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06 JULY 2022

TAX ALERT

Taxation of distributions made by fiscally transparent entities

BACKGROUND

On 1 July 2022, the Mauritius Revenue Authority ('MRA') issued a communiqué clarifying the tax treatment of capital gains distributed by foreign fiscally transparent entities. The communiqué follows the MRA's own contradictory ruling, TR 235 ruling (the "Tax Ruling").

TR 235

The Tax Ruling pertains to a GBC company (the "Company") which pools funds from investors worldwide (excluding Indian residents) to invest in India via Alternative Investments Funds Category II and III ("AIF"). The AIFs are registered as funds under the India Trusts Act and serve to pool capital from Indian and foreign investors and for re-investment as per a pre-determined strategy, akin to mutual funds. The investors hold units in and are beneficiaries of the AIFs. The AIFs accrue dividend and interest income as well as capital gains from the disposal of its investments and subsequently distribute them to unit holders, accordingly.

The Company sought to know the tax treatment of each such distribution, and whether the distributions received by the Company through the AIFs retain their initial characteristics.

The MRA ruled that *"[o]n the basis of the facts mentioned above, as a unit holder in the AIF, [the Company] will receive dividend income and capital gains from the subsequent disposal of these units. It is ruled that all income distribution made by the AIF Category II and III to [the Company] will be treated as dividend income and therefore **not** retain their initial characteristics*" (our emphasis).

Communiqué

The MRA communiqué came swiftly after a series of concerned press releases in India. It clarified that income which is distributed by a foreign fiscally transparent entity "retains its initial character in Mauritius" and as such, any capital gains eventually distributed by a foreign fiscally transparent entity to a Mauritian resident shall be treated as such, i.e., no income tax shall be applicable to the distribution.

Our Observations

The (almost) *volte-face* of the MRA is in our view well founded and necessary (in fact it is regrettable that the Tax Ruling was issued in the first place). Not only does the Tax Ruling entailed serious ramifications on the way investments are typically structured, but in our view, the ruling was wrong in law.

As aptly set out in the classic English authority *Rae v Lazard Investments Co Ltd (1963) 41 TC 1*, the basic principles of cross-border taxation provide that the taxation of any foreign income or distribution received by a local taxpayer can only be determined after considering the character and nature of the foreign income in its local jurisdiction.

In determining the character of a payment under the foreign jurisdiction, the machinery under which the payment is made and its taxation under the foreign law, is key. This does not mean that the Mauritius tax law should not be applicable; but it should only apply **after** the nature of the foreign sourced income is determined as a matter of the foreign law which regulates it.

The MRA's Tax Ruling wholly disregarded this principle by ignoring the nature of the AIF distributions and simply treated all foreign distributions as being income in nature. To the extent that tax rulings are binding on the Director General of the MRA, we would respectfully suggest that the Tax Ruling be revoked and replaced by a ruling which is correct in law, rather than left to be clarified by a hastily drawn communiqué.

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About Prism Chambers

Prism Chambers is a full-service business law firm based in Mauritius which specialises in all aspects of revenue law.

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