TR 204

Facts

V is a public company limited by shares. V owns and operates several hotels in Mauritius, Seychelles and Morocco. V also has land available for development in Mauritius, Seychelles and Morocco (the "Land Bank"). The Land Bank includes land for property development currently undertaken in Morocco by F. F is a private company established in Morocco and is a wholly-owned subsidiary of V.

V has set up a wholly-owned subsidiary: G, a Mauritian company, to concentrate on property development. V intends to transfer the Land Bank to G: it will also transfer its investment in F to G. The investment and proposed restructuring exercise in so far as it concerns F is described below.

V would distribute its investment in G to its shareholders by way of dividend in specie. Subsequent to the distribution, V and G along with their respective subsidiaries or associates, as the case may be, would be two distinct companies with separate and distinct business activities. G would engage the required property development specialists, enabling V to focus on its hotel operations.

V has since the inception of F's property development project injected capital into F by way of equity and current account receivable. The receivable component is made up of:

(i) funds transferred from V to F ("the intercompany financing"); and

(ii) project related expenses borne on behalf of F. V recharged the project related expenses to F at cost plus 5% so that the total amount recharged by V formed part of its gross taxable income.

V in its books initially recognized –

(i) equity investment in F ; and

(ii) current account receivable from F.

These two components are assessed for impairment annually for financial reporting purposes.

V has gradually reclassified the current account receivable from F into investment (quasi equity): over the last two years, all the receivables from F have been reclassified as investment (quasi equity) by V in accordance with the relevant accounting standard. F, however, still accounts a payable in favour of V instead of equity.

<u>The carrying value of the total investments in F is made up of:</u>

- Original value of equity investment
- Current account: reclassified into quasi equity
- Gross value
- Total Impairment

V has accounted the impairment losses as unauthorized deductions for income tax purposes.

V would transfer its total investments in F at its existing carrying value to G.

V would also give G the rights to receive any future refund of current account payables recognized in the books of F. F will continue to recognize V as the creditor in its books as it is onerous and financially unfeasible to register a change of creditor from V to G in Morocco. F will therefore continue to account the payable in favour of V, and V will surrender the rights to the receivable to G by executing a proper deed with G in accordance with the Moroccan and Mauritian laws. A share transfer form would be executed under the Moroccan laws such that V would no longer be the shareholder of F.

V would record the following in its income statement:

(i) the 'refund' relating to the transfer of debt receivables will be accounted as 'other income'.

(ii) the cession of debt receivable to G will be accounted as 'other expenses'

G will account for the cession of debt receivable from V as 'other income' in its income statement.

Points at issue

V

(a) Whether the ‘refund’ relating to the transfer of debt receivable will be considered as capital in nature and therefore, outside the purview of the Income Tax Act?

(b) Whether the other expenses arising on account of cession of debt receivable to G will be treated as an allowable deduction?

G

Whether the other income arising on account of cession of debt receivable by V will be considered as capital in nature and therefore, outside the purview of the Income Tax Act?

Ruling

Based on the above facts of the case it is confirmed that:

In the books of V:

(a) the refund is in relation to a debt and is capital in nature ; and

(b) the other expenses are in connection to the cession of debt receivable to G and will not be an allowable deduction for income tax purposes.

In the books of G, the other income arising on account of cession of debt receivable by G will be capital in nature and will not be subject to income tax.