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Facts

A currently has share capital consisting of Ordinary shares, and these are 100% held by B. The holder of these Ordinary shares has voting rights and the right to dividends.

(i) Creation of a new class of shares and issue of these shares to its holders

A has created a new class of shares ("the Management shares") and an agreed number of these shares have been offered to its current directors and Mr C at a nominal value of MUR 1 per share. At the date that these Management shares have been offered, the fair value was quoted in USD.

The directors of A earn monthly emoluments and are tax resident in Mauritius. Mr C is not an employee of A. He is employed in Country D by another group related entity but carried out business development for A within Country D.

The Management shares will not have voting rights, but will offer its holders the right to an agreed percentage of the annual dividend immediately post its issue.

(ii) Annual dividend distribution rights

The annual dividend distribution will be approved by the Board of A and paid out of retained earnings based on the following criteria:

1. An agreed portion of the approved dividend shall be paid to the Ordinary shareholders.

2. The Management shareholders shall be entitled to the remaining approved dividend, or the agreed percentage of the approved dividend, whichever is the lesser.

The minimum dividend paid to the Ordinary shareholders shall increase by a specific percentage annually.

Any decision to declare and pay a dividend each year will be at the discretion of the Board and only be authorised if A has sufficient retained earnings. The Management shareholders are therefore not guaranteed an annual dividend distribution as the annual dividend distribution will be entirely at the discretion of the board of A.

(iii) Option to buy back

A has an option to buy back the Management shares from the holders at the time of dismissal/retirement/resignation of any holder, or if A is sold to a third party, whichever event occurs first.

A also has an option to terminate the agreement after an agreed number of years, but is required to buy back the Management shares on termination.

At the time of any buy back, the price for the buyback shall be based on the fair value of the Management shares, based on A's most recent annual accounts.

Points at issue

(a) Whether the difference between the fair value and the nominal value of the Management shares at date of issue shall be treated as a benefit in kind to the directors and PAYE should be applied?

(b) Whether the difference between the price paid to the Management shareholders at buy back and the fair value of the Management shares at issue date shall be treated as capital gains in the hands of the Management shareholders and therefore not taxable for the Management shareholders?

(c) Whether the capital paid by A to the Management shareholders at buy back shall be deductible for tax purposes for A?

(d) Whether the annual dividend paid to the Management shareholders will be treated as dividend income in the hands of the Management shareholders?

(e) Whether Mr C shall be subject to any taxes in Mauritius as part of the above transaction?

Ruling

The creation of a new class of shares, Management shares, including the option to buy back the shares from the holders, is a scheme which has been designed to confer a tax benefit to the directors of A. The above arrangement would therefore be caught under the anti-avoidance provisions of Section 90 of the Income Tax Act.

Hence, on the basis of the above, it is ruled that:

(a) The difference between the fair value and the amount paid in respect of the Management shares at date of issue shall not be treated as a benefit in kind to the directors and PAYE shall not be applied thereon.

(b) The difference between the price paid to the Management shareholders at buy back and the fair value of the Management shares at issue date shall be revenue in nature and shall therefore be subject to income tax in the hands of the Management shareholders.

(c) Any distributions made by A in connection with the Management shares shall be deductible for tax purposes for A to the extent to which the distributions have exclusively been incurred in the production of gross income in accordance with Section 18 of the Income Tax Act.

(d) The distribution paid to the Management shareholders will be treated as a taxable benefit instead of dividend income in the hands of the Management shareholders

(e) On the basis of information provided, we are unable to give a ruling on the personal tax liability of Mr C in Mauritius.