

MAURITIUS REVENUE AUTHORITY

STATEMENT OF PRACTICE (SP 19/20)

TAX TREATMENT OF ASSETS ACQUIRED UNDER LEASE

(sections 18, 19, 24 & 26 of the Income Tax Act)

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1. Aim/ Objective

The aim of this Statement of Practice is to clarify the tax treatment for assets acquired under lease.

International Financial Reporting Standard (“IFRS”) 16 – *Leases* was issued by the International Accounting Standard Board on 13 January 2016 and is effective for periods beginning on or after 1 January 2019, with earlier adoption permitted. It has superseded IAS 17 wherein the classification of leases as either finance leases (“FL”) or operating leases (“OL”) for the lessees has been removed.

Entities which have adopted or will adopt IFRS 16 should follow the present Statement of Practice.

2. Current tax treatment under IAS 17

The current tax treatment under IAS 17 for lessor is as follows:

<i>Classification of lease as per IAS 17</i>	<i>Current tax treatment for lessor</i>
Operating Lease	<ul style="list-style-type: none">• Lease income received by a lessor under an OL is subject to tax when the lease income accrues to the lessor under the lease arrangement.• Annual allowance is given to the lessor in respect of the leased asset, if the leased asset qualifies as a machinery or plant.
Finance lease	<ul style="list-style-type: none">• The lessor is not allowed to claim annual allowance.• Under such circumstances, the lessor is taxed on the interest income on an accrual basis. Principal repayment is not taxable.

The current tax treatment of leases under IAS17 for a lessee is as follows:

<i>Classification of lease as per IAS 17</i>	<i>Current tax treatment for lessee</i>
Operating Lease	<ul style="list-style-type: none">• A lessee is allowed to claim the contractual lease payments as deductions.• Annual allowance is not allowed on the leased asset.
Finance lease	<ul style="list-style-type: none">• Annual allowance in respect of the leased asset would be given to the lessee.• The lessee is allowed a deduction of the interest expense on an accrual basis.• Principal repayment is not deductible.

3. Accounting treatment under IFRS 16

3.1 Treatment by lessees

A lessee would apply a single lessee accounting model. Unless exemption applies, a lessee is required to recognise:

- (i) a Right Of Use ("ROU") asset representing its rights to use underlying leased assets, and
- (ii) a lease liability representing its obligation to make lease payments.

The ROU asset will be depreciated over the term of the lease whereas the lease liability will be reduced by successive payments effected by the lessee. Further, the interest element forming part of the payment will be recorded as an expense in the statement of profit and loss together with the depreciation charge in respect of the "right of use". Subject to an election of the lessee, short-term leases (i.e where the lease period is less than 12 months) and leases for which the underlying asset is of low value may be exempted from the requirement.

3.2 Treatment by lessors

Lessors shall continue to classify each lease as finance lease or operating lease.

A lease is classified as finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset.

Examples of situations that individually or in combination would normally lead to a lease being classified as a FL are:

- a) the lessor transfers ownership of the underlying asset to the lessee by the end of the lease term;
- b) the lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised;
- c) the lease term is for the major part of the economic life of the underlying asset even if the title is not transferred;
- d) at the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset; and
- e) the underlying asset is of such a specialised nature that only the lessee can use it without major modification.

4. Tax treatment of leases following the IFRS 16

A. By lessor

Given that the accounting treatment for the lessor remains substantially unchanged, the existing tax treatment as set out in paragraph 2 above will be retained.

B. By lessee

Where the lessee recognises a lease as a balance sheet item in accordance with IFRS 16 as per paragraph 3.1 above, he will have, for income tax purposes, to determine whether it falls within the classification of finance lease or operating lease as per the criteria in paragraph 3.2 above.

In the case of a finance lease, the lessee will claim the finance cost (interest) as an allowable deduction in accordance with section 18 or 19 of the Income Tax Act and annual allowance on the value of the leasehold assets recognised in the balance sheet.

(i) In the case of an operating lease:

- a. the lessee should continue to claim the rental expenditure as a deduction in so far that it satisfies section 18 of the Income Tax Act;
- b. the interest expenses claimed in the statement of profit and loss on the lease assets under IFRS 16 will not be an allowable deduction; and
- c. the lessee will not be entitled to claim annual allowance in respect of the assets under lease if depreciation has been charged only for 'right of use' as per IFRS 16

5. Tax treatment of sub-leases under IFRS 16

A sub-lease is a transaction whereby a lessee leases an asset from a lessor (head lease) and the lessee then re-leases the same asset (as intermediate lessor or "IL") to another third party lessee (sub-lease).

For tax purposes, if the sub-lease is regarded:

- (a) as an OL, the IL would be taxed on the lease income;
- (b) as a FL and a sale is regarded to have taken place, the IL would be taxed on the interest income on an accrual basis

6. Exceptions

Entities not adopting IFRS 16 will continue to apply IAS 17 as set out in paragraph 2 above and the exception to IFRS 16 will also include:

- (i) short term lease where the lease period is less than 12 months; and
- (ii) low value assets of below or equal to Rs 50,000.

7. Application of TDS

All lease payments made to any person other than an individual or an exempt body of person, in respect of an operating lease which falls under the definition of 'rent' under section 111A(j) of the Income Tax Act shall be subject to TDS at the rate applicable under the Sixth Schedule of the Income Tax Act.

Lease payments in respect of finance lease will not be subject to TDS.

Mauritius Revenue Authority

15 June 2020