



The Mauritian Authorities, in the context of taxability of carried interest structured through management shares, have held that the amount received by Investment Managers on redemption of management shares is business income and not capital gains

An Investment Manager (IM) incorporated in Mauritius, holding a GBL1 licence, had filed an application for a Tax Ruling under Section 159 of the Mauritian Income Tax Act, 1995 (MITA). The issue was - whether the allocation of the redemption proceeds of the Management Shares to IM will qualify as capital gains, and hence, not be taxable in Mauritius.

The Mauritian Tax Authorities have held that the redemption proceeds cannot be said to represent a capital gain in the hands of IM. Further, the amount received by IM was remuneration for the advisory and management services it provided to the Fund LLC (the 'Fund') and is, therefore, subject to tax in Mauritius, in accordance with Section 10 of the MITA.

Facts of the case

IM was incorporated in Mauritius and was holding a GBL1 licence. Appointed as Investment Manager, it provided investment advisory services to the Fund, a closed-ended fund incorporated in Mauritius holding a GBL1 licence. In addition to a fixed advisory or management fees ranging between 1.5 percent to 2 percent, IM was entitled to receive a variable element alongside the investors in the economic benefits of the Fund, in accordance with the distribution waterfall which sets out how the proceeds from the sale of investments should be distributed between the investors and IM.

The Fund had two classes of shares, viz, Preference Shares and Management Shares. The Preference Shares were issued to investors

who commit capital in the Fund and take risks. IM was holding Management Shares which were of a nominal amount of USD10 in the Fund and was not entitled to receive any dividend. In case of winding up, it will receive the nominal paid up value of the Management Shares, after holders of Preference Shares will have received the nominal paid up value of the Preference Shares.

The Fund had subscribed for units in an Indian Trust, a contributory trust incorporated in India. The Indian Trust had, in turn, made direct equity investments in Indian companies.

The Indian Trust had remitted proceeds from divestments to the Fund by way of redemption of the units subscribed. In accordance with the constitutive documents of the Fund, the allocation of the redemption proceeds representing the cost of the units and any capital gains from the transaction was as follows:

- Return of the cost of capital contributed by the shareholders in the Fund;
- An additional amount (a preferred return) to the Fund shareholders to be calculated at an annual rate of 9 percent compounded semi-annually on all capital contributions from the time of drawdowns; and
- The balance of divestment proceeds in the ratio of 80 percent to the Fund's shareholders and 20 percent to IM.

IM may be entitled to a share of 25 percent of the preferred return at the above-referred second point varying between 6 percent and 9 percent; and in addition to this preferred return, a 20 percent share in the allocation of the balance of divestment proceeds.

Issue raised

Whether the allocation of the redemption proceeds of the Master Shares to IM will qualify as capital gains and hence not be taxable in Mauritius.

The Ruling

The Mauritian Tax Authorities have held that unlike other investors who commit capital in the Fund, IM was holding Management Shares which were of a nominal value of USD10 and it did not entitle IM to dividends. Therefore, the allocation of the redemption proceeds cannot be said to represent a capital gain in the hands of IM. The amount receivable by IM was remuneration for the advisory and management services it provided to the Fund, and is therefore subject to tax in Mauritius, in accordance with Section 10 of the MITA.

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