MAURITIUS REVENUE AUTHORITY

Statement of Practice (SP 5/10)

VAT on Islamic Finance Transactions (Murabaha)

Under the Guideline for Institutions Conducting Islamic Banking Business issued by the Bank of Mauritius, a contract under Murabaha is defined as a sale contract whereby the islamic banking institution sells to a client at an agreed profit-margin plus cost (selling price) a specific kind of asset that is already in its possession. This Practice Note addresses the issue of VAT on transactions between a client and a financial institution that involve the sale and repurchase of stock/asset under the Murabaha principles.

2. The financial institution purchases the stock/asset from the client and then sells it back to the client at a profit under a Murabaha arrangement. This arrangement is merely the provision of finance facility by the financial institution to the client. The profit margin added by the financial institution to the selling price may be regarded as the interest element charged under normal non-islamic finance when providing finance facilities.

3. Under Murabaha principles, the financial institution temporarily holds legal title of the stock/asset pending its repurchase by the client. During this period, the financial institution has the custody of the stock/asset without any use and enjoyment thereof. In addition, since the arrangement is simply of a financial nature, there is no transfer of risks and rewards associated with the stock/asset. In the circumstances, the purchase and sale back of the stock/asset is deemed to be outside the scope of VAT.

4. The client will recognise the sale of the stock/asset to the financial institution and the subsequent repurchase of the stock/asset at cost in his books of accounts in accordance with International Financial Reporting Standards. However, where the client is VAT registered, he will not charge VAT on the sale to the financial institution. Similarly, the financial institution will not charge VAT to the client when it sells back the stock/asset to the client.

5. As regards the additional cost incurred by the client on the repurchase of the stock/asset (i.e the agreed profit margin charged by the financial institution) this will be expensed in the income statement as a finance charge. The profit margin realized by the financial institution on the eventual sale back of the stock/asset to the client may thus be assimilated to finance charges under a finance lease agreement and is therefore exempt from VAT in accordance with item 30(a) of the First Schedule to the Value Added Tax Act.

6. However, in the event the financial institution sells the stock/asset to a person other than the client (for example, where the client makes a default in payment) it should charge VAT thereon to the third party at the applicable rate.

7. Proper records should be kept in respect of all finance transactions under Murabaha by both the client and the financial institution and should be made available to MRA officers at the time of audit.

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