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STATEMENT OF PRACTICE SP 23/21: Tax Treatment Arising from Adoption of IFRS 15 – Revenue from Contracts with Customers

The Mauritius Revenue Authority (MRA) has on 15 th February 2021 issued a Statement of Practice to provide guidance on the tax treatment for entities which have adopted IFRS 15.

IFRS 15 is the new standard on revenue recognition which was issued by the International Accounting Standards Board (IASB) in May 2014 and is effective for accounting periods beginning on or after 1 st January 2018. An entity may adopt IFRS 15 by using one of the following methods:

Full Retrospective	Modified Retrospective
• The financial statements are presented as if IFRS 15 has always been applied • Comparatives (including the opening balance sheet) are restated.	• The financial statements are retrospectively adjusted but the cumulative impact is recognised at the date of initial application (1st January 2018 for calendar year ends) • Comparatives are not restated and are presented using existing accounting standards

ACCOUNTING TREATMENT

Unlike IAS 18 which recognises revenue based on the transfer of risks and rewards, revenue recognition under IFRS 15 is based on the transfer of control over goods and services to a customer. The amount of revenue recognised is the amount allocated to that performance obligation.

An entity must be able to reasonably measure the outcome of a performance obligation before the related revenue can be recognised. In some situations, it may not be possible to reasonably measure the outcome of a performance obligation, such as in the early stages of a long-term contract. In these circumstances, revenue is recognised only to the extent of costs incurred. Additionally, depending on the circumstances of the case, revenue can be recognised over time or at a point in time.

TAX TREATMENT

Revenue is recognised in the Income Tax Act 1995 as per the following provisions which are reproduced below:

Section 5 - Derivation of Income

“ … (2) Subject to the other provisions of this Act, income shall be deemed to be derived by a person when:
(a) It has been earned or has accrued; or …. “

Section 12 - Income received in anticipation

"Where income is derived by a person in any year by way of premium or payment in advance or in any like manner by way of anticipation, the Director-General may, on the written application of that person during the following year, apportion that income between the income year and any number of subsequent years not exceeding 5, and the part so apportioned to each of those years shall be deemed to be income derived in that year. "

For income tax purposes, the amount of revenue that must be recognised by a taxpayer in a year should be the amount of income that has accrued to him in the year. This is in line with IFRS 15 as the standard does not deviate from the accruals concept. Therefore, in most cases the accounting revenue as determined by IFRS 15 would be accepted as revenue for tax purposes.

An entity would continue to be entitled to its income once the service is performed or goods are transferred. The acceptance of the accounting revenue as determined under IFRS 15 is consistent with the above-mentioned income tax principle of 'derivation of income' laid down in Section 5(2) (a) of the Income Tax Act. However, there are some exceptions as discussed below.

- **Exceptions**

IFRS 15 will have little, if any, effect on the amount and timing of recognition in straightforward short-term arrangements. However, for long-term services contracts and multi-element arrangements, as described below, there might be significant changes to the amount or the timing of the recognition of revenue.

Nonetheless, any difference in the amount of revenue recognised under IFRS 15 from the amount recognised otherwise is largely a timing difference given that the entire amount of revenue from the contract would eventually be recognised and therefore subject to tax.

- **Advance Payment**

Advanced payment received is accounted for as a current liability in the seller's balance sheet. In case the revenue from the underlying sales is not expected to be recognised within one year, the seller should classify the liability as a long-term one. As a result, advanced payment may be deferred and recognised in future years. However, the provisions of Section 12 of the Income Tax Act as mentioned above will apply to this revenue recognition.

- **Contracts with Significant Financing Components**

As required by the standard, an entity must account for the financing effect, in the form of interest income or interest expense, when it receives advanced consideration or payments are made after goods are delivered. This is required if the timing between the transfer/ receipt of goods or services and payment is more than one year. However, these accounting adjustments for treating part of the consideration as interest are theoretical in nature and must not be taken into consideration for tax purposes.

- **Transitional Adjustments**

Irrespective of whether full retrospective method or modified retrospective method is implemented for accounting purposes, prior years' or prior accounting periods' income could be over-recognised or under-recognised when IFRS 15 is first adopted ('initial year'). This transitional adjustment can be upward or downward and, is considered revenue in nature. As such, it would be subject to tax or tax deductible in the initial year.

- **Our view**

Although Section 12 of the Income Tax Act 1995 has always been present, taxpayers have rarely been seen to apply this section of the law. As such, with the MRA's Statement of Practice, there is now clarity on how to apportion deferred revenue for tax purposes.

As stated by the MRA, applying this section might result in only a timing difference given that the entire amount of revenue from the contract would eventually be recognised.

However, for long term service contracts (above 6 years), this can cause other issues. For instance, recognising income at an early stage without corresponding expenses might lead to higher taxes in the first years compared to what would have been taxed under IFRS 15. This could affect a company's cash flow.

- **How can we help?**

At Andersen, we provide a range of accounting and tax services that are tailored to your specific needs. Our team of experienced professionals are well placed to provide guidance on the tax treatment for entities which have adopted IFRS 15.

Should you have any query, please liaise with your usual contact person at Andersen in Mauritius or write to us on info@mu.Andersen.com.

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Stewardship
We hire the best and the brightest and we invest in our people to ensure that legacy.

Independence
Our platform allows us to objectively serve as our client's advocate; the only advice and solutions we offer are those that are in the best interest of our client.

Seamless
Our firm is constructed as a global firm. We share an interest in providing the highest level of client services regardless of location.

Transparency
We value open communication, information sharing and inclusive decision making.

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