INLAND REVENUE
AUTHORITY
OF SINGAPORE

IRAS e-Tax Guide

Income Tax Treatment Arising from Adoption of Financial Reporting Standard 115 (FRS 115) – Revenue from Contracts with Customers

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1. Aim

1.1 This e-Tax guide provides guidance on the tax treatment for entities adopting FRS 115 and explains the tax treatment of transitional adjustments made from the adoption of the Standard.

1.2 Section 34I and this e-Tax guide apply to you if you prepare or maintain your financial accounts for any basis period for a year of assessment in accordance with FRS 115 for the first time.

2. At a Glance

2.1 The Accounting Standards Council issued FRS 115 on 19 Nov 2014. FRS 115 is effective from annual periods beginning on or after 1 Jan 2018. Earlier application is permitted.

2.2 For tax purposes, the accounting changes under FRS 115 are relevant because the accounting profit (which includes the accounting revenue) serves as the starting point for the computation of tax liabilities.

2.3 With the adoption of FRS 115, the accounting revenue as determined in accordance with the Standard would continue to be accepted as the revenue in most cases for tax purposes, except where specific tax treatment has been established through case law or provided under the law, or where the accounting treatment deviates significantly from tax principles.

2.4 Any upward transitional adjustment that is revenue in nature would be subject to tax and any downward transitional adjustment that is revenue in nature would be deducted from the amount of exempt income or allowed as a deduction (as the case may be), in the year of assessment (“YA”) relating to the basis period in which the FRS 115 is adopted for the first time (hereafter referred to as “initial YA”).

3. Background

3.1 FRS 115[1] was developed with the objective of removing inconsistencies and weaknesses in previous revenue requirements, establishing a more robust framework for addressing revenue issues, streamlining the volume of accounting guidance, as well as improving comparability and disclosure requirements.

3.2 It applies to contracts which an entity has with its customers. Under the Standard, an entity is required to recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services, by applying the following steps:
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a) Step 1: Identify the contract(s) with a customer;
b) Step 2: Identify the performance obligations in the contract;
c) Step 3: Determine the transaction price;
d) Step 4: Allocate the transaction price to the performance obligations in the contract and
e) Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.

3.3 For more details on FRS 115, please refer to the Standard available on the Accounting Standards Council website at www.asc.gov.sg.

4 Accept Accounting Revenue Recognised under FRS 115

4.1 Broadly speaking, for income tax purposes, the amount of revenue that is recognised by a taxpayer in a year should be the amount of income that has accrued to the taxpayer in the year i.e. the amount of income that the taxpayer has become entitled to in the year. To minimise complexities in tax rules and compliance burden for taxpayers, the accounting revenue as determined in accordance with FRS 115 would be accepted as the revenue for tax purpose in most cases. 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 FRS 115 is consistent with the "entitlement to income" tax principle.

[1]FRS 115 supersedes:
a) FRS 11 *Construction Contracts*;
b) FRS 18 *Revenue*;
c) INT FRS 113 *Customer Loyalty Programmes*;
d) INT FRS 115 *Agreements for the Construction of Real Estate;*
e) INT FRS 118 *Transfers of Assets from Customers*; and
f) INT FRS 31 *Revenue- Barter Transactions Involving Advertising Services*.

4.2 Any difference in the amount of revenue recognised under FRS 115 from the amount of revenue recognised otherwise is largely a timing difference given that the entire amount of revenue from a contract would eventually be subject to tax.

4.3 However, there are a few exceptions as follows:

a) where specific tax treatment has already been: -
   (i) established through case law; or
   (ii) provided under the law[2]; and

b) in exceptional circumstances where the accounting treatment deviates significantly from tax principles, in the case of contracts with significant financing components

<u>Specific tax treatment established through case law</u>

4.4 Profits of property developers are recognised for tax purposes when a property development project is substantially completed, i.e. when the Temporary Occupation Permit is granted, regardless of the revenue recognition method adopted for accounting purposes under current accounting standards[3]. The existing tax treatment for property developers is retained with the adoption of FRS 115. For more details of the income tax treatment for property developers, please refer to the IRAS e-Tax Guide “Income Tax: Taxation of Property Developers” published on 6 Mar 2013.

<u>Significant financing components</u>

4.5 In determining the transaction price under FRS 115, an entity shall adjust the promised amount of consideration for the effects of the time value of money if the timing of payments agreed to by the parties to the contract (either explicitly or implicitly) provides a significant benefit of financing the transfer of the goods or services to the customer or the entity. Such a contract is considered to contain a significant financing component which has to be recognised under FRS 115.

4.6 An entity is required to present the effect of financing (interest revenue or interest expense) separately from the revenue from contracts with customers under certain circumstances. Such interest revenue and interest expense are notional adjustments made due to the accounting requirements under FRS 115 and should be disregarded for tax purposes.

4.7 Notional interest expenses are <u>not</u> within the scope of sections 12(6) and 45(1) of the ITA as the amounts are not incurred for tax purposes and there is no actual interest payment made to a non-resident. Tax adjustments need to be

[2] For example, section 10F of the Income Tax Act (ITA) on the ascertainment of income from certain public private partnership arrangements.
[3] MPD Pte Ltd v Comptroller of Income Tax (1998) MSTC 5, 249

made to the tax computation to disallow any notional interest expense and subject the correct amount of revenue to tax as income in the year it is earned.

4.8 Similarly, notional interest income is an accounting construct and accordingly should not be brought to tax. The necessary tax adjustments would have to be made in the tax computation to bring the correct amount of revenue to tax as income in the year it is earned.

4.9 Information relating to adjustments from significant financing components should be clearly disclosed in the tax computation.

4.10 Please refer to **Annex 1** for the examples.

5 Tax / Allow Revenue Transitional Adjustments in the initial YA

5.1 An entity would adopt FRS 115 using one of the following two methods:

a) retrospectively to each prior reporting period presented in accordance with FRS 8 Accounting Policies, Changes in Accounting Estimates and Errors; or
b) retrospectively with the cumulative effect of initially applying the FRS 115 recognised at the date of initial application (i.e. the start of the reporting period in which an entity first applies the FRS 115).

5.2 In the initial YA, there could be an over-recognition or under-recognition of income attributable to prior YAs. To avoid the need to track pre-FRS 115 determined revenue (which would be recognised later under FRS 115), any downward transitional adjustment that is revenue in nature would be deducted from the amount of exempt income or allowed as a deduction (as the case may be), in the initial YA. The related revenue would be taxed accordingly when it is subsequently recognised under FRS 115. In other words, once the transitional adjustment is allowed in the initial YA, the taxation of the related revenue starts on a clean slate and any tax adjustment needs to be made only in the initial YA.

Any upward transitional adjustment that is revenue in nature would be subject to tax and any downward adjustment that is revenue in nature would be deducted from the amount of exempt income or allowed as a deduction (as the case may be), in the year of assessment ("YA") relating to the basis period in which the FRS 115 is adopted for the first time (hereafter referred to as "initial YA").

5.3 The same would apply to income under-recognised in prior YAs. In this case, the income that was under-recognised should be taxed in the initial YA.

5.4 Regardless of whether method (a) or (b) in paragraph 5.1 is adopted for accounting purposes, the upward or downward transitional adjustments which are revenue in nature would be assessed to tax, deducted against exempt income or allowed a deduction in the initial YA[4]. This approach would minimise tracking difficulties in respect of computing the amount of revenue that should be recognised in subsequent years.

5.5 For ease of compliance, the transitional adjustment would be taxed at the rate applicable to trade income being taxed in the initial YA. This approach minimises efforts to trace each adjustment back to the year in which the transaction arose and the applicable tax rate then. To elaborate, the tax rates that would apply for each instance in the relevant YA would be:

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

5.6 Please refer to **Annex 2** for the examples.

6 Contact Information

6.1 For any enquiries on the contents of this e-Tax guide, please call IRAS at 1800-356 8622.

[4] This is similar to a previous position taken for prior year adjustments arising from compliance of SAS 11 and FRS 11 – Construction Contracts.

Annex 1 - Tax treatment for entities with contracts containing significant financing components

Example 1: Where an **advance payment** is received by the entity (i.e. the taxpayer)

- Contract to sell Product X, with upfront cash receipts of S$50,000
- Delivery in 2 years
- Taxpayer's incremental borrowing rate is 5%

Applicable journal entries (in taxpayer's books):

Dr Cash S$50,000
Cr Contract liability S$50,000
[Recognition of contract liability upon cash receipt]

During the 2 years from contract inception until the transfer of Product X:
Dr **Interest expense S$5,125** [S$50,000 x (1.05^2-1)]
Cr Contract liability S$5,125
[Recognition of interest expense on upfront payment]

Tax adjustment:
Not incurred (i.e. no legal obligation to pay) by taxpayer and therefore, not deductible.

Dr Contract liability S$55,125
Cr **Revenue S$55,125**
[Recognition of revenue for the transfer of Product X at end of 2 years]

Tax adjustment:
Revenue accrued to the taxpayer (i.e. the amount the taxpayer is entitled) should be S$50,000. **Disclosure has to be made in tax computation so that only $50,000 should be subject to tax.**

Example 2: Where a **deferred payment** is received by the entity (i.e. the taxpayer)

- Contract to sell Product Y, with deferred cash payment of S$50,000 2 years later
- Upfront delivery of Product Y
- Entity's incremental borrowing rate is 5%

Applicable journal entries (in taxpayer's books):

Dr Receivable S$45,351
Cr **Revenue S$45,351**
[Recognition of revenue and contract receivable upon delivery of Product Y]

Tax adjustment:
Revenue accrued to the taxpayer (i.e. the amount the taxpayer is entitled) is S$50,000. **Disclosure has to be made in tax computation so that full S$50,000 should be subject to tax.**

During the 2 years from contract inception until the receipt of cash payment:
Dr Receivable S$4,649 [S$45,351 x (1.05^2-1)]
Cr **Interest income S$4,649**
[Recognition of interest income]

Tax adjustment:
An accounting construct and should not be taxable. Otherwise would lead to double taxation.

Dr Cash S$50,000
Cr Receivable S$50,000
[Recognition of cash receipt at the end of 2 years]

Annex 2 – Numerical illustration of transitional adjustments

Transitional tax adjustments allowed a deduction in the initial YA

Example 3 - Gross non-trade income (not remitted)
Transitional adjustment for income over-recognised

	YA 2019		
	17%	**10%**	**Total**
	$	**$**	**$**
Gross trade revenue	5,000	6,000	11,000
Gross non-trade royalty income (not remitted)	400	-	
Apportionment ratio	5000/11000	6000/11000	
Net profit before tax	1,800	2,500	4,300
Less: Transitional adjustment for trade income over-recognised in prior YAs due to adoption of FRS 115	(909)	(1,091)	(2,000)
	891	1,409	2,300
Add: Non-tax deductible expenses	150	200	350
Adjusted profit/(loss)	1,041	1,609	2,650
Less: Separate source/non-taxable income	(400)	-	(400)
	641	1,609	2,250

Annex 2 – Numerical illustration of transitional adjustments

Transitional tax adjustments assessed to tax in the initial YA

Example 4 - Gross non-trade income (remitted)
<u>Transitional adjustment for income under-recognised</u>

	YA 2019		
	17%	**10%**	**Total**
	$	**$**	**$**
Gross trade revenue	5,000	6,000	11,000
Gross non-trade royalty income (remitted)	400	-	400
	5,400	6,000	11,400
Apportionment ratio	5400/11400	6000/11400	
Net profit before tax	1,800	2,500	4,300
<u>Add</u>: Transitional adjustment for trade income under-recognised in prior YAs due to adoption of FRS 115	947	1,053	2,000
	2,747	3,553	6,300
<u>Add</u>: Non-tax deductible expenses	150	200	350
Adjusted profit/(loss)	2,897	3,753	6,650