

## Supreme Court judgment with respect to apportionment of expenses attributable to capital gains



### Background

Recently, the Supreme Court of Mauritius has held in the case of *JPMorgan Sicav Investment Company (Mauritius) Limited ("The Taxpayer") v the Assessment Review Committee ("ARC") and the Director General of the Mauritius Revenue Authority ("MRA")*, that common expenses attributable to capital gains should be disallowed, based on the following formula, in accordance with Sections 18 and 26 of the Income tax Act 1995 ("ITA"):

$$\frac{\text{Capital gains}}{\text{Income} + \text{Capital gains}} \times \text{Allowable Expenses}$$

### Facts of the case

- The Taxpayer holds a Category 1 Global Business Licence ("GBL 1") and is an investment holding company.
- The Taxpayer derived investment income in the form of dividend and interest. It also derived gain on disposal of investment.
- The Taxpayer treated all its common expenses, i.e. expenses relating to taxable as well as capital gains, as allowable expenses.

- The MRA raised an assessment for years 2004/05, 2006/07 and 2007/08 and part of the expenses claimed by the Taxpayer were disallowed as per the apportionment formula mentioned above.
- The Taxpayer made a representation before the ARC, which upheld the decisions of the MRA to disallow common expenses attributable to the capital gain.
- The Taxpayer appealed against the ARC's ruling before the Supreme Court.

### Taxpayer's contentions

- The ITA does not provide for such a formula to apportion expenses relating to both taxable income and capital gains.
- Section 26 of the ITA was not applicable to determine the assessment.
- Different principles should be used for disallowing expenses depending on the nature of such expenses.
- Expenses incurred to produce both income and capital gains are allowable under section 18 of the ITA.
- The best judgment assessment should not have been used for apportionment of expenses in respect of capital gains.

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### Supreme Court's Judgment

- Sections 18 and 26 of the ITA are not mutually exclusive and therefore, both sections should be read together regarding the deductibility of expenses.
- The MRA could use the best of judgment assessment to deal with the apportionment of expenses attributable to gross income.
- Tax ruling 50 which stipulates that expenses directly attributable to the sale of shares are not allowable is correct.
- Capital gains and exempt income are both excluded from the definition of gross income. Therefore, both expenses considered to be capital in nature and attributable to exempt income should be disallowed under sections 18 and 26.
- The expenses incurred produced two types of income; one is revenue income which arises in the trading activities and second is capital gains which is when the company decides of the right time for disposal. Thus, the expenses cannot be said to have been "exclusively" or solely incurred for the production of gross income.
- A company cannot benefit from non-taxable capital gains and at the same time benefit from deductions of the expenses which have produced such capital gains, i.e. a "double benefit".

### Our comments

- The Supreme Court's judgment does not address the issue of apportionment of expenses in case of capital loss.
- Companies deriving capital gains should review and assess the impact of this judgment on their tax liability including their tax liabilities for prior open years of assessment.

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