

TR 273

Facts

M is incorporated in Mauritius and holds a Global Business Licence. M holds 50 ordinary shares in N, a company incorporated in South Africa, representing 50% of the capital of N and 50% of voting rights. Two unrelated entities hold collectively the remaining 50 Ordinary A shares in N.

O, a company based in Geneva, has previously lent and advanced a sum of Rand 920,727,090.40 (nine hundred and twenty million, seven hundred and twenty-seven thousand and ninety Rand and forty cents) (the "**Capital Sum**") to N ("**the Borrower**"). The amount was advanced pursuant to a commercial arrangement between both parties, whereby N was to develop coal assets using working capital provided by O. In return, O would become the ultimate buyer of coal meeting export grade qualities, produced by these assets.

N has been in financial difficulty for several years and was unable to meet its commitments under the arrangement as well as being unable to repay the funds to O. The main business issues for N were that it did not have sufficient capability to mine enough coal to cover the agreements. Because of the amount owed to O, N was technically insolvent, and this significantly hampered its ability to do business successfully.

During 2021 and 2022, N changed the nature of its business and undertook to become a contract mining services provider as opposed to a company which mined coal for its own account. N obtained 2 material tenders to mine coal for P, a large coal mining company in South Africa. However, these contracts required O to agree to subordinate the amount owed to it below the amount payable to P, which materially decreased the chance of repayment to O.

During 2022, N began to make small payments against the amount owed to O. However, two material risks also became clear. Firstly, that in order to execute the mining contracts, N would have to procure vast amounts of finance for equipment. This would be difficult and would require further subordination of the amount owed to O. Secondly, N came under investigation by the South African tax authorities in relation to various tax issues. Given these additional risks and because M did not want to further subordinate its debt, O indicated its interest to disengage with N on the arrangement.

Being the parent company of N and for the purpose of enabling N to continue with its operations/deliver on its contracts, M acquired the Capital Sum, together with any interest accruing thereon (collectively referred to as "**the Loan**") from O for an amount of USD 5.9 million. The amount due by N to O was therefore novated to M with effect from 17 January 2023. The relevant authorisation from the South African Bank Q was also received to allow for the novation of the Loan from O to M.

Further to the acquisition of the Loan by M, the new parties to the Loan are now M ("**Lender**") and N ("**Borrower**"). The Loan will bear interest at the prime rate charged by the South African Bank R plus 1.5%. Interest shall accrue monthly in arrears and shall be calculated on the basis of nominal, annual, compounded monthly based on a 365-day year.

M and O are not related parties. At the time of acquisition of the Loan, it was assessed that N would struggle to ever fully repay the outstanding amount. Accordingly, the Capital Sum was acquired by M from O at a nominal value (USD 5.9 million). O's willingness to sell at this price demonstrated their assessment of the risks involved with the Loan. M's purchase

of the Loan and willingness to subordinate it completely in relation to not only P's interests but also in relation to any further financing achieved in relation to purchase of necessary capital mining equipment has allowed N to achieve financing for new equipment which has in turn allowed N to win additional contracts for contract mining services. Consequently, as from April 2023, N finds itself in an improved financial position which may allow it to begin to repay the Capital Sum, plus the interest payable on the Loan. There is still no assurance that N will ever be able to repay the entire amount or even a majority of it.

M therefore acquired the Loan principal at a smaller amount (USD 5.9 million) in relation to the total debt outstanding (Rand 920,727,090.40) and it may recover a higher loan principal amount from N over the amount paid to acquire the Loan principal. M may therefore recognise a gain on the difference between the Loan principal acquisition price and the amount it will recover on the Loan principal from N.

Points at issue

- (i) Whether the gain arising for M between the acquisition price of the Loan principal (USD 5.9 million) and the amount of Loan principal that it may recover over the acquisition price is capital in nature and therefore will not be subject to income tax in Mauritius?
- (ii) Whether the interest charged on the Loan at South African Prime rate + 1.5% will be considered as an arm's length rate in accordance with section 75 of the Income Tax Act?

Ruling

On the basis of the facts mentioned above, it is ruled that –

- (i) Any gain that may arise for M between the acquisition price of the Loan principal and the amount that it may recover will be considered as capital in nature and therefore will not be subject to income tax in Mauritius.
- (ii) Interest charged by South African Bank R which is not related to M on the loan of Rand 920,727,090.40 (nine hundred and twenty million, seven hundred and twenty-seven thousand and ninety Rand and forty cents) at South African Prime rate + 1.5% will be considered as an arm's length rate in accordance with section 75 of the Income Tax Act.