the appellant were not in respect of capital employed exclusively in the production of gross income of the applicant".* ***(sic)***

In relation to ground 1, the question is whether the Assessment Review Committee (ARC) did apply the right test pursuant to section 19 (1) of the Income Tax Act 1995 (the Act) which is concerned with the expenditure incurred on interest in the production of income. The text reads as follows:

> *"Subject to the other provisions of this section, where in an income year a person has incurred expenditure on interest in respect of capital employed exclusively in the production of gross income specified in section 10(1)(b),*
>
> *(c) or (d), as the case may be, he shall be allowed, in that income year, a deduction in respect of the interest from the gross income in the production of which the capital was employed".*

Interest on capital is deductible from gross income where the capital is employed '*exclusively*' in the production of gross income. This is the test for deductibility. This is indeed the test which was adopted by the ARC where at page 14 of the brief, it sets down the reason advanced by the respondent to disallow part of the interest paid in respect of loans and overdrafts taken by the appellant and claimed by it as deduction for tax purposes – "*The reason for disallowing part of the interests is because these would not be in respect of capital employed exclusively in the production of gross income of applicant*". (Emphasis underlined).

The ARC then went on to consider section 58 of the Act which mentions that the provisions of section 19 of the Income Tax Act which apply to an individual shall apply in all respect to a company. The ARC also reproduced in full the text of section 19 which clearly spells out the proper test which should be applied, namely the incurring of "*expenditure on interest in respect of capital employed exclusively in the production of gross income specified in section 10(1)(b),(c) or (d)*."

Again, after considering the provisions of section 26 of the Act which provides that no deduction shall be made inter alia in respect of .... "*(b) any expenditure or loss to the extent to which it is incurred in the production of income which is exempt income*", the ARC went on to state that the loans taken by the appellant were supposedly in respect of capital employed exclusively in the production of gross income.

Exception is taken by the appellant on the ground that the ARC did in fact apply the wrong test when on several occasions from page 18 of the brief onwards, it chose to use the infelicitous term '*necessary*' in relation to the production of income.

Now, the submission of learned counsel for the appellant stems from a comparison of the text of sections 17, 18 and 19 of the Act. Section 17 provides that "*Any expenditure which is wholly, exclusively and necessarily incurred by a person in performing the duties of an office or employment shall be deductible from the gross income referred to in section 10(1)(a) in the income year in which the expenditure is incurred*". There is therefore a three-pronged-test. On the other hand, under sections 18 and 19, there is just one element which needs to be considered, namely the expenditure is "*exclusively incurred*" in the production of gross income.

It was submitted on behalf of the appellant that since our case falls under section 19, proof of the element of "*necessarily incurred*" has been wrongly imported by the ARC into the test. We believe that this is a wrong reading of the decision of the ARC taken globally in its proper context.

We wish to observe that the first time the word "*necessary*" appears in the findings of the ARC is from a quotation of the judgment of the Judicial Committee in **Ward and Co. v Commissioner of Taxes [1923 AC 145]** which was cited in **Vacoas Transport v Commissioner of Income Tax [1977 MR 346]**. In **Ward**, the Judicial Committee stated "*Their Lordships agree with this reasoning. The expenditure in question was not necessary for the production of profit, nor was it in fact incurred for that purpose.......*". It is after citing that passage that the ARC then observed that the appellant "*had to show positively how the loans taken by the applicant were necessary for the production of income of the applicant*". It went on in the same paragraph to state that the parent company "*then has the burden of showing that the loans taken by it were necessary for the production of its income and that the loans in turn given to subsidiaries (which necessarily have to be made on an arm's length basis) will ultimately produce income for the parent company*". It must be observed that the term "*necessarily*" in relation to the arm's length has nothing to do with the test which has to be applied pursuant to section 58 taken in conjunction with section 19. The use of the word 'necessary' here refers to the test of arm's length which is provided by section 75 of the Income Tax Act, the relevance of which, we shall analyse in due course. Finally, at page 19, the ARC observes that in the light of the evidence available to the respondent, it was reasonable for the respondent to find that a large part of the loans taken by the appellant were '*not necessary*' for the production of income of the appellant but were in turn, lent out to subsidiaries. We believe that the term '*not necessary*' used by the ARC has nothing to do with imposing a requirement of proving an extra element of an expenditure having to be '*necessarily*' incurred as required under section 17 of the Act.

Learned counsel for the respondent relied on the case of **Cheval de Mer Ltée v The Mauritius Revenue Authority [2007 SCJ 210]** in which the Supreme Court did not find fault with the reasoning of the Tribunal which could not find any nexus, whether as a first link or an essential link in a chain of causation between the capital borrowed and the production of the income so as to be within the operative meaning of the term "*employed exclusively in the production of gross income*" under section 19(1) of the Act.

Accordingly, we are of the view that on a proper reading of the decision of the ARC, the singular test set down by section 58 and section 19 of the Act has been applied.

With regard to ground 2, the ARC laid stress on the fact that the appellant had a different legal entity from each of the subsidiaries and that there was no evidence adduced to show how the former would derive income from the loans made to its subsidiaries. The appellant has submitted that the ARC erred in law by failing to recognise the concept of groups of companies. Reliance was placed on the case of **De Chazal and anor v Commissioner of Income Tax [1992 MR 9]**. We believe that the passage found at page 3 of that judgment which reads as follows: "*On the other hand, the concept of groups of companies is now a recognised feature of our law and a worker is entitled to assume, on moving around within the group, that his service is not broken;……….*" has no application to our case since it was stated in a different context. The concept of 'groups of companies' whatever that term may connote in commercial, social or even legal context has not achieved the degree of similitude and oneness as submitted by learned counsel for the appellant. Such a concept has never meant, for example that the loss incurred by a subsidiary may be offset against the profit realised by a parent company for tax purposes. Companies may exist within a group spread over several tiers with different percentages of ownership which would preserve control to the parent company, but the substratum remains that each company has and retains a personality and entity of its own. The concept of groups of companies cannot therefore be justifiably invoked in aid of the appellant's claim with regard to the parent company deriving income from the loans made to its subsidiaries.

The crux of the matter remains in the unreasonable and unjustifiable stand of the parent company taking loans and paying interest thereon and then passing those loans to its subsidiaries interest free. Again, as we have stated, the different companies have different entities although they do form part of the same group of companies and may have identical commercial interest. They must retain their individual personality. Section 75 of the Income Tax Act which is entitled '**Application of arm's length test**' provides in its paragraph (1) (b) that this section shall apply "*to any case where in the carrying on of any business in Mauritius, any person controlling that business……. by reason of his relationship or otherwise with any other person, is not in the opinion of the Director-General at arm's length with that person with respect to any commercial or financial transaction.*"

Grounds 3 and 6 can be considered together. Learned counsel for the appellant submitted that the situations in which the Director-General may refuse to allow a deduction on expenditure incurred as interest are delimited by section 19(3) of the Act to the two situations which are mentioned at subparagraph (a) and (b). He submitted that the present situation which concerns interest paid on the loan by the appellant and which loan was passed on interest free to its subsidiaries did not fit within the two situations envisaged by the two subparagraphs. That may well be the case, but the first hurdle which the appellant had to overcome is the one set by section 19(1) of the Act.

As rightly pointed out in the skeleton arguments submitted on behalf of the respondent, the appellant in the first place did not commit itself to any specific limb of section 10(b) to (d) of the Act with regard to the characterisation of gross income which was allegedly to be produced. In fact, there was no evidence on record to show that any gross income was produced as a result of the expenses incurred by the appellant.

With regard to grounds 4 and 5, section 26(1) (b) provides that notwithstanding sections 18 and 19 but subject to this section, no deduction shall be made in respect of any expenditure or loss to the extent to which it is incurred in the production of income which is exempt income. The stand of the appellant was to the effect that it had made loans to its subsidiaries without interest in the form of an investment on which it had itself paid interests to the bank. An investment and a loan are two distinct notions which can hardly converge. Even, if the loan could be considered as an investment which would result eventually in the payment of dividends from its subsidiaries, dividends are exempt income pursuant to Sub-Part B of Part ll of the Second Schedule to the Act. We have noted that the ARC has in fact borne in mind that by virtue of section 19(1) of the Act, interest expenditure in respect of capital employed '*exclusively*' in the production of the gross income of its business in that income year was allowable but that it was subject to section 26(1) (b) which, ***inter alia***, provides that *"any expenditure…… to the extent to which it is incurred in the production of income which is exempt income amounts to an unauthorised deduction*."

We find it strange that although there is evidence to the effect that the "*investment*" in the four subsidiaries in Réunion Island was effected through another subsidiary of the appellant, namely Heidelberg Océan Indien Limitée, the loans were considered to have been made by the parent company, namely the appellant, which admittedly has a distinct legal personality from its subsidiaries.

We are of the view that the overall single factor which must weigh heavily against the appellant is the fact that for reasons best known to itself, it chose to give interest-free loans to its subsidiaries after obtaining those very loans upon payment of interest. For that reason and in the light of other reasons spelled out in our judgment, we find that the ARC's decision, rallying to the decision of the respondent and disallowing the deduction of the interest paid to the banks from the gross income of the appellant, cannot be faulted.

The appeal has no merit and is set aside with costs.

Y K J Yeung Sik Yuen
Chief Justice

G Angoh
Judge

31 January 2011

Judgment delivered by Hon Y K J Yeung Sik Yuen, Chief Justice

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<u>For Appellant</u>: **Mr G Ollivry, Q. C. together with Mr R Bhadain, of Counsel Mr B Sewraj, Attorney**
<u>For Respondent</u>: **Mr R Ramloll, Acting Assistant Parliamentary Counsel together with Miss G Gareeboo, Senior State Counsel State Attorney**


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