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Interaction between leases and taxation in Mauritius

Lease accounting has been revisited in 2016 by the International Accounting Standards Board (IASB) to introduce a single accounting model for lessees. IAS 17 which dealt with leases was replaced by IFRS 16 which became effective for annual periods beginning on or after 1 January 2019.

Previously, IAS 17 required a lessee to account for a lease expense only whereas IFRS 16 has urged the recognition of a Right Of Use asset and an underlying lease liability on the statement of financial position of the lessee. The Right Of Use asset represents the right of the lessee to use the leased asset in return for obligations to make lease payments under the lease liability. The lease accounting for lessors remained unchanged from the existing provisions of IAS 17.

Exceptions

Short term leases of less than 12 months and leases of low value fall within the exception of IFRS 16 where the lessee is not obliged to apply the new requirements of IFRS 16 and can choose not to capitalise short-term leases in the statement of financial position and rather recognise lease payments as an expense.

Amendments

IFRS 16 was subsequently amended in 2020 and 2021 to incorporate Covid 19 Related Rent Concessions, Interest Rate Benchmark Reform and recently in 2022, to account for Lease Liability in a Sale and Leaseback transaction.

Taxation

Lease arrangements are predominant in most financial transactions. Leases and taxation are interlinked, and the proper tax treatment with distinction between operating and finance leases is key.

A finance lease arrangement occurs when all risks and rewards incidental to the ownership of the leased asset is transferred to the lessee as opposed to an operating lease arrangement which restricts the risks and rewards to the lessor as there is no transfer of ownership.

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Tax treatment for Lessors

Tax treatment for lessors

Operating leases

- Lease income accrued is taxable at 15%
- Annual Allowance is granted on machinery or plant qualified as leased asset
- Where the leased asset is used in the production of both taxable and exempt income, the annual allowance is limited to the proportion of taxable income to sum of the total taxable and exempt income

Finance leases

- Interest income is taxable at 15% on a accrual basis and principal repayment is not taxable
- Annual allowance is not applicable

It is key to point out that interest derived by a leasing company does not qualify for the partial exemption regime. Conversely, income derived by companies engaged in ship and aircraft leasing, and leasing and provision of international fibre capacity may avail of the partial exemption regime after satisfying the substance conditions.

Of note, under the finance lease, considering the fact that lessors are not regarded as the ultimate owner, they are not entitled to any annual allowance on the leased asset.

Tax treatment for Lessees

IFRS 16 requires that the Right of Use Asset is depreciated over the term of the lease contract and the lease liability is amortised using the effective interest rate method. The tax treatment will differ between an operating lease and a finance lease.

Tax treatment for lessees

Operating leases

- Depreciation on Right of Use Asset is non allowable
- Claim of Annual Allowance is not permissible on Right of Use Asset
- Finance costs incurred on the lease payments cannot be claimed as deduction
- Lease payments are allowable expenses insofar as they satisfy the deductibility test of section 18 of the Income Tax Act
- Lease payments are subject to Tax Deduction at source (TDS) at the rate of 7.5% for residents and 10% for non residents

Finance leases

- Depreciation on Right of Use Asset is non allowable
- Annual Allowance can be claimed on the amount of Right of Use Asset recognised in the statement of financial position
- Finance costs on the lease payments are treated as allowable expenses in accordance with sections 18/19 of the Income Tax Act
- Lease payments cannot be claimed as deductions
- Lease payments do not qualify for TDS

Regarding a sub-lease arrangement, the intermediate lessor would be taxed on the lease income for an operating lease and on the accrued interest income for a finance lease.

Although the tax treatment seems straight forward, complex lease arrangements combined with other income generating activities may sometimes prove to be challenging in determining the overall tax impact.

Our tax advisory team shall be pleased to assist you further in case you require any clarity on the above tax treatment of assets acquired under a lease (IFRS 16) which follows the practice of the Mauritius Revenue Authority.

Get in touch with us

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