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Facts

Company A (a company to be incorporated in Mauritius which will hold a Category 2 Global Business Licence) ("Co A") issues a convertible debenture ("CD") of ZAR 500 million to Company B (a company to be incorporated and to be listed in Mauritius on the SEM, and which will hold a Category 1 Global Business Licence) ("Co B").

The terms of the CD are as follows:

- Interest accrues at 8% per annum on the CD over a 5 year period but is only paid on redemption;
- Capital and accrued interest on the CD is paid at the option of Co A after 5 years either:
    - in cash; or
    - the issue of shares in Co A ("the Shares").

Co B will therefore realise its investment ("the Disposal") either through:

- redemption of the CD in cash by Co A; or
- sale of the CD or the shares by Co B.

The CD and the interest earned on the CD will be disregarded for accounting purposes and will be reflected as a share investment ("the Investment"). The carrying value of the investment will be either at:

- Fair value; or
- Amortised cost

with any changes in the value being reflected as a profit or loss in the income statement.

Points at issue

a) Whether the proceeds realised on the disposal of the CD or Shares will be treated as a capital gains realised by Co B?; or

b) Whether Co B will be subject to income tax in Mauritius on the proceeds realised on the disposal of the CD or Shares?

Ruling

a) Section 5(2) (a) of the Income Tax Act 1995 provides that *"income shall be deemed to be derived by a person when it has been earned or has accrued"*. In the light of the foregoing, though the interest is accrued and is only payable on redemption, Company B will be subject to income tax on the yearly interest accrued.

b) Company B being holder of a Category 1 Global Business Licence, the net gain on the disposal of the investment (excluding the accrued interest) will not be subject to tax in accordance with Items 7 and 8 of Sub-Part C of Part II of the Second Schedule to the Income Tax Act 1995.