Summary of Responses: Public Consultation on Proposed Income Tax Treatment Arising from the Adoption of FRS 109 – Financial Instruments

IRAS conducted a public consultation between 1 Jul 2016 to 1 Aug 2016 to seek comments on the proposed income tax treatment for entities adopting FRS 109 (hereafter called "FRS 109 tax treatment"). Comments were received from 10 respondents. IRAS would like to thank all respondents for their comments. A summary of the key comments received and our responses is provided below.

A. Transitional tax adjustment for a taxpayer currently adopting FRS 39 tax treatment

1.

Financial Asset	C&M[1] under FRS 39	C&M under FRS 109
Equity instrument	AFS[2]	FVTPL[3]

Comment

For any amount of impairment loss on equity instrument (that is on revenue account) which had been allowed as a deduction under the FRS 39 tax treatment, IRAS has proposed to tax such amount fully in the transitional year. Unless there is a write back/reversal of the impairment loss made under FRS 39 at DIA[4], IRAS' proposed tax treatment would result in no corresponding deduction for such impairment loss upon the disposal of the equity instrument. It is therefore suggested that in the transitional year, impairment loss allowed previously under FRS 39 would not be taxed unless there is a write back/reversal of such loss.

IRAS' response

Accepted. This is based on the understanding that the impairment loss on equity instrument recognised under FRS 39 may not be written back/reversed at DIA, and accordingly the carrying value measured at FVTPL at DIA will be the same as the fair value under FRS 39 on the day immediately before DIA.

[1] C&M stands for Classification and Measurement

[2] AFS stands for Available-For-Sale

[3] FVTPL stands for Fair Value Through Profit or Loss

[4] DIA stands for the Date of Initial Application. It refers to the date when an entity first applies the requirements in the transition provisions of FRS 109 and it must be the beginning of a reporting period.

2.

Financial Asset	C&M under FRS 39	C&M under FRS 109
Debt instrument	Amortised cost	FVOCI[5]
Debt instrument	FVTPL	Amortised cost
Debt instrument	FVTPL	FVOCI
Equity instrument	FVTPL	FVOCI

Comment
The transitional tax adjustments shown in the table at paragraph 9.3 of the public consultation paper are not comprehensive. Transitional tax adjustments in respect of the above measurement categories have not been considered.

IRAS' response
Feedback in respect of debt instrument is accepted. The transitional tax adjustments in respect of the above measurement categories for debt instruments will be included in the e-Tax Guide on FRS 109 tax treatment.

Feedback in respect of equity instrument is not accepted given that there is no transitional accounting adjustment for equity instruments that transit from FVTPL under FRS 39 to FVOCI under FRS 109.

3. Additional impairment loss recognised under FRS 109 at DIA

Comment
For debt instrument on revenue account, IRAS has proposed that:
(i) impairment loss previously allowed as a deduction under the FRS 39 tax treatment will not be taxed in the transitional year unless there is a write-back/ reversal, and
(ii) additional impairment loss upon transition to FRS 109 (i.e. additional amount recognised under FRS 109 at DIA) will not be allowed as a deduction.

There seems to be an inconsistent tax treatment for impairment loss made under FRS 39 and the additional impairment loss made under FRS 109 at DIA.

IRAS' response
Accepted with modification. Under FRS 109, impairment loss is recognised using an expected credit loss model. At each reporting date, loss allowance for a financial instrument will be measured at:

- an amount equal to lifetime expected credit losses if the credit risk on that financial instrument has increased significantly since initial recognition – whether assessed on an individual or collective basis – considering all reasonable and supportable information, including that which is forward-looking; or
- an amount equal to 12-month expected credit losses if the credit risk on that financial instrument has not increased significantly since initial recognition.

For income tax purpose, only lifetime expected credit losses assessed based on evidence of a financial asset being credit-impaired at the reporting date (i.e. stage

[5] FVOCI stands for Fair Value Through Other Comprehensive Income.

3 of expected credit loss model mentioned in paragraph 7.12 of the public consultation paper), which is akin to impairment loss recognised under FRS 39 using the incurred loss model, is allowed as a deduction.

In view of the feedback, any additional impairment loss recognised under FRS 109 at DIA may be allowed as a deduction to the extent that such loss relates to lifetime expected credit losses for credit-impaired financial assets. Otherwise, no deduction will be allowed.

B. Financial asset measured at FVOCI

Comment
For equity instruments measured at FVOCI, taxpayers are required to submit a list of such instruments that are on revenue account and capital account. For debt instruments measured at FVOCI, they are required to submit a list of such instruments that are on capital account. For subsequent years of assessment after the initial application of FRS 109, taxpayers will have to update the list of equity and debt instruments with any addition or disposal of such instruments.

Whether the FVOCI equity or debt instrument is on revenue or capital account is irrelevant for tax purpose during the life of the instrument, since all gains or losses are recognised in OCI[6].

As financial assets measured at FVOCI are prima facie on capital account, for administrative convenience, one respondent suggested that IRAS could perhaps consider allowing taxpayers to submit a list of equity and debt instruments that are on revenue account. Another respondent suggested that taxpayers be required to submit the list of equity and debt instruments only in the year of disposal of such instruments.

IRAS' response
Since the cumulative gain or loss (which includes the related exchange differences) of an equity instrument previously recognised in OCI will not be reclassified from equity to profit or loss when it is derecognised, taxpayers should submit a list of all equity instruments derecognised, regardless of whether they are on revenue or capital account. The list should be submitted in the year of assessment relating to the basis period in which the derecognition occurs.

In the case of a debt instrument, while the gain or loss arising from the change in fair value of the instrument is recognised in OCI, the impairment and foreign exchange gain or loss of such instrument is recognised in profit or loss. When the debt instrument is derecognised, the cumulative gain or loss previously recognised in OCI will be reclassified from equity to profit or loss. If the debt instrument is on capital account, any impairment, foreign exchange or fair value gain or loss will not be taxable or deductible, and tax adjustment is required. Hence, for tax adjustment purpose, taxpayers should submit a list of debt

[6] OCI stands for Other Comprehensive Income.

instruments that are on capital account on a yearly basis together with their income tax returns.

C. Impairment under FRS 109

Comment

IRAS proposed that any claim for tax deduction for impairment loss under stage 3 of the expected credit loss model must be made with reasonable and supportable objective evidence. It would be helpful for IRAS to provide examples where "reasonable and supportable objective evidence" would be required to support a taxpayer's claim for impairment loss.

IRAS' response

For financial instruments that are on revenue account, only lifetime expected credit losses assessed in accordance with FRS 109 based on evidence of a financial asset being credit-impaired at the reporting date (i.e. referred to as "stage 3 of the expected credit loss model" in the public consultation paper) will be allowed as a deduction.

"Credit-impaired financial asset" and "reasonable and supportable information" are requirements in FRS 109 and details of which can be found in Appendix A of FRS 109 and paragraphs B5.5.49 to B5.5.54 of Appendix B of FRS 109 respectively.

D. Payment by instalment

Comment

Some respondents indicated that if no option to remain on pre-FRS 39 tax treatment is given, then taxpayers moving from pre-FRS 39 tax treatment to FRS 109 tax treatment may be faced with a huge tax burden in the transitional year. They should be allowed to settle the taxes by instalments over a period of time, so as to allow them to ease the cash flow impact.

IRAS' response

Accepted. To ease transition for taxpayers who may face cash flow issues due to additional tax payable arising from the move from pre-FRS 39 tax treatment to FRS 109 tax treatment, an additional 3-month instalment will be provided, upon request, for taxpayers who are currently on the pre-FRS 39 tax treatment.