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# Ruling issued by the Assessment Review Committee

In the matter of:

Seacom Ltd

v/s

The Director General,
Mauritius Revenue Authority

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***Key Issue***

*Whether the interest expense incurred by Seacom Ltd on the loans taken from Seacom Capital Ltd (its holding company), which were used to grant interest-free loans to its subsidiaries, can be considered as having been incurred in the production of gross income, and therefore be considered as a tax-deductible expense?*

**Executive Summary**

On 4 March 2024, in the matter of Seacom Ltd v/s Director General, MRA, the Assessment Review Committee (ARC) ruled in favour of the Mauritius Revenue Authority (MRA) on whether interest incurred on loans entered into by Seacom which were used to grant interest free loans to related companies is deductible for corporate tax purposes under section 19 of Income Tax Act (ITA).

**Detailed Discussions**

Seacom Ltd (Seacom) holds a Global Business Licence and its principal activity is the sale of wholesale international capacity in Southern and Eastern Africa. In the Years of Assessment 2010 to 2015 Seacom took interest bearing loans and then granted interest free loans to its related companies. The MRA disallowed the interest incurred by Seacom under section 19(1) of the ITA on the basis that Seacom did not derive any income from the loans it had taken.

Section 19(1) of the ITA reads as follows:

*"subject to the other provisions of this Section, where in an income year a person has incurred expenditure on interest in respect of* ***capital employed exclusively in the production of gross income*** *[our emphasis] specified in Section 10(1)(b)(c) or (d), as the case may be, he shall be allowed in that income year, a deduction in respect of the interest from the gross income in the production of which the capital was employed."*

Seacom produces income through the provision of wholesale internet and ICT services worldwide. The Seacom cable connects to a landing station in South Africa, Mozambique, Tanzania, Kenya and others, and Seacom cannot provide local capacity to clients in these countries without the local portion. Seacom optimises income and profits by establishing its own terrestrial network through its subsidiaries/affiliates and the terrestrial network is owned by the local subsidiary/affiliate.

Amongst others, Seacom argued that:

- The interest free loans to the subsidiaries/affiliates were to ensure the local portion could provide capacity to all clients, and the interest free loans were also meant to ensure the establishment of the infrastructure by the subsidiaries/affiliates. In effect the funding model facilitated Seacom's direct connection with its clients to maximise its own profits/income.
- The subsidiaries/affiliates were not expected to generate their own profits and declare dividends. It was commercially reasonable for Seacom not to have charged interest on its subsidiaries/ affiliates.
- The funds were used by the subsidiaries/affiliates to set-up and operate the "local portion" which in turn allowed Seacom to provide services directly to various clients in those countries, generating maximum profit for Seacom in Mauritius.
- The service fees generated by Seacom are derived directly from services rendered to clients in-country, through the facilitation of the subsidiaries/affiliates. This would not have been possible without the local portion of the network.

Even though the MRA admitted that Seacom would not have been able to sell services in these countries without the subsidiaries/affiliates, the qualm of the MRA was that the capital employed by Seacom Ltd was not exclusively employed in the production of gross income, because Seacom did not charge interest to the subsidiaries and in effect did not derive any income from the capital employed by the subsidiaries: **the MRA in fact argued that under Section 19(1) of the ITA, the revenue must be matched with the expense claimed (matching concept)**. When matching revenue and expense, the MRA found that in the present case the interest expenses were incurred by Seacom on loans employed in setting up the subsidiaries/affiliates and the revenue was customer fees derived by the subsidiaries only.

The ARC agreed with the MRA, and ruled that under section 19(1) of the ITA, interest expense would be deductible only if the capital was employed in the production of gross income by Seacom. According to the ARC, it is not enough to show that the taxpayer has derived income from the whole arrangement. For the purpose of section 19(1) of the ITA, **it must be shown that the capital was employed exclusively in the production of gross income of the taxpayer**, and according to the ARC, this was not the case here: In the current matter, while the whole scheme may have allowed Seacom to derive gross income from the Seacom system (the submarine fibre optic cable system), this is not what is required for interest expense to be deductible under section 19(1) of the ITA. The test upheld by the Supreme Court in the following cases is that the interest expense must have been incurred by capital employed in the production of gross income of the taxpayer:

- In Robert Le Maire Intergraph Ltd v/s Director General, MRA (Robert Le Maire) the Supreme Court decided that even where companies exist in groups and may have identical commercial interests, **the substratum remains that each Company has and retains a personality and entity of its own.** The Supreme Court found it unreasonable and unjustifiable that the parent company in that case took loans and paid interest thereon and then passed those loans interest free to its subsidiaries. The Supreme Court found that the MRA was justified in disallowing a deduction of the interest paid to the bank from the gross income of the Applicant.
- Additionally in the case of Robert Le Maire , the Supreme Court referred to the case of Cheval de Mer Ltée v/s The MRA [2007] SCJ 210 in which the Supreme Court approved a decision of the Tribunal that there was no nexus *"whether as a first link or an essential link in a chain of causation between the capital borrowed and the production of the income so as to be within the operative meaning of the term 'employed exclusively in the production of gross income'"*.
- In the case of JP Morgan Sicav Investment Co (Mtius) Ltd v/s The ARC & Anor [2017] SCJ 23 the Supreme Court referred to the case of Mallalieu v/s Drummond (HM Inspector of Taxes) [1983] 2 AC 861 and held that *" 'exclusively' means 'only' and 'solely', that is, its plain dictionary meaning. It is also clear that the expenses allowable are not determined by the intention of the taxpayer but by the objective results achieved by such expenses."*

The ARC held that in the present case, the loans were applied by the subsidiaries/affiliates for their purposes and the subsidiaries/affiliates derived gross income therefrom. Seacom did not derive any income from the capital employed by the subsidiaries/affiliates: in the arrangement with subsidiaries/affiliates Seacom derived income from the Seacom services for which the capital (loans) was not employed. According to the ARC, there was therefore no such nexus, as the capital was employed by the subsidiaries/affiliates for the production of their own gross income. There was no first link and no essential link because Seacom could have derived gross income without setting up the subsidiaries and without incurring the interest expense.

**Concluding remarks**

It is worth noting that in this matter, the MRA did not invoke the arm's length principle under section 75 of the ITA to challenge the transaction between Seacom and its affiliates. Furthermore, since the matter of the arm's length principle was not invoked by either the MRA or the appellant in its ground of objections, the ARC did not consider the appellants' subsequent representations to the ARC to consider the arm's length principle under section 75 of the ITA. The ARC has therefore not considered the application of section 75 to this matter and the interaction of section 19 of the ITA with section 75 of the ITA.

It may be noted that in the case of Innodis Ltd, the MRA imputed interest income on the interest free loans granted by Innodis Ltd to its subsidiaries in accordance with section 75 of the ITA, and the Supreme Court ruled in favour of the MRA. There are several cases pending on interest free loans at the ARC, and the facts and circumstances of each case should therefore be independently assessed. Furthermore, we understand that Seacom has appealed to the Supreme Court on the ARC's ruling, and it remains to be seen how the matter unfolds.

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