

Tax treatment of foreign exchange gains or losses

Foreign exchange gains or losses typically arise from cross border transactions which are denominated in foreign currencies. These transactions include import and export of goods and services, acquisition and disposal of assets as well as intercompany loans.

For accounting purposes, no distinction is made in the profit and loss account regarding exchange differences that are capital or revenue in nature or those that are realised or unrealised. The tax treatment of foreign exchange gains or losses differs from its accounting treatment.

For tax purposes, in the absence of a capital gains tax regime, any foreign exchange gains associated with a transaction which is capital in nature are not taxable under the Mauritius Income Tax Act ("ITA"). Any capital losses arising out of foreign exchange transactions are non-deductible as they are capital in nature.

Foreign exchange differences arising out of transactions that are revenue in nature may be realised or unrealised. Under the ITA, income tax is payable on income which is derived by a person and any income is deemed to be derived when it is earned or accrued.

The issue of whether foreign exchange gains resulting from the translation of bank balances held in foreign currencies at year end are to be regarded as accrued and subject to tax was canvassed by the Assessment Review Committee ("ARC") in the case of *Sotraviv Ltee vs the Mauritius Revenue Authority* (ARC/LTD/54-09).

The Mauritius Revenue Authority ("MRA") argued that the word "accrued" should have the meaning as ascribed under accounting standards and as long as an item is recognised in the financial statements, it would be deemed to have been accrued. *Sotraviv Ltee* contended that for income to be earned, there has to be a transaction. In the present case, there was no transaction but merely a translation exercise undertaken for reporting purposes in Mauritian rupees.

The ARC commented that income which is 'accrued' means income which has been 'ascertained but not yet received' and use of the word 'accrued' does not have the meaning 'prepared in accordance with accounting standards'.



In the Sotravac case, the ARC reproduced the following two cardinal principles of tax law:

- I. The word 'profits' connotes actual or realised and not potential or anticipated profits; and
- II. Neither profits nor losses may be anticipated

The ARC referred to several foreign tax cases, one of which was the decision of the Federal Supreme Court of Switzerland (Ref 2C_887/2009) on translation differences arising from the conversion of the financial results of a corporation from its functional currency into Swiss francs. A clear distinction had been made between foreign exchange currency translations and foreign exchange currency transactions.

It was held that gains or losses arising from a translation exercise are not subject to tax since a translation is a legal fiction unlike a real business transaction. The ARC thus concluded that unrealised gains arising on the translation of foreign bank accounts is not deemed to have been earned and therefore do not constitute income subject to tax.

The MRA issued a Statement of Practice (SP 10/12) in December 2012 which allows taxpayers the option to elect to tax only when gains of a revenue nature are realised or claim losses on a realised basis.

In the absence of an election, gains/losses of a revenue nature will be taxed/claimed as deduction even if they are unrealised. SP 10/12 does not make a distinction between transaction differences and translation differences. Since Mauritius does not have a specific legislation to provide that foreign exchange profits and losses, whether realised and unrealised, are taxable or deductible, the ARC commented that SP 10/12 does not constitute a proper application of the law.

SP 10/12 has been widely applied by taxpayers since it provides flexibility. Businesses that do not elect to be taxed on a realised basis are relieved of the administrative burden of distinguishing between realised and unrealised foreign currency transactions. At times, these transactions can be quite voluminous.

In the light of the ARC determination in the Sotravac case, we believe that in order to provide a legal basis to SP 10/12, there is a need to amend the ITA to allow taxation/deductibility of unrealised gains/losses. ■

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