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A: Sharing and shifting of corporate losses – The new profit shifting?

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Summary and conclusions

Tax-resident companies established in Mauritius and foreign companies deriving source income from Mauritius are regulated by the Mauritius Revenue Authority (MRA). Under the Income Tax Act of 1995 of Mauritius, a company is a tax resident if it is incorporated under the laws of Mauritius or if it has its central management and control in Mauritius. The standard headline tax rate is 15% and this is applied uniformly to all companies. The tax year runs from 1 July of a year to 30 June of the following year. The tax year is commonly known under the tax jargon as year of assessment. Tax loss is the tax-adjusted loss after deducting expenses as allowed under the Income Tax Act 1995 from the accounting profit. 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 loss with existing tax rules specified in the Income Tax Act 1995.

Tax-resident companies are taxed on a stand-alone basis and there is no group loss compensation system in Mauritius. Tax loss may be carried forward for the next five succeeding years of assessment following the year of assessment in which the loss was incurred. In the case where the losses are not fully offset against the chargeable income in the next five years of assessment, the amount of unrelieved loss shall lapse eventually. Nevertheless, the five-year limit is not applicable to a tax loss arising due to the deduction of annual allowance and hence may be carried forward indefinitely.

In the event of a takeover or 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 as 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.

The Income Tax Act 1995[3] makes provision for anti-avoidance rules to counter the effect of creating artificial losses which will result in the reduction of the overall tax liability of

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[3] The Act in Mauritius is titled the Income Tax Act 1995. However, each year the Income Tax Act is updated following the promulgation of the Finance Act.

the company. In the circumstances where the MRA determines that the amount of tax loss claimed by the taxpayer is overstated, the latter may revise the quantum of the unrelieved loss through a notice of determination.

In Mauritius, permanent establishments are taxed under the same mechanism as a tax-resident company and are subject to the same income tax laws for the computation of tax loss except with regard to the deduction of certain expenses such as interest or royalties paid to the foreign parent company.

Part One: General aspects of corporate tax losses

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 or loss, 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 on 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 income tax laws of Mauritius are governed under the Income Tax Act 1995 and are further reinforced by the Income Tax Regulations 1996 and Income Tax (Foreign Tax Credits) Regulations 1996. Under section 2 of the Income Tax Act 1995, loss for tax purposes is defined as the amount of deficit when the allowable deductions exceed the gross income in an income year. It can be inferred from the definition of loss in the Income Tax Act 1995 that loss for tax purposes differs from an accounting loss in the sense that not all expenses recognised under International Financial Reporting Standards are deductible under the income tax laws. Hence, some adjustments are required to compute the corporate tax loss.

1.1.1. *Pre-operating loss*

The preparation of financial accounts is governed by the Financial Reporting Council and also encompasses the international accounting standards as set by the International Accounting Standard Board. The international accounting standards require financial accounts to be drawn up on a true and fair basis and thus also involve the estimate of some provisions. In the case of a new start-up business, it also necessitates taking pre-operating expenses into consideration. However, section 18 of the Income Tax Act 1995 stipulates that only expenses incurred in the production of gross income are deductible to compute the taxable profit or loss. Considering this specific section, any pre-operating expenses such as

costs associated with forming and registering the company shall not be taken into account to compute the loss for tax purposes.

1.1.2. *Loss carry back*

In Mauritius, any loss incurred in a year of assessment may not be carried back to offset against the taxable profit which is known as chargeable income under the Income Tax Act 1995, arising in the previous years of assessment.

1.1.3. *Loss carry forward*

In accordance with sections 20 and 59 of the Income Tax Act 1995, any loss incurred during a year of assessment may be set off against its chargeable income by the taxpayer. Any loss incurred in a year of assessment may be carried forward for the next five years after which the said loss shall be lapsed in case it has not been offset against any chargeable income. However, it is to be noted that any loss attributable to tax depreciation which is commonly known as annual allowance under the Income Tax Act 1995, is not subject to the limit of five years and may thus be carried forward indefinitely. On the other hand, loss carry back is not allowed.

The rationale behind the limit of five years was initially proclaimed as an incentive for the economic welfare of the country, encouraging new start-ups. From a holistic point of view, the reason may be to allow start-up companies and loss-making companies to boost their financial performance which in turn will increase or contribute to the economy in the form of corporate taxes and employment taxes.

1.1.4. *Transfer of losses in reorganisation schemes*

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

When a company acquires another entity or there is a merger of companies 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.

However, if more than 50% of the employees are 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 for 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 loss relief in Mauritius.

1.1.5. *Group loss compensation*

Pursuant to the Companies Act 2001, every parent company that has one or more subsidiaries as of 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 Income Tax Act 1995.

1.1.6. *The role of anti-abuse provisions (GAARs and/or SAARs) in the context of losses*

Anti-avoidance provisions are incorporated in the Mauritius Income Tax Act where the MRA is empowered to lift the corporate veil of questionable practices of tax planning in certain circumstances. Thin capitalisation is an example of tax avoidance which is practised 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, when a person related to 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 with respect to the management fees will not be allowed as an expense for computing the chargeable income of the company. In any transaction deemed to be designed to reduce the tax liability of the company or to obtain any other tax benefit by the Director-General, the expense in relation to that transaction may not be used 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 practised by many companies. In order to counteract any excessive interest charged, it 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.

1.2. Key principles of tax treaty law relevant in case of losses

1.2.1. Profit allocation of PE's

In Mauritius, a foreign company, under the ambit of the Companies Act 2001, is defined as a body incorporated outside Mauritius and is only required to register with the Registrar 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, personal representative or trustee, whether through its employees, an agent or in any other manner.

This structure is commonly known as a branch and is treated as a Mauritius-incorporated company for most purposes. 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 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.

Some states apply a higher rate of tax on foreign companies with a permanent establishment or branch in their state. The branch will be taxed in its country of incorporation on its consolidated accounts which will include profit or losses from the Mauritius branch. In Mauritius, we do not have the concept of additional branch profit tax. Under the Double Tax Treaty Agreements concluded by Mauritius, a branch is classified as a permanent establishment, and 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 or loss 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 regarding the nature and extent of the management services rendered.

A foreign branch is subject to the same applicable laws as a resident company in claiming and carrying forward tax losses.

1.2.2. Profit/loss recognition in relation to foreign subsidiaries

There are no provisions stipulated under the Income Tax Act 1995 for group taxation or offsetting tax losses among subsidiaries as is the case in Sweden. Therefore, any loss incurred by a foreign subsidiary is neither transferable nor consolidated at the Mauritian parent level to reduce the group's tax liability.

Part Two: Utilization of corporate losses for tax planning

2.1. General overview

With economies around the globe suffering from the recent Covid-19 pandemic, the effect on the financial aspect of many businesses was seen whereby a lot of them were incurring heavy financial losses. Such losses signify a lack of tax revenue both currently and in the future where they may be offset against taxable profits.

However, tax losses may also be viewed as an open invitation for tax planning resulting in loss of tax revenues. Tax losses are treated differently in different countries. One common approach includes allowing tax losses to be offset against other income in the same period or future periods which may be capped. There are also some jurisdictions where carrying back losses is permitted, such as the United Kingdom.[4]

There are also instances where losses of a company in one country can be offset against another's profits if they are within the same group or consortium.

These provisions have been exploited so that losses can be shifted to a loss-making entity, artificial losses are created or multiple use of the same losses occurs, which leads to a fiscal mismatch. Moreover, there are also cases where planning was made to circumvent any time limit.

In the aftermath of Covid-19, many companies are keen on opting for tax loss planning, effectively using the losses created during the pandemic. This will have a negative effect on economies of countries. Therefore, revenue authorities should be more vigilant and any loopholes vis-à-vis tax loopholes.

2.2. Tax planning involving losses

2.2.1. Shifting profits to loss-making entity

Multiple schemes fall under this umbrella for instance when income is shifted to a loss-making entity via ambulatory charges such as financing, management fees and licensing

[4] For UK tax purposes, trading losses for companies may be carried back against total profits of the previous twelve months.

fees such that the loss is utilised in the loss-making company and a deduction is given on the other side to the tune of the charge.

Shifting losses can also occur where complex restructuring is done in a view to transfer the losses through companies or trusts to a loss-making entity. This is usually done with group companies. The restructuring usually includes transferring of companies and via raising financing between related companies where interest received can be used against tax losses and the interest can be claimed as expenses on the other hand.

Such tax avoidance schemes are dealt with under the General Anti-Abuse Rule ("GAAR") in Mauritius. In Mauritius, the GAAR is embedded in the Income Tax Act 1995 ("ITA"). Section 2 of the ITA defines tax avoidance to include directly or indirectly:

(a) altering the incidence of income tax;
(b) relieving any person from liability to pay income tax:
(c) avoiding, reducing, or postponing any liability to pay income tax.

Based on the definition above, one can conclude that the tax avoidance definition entails numerous tax planning schemes, including tax loss planning both at an in-country level and in cross-border transactions. These provisions are detailed under section 90(1)(a) – (g) of the ITA. Section 90 is premeditated to capture any transactions designed to avoid liability to income tax and depicted as follows:

"90. Transactions designed to avoid liability to income tax

(1) This section shall apply where any transaction has been entered into or effected and that transaction has, or would have had but for this section, the effect of conferring a tax benefit on a person, hereinafter referred to as relevant person, and having regard to –
  (a) the manner in which the transaction was entered into or carried out.
  (b) the form and substance of the transaction.
  (c) the result in relation to the operation of this Act that, but for this section, would have been achieved by the transaction.
  (d) any change in the financial position of the relevant person that has resulted, will result, or may reasonably be expected to result, from the transaction.
  (e) any change in the financial position of any person who has, or has had, any connection, whether of a business, family or other nature, with the relevant person, being a change that has resulted or may reasonably be expected to result from the transaction.
  (f) whether the transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm's length under a transaction of the kind in question; and
  (g) the participation in the transaction of a corporation resident or carrying on business outside Mauritius,

the Director-General may conclude that the person, or one of the persons, who entered into or carried out the transaction, did so for the sole or dominant purpose of enabling the relevant person, either alone or in conjunction with other persons, to obtain a tax benefit."

The definition of the term "transactions" is broad under section 90(1) of ITA covering a long but not limited list of situations for tax avoidance. Emphasis is laid on the factor of obtaining a tax benefit.

Section 90(1)(b) deals with broad issues like any transactions that are not at arm's length between related parties so it may address issues not covered by the standard CFC rule. This is strengthened by section 75 of the ITA.

The word “and” between (f) and (g) implies that both conditions need to be fulfilled simultaneously when applying the GAAR.

In practice, the GAAR is aimed at transactions involving excessive charges such as in financing income, management fees, royalties and involving transactions between related parties that are found not to be at arm’s length.

2.2.2. *Circumventing change of ownership restrictions on carry-over of losses*

There may also be instances where companies with huge losses are purchased to use the tax losses. However, such planning falls under the ambit of section 59 of ITA which relates to losses which is clarified in the Income Tax Regulation 1996 (“ITR”), detailed below:

“For the purposes of section 59(b) of the Act, where a company claims to carry forward to an income year any loss incurred by it in any former income year, the claim shall not be allowed unless the Director-General is satisfied that –

(a) at the end of each of those income years not less than 50 per cent in nominal value of the allotted shares in the company was held by or on behalf of the same persons; and
(b) where the company has paid-up capital at the end of each of those income years, not less than 50 per cent of the paid-up capital at the end of each of those income years was held by or on behalf of the same persons.”

The above section implies that if there is a change in shareholding of 50% or more, no tax losses would be allowed to be carried forward.

However, incentives were provided by the regulators in a view of the difficult economic circumstances whereby losses may be carried forward on a merger or take-over to specific type of entities.

Section 59A (1) states that where –

(a) “a company takes over another company engaged in manufacturing activities.
(b) 2 or more companies engaged in manufacturing activities merge into one company.
(c) a company takes over, or acquires the whole or part of the undertaking of another company and the Minister has deemed such a take-over or transfer of undertaking to be in the public interest, any unrelieved loss of the acquiree may be transferred to the acquirer in the income year in which the takeover or merger takes place, on such conditions relating to safeguard of employment or on such other terms and conditions as may be approved by the Minister of Finance and Economic Development (“MOFED”).”

Additionally, unrelieved losses may also be carried forward where there is a change in the shareholding of more than 50% in a manufacturing company or in a company facing financial difficulty which has accumulated unrelieved losses, provided the MOFED is satisfied that the conditions relating to safeguarding employment or other conditions that the MOFED may impose are complied with.

The carrying forward of unrelieved loss is granted after severe scrutiny and is closely monitored so that in cases where, at any time before the expiration of three years from the date of the takeover or merger, more than 50% of the employees of the acquiree taken over by the acquirer or of the employees of both the acquiree and the acquirer, are made redundant, any loss transferred shall be withdrawn and the amount of the loss so withdrawn shall be deemed to be the gross income of the acquirer in the income year in which the employees are made redundant.

It furthermore adds that any unrelieved loss transferred shall be deemed to be incurred by the acquirer in the income year in which the loss is transferred and shall be available for set-off against the net income of the acquirer.

Under the ITA, for the purpose of the section 59,

"acquiree" means a company of which the assets and liabilities have been acquired by another company through a takeover or merger;

"acquirer" means a company which has acquired the assets and liabilities of another company by means of a takeover or merger.

The GAAR, under section 90 of the ITA is used to counter such planning point however giving ample care to cater for the difficult economic circumstances.

2.2.3. *Circumventing time restrictions on the carry-over of losses*

Financial instruments and reorganizations are usually key to schemes devised to circumvent time restrictions on carry-over of losses whereby it is more beneficial for companies.

However, no such schemes were noted in past years by the revenue authority whereby attempt was made to use specific instruments to circumvent these restrictions. However, the MRA is empowered under section 90 of the ITA to counter these schemes.

2.2.4. *Incorrect application of Transfer Pricing Rule*

Currently, Mauritius does not have any specific Transfer Pricing Guidelines but follows a general rule, under the ambit of section 75 of ITA, whereby it is required for transactions between companies to be at arm's length range.

No cases were seen where losses have been challenged from a transfer pricing perspective by the MRA.

2.2.5. *Planning around rules of recognition or treatment of loss*

Mauritius does not have tax consolidation rules. Moreover, with the lapsing of losses whereby there is change of more than 50% in ownership, the planning point is remote. The MRA is yet to encounter such schemes.

Part Three: Impacts of BEPS on the treatment of losses

3.1. General overview

Mauritius currently does not have any specific transfer pricing legislation and interest deductibility regulations. Moreover, BEPS has led to the introduction of specific CFC regulation in Mauritius.

However, no impact of BEPS was encountered on treatment of losses in Mauritius.

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