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Facts

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.

Points at issue

- 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.

Ruling

- 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.