

Bhurtun Chambers

ARC Findings Update No. 5 of 2024:

AVAGO TECHNOLOGIES TRADING LTD V/S DIRECTOR GENERAL-MRA

ARC/IT/602/15, IT/145-16, IT/265-17

05 July 2024

FACTS

The Applicant Company (hereinafter referred to Applicant) is a GBL 1 company in Mauritius forming part of the Avago group – a multinational enterprise in the semiconductor industry. The Applicant is wholly owned by GEN IP (Singapore) which is also part of the Avago group.

By virtue of a License Agreement, the Applicant held a portfolio of IP from GEN IP which it made available to related and unrelated Contract Manufacturers for the manufacture of Avago Products. The Applicant sold the finished products to ATIS – another entity of the Avago group.

The License agreement stipulated that the Applicant would retain 7% of the Operating profits and although the Agreement was amended to provide that the Applicant would receive an arm's length return, in effect the Applicant continued to retain the 7% Operating profits as an arm's length profit. The remainder of the profits (before royalty) went to the GEN IP (IP holders) as royalty.

The Applicant sought to deduct the royalty amount under **s.18 Income Tax Act (ITA)** as allowable expenses for the years under consideration.

The Respondent did not deny that some royalty was payable and should be allowed under **s.18 ITA**. However, the Respondent did not agree that the royalty was wholly and exclusively incurred in the production of gross income. The latter was of the view that the payments of royalty were not in accordance with the arm's length principle under **s.75 ITA** and that there was a tax avoidance arrangement as envisaged under **s.90 ITA** under the license Agreement.

ISSUE

The ARC found that the issues raised in the Applicant's Grounds of Representation turned around two main issues:

- (1) Whether the royalty payment made by the Applicant for each year under consideration was an allowable deduction under **s.18 ITA**. If the whole amount of royalty paid was found to be an arm's length amount which any unrelated party would have agreed to pay, then the whole amount of royalty for each year would be allowable and the question of tax avoidance under **s.90 ITA** would not arise.
- (2) If the amount of royalty payment claimed as deduction under **s.18 ITA** is found not to be at arm's length, whether the Applicant had embarked on a scheme the sole/main purpose of which was to avoid paying tax in Mauritius as envisaged in **s.90 ITA**.

CONCLUSION AND REASONING OF THE ARC

The ARC found all the Grounds of representations of the Applicant to be devoid of any merit and ruled in favour of the Respondent.

The Committee explained that it is for an Applicant to prove that under **s.18 ITA** the whole amount claimed as royalty expenses are allowable, and that if the Applicant fails to discharge this burden of proof, it is for the MRA (Respondent) to prove that the transaction gets caught under **s.90 ITA**. In the present case, the Committee found that the Transactional Net Margin Method (TNMN) method used to attribute all residual profits to IP was not properly done. The Committee found that the Respondent was right based on information available including the research work done by the MRA Officer, not to allow the whole amount of royalty claimed and to allow only 5% of sales as deductible royalty expense because this was the trend in the industry. The Applicant had failed to prove that the amount of royalty claimed was at arm's length and was fully deductible.

Having found that the Applicant had failed to prove that the royalty expense for each year was at arm's length, the Committee proceeded to decide whether the Applicant had embarked on a scheme to avoid paying taxes in Mauritius as envisaged under **S.90 ITA**.

The Committee stated that it had no doubt the Applicant entered into the License Agreement with GEN IP and IP Holders so that it would confer a tax benefit to the Applicant. The Committee considered that the Respondent had rightly considered that the transaction had created rights or obligations which would not normally be created between person dealing with each other at arm's length under a transaction of the kind in question; and that the Respondent rightly concluded that the person, or one of the persons, who entered into or carried out the transaction, did so for the sole or dominant purpose of enabling the relevant person, either alone or in conjunction with other persons, to obtain a tax benefit.

The Committee further considered that that the royalty was purposely inflated beyond an arm's length amount for the sole/dominant purpose of the Applicant (and GEN IP in Singapore) obtaining a tax benefit in Mauritius.

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