K is incorporated in Mauritius as a domestic company. It has entered into a loan facility agreement with L, a UK resident company with 100% indirect interest in K. As per the loan facility agreement, L agreed to make advances to K up to an overall maximum facility of MUR 10 billion bearing interest at 8%.

K’s main activity is to hold investments in M and N (both Indian incorporated companies) and has used the facilities made available by L to finance the acquisition of these entities. During the past years K has been incurring tax losses and has not been able to repay the facilities and interest accrued as per the terms of the loan agreement.

K has been accruing interest expenses which have been treated as deductible in its annual tax returns as per the provisions of section 19 of the Income Tax Act.

As K has been making losses since its incorporation and is not in a position to settle the interest accrued and capital facilities advanced by L to date, it is now contemplating to waive some of the interest payable and convert the loan portion into equity.

1) Whether the waiving of interest claimed in the books of K will be subject to tax?
2) Whether unrelieved losses brought forward will be available for offset against future income including the income arising from reversal of accrued interest?
3) The tax implications if L releases K from its obligations of the loan capital facilities in consideration for an issuance of ordinary share capital in K.

1) Since the accrued interest had been treated as deductible expenses for tax purposes in the company’s returns for the previous years, the interest waived will be taxable upon reversal.
2) The losses carried forward will be available for set off against future income and the income arising from the waiving of interest subject to the limit of 5 succeeding years stipulated in Section 20(1) (b) of the Income Tax Act.
3) The conversion of the capital portion of the loan facilities into equity being a capital transaction will not be subject to tax under the Income Tax Act.