

Mauritius aligns intellectual property incentives with nexus approach

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Executive summary

Mauritius' *Finance (Miscellaneous Provisions) Act 2017* introduced, with effect from 24 July 2017, an eight-year income tax exemption for companies set up after 1 July 2017 that are involved in innovation driven activities for the development of intellectual property (IP) assets in Mauritius. The exemption starts as from the year in which the company starts its innovation driven activities.

On 7 June 2019, the Mauritian Finance Minister amended the scope of the exemption consistent with the nexus approach described in the Organisation for Economic Co-operation and Development (OECD)/G20 Base Erosion and Profit Shifting (BEPS) Action 5 report: the nexus approach is the subject matter of the Income Tax (Amendment) Regulations 2019 (the Regulations). The eight-year income tax exemption will be provided on income derived from qualifying assets, and will depend on the level of research and development (R&D) undertaken by the company in Mauritius.

Detailed discussion

The Regulations provide that the exemption only applies in the following instances: (i) a company that carries out R&D activities that lead to the creation of the patent; (ii) copyrighted software; or (iii) only to smaller companies, with other IP that could be patented.

The methodology uses expenditure as a proxy to determine whether the R&D activity leading to the development, improvement or creation of the asset was carried out by the Mauritian company. The following formula will be applied to determine the qualifying income for the purposes of the exemption:

$$\left[\frac{\text{Qualifying expenditure on the qualifying asset or family of products or assets} + \text{Uplift expenditure}}{\text{Overall expenditure on the qualifying asset or family of products or assets}} \right] \times \text{Overall income from qualifying asset or family of products or assets}$$

Qualifying assets

Qualifying IP assets are patents and copyrighted software. In relation to smaller companies, it includes IP assets that are functionally equivalent to patents if those assets are certified as being novel, non-obvious and useful by the Mauritius Research Council. Smaller companies are those that:

- (a) Have no more than €50 million (or near equivalent in Mauritian Rupee) in global groupwide turnover; and
- (b) Do not themselves have more than gross income of €7.5 million (or near equivalent in Mauritian Rupee) by way of from all IP assets.

A five year-average applies for the purposes of the above thresholds.

In line with nexus approach under the BEPS Action 5 report, the Regulations exclude trademarks, logos and comparable assets produced by the Mauritian company.

The eight-year income tax exemption is available to a company if the qualifying IP asset results from the R&D activity undertaken by the company itself. The company must also track the overall income, the qualifying expenditure, and the overall expenditure (all three parameters resulting from the qualifying asset or family of products or assets) and it should be able to substantiate how the income and expenditures are linked to the qualifying asset or family of products or assets. "Family of products or assets" for the purposes of the Regulations means the smallest group of qualifying assets, as a common source of income, for which the qualifying expenditure and the overall expenditure can be reasonably identified.

Overall income from qualifying asset

The income tax exemption applies on the gross income from the qualifying asset or family of products or assets. The income comprises royalties, license fees, or any amount of insurance or compensation relating to the asset provided that the amounts are taxable as business profits; capital gains derived from the sale of a qualifying asset or family of products or assets would not be considered as income derived from those assets.

Qualifying expenditure

The company must have incurred the expenditure wholly and exclusively on R&D activities in Mauritius leading to the development, improvement and constitution of the qualifying IP asset, or family of products or assets. The qualifying expenditure however excludes acquisition costs (costs incurred for acquiring the IP or market value of the IP in the case of a transaction), interest payments and payments to group members for R&D activities outside of Mauritius.

The prescribed formula under the Regulations permits an "up-lift" expenditure to be included in the qualifying expenditure. The "up-lift" amount is limited to 30% of the qualifying expenditure. The up-lift may increase the amount of the qualifying expenditure, but only to the extent that the taxpayer has non-qualifying expenditure: the resulting increased qualifying expenditure should not exceed a company's overall expenditure. For this purpose, the overall expenditure means the total qualifying expenditure, acquisition costs and outsourcing costs.

Losses

Losses arising on a qualifying IP asset or family of products or assets in an income year would may be set off against the **net income** arising from the qualifying asset or family of products assets in that income year. Any excess loss would be available for carryforward to offset against the **income** (gross) from the qualifying IP asset or family of products or assets in subsequent years. The Regulations do not appear to restrict the number of years the losses may be utilized. Under the general rule, losses that are not attributable to annual allowances can be utilized against the taxable profits for the succeeding five years only.

Implications

- ▶ The changes are effective from 7 June 2019, and should be applied prospectively. Existing companies involved in IP-related activities should review and reconsider their business model in light of these changes: otherwise the exemption may not apply. Global business companies should also consider the interaction of the above changes with the transitional provisions for IP assets under the *Income Tax Act*: the transitional provisions on the repeal of the presumed foreign tax does not apply to income from certain IP assets.
- ▶ To benefit from the eight-year income tax exemption, companies should keep track of the qualifying income, qualifying expenditure and overall expenditure on qualifying IP assets. Companies should therefore review their existing processes and systems and, where required, implement an adequate mechanism to comply with the tracking requirements, and to also to substantiate how the income and expenditures are linked to the qualifying asset or family of products or assets.
- ▶ The overall income includes compensation so that any incidental income would also be taken into account for purposes of the exemption.
- ▶ Expenses are generally allowable if they are incurred in the production of the gross income of the person. The Regulations provide that the R&D expenditure should be incurred wholly and exclusively for purposes of the development activities. Expenses with dual purposes should be properly classified to ensure that the computation of the qualifying expenditure is accurate: appropriate evidence should be in place to demonstrate the purpose of the related expense.
- ▶ Clarity should be provided on the timing of the inclusion of the qualifying expenditure in the nexus formula. In that respect, BEPS Action 5 report specifically provides that the qualifying expenditure should be included at the time the expenditure is incurred irrespective of the treatment for accounting or other tax purposes.

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