

## **Summary of Responses – Public Consultation on Income Tax Implications arising from the Adoption of Financial Reporting Standard 115 - Revenue from Contracts with Customers (FRS 115)**

IRAS conducted a public consultation between 12<sup>th</sup> October 2015 to 11<sup>th</sup> November 2015 to seek feedback on the income tax implications arising from the adoption of FRS 115. Comments were received from 7 respondents. IRAS wishes to thank all respondents for their comments.

A summary of the key comments received and our responses is provided in the following paragraphs.

### **A. Acceptance of accounting revenue as determined under FRS 115 as revenue figure in assessing tax liability**

#### Comment:

We suggest that taxpayers be given a choice to opt in or opt out of FRS 115 tax treatment.

#### IRAS' response:

To minimise complexities in tax rules and compliance burden for taxpayers, the accounting revenue as determined under FRS 115 would continue to be accepted as the revenue in most cases 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 accounting revenue as determined under FRS 115 is consistent with the "entitlement to income" tax principle. As such, there is no need to provide a choice to opt in or opt out.

As mentioned in the e-Tax Guide, there are certain exceptions as follows:

- a) where specific tax has already been:
  - i) established through case law; or
  - ii) provided under the law; and
  
- b) in exceptional circumstances where the accounting treatment deviates significantly from tax principles, such as in the case of contracts with significant financing components.

### **B. Estimated expenses**

#### Comment:

IRAS has assessed that the difference between the estimated revenue recognised arising from adopting FRS 115 and the revenue for tax purposes is a mere timing difference and the entire amount of revenue from a contract would eventually be subject to tax. As such, IRAS would accept the estimated revenue as determined in accordance with FRS 115 as the revenue for tax purposes so as to avoid unnecessary complexities in tax rules and to minimise compliance burden on entities. On the other hand, IRAS is of the view that corresponding estimated expenses should only be deductible if they have been incurred by the entity, notwithstanding the accounting treatment.

The above tax treatment for estimated revenue and estimated expenses would result in a mismatch of income and expenses for tax purposes. Since the difference between the estimated expenses and the expenses allowed for tax deduction is also a mere timing difference, we propose that a tax deduction be given on the estimated expenses when they are recognised in the accounts, to the extent that they could be directly attributed to the estimated revenue recognised. If the estimated expenses are not incurred subsequently by the entity, the reversal of the expenses is to be brought to tax in the year in which the expenses are reversed.

*IRAS' response:*

Not accepted. We understand that such estimated expenses could take the form of consideration that an entity pays or is expected to pay to its customers. Under FRS 115, consideration payable to customers is accounted for as a reduction in the transaction price and therefore of revenue. For example, estimated volume rebate would be offset against estimated revenue recognised. Such estimated expenses would be offset against accounting revenue as determined under FRS 115. As such, there is no need to adopt the suggestion.

Any other estimated expenses would continue to be allowed only when they are incurred based on existing tax principles under sections 14 and 15 of the Income Tax Act (ITA).

## **C. Transitional adjustments**

### **1. When to subject transitional tax adjustments to tax**

*Comment:*

The proposal to treat the profit/loss arising from transitional adjustments as income/loss subject to tax under section 10(1)(a) of the ITA in the Year of Assessment ("YA") relating to the year in which FRS 115 is first adopted appears to be made on the assumption that the income of a business entity that has contracts with customers is automatically income that is derived from a trade, business, profession or vocation. However, this may not always be the case as when the business entity has an agreement which is a contract with customers within the scope of FRS 115, but the income may not necessarily be regarded as income from a trade, business, profession or vocation for tax purposes but rather non-trade income.

For clarity, we suggest that the proposal to treat the profit/loss arising from transitional adjustments as income/loss subject to tax in the YA relating to the year in which FRS 115 is first adopted be applied also to Singapore-sourced non-trade income.

*IRAS' response:*

Accepted. The tax treatment for transitional tax adjustments would apply to both trade income, and non-trade income within the scope of FRS 115, for example, royalty income. In the case of non-trade income, the transitional tax adjustments would apply only to such income that is remitted.

## 2. Tax rate at which transitional tax adjustments should be subject to tax

### Comment:

Some taxpayers may be aggrieved by the proposal to treat the profit/loss arising from transitional adjustments as income/loss subject to tax in the YA relating to the year in which FRS 115 is adopted. For example, when the transitional adjustments relate to a prior reporting period when the entity was enjoying one or more concessionary tax rate and / or tax exemption on its income and the company does not continue to enjoy such tax incentive subsequently after the year of change. Perhaps the IRAS could allow those taxpayers who are able to do proper tracking of FRS 115 transitional adjustments and subsequent recognition to apply the tax incentive accordingly.

### IRAS' response:

Not accepted. To ease compliance, the transitional tax adjustments would be subject to tax or allowed a deduction (as the case may be) at the same tax rate(s) that would apply to the income / loss derived by the taxpayer during the basis period of a YA where FRS 115 is first adopted (hereafter referred to as "initial year of assessment"). This approach minimises efforts to trace each adjustment back to the year in which the transaction arose and the applicable tax rate then.

To illustrate, in the case of trade income, the tax rates that would apply for each instance in the initial year of assessment are set out in the table below.

<b>Where the entity is:</b>	<b>Applicable tax rate</b>
Not enjoying any incentive on its trade income	Taxed at the applicable normal tax rate ("NTR") in the initial year of assessment
Enjoying incentive and concessionary tax rate ("CTR") on its trade income	Taxed at the applicable CTR in the initial year of assessment
Enjoying incentives and enjoying multiple CTR and / or NTR on its trade income	Apportionment to the different applicable tax rates in the initial year of assessment based on the respective revenue from the different trades

A similar approach would be adopted for non-trade income.

## 3. Additional tax payable arising from the transitional tax adjustments

### Comment:

To ease the cash flow burden of the additional tax payable as a result of the transitional tax adjustments, we suggest that a 5-year instalment plan be introduced for the payment of the additional tax payable.

### IRAS' response:

Taxpayers facing financial hardship may be granted instalment plans for payment of taxes on a case-by-case basis.

## **D. Tax treatment of significant financing components**

### *Comment:*

Briefly, it is proposed that interest income or interest expenses that are required to be recognised under FRS 115 for contracts with significant financing components would be disregarded for tax purposes. To avoid doubt, IRAS may wish to clarify that such interest expenses would not be subject to withholding tax.

### *IRAS' response:*

The interest income or expenses required to be recognised under FRS 115 for contracts with significant financing components are notional adjustments. Singapore withholding tax is not applicable to notional amounts arising only because of accounting requirements under FRS 115.