

TR 214

Facts

L is incorporated in Mauritius and it currently holds a Global Business Licence and a Credit Finance Licence issued by the Financial Services Commission (FSC). L is engaged in the business of leasing equipment to customers under an Ijarah Finance Scheme (the “Ijarah Finance Scheme”).

Ijarah Finance Scheme is an Islamic financing technique used to finance the acquisition of assets on terms compliant with the principles of Shariah. In an Ijarah transaction, the financing party would typically purchase property desired by its client and then lease it to the client for a lease fee. Some Ijarah transactions give the client the right (but not the obligation) to purchase the asset at or before the end of the lease term.

The structure of such Ijarah Finance Scheme of L is as follows-

- The customer identifies the equipment it requires and makes an application for finance at L;
- L performs a due diligence on the customer prior to approving the application;
- Once the application is approved, L requests authorisation from a Shariah Board. The Shariah Board certifies the Islamic financial products as being Shariah-compliant in accordance with the Islamic Law;
- L purchases the required equipment and appoints an agent to get the equipment delivered to the customer’s premises;
- L leases the equipment directly to the customer under a lease agreement. The lease agreement will be based on the concept of Ijarah and all the rules of an Ijarah will be applicable;
- L will charge the customer a lease fee. The lease fee will comprise of –
 - (i) a capital element (the capital repayment); and
 - (ii) (ii) an effective return element (the finance income);
- At the end of the lease term, the customer has the option to either purchase the equipment from L or return the equipment to L. The Ijarah financing agreement is equivalent to a normal finance lease agreement; and

- L leases equipment directly to the final customer and there is no sub-lease agreement.

The customers of L are not tax resident in Mauritius and they are not related to L.

Points at issue

1. Whether the effective return element of the lease fee will be treated as interest income and the capital element as principal repayment for the purposes of the Income Tax Act?
2. Whether the effective return will be treated as interest income for the purposes of section 10 of the Income Tax Act and item 7 of Sub-Part B of Part II of the Second Schedule to the Income Tax Act?

Ruling

On the basis of facts mentioned above,

1. the effective return element of the lease fee under the Ijarah financing arrangement will be treated for income tax purposes as gross income derived from the leasing business. Repayment of the principal is not taxable.
2. the effective return element of the lease fee, although for accounting purposes may be characterised as interest income, will constitute the gross income of L for income tax purposes arising from the company's Shariah-compliant business of leasing equipment. Hence, it will be treated as gross income under section 10(1)(b) of the Income Tax Act rather than section 10(1)(d) of the Income Tax Act. Consequently, the income derived by L from its leasing business activities will not be treated as interest income for the purposes of item 7 of Sub-Part B of Part II of the Second Schedule to the Income Tax Act.