

TR 251

Facts

M was incorporated in Mauritius on 18 December 2001. M was set up as an Investment Fund with a Category 1 Global Business Licence, and consequently has been authorised to operate as a Closed-End Fund, categorised as Professional Collective Investment Scheme as per the FSC letter dated 6 January 2011.

M has appointed N to act as Fund Manager. An agreement to this effect was signed on 30 April 2002 (the "Initial Agreement"). N was incorporated in Mauritius and was a subsidiary of bank P. N was contracted to provide fund management services to M. These fund management services were provided by a division of P known as the Q who are designated advisers to N.

During the year 2013, N was acquired by a South African subsidiary of R and the Q division was taken on by R. The Initial Agreement was subsequently amended and replaced by an agreement dated 8 November 2013 made between M, Q and R ("FMA").

After a tender process, the FMA was subsequently terminated on 8 May 2016. The terms of the termination were contained in a Termination Agreement ("TA") dated 9 May 2016. Under the FMA, Q's fees consisted of a fixed fee and a performance fee (25% of the profit or loss before any taxes and performance fee).

The TA provided that for the final accounting period (1 January to 8 May 2016) outstanding fees would be calculated on the basis of management accounts for M prepared by Q in accordance with International Financial Reporting Standards ("IFRS").

Q prepared draft accounts which were sent to M on 5 August 2016 and proposed the following:

- The reversal, in whole or in part, of impairment losses on loans to two projects, against which provisions had been made in earlier periods. These amounted to USD 46,868,000 and USD 23,134,348 respectively; and
- The recognition of the value of share warrants amounting to USD 2,206,596 which had not appeared in earlier accounts at all.

M rejected those proposals and prepared accounts which maintained the provisions and recorded the value of the warrants as zero. These accounts were approved by the board of directors and were certified by its auditors on 13 October 2016. The effect of the changes made in the M accounts was to reduce the performance fee.

Q and R both disputed the amount of the performance fee and filed for arbitration, as per the terms of the FMA. The main issue of the dispute was whether the M accounts were, as the TA required, in accordance with IFRS and whether the appropriate accounts for determining the performance fee were those prepared by Q in August or those issued by M in October.

On 10 June 2021, the arbitrator concluded that the accounts prepared by M did not comply with IFRS and that M was in breach of the contract. Q was thus entitled to the performance fee it would have received if M had complied with the contract. As a result, the performance fee amounted to USD 18,052,236.10.

Subsequently, M was ordered to pay Q the sum of \$18,052,236 together with interest at the rate of 2% above the monthly London Inter-Bank Offered Rate for US Dollar, compounded annually, from 27 October 2016 to the date of final payment. M was also instructed to pay the legal fees incurred by the claimants, namely N and R.

Points at issue

Whether the below payments made by M could be treated as tax deductible for income tax purposes -

- The performance fee of \$18,052,236;
- The interest on the performance fee due;
- Legal fees payable to N and R; and
- Legal fees incurred by M?

Ruling

On the basis of the facts provided, it is ruled that:

- (i) The performance fees of \$18,052,236 to the extent it has been incurred to produce a taxable income would be treated as an allowable expense for income tax purposes.
- (ii) The interest on the performance fee would not be an allowable deduction in accordance with section 19(1) of the Income Tax Act.
- (iii) The legal fees payable to N and R and legal fees incurred by M would not be an allowable deduction as they were not been incurred exclusively in the production of gross income by virtue of section 18(1) of the Act.