



INLAND REVENUE  
AUTHORITY  
OF SINGAPORE

# IRAS e-Tax Guide

Income Tax: Income Tax Treatment Arising from  
Adoption of FRS 109 – Financial Instruments



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### Abbreviations

AFS	Available-for-sale
C&M	Classification and measurement
CIT	Comptroller of Income Tax
DIA	Date of initial application of FRS 109
ECL	Expected credit loss
FRS 17	Financial Reporting Standard 17 <i>Leases</i>
FRS 39	Financial Reporting Standard 39 <i>Financial Instruments: Recognition and Measurement</i>
FRS 109	Financial Reporting Standard 109 <i>Financial Instruments</i>
FVOCI	Fair value through other comprehensive income
FVTPL	Fair value through profit or loss
ITA	Singapore Income Tax Act
MAS	Monetary Authority of Singapore
OCI	Other comprehensive income
P&L	Profit and loss account
TAM	Total asset method
YA	Year of Assessment

**1. Aim**

- 1.1 This e-Tax Guide provides guidance on the tax treatment for entities adopting FRS 109.
- 1.2 It will be relevant to you if you are required to comply with the requirements in FRS 109 for recognising, classifying and measuring financial assets, financial liabilities, and some contracts to buy or sell non-financial items.

**2. At a Glance**

- 2.1 The Accounting Standards Council issued FRS 109 in Dec 2014. FRS 109, which replaces the existing FRS 39, applies to entities for annual periods beginning on or after 1 Jan 2018. For annual periods beginning before 1 Jan 2018, an entity may choose to apply early –
  - a. FRS 109 in its entirety; or
  - b. only the requirement to present in OCI the effects of changes in the credit risk of financial liabilities that are designated as at FVTPL, without applying the other requirements in FRS 109.
- 2.2 Similar to the approach taken during the adoption of FRS 39, if a taxpayer adopts FRS 109 for accounting purpose, the tax treatment of its financial assets and financial liabilities will generally follow the accounting treatment, except where specific tax treatment has been established under case law or provided under the statutes, or where accounting treatment deviates significantly from tax principles (called in this guide “FRS 109 tax treatment”).
- 2.3 Unless an election is made, the FRS 109 tax treatment does not apply to taxpayers that do not need to comply with FRS 109 for accounting purpose<sup>1</sup>.

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<sup>1</sup> For example, taxpayers which qualify for and have chosen to comply with the Singapore Financial Reporting Standards for Small Entities.

### 3. Glossary<sup>2</sup>

12-month expected credit losses	The portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date.
Credit-impaired financial asset	<p>A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired include observable data about the following events:</p> <ul style="list-style-type: none"> <li>a. significant financial difficulty of the issuer or borrower;</li> <li>b. a breach of contract, such as a default or past due event;</li> <li>c. the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;</li> <li>d. it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;</li> <li>e. the disappearance of an active market for that financial asset because of financial difficulties; or</li> <li>f. the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.</li> </ul> <p>It may not be possible to identify a single discrete event – instead, the combined effect of several events may have caused financial assets to become credit-impaired.</p>
Effective interest method	The method that is used in the calculation of the amortised cost of a financial asset or a financial liability and in the allocation and recognition of the interest revenue or interest expense in profit or loss over the relevant period.
Lifetime expected credit losses	The expected credit losses that result from all possible default events over the expected life of a financial instrument.

<sup>2</sup> As defined in Appendix A of FRS 109.

#### **4. Current Tax Treatment**

- 4.1 Where the FRS 39 tax treatment applies, the tax treatment is aligned with the accounting treatment under FRS 39 for the following:
- a. Financial assets on revenue account;
  - b. Financial liabilities (excluding convertible debt securities) that do not constitute accretion to capital;
  - c. Impairment losses incurred on financial assets on revenue account and reversal of such losses.
- 4.2 As long as a financial instrument is on revenue account, any unrealised gain or loss recognised in the P&L will be taxable or allowable as a deduction. Without applying the FRS 39 tax treatment, such unrealised gain or loss would generally be taxable or allowable as a deduction when it is realised.
- 4.3 For financial assets on revenue account that are classified as held-to-maturity investments, or loans and receivables, the interest income subject to tax is that reflected in the P&L, calculated using the effective interest method. On the other hand, for debt securities and negotiable certificates of deposits, which are on capital account, the taxable interest income is computed based on the coupon rate or contractual interest rate and the provisions of section 10(12) of the ITA respectively.
- 4.4 If the CIT agrees that a financial asset is on capital account, any gain or loss from such an asset is neither taxed nor allowed as a deduction.
- 4.5 For financial liabilities that are on revenue account and are measured at amortised cost using the effective interest method, the interest expense computed under FRS 39 is allowed as a deduction if the conditions for deduction under the ITA are met. For financial liabilities that constitute accretion to capital, only interest expenses incurred based on the contractual interest rate, and specified borrowing costs incurred as a substitute for interest expense or to reduce interest cost, are allowed for tax deduction under section 14(1)(a) of the ITA.
- 4.6 For a hedging instrument acquired under a bona fide commercial arrangement for the sole purpose of hedging against any risk, where the underlying asset or liability is on revenue account, the unrealised gains are taxed and unrealised losses are allowed as a deduction. However, if the underlying asset or liability is on capital account, the unrealised gains or losses will not be taxed nor allowed as a deduction.
- 4.7 More details on the FRS 39 tax treatment can be found in the IRAS e-Tax Guide “Income Tax Implications arising from the Adoption of FRS 39 – Financial Instruments: Recognition & Measurement”.

## **5. Fundamentals of FRS 109**

- 5.1 Under FRS 109, financial assets are classified on the basis of the business model within which they are held and their contractual cash flow characteristics. FRS 109 introduces a FVOCI measurement category, while removing the held-to-maturity, loans and receivables, and AFS categories.
- 5.2 FRS 109 also introduces requirements relating to a financial liability designated at FVTPL, to address the fair value changes attributable to the changes in the credit risk of that financial liability. Any such attributed fair value gain or loss is to be presented in the OCI unless there is an accounting mismatch.
- 5.3 As for impairment requirement, it is no longer necessary for a loss event to have occurred before impairment losses are recognised under FRS 109. Instead, an entity always accounts for expected credit losses.
- 5.4 On the hedge accounting requirements under FRS 109, where the time value of an option contract was not designated as a hedging instrument under FRS 39, an entity must apply retrospectively the hedge accounting rules under FRS 109 to present in OCI the change in the time value of that option contract. The hedge accounting rules to present in OCI under FRS 109 also apply to the forward element of a forward contract and foreign currency basis spread of a financial instrument where the forward element and foreign currency basis spread were not designated as a hedging instrument under FRS 39.
- 5.5 A brief overview of the FRS 109 accounting treatment is provided in Annex A.

## **6. FRS 109 Tax Treatment**

- 6.1 With FRS 109 replacing FRS 39, taxpayers who apply FRS 109 for accounting purpose must apply FRS 109 tax treatment from the YA of the basis period in which FRS 109 is first applied for accounting purpose. Details of the FRS 109 tax treatment are provided in the following paragraphs and a summary of the same is in Annex B.

### **A. Financial Assets**

#### Financial assets measured at FVTPL (including those designated as at FVTPL)

- 6.2 Similar to the FRS 39 tax treatment, the tax treatment for financial assets on revenue account is aligned with the accounting treatment under FRS 109.



This means that all gains or losses (including related exchange differences<sup>3</sup>) recognised in the P&L will be taxed or allowed as a deduction, even though they are not realised.

- 6.3 For financial assets on capital account, taxpayers should submit an itemised list of these assets, including those that are derecognised during the year, to the CIT for his determination whether the assets are indeed on capital account. The list should be submitted yearly together with the income tax return. Similar to the FRS 39 tax treatment, where the CIT has agreed that the financial assets are on capital account, any gains or losses (including related exchange differences) recognised in the P&L will not be taxed or allowed as a deduction. In such a case, the taxpayer will have to track the gains or losses recognised in the P&L and make the necessary tax adjustments.

#### Financial assets measured at FVOCI

- 6.4 For equity instruments measured at FVOCI, all gains or losses (including related exchange differences<sup>4</sup>) on such instruments are recognised in OCI. At the time of derecognition<sup>5</sup>, the cumulative gains or losses previously recognised in OCI are not transferred to the P&L. To determine the appropriate tax adjustments to be made in the YA of the basis period in which an equity instrument is derecognised, taxpayers should provide the CIT with an itemised list of equity instruments derecognised; including information such as disposal proceeds, cost/carrying amount at DIA, cumulative gain or loss previously recognised in OCI and whether an equity instrument was held on capital or revenue account. The list should be submitted together with the income tax return for the YA of the basis period in which an equity instrument is derecognised. For the derecognition of equity instruments on revenue account, tax adjustments will be made in the tax computations to bring to tax or allow as a deduction (as the case may be) the cumulative gains or losses previously recognised in OCI.
- 6.5 For debt instruments measured at FVOCI, the table below shows the tax treatment.

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<sup>3</sup> Exchange differences arising on financial instruments measured at FVTPL are not separately disclosed in the financial statements (paragraph C29(52(a)) of Appendix C of FRS 109).

<sup>4</sup> All gains or losses recognised in OCI include any related foreign exchange component of an equity instrument measured at FVOCI (see paragraph B5.7.3 of Appendix B of FRS 109). Hence, any reference to gains or losses, or cumulative gains or losses, in this paragraph, includes related exchange differences.

<sup>5</sup> Time of derecognition generally refers to the time when a financial instrument is disposed of.

Debt instrument on revenue account	Debt instrument on capital account
<ul style="list-style-type: none"> <li>• Fair value gain or loss recognised in OCI will not be taxed or allowed as a deduction</li> <li>• Cumulative gains or losses previously recognised in OCI, which are transferred to the P&amp;L at the time of derecognition of the instrument, will be taxed or allowed as a deduction</li> </ul>	<ul style="list-style-type: none"> <li>• Fair value gain or loss recognised in OCI will not be taxed or allowed as a deduction</li> <li>• Cumulative gains or losses previously recognised in OCI, which are transferred to the P&amp;L at the time of derecognition of the instrument, will not be taxed or allowed as a deduction.</li> <li>• Tax adjustments are required</li> </ul>
<ul style="list-style-type: none"> <li>• Impairment loss, reversal amount of impairment loss and foreign exchange gain or loss recognised in the P&amp;L will be taxed or allowed as a deduction</li> </ul>	<ul style="list-style-type: none"> <li>• Impairment loss, reversal amount of impairment loss and foreign exchange gain or loss recognised in the P&amp;L will not be taxed or allowed as a deduction</li> <li>• Tax adjustments are required</li> </ul>
<ul style="list-style-type: none"> <li>• Interest income based on the amount recognised in the P&amp;L, which is calculated using the effective interest method under FRS 109, will be taxed</li> </ul>	<ul style="list-style-type: none"> <li>• Interest income recognised in the P&amp;L under FRS 109 will be adjusted to that computed based on the coupon/contractual interest rate<sup>6</sup> (for debt securities) and that computed based on the provisions of section 10(12) of the ITA (for negotiable certificates of deposit)</li> <li>• For discount/premium derived from debt securities, tax adjustment will be made to assess such discount/ premium to tax upon maturity or redemption of the debt securities in accordance with the provisions of section 10(8A)</li> <li>• Tax adjustments are required</li> </ul>

<sup>6</sup> This is because interest income computed in accordance with FRS 109 is based on effective interest method, which includes the transaction cost, discount and premium.

- 6.6 For debt instruments on capital account, the requirements at paragraph 6.3 to provide a yearly listing and to track the gains or losses (exchange differences and impairment) recognised in the P&L are also applicable.

Financial assets measured at amortised cost

- 6.7 The tax treatment for debt instruments measured at amortised cost is the same as that for debt instruments measured at FVOCI as shown in the table at paragraph 6.5. Where a debt instrument on revenue account is derecognised, any gain or loss on the derecognition of that instrument recognised in the P&L will be taxed or allowed as a deduction. For debt instruments on capital account, the requirements at paragraph 6.3 to provide a yearly listing and to track the gains or losses (exchange differences and impairment) recognised in the P&L are also applicable.

**B. Financial Liabilities**

- 6.8 Under FRS 109, all financial liabilities are measured at amortised cost, except for certain financial liabilities that are measured or designated as at FVTPL. The classification and measurement of financial liabilities are largely similar to those under FRS 39, except for fair value changes attributable to the changes in the credit risk of a financial liability that is designated as at FVTPL.

Financial liabilities designated as at FVTPL

- 6.9 All gains or losses (including related exchange differences) on a financial liability that is measured at FVTPL are recognised in the P&L, except for the amount of gain or loss that is attributable to the changes in the credit risk of that financial liability. Such attributed gain or loss on the effects of changes in the financial liability's credit risk will be recognised in OCI under FRS 109. However, where the presentation in OCI would create or enlarge an accounting mismatch in the P&L, such attributed gain or loss continues to be recognised in the P&L. Under FRS 39, gain or loss on the effects of changes in a financial liability's credit risk was recognised in the P&L.

6.10 The table below shows the tax treatment for financial liabilities measured or designated as at FVTPL.

Financial liability on revenue account	Financial liability on capital account
<ul style="list-style-type: none"> <li>Gain or loss (including related exchange differences and the effects of changes in the credit risk of the financial liability) recognised in the P&amp;L will be taxed or allowed as a deduction, even though they are not realised</li> </ul>	<ul style="list-style-type: none"> <li>Gain or loss (including related exchange differences and the effects of changes in the credit risk of the financial liability) recognised in the P&amp;L will not be taxed or allowed as a deduction</li> <li>Tax adjustments are required</li> </ul>
<ul style="list-style-type: none"> <li>Gain or loss on the effects of changes in the financial liability's credit risk recognised in OCI will not be taxed or allowed as a deduction</li> <li>Cumulative gains or losses on the effects of changes in the financial liability's credit risk previously recognised in OCI, which are not transferred to the P&amp;L<sup>7</sup> at the time of derecognition of that liability, will be taxed or allowed as a deduction</li> <li>Tax adjustments are required</li> </ul>	<ul style="list-style-type: none"> <li>Gain or loss on the effects of changes in the financial liability's credit risk recognised in OCI will not be taxed or allowed as a deduction</li> <li>Cumulative gains or losses on the effects of changes in the financial liability's credit risk previously recognised in OCI, which are not transferred to the P&amp;L at the time of derecognition of that liability, will not be taxed or allowed as a deduction</li> </ul>
<ul style="list-style-type: none"> <li>Interest expense, borrowing cost and the related exchange differences recognised in the P&amp;L will be allowed as a deduction</li> </ul>	<ul style="list-style-type: none"> <li>Please refer to paragraph 6.12 for the tax treatment on interest expense, borrowing cost and the related exchange differences</li> </ul>

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<sup>7</sup> Although not transferred to the P&L at the time of derecognition, an entity may transfer the cumulative gains or losses within equity (paragraph B5.7.9 of Appendix B of FRS 109).

Financial liabilities measured at amortised cost

6.11 The table below shows the tax treatment for financial liabilities measured at amortised cost.

Financial liability on revenue account	Financial liability on capital account
<ul style="list-style-type: none"> <li>Exchange differences recognised in the P&amp;L will be taxed or allowed as a deduction, even though they are not realised</li> <li>Gain or loss recognised in the P&amp;L at the time of derecognition of the financial liability will be taxed or allowed as a deduction</li> </ul>	<ul style="list-style-type: none"> <li>Exchange differences recognised in the P&amp;L will not be taxed or allowed as a deduction</li> <li>Gain or loss recognised in the P&amp;L at the time of derecognition of the financial liability will not be taxed or allowed as a deduction</li> <li>Tax adjustments are required</li> </ul>
<ul style="list-style-type: none"> <li>Interest expense and borrowing cost (both calculated using the effective interest method under FRS 109) and the related exchange differences recognised in the P&amp;L will be allowed as a deduction</li> </ul>	<ul style="list-style-type: none"> <li>Please refer to paragraph 6.12 for the tax treatment on interest expense, borrowing cost and the related exchange differences</li> </ul>

Financial liability on capital account - Interest expense, borrowing cost and related exchange differences

6.12 Interest expense and borrowing cost (including related exchange differences) recognised in the P&L under FRS 109 will not be allowed as a deduction. Instead, only interest expense incurred based on contractual interest rate and the related exchange differences on the payment of interest will be allowed as a deduction under section 14(1)(a)(i) of the ITA. Borrowing cost (other than interest expense) which is incurred as a substitute for interest expense or to reduce interest cost (known as “prescribed borrowing cost”<sup>8</sup>) will be allowed as a deduction under section 14(1)(a)(ii)<sup>9</sup>. Where such borrowing cost is in the form of a discount or premium on redemption of debt securities (including the redemption of convertible debt securities), the deduction under section 14(1)(a)(ii) is allowed as a deduction only at the time the discount or premium is incurred by the issuer (i.e. at maturity or redemption of debt securities), and the deduction is given in respect of the difference between the redemption price and the issue price of the debt securities.

<sup>8</sup> Income Tax (Deductible Borrowing Costs) Regulations 2008.

<sup>9</sup> Please refer to IRAS e-Tax Guide “Income Tax: Tax Deduction for Borrowing Costs Other Than Interest Expenses” for details.

- 6.13 The above tax treatment also applies to an issuer that issues debt securities that are convertible to another company's shares (commonly known as exchangeable debt securities).

Financial liability (whether on revenue account or on capital account) –  
Convertible debt securities

- 6.14 An issuer of convertible debt securities<sup>10</sup> (which provide an option to the holder of debt securities to convert its debt securities to the issuer's own shares) is required to reflect the liability and equity components of such debt securities separately on the issuer's statement of financial position (or balance sheet). At initial recognition, the issuer is required to fair value the liability component (as if there was no equity component), and the equity component will be the difference between the fair value of the convertible debt securities as a whole and the fair value of the liability component. Thereafter the issuer is required to amortise the discount/premium to the P&L, where the discount/premium is the difference between the redemption price and the liability component initially recognised in the financial statements.
- 6.15 For tax purpose, the discount/premium attributable to the equity component or the embedded derivative (which is the option to convert the debt securities into equity) is not allowable as a deduction because there is no actual cash outlay and such discount/premium is capital in nature (being related to the issuer's share capital). This is notwithstanding that the discount/premium attributable to the liability component may be allowable as a deduction under section 14(1). Hence, tax adjustment is required.
- 6.16 For example, if an issuer issues convertible bond at \$100 that is redeemable at a premium of \$10 and if such premium is deductible under section 14(1), and assuming the fair value of the liability component is \$95, the equity component will be \$5. During the tenure of the convertible bond, the difference between the redemption price of \$110 and fair value of liability component at initial recognition of \$95, will be amortised to the P&L in accordance with FRS 109. For tax purpose, only the premium of \$10 (being the premium on redemption) is allowable as a deduction, while the premium attributable to equity component of \$5 will not be allowed as a deduction because there is no actual cash outlay and the premium is capital in nature.

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<sup>10</sup> Paragraphs 28 to 32 of FRS 32 *Financial Instruments: Presentation*.

## C. Impairment

6.17 The key changes in impairment requirements under FRS 109 are as follows:

- a. **Impairment methodology.** Previously, under the FRS 39 incurred loss model, impairment losses are only recognised in the P&L<sup>11</sup> when there is objective evidence of impairment as a result of loss events. Under the FRS 109 ECL model, impairment losses, which represent 12-month ECL or lifetime ECL, are recognised when there is some risk of default or even in the absence of loss events.
- b. **Recognition and measurement of impairments in respect of financial guarantee contracts and loan commitments.** Impairments were previously recognised and measured as a provision under FRS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Such impairments are now recognised and measured as a provision for ECL under FRS 109.

6.18 Impairment losses recognised in the P&L in respect of credit-impaired financial instruments<sup>12</sup> that are on revenue account are allowable as a deduction. Any reversal amount subsequently recognised in the P&L is taxable and indexation<sup>13</sup> is not required in respect of the amount reversed.

6.19 No deduction will be allowed for impairment losses in respect of the following:

- a. Credit-impaired financial instruments that are on capital account;
- b. Non-credit-impaired financial instruments, regardless of whether they are on revenue or capital account.

Special rules for impairment of financial instruments on revenue account for banks (including merchant banks) and qualifying finance companies<sup>14</sup> in certain circumstances

6.20 To promote the overall robustness and stability of Singapore financial system, the impairment losses on non-credit-impaired loans and debt securities<sup>15</sup> recognised in the P&L of banks, merchant banks and qualifying finance

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<sup>11</sup> In the statement of financial position (or balance sheet), such losses are reflected as loss allowance.

<sup>12</sup> These include debt instruments, lease receivables, contract assets or loan commitments and financial guarantee contracts (paragraph 5.5.1 of FRS 109).

<sup>13</sup> Indexation is the adjustment to compensate for the reduction of tax rate between the YA a deduction was allowed to the YA the same amount is brought back to tax.

<sup>14</sup> Refer to the definition of “qualifying finance company” under section 14I(7) of the ITA.

<sup>15</sup> Under FRS 109, there is no impairment requirement for equity instruments.

companies will be allowed as a deduction, for a prescribed period<sup>16</sup>, under section 14I of the ITA<sup>17</sup>.

- 6.21 Banks, merchant banks and qualifying finance companies must satisfy the provisions in section 14I for the purpose of determining an amount of impairment to be allowed as a deduction under section 14I. In this regard, the prescribed value of investments in securities as referred to in section 14I(5), will exclude the prescribed value of investment in equity instrument. Any subsequent reversal amount of the impairment is taxable to the extent that the impairment was allowed as a deduction under section 14I. Indexation of the taxable amount is not required.

Transfer of loans by banks (including merchant banks) and finance companies

- 6.22 When a bank or finance company (called “transferor”) transfers to another entity (called “transferee”) a credit-impaired loan and a cumulative amount of impairment losses for that credit-impaired loan for which a deduction was previously allowed to the transferor, the tax treatment in the table below will apply.

Transferor	Transferee*	Tax treatment
Bank or finance company	Bank or finance company	The deduction of impairment loss previously allowed to the transferor is treated as having been allowed to the transferee.  Any subsequent reversal amount of that impairment loss is treated as a trading receipt of the transferee in the YA of the basis period in which the reversal amount is recognised in the P&L. No indexation of the reversal amount is required.
Bank or finance company	Non-bank or non-finance company	The deduction of impairment loss previously allowed to the transferor is treated as a trading receipt of the transferor in the YA of the basis period in which the date of transfer falls.

\* On date of transfer of credit-impaired loan

<sup>16</sup> Banks, merchant banks and qualifying finance companies will be able to claim a section 14I tax deduction till YA 2019 or YA 2020, depending on their financial year end.

<sup>17</sup> Should there be any additional impairment amounts for non-credit-impaired exposures as required by MAS on prudence grounds, the additional amounts will similarly be allowed as a deduction under section 14I.



- 6.23 Where the transfer by a bank or qualifying finance company is in respect of a non-credit-impaired loan, the same tax treatment shown in the table at paragraph 6.22 will apply. This is provided in section 14I.

#### **D. Hedging Instruments**

##### General tax treatment

- 6.24 For a hedging instrument that is acquired under a bona fide commercial arrangement for the sole purpose of hedging against any risk associated with an underlying asset or liability, the following tax treatment applies:
- a. Any gain or loss in respect of the hedging instrument (called the “gain on hedging instrument” or “loss on hedging instrument”) that is recognised in the P&L will be taxed or allowed as a deduction where the underlying asset or liability is on revenue account (e.g. trade receivables, and trade payable arising from inventory purchase). This is regardless of whether the gain or loss on hedging instrument is realised or unrealised.
  - b. Any gain or loss on hedging instrument recognised in the P&L will not be taxed or allowed as a deduction where the underlying asset or liability is on capital account. Hence, tax adjustment is required to disregard the gain or loss on hedging instrument recognised in the P&L.
- 6.25 On the other hand, where the gain or loss on hedging instrument is recognised in OCI, the gain or loss will not be taxed or allowed as a deduction. This is regardless of whether the underlying asset or liability is on revenue account or on capital account.

##### Option agreement as a hedging instrument

- 6.26 An option contract is an agreement between two parties, i.e. an option issuer and an option holder, where the option issuer provides the option holder with a right but not an obligation to buy or sell an underlying asset or instrument (i.e. the underlying hedged item) at a specific strike price within a specified period or on a specified date. For the provision of this right, the option issuer will charge and the option holder will pay, a premium (known as the “option premium”) under the option agreement.
- 6.27 The value of an option contract comprises two parts – intrinsic value<sup>18</sup> and time value<sup>19</sup>. Time value refers to the amount of option premium that is in excess of the intrinsic value. For accounting purpose, where the time value

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<sup>18</sup> Intrinsic value of an option is the difference between the market value of the underlying and the strike price of the option.

<sup>19</sup> Time value of an option is equal to the option premium minus intrinsic value.

of an option is excluded from hedge accounting, the change in fair value of the time value of the option is accounted for at FVTPL under FRS 39 and thus recognised in the P&L; whereas it must be recognised in OCI under FRS 109 which is to be applied retrospectively. The cumulative amount of change in fair value of the time value in OCI is subsequently either amortised to the P&L or adjusted against the initial cost of the underlying hedged item. The tax treatment at paragraph 6.24 will apply to cases where the cumulative amount in OCI is subsequently amortised to the P&L.

- 6.28 Where the cumulative amount in OCI is adjusted against the initial cost of the underlying hedged item, and the underlying hedged item relates to a qualifying machinery or plant for the purpose of claiming capital allowance under section 19 or 19A of the ITA, the amount of option premium that is included in the cost of the machinery or plant will not qualify for capital allowance. This is because option premium is a cost incurred to acquire a right under an option contract and thus it is not regarded as part of the cost of a machinery or plant for tax purpose. Accordingly, tax adjustment is required to exclude the amount of option premium from the cost of the machinery and plant when computing capital allowance.

#### **E. Interest-Free Loans, Loans at Below-Market Interest Rate and Non-Arm's Length Loans**

##### Interest-free loans (measured using effective interest method)

- 6.29 Where an interest-free loan is measured using the effective interest method, an effective interest rate is imputed using a comparable market interest rate (of say 5%). As a result, there will be a "loss" (or "gain") recognised at initial recognition of the loan. Such "loss" (or "gain") on the interest-free loan will be recognised in the P&L, either immediately at initial recognition of the loan or amortised over the life of the loan. In addition, an "interest income" (or "interest expense") imputed based on the market interest rate (of say 5%) will be recognised in the P&L over the life of the loan. As they are merely book entries, there is neither receipt nor payment for such imputed "interest income" (or "gain") and "loss" (or imputed "interest expense") under an interest free loan. Hence, despite the accounting treatment, the imputed "interest income" (or "gain") recognised in the P&L will not be taxed and the "loss" (or imputed "interest expense") recognised in the P&L will not be allowed as a deduction. Tax adjustments will be required to disregard these items.

##### Loans at below-market interest rate (measured using effective interest method)

- 6.30 The accounting treatment for an interest-free loan is also applicable to a loan at below-market interest rate. An example of a loan at a below-market interest rate is a loan provided by an employer to its employees (as a form of employee benefit) at an interest rate of say 1% when the market interest rate is say 5%. In this case, there will be a "deferred staff cost" recognised at initial

recognition of the loan. Depending on the condition(s) attached to the loan, such “deferred staff cost” may be recognised immediately to the P&L, or amortised and recognised in the P&L over the life of the loan. In addition, apart from the interest received computed based on the contractual interest rate of say 1%, there will be an “interest income” recognised in the P&L over the life of the loan which is imputed based on the market interest rate of say 5%. The difference between the amount of imputed “interest income” and the amount of “deferred staff cost” that are recognised in the P&L, over the life of the loan, adds up to the total amount of interest received computed based on the contractual interest rate. Despite the accounting treatment, the imputed “interest income” recognised in the P&L will not be taxed and the “deferred staff cost” recognised in the P&L will not be allowed as a deduction because they are merely book entries. For tax purpose, only the interest income computed based on the contractual interest rate will be taxed. Tax adjustments will be required to disregard any imputed “interest income” and “deferred staff cost” recognised in the P&L.

Non-arm’s length loans (measured using effective interest method)

- 6.31 For a non-arm’s length loan, the accounting treatment and the tax treatment are similar to those of an interest-free loan and a loan at below-market interest rate. Any imputed “interest income” (or “gain” on loan) recognised in the P&L will not be taxed and any “loss” on loan (or imputed “interest expense”) recognised in the P&L will not be allowed as a deduction because they are merely book entries. Tax adjustments will be required to disregard these items. For tax purpose, only interest expense computed based on contractual interest rate will be allowed as a deduction and interest income computed based on contractual interest rate will be taxed. In addition, as such loan is not transacted at arm’s length, the CIT is not precluded from making further adjustment to the interest income or interest expense based on the arm’s length principle<sup>20</sup>.

**F. YA of Adjustment where a Financial Instrument is Discovered to be on Revenue Account instead of on Capital Account and Vice Versa**

- 6.32 Where in any YA, there is information showing that a financial instrument (regardless of an asset or a liability) ought to be regarded as on revenue account instead of on capital account, or vice versa, instead of revising or amending the assessments for the earlier YAs, all the tax adjustments in respect of the gains or losses of that financial instrument that were previously recognised in the P&L (regardless of unrealised or realised), will be made in the YA in which the financial instrument is discovered to be regarded as such. The same tax treatment will also apply to the gain or loss in respect of the related hedging instruments.

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<sup>20</sup> Section 34D of the ITA applies.

- 6.33 Despite the above, any additional assessment must be made within the period of four years beginning immediately after the end of the YA of the basis period in which the financial instrument is disposed of.

Example

- Taxpayer's financial year ends on 31 December
- Taxpayer has two financial instruments, both disposed of in 2018
  - Instrument A – Treated as on capital account; cumulative gains (including those that were unrealised previously) have not been taxed
  - Instrument B – Treated as on revenue account; cumulative losses (including those that were unrealised previously) have been allowed as a deduction
- In 2021, CIT discovers that –
  - Instrument A ought to be on revenue account
  - Instrument B ought to be on capital account
- CIT to raise additional assessment for YA 2021 (i.e. YA of discovery) by 31 Dec 2023

- 6.34 As for the issuance of any amended assessment, a claim must be made by the taxpayer within the period of four years beginning immediately after the end of the YA of the basis period in which the financial instrument is disposed of.

Example

- Taxpayer's financial year ends on 31 December
- Taxpayer has two financial instruments, both disposed of in 2018
  - Instrument C – Treated as on capital account; cumulative losses (including those that were unrealised previously) have not been allowed as a deduction
  - Instrument D – Treated as on revenue account; cumulative gains (including those that were unrealised previously) have been taxed
- In 2021, CIT discovers that –
  - Instrument C ought to be on revenue account
  - Instrument D ought to be on capital account
- Taxpayer to make a claim, in writing, to the CIT by 31 Dec 2023
- Subject to the CIT's agreement, an amended assessment for YA 2021 will be issued

## **7. Value of Assets to be Used in the Total Asset Method (“TAM”) for Computing Interest Adjustment**

- 7.1 Previously, for taxpayers who have not opted out of FRS 39 tax treatment, by default, the value of financial assets to be used in the TAM<sup>21</sup> when making interest adjustment is the value reported in the statement of financial position (or balance sheet) without adjustment for any impairment allowances made and valuation surplus/deficit. Despite the default treatment, taxpayers may elect to use the historical cost of the financial assets as the value of the assets when making interest adjustments using the TAM. Once elected, the historical cost must be applied consistently.
- 7.2 Taxpayers, who were on FRS 39 tax treatment and had previously elected to use historical cost as the value of their financial assets for TAM purpose, can continue to use the historical cost as the value of their financial assets for TAM purpose when they transit into FRS 109 tax treatment. For these taxpayers, they must continue to track the historical costs of all assets separately and keep proper records on such costs.
- 7.3 For taxpayers who did not make an election to use historical cost as the value of their financial assets for TAM purpose while they were on FRS 39 tax treatment<sup>22</sup>, the election is no longer available to them after they transit into FRS 109 tax treatment. These taxpayers will continue to use the value of financial assets reported in the statement of financial position (or balance sheet) as the value of assets for TAM purpose. Where such taxpayers have entered into an option agreement to hedge against the cost of the acquisition of their machinery or plant, the value of the machinery or plant to be used for TAM purpose is the cost of the machinery or plant without the amount of option premium.
- 7.4 While the default treatment for the value of financial assets to be used for TAM purpose under FRS 109 tax treatment is the value of the financial assets reported in the statement of financial position (or balance sheet), taxpayers whose first set of financial accounts is prepared and maintained in accordance with FRS 109 and who wish to use the historical cost of their financial assets as the value of assets for TAM purpose, can submit a written election<sup>23</sup> to the CIT together with their first income tax return. Once an election is made, these taxpayers must ensure that:

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<sup>21</sup> Please refer to IRAS e-Tax Guide “Income Tax: Total Asset Method for Interest Adjustment” for more details on TAM.

<sup>22</sup> This includes taxpayers who have made an election to use historical cost while they were on FRS 39 tax treatment but have subsequently opted to use the value of the financial assets as shown in the statement of financial position (or balance sheet).

<sup>23</sup> An election is taken as having been made if a taxpayer submits a tax computation using the historical cost of its financial assets as the value of assets when making interest adjustment using the TAM.

- a. The historical costs of all financial assets are tracked separately;
  - b. Proper records on the cost of all financial assets are kept; and
  - c. The historical cost is applied consistently to the TAM when making interest adjustments.
- 7.5 The following taxpayers, that have previously elected to use historical cost of their financial assets as the value of assets for TAM purpose, will continue to apply the historical cost consistently:
- a. Taxpayers that do not need to comply with FRS 109
  - b. Insurer that apply the temporary exemption from FRS 109
- 7.6 Regardless of when the election to use historical cost is made (i.e. when under FRS 39 tax treatment or FRS 109 tax treatment), taxpayers may, at any time thereafter, exercise an **irrevocable** option to use the value of their financial assets as shown in the statement of financial position (or balance sheet) as the value of assets for TAM purpose.

## 8. Transition to FRS 109 Tax Treatment

- 8.1 When FRS 109 is first applied for accounting purpose (i.e. at DIA), a taxpayer may have to reclassify its financial assets and financial liabilities, and remeasure the carrying amounts of the reclassified financial assets and financial liabilities in accordance with FRS 109. Any difference between the remeasured carrying amount at DIA<sup>24</sup> and the previous carrying amount<sup>25</sup>, which represents the unrealised gain or unrealised loss, is recognised in the opening retained earnings at DIA<sup>26</sup> (or other components of equity, as appropriate).
- 8.2 In addition, the taxpayer must apply the impairment requirements in accordance with FRS 109 for the recognition and measurement of a loss allowance<sup>27</sup> for a financial asset, a lease receivable, a contract asset or a loan commitment and a financial guarantee contract. Any difference between –

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<sup>24</sup> Remeasured carrying amount at DIA refers to the remeasured carrying amount at the beginning of the financial year in which FRS 109 is first applied.

<sup>25</sup> Previous carrying amount refers to the carrying amount at the end of the financial year immediately before the DIA.

<sup>26</sup> Opening retained earnings at DIA refers to the balance of retained earnings at the beginning of the financial year in which FRS 109 is first applied.

<sup>27</sup> Loss allowance is defined in FRS 109 to mean the allowance for ECL on financial assets measured at amortised cost, lease receivables and contract assets, the accumulated impairment amount for financial assets measured at FVOCI and the provision for ECL on loan commitments and financial guarantee contracts.

- a. the opening loss allowance at DIA determined in accordance with FRS 109; and
- b. the ending<sup>28</sup> impairment allowance in accordance with FRS 39 or provision in accordance with FRS 37,

which represents the impairment loss or impairment gain (i.e. reversal), is recognised in the opening retained earnings at DIA.

8.3 The unrealised gain or loss and the impairment loss or gain, recognised at DIA, are collectively known as the transitional accounting adjustment. Where the transitional accounting adjustment is recognised in other components of equity at DIA, there will be no tax adjustment required. However, where the transitional accounting adjustment is recognised in the opening retained earnings at DIA, it may, under certain circumstances, be subject to tax or allowed as a deduction in the YA of the basis period in which FRS 109 is first applied (“transitional YA”). The transitional YA is also the first YA in which FRS 109 tax treatment applies.

#### A. Transition from FRS 39 Tax Treatment to FRS 109 Tax Treatment

8.4 The tables below show the applicable tax treatment for transitional accounting adjustments that are recognised in the opening retained earnings at DIA. Taxpayers are required to show the details of how each tax adjustment is arrived at in their tax computations and must keep sufficient documents to support the tax adjustments. Taxpayers are not required to submit the documents with their income tax returns but must do so upon the CIT’s request.

**Table A: Financial Asset – Equity Instrument**

	C&M under		Tax treatment in transitional YA
	FRS 39	FRS 109	
i.	AFS/ Unquoted equity instrument carried at cost <sup>29</sup>	FVTPL	<u>Financial asset on revenue account</u> <ul style="list-style-type: none"> <li>• To tax or allow as a deduction, the unrealised gain or loss, recognised in the opening retained earnings at DIA</li> </ul> <u>Financial asset on capital account</u>

<sup>28</sup> Ending impairment allowance and provision refer to the amount of impairment allowance and provision as at the end of the financial year immediately before the DIA.

<sup>29</sup> The category of “financial assets carried at cost” also includes a derivative asset that is linked to, and must be settled by, delivery of an unquoted equity instrument. Such derivative asset is accounted for at cost in accordance with FRS 39 (see paragraph 66 of FRS 39). See paragraph 7.2.12 of FRS 109 for the transitional accounting adjustment.

	C&M under		Tax treatment in transitional YA
	FRS 39	FRS 109	
			<ul style="list-style-type: none"> <li>No tax adjustment is required</li> </ul>

**Table B: Financial Asset – Debt Instrument, Loans and Receivables**

	C&M under		Tax treatment in transitional YA
	FRS 39	FRS 109	
i.	AFS/ Amortised Cost	FVTPL	<p><u>Financial asset on revenue account</u></p> <ul style="list-style-type: none"> <li>To tax or allow as a deduction, the unrealised gain or loss, recognised in the opening retained earnings at DIA</li> <li>To tax, the reversal amount of impairment loss, recognised in the opening retained earnings at DIA, to the extent that the amount had been previously allowed as a deduction under FRS 39 tax treatment</li> </ul> <p><u>Financial asset on capital account</u></p> <ul style="list-style-type: none"> <li>No tax adjustment is required</li> </ul>
ii.	AFS/ Amortised Cost	FVOCI/ Amortised Cost	<p><u>Financial asset on revenue account</u></p> <ul style="list-style-type: none"> <li>To tax, the reversal amount of impairment loss, recognised in the opening retained earnings at DIA, to the extent that the amount had been previously allowed as a deduction under FRS 39 tax treatment</li> <li>To allow as a deduction, the impairment loss recognised in the opening retained earnings at DIA, to the extent that the amount is in respect of a credit-impaired financial instrument</li> </ul> <p><u>Financial asset on capital account</u></p> <ul style="list-style-type: none"> <li>No tax adjustment is required</li> </ul>
iii.	FVTPL	FVOCI/ Amortised Cost	<p><u>Financial asset on revenue account</u></p> <ul style="list-style-type: none"> <li>To tax or allow as a deduction, the unrealised gain or loss, recognised in the opening retained earnings at DIA</li> <li>To allow as a deduction, the impairment loss recognised in the opening retained earnings at DIA, to the extent that the</li> </ul>



	C&M under		Tax treatment in transitional YA
	FRS 39	FRS 109	
			<p>amount is in respect of a credit-impaired financial instrument</p> <p><u>Financial asset on capital account</u></p> <ul style="list-style-type: none"> <li>No tax adjustment is required</li> </ul>

**Table C: Financial Liability**

	C&M under		Tax treatment in transitional YA
	FRS 39	FRS 109	
i.	FVTPL	FVTPL	<p><u>Financial liability on revenue account</u></p> <ul style="list-style-type: none"> <li>To tax or allow as a deduction, the unrealised gain or loss on the effects of changes in the financial liability's credit risk, recognised in the opening retained earnings at DIA</li> </ul> <p><u>Financial liability on capital account</u></p> <ul style="list-style-type: none"> <li>No tax adjustment is required</li> </ul>
ii.	Derivative liability carried at cost <sup>30</sup>	FVTPL	<p><u>Financial liability on revenue account</u></p> <ul style="list-style-type: none"> <li>To tax or allow as a deduction, the unrealised gain or loss, recognised in the opening retained earnings at DIA</li> </ul> <p><u>Financial liability on capital account</u></p> <ul style="list-style-type: none"> <li>No tax adjustment is required</li> </ul>
iii.	Not applicable <sup>31</sup>	Loan commitment/ Financial guarantee contract	<p><u>Financial liability on revenue account</u></p> <ul style="list-style-type: none"> <li>To allow as a deduction, the provision for impairment recognised in the opening retained earnings at DIA, to the extent that the amount is in respect of a credit-impaired financial instrument</li> </ul> <p><u>Financial liability on capital account</u></p> <ul style="list-style-type: none"> <li>No tax adjustment is required</li> </ul>

<sup>30</sup> A derivative liability that is linked to, and must be settled by, delivery of an unquoted equity instrument is accounted for at cost in accordance with FRS 39 (see paragraph 47(a) of FRS 39). See paragraph 7.2.13 of FRS 109 for the transitional accounting adjustment.

<sup>31</sup> Provisions for loan commitment and financial guarantee contracts were previously recognised and measured in accordance with FRS 37.

**Table D: Time Value of Option Contract, Forward Element of Forward Contract and Foreign Currency Basis Spread of Financial Instrument (that are excluded from hedge accounting under FRS 39)**

	Recognition under		Tax treatment in transitional YA
	FRS 39	FRS 109	
i.	P&L	OCI	<u>Underlying hedged item on revenue account</u> <ul style="list-style-type: none"> <li>To tax or allow as a deduction, the unrealised gain or loss recognised in the opening retained earnings at DIA</li> </ul> <u>Underlying hedged item on capital account</u> <ul style="list-style-type: none"> <li>No tax adjustment is required</li> </ul>

**B. Transition from pre-FRS 39 Tax Treatment to FRS 109 Tax Treatment**

8.5 For taxpayers transiting from pre-FRS 39 tax treatment to FRS 109 tax treatment, please refer to the applicable tax treatment required in the transitional YA in Annex C.

8.6 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 for taxpayers who are currently on the pre-FRS 39 tax treatment. This applies to taxes payable for the YA relating to the basis period in which FRS 109 is first adopted. The additional 3-month instalment is given upon request by taxpayers. Requests for longer instalment periods will be handled on a case-by-case basis.

**9. Reclassification of Financial Assets after Adoption of FRS 109**

9.1 FRS 109 requires an entity to reclassify its financial assets from one measurement category to another measurement category if the entity changes its business model for managing financial assets after it has adopted FRS 109<sup>32</sup>. Based on the reclassification requirements under FRS 109, only financial assets that are debt instruments<sup>33</sup> can be reclassified. The reclassification is applied prospectively from the reclassification date. There

<sup>32</sup> Reclassification of financial instruments after the adoption of FRS 109 is only applicable to financial assets and not financial liabilities (see paragraphs 4.4.1 and 4.4.2 of FRS 109).

<sup>33</sup> Only debt instruments can be reclassified after the adoption of FRS 109 although the reclassification is expected to be infrequent (see paragraph B4.4.1 of Appendix B of FRS 109). Equity instruments are by default measured at FVTPL and the designation at FVOCI is by an irrevocable election at initial recognition (see paragraph 4.1.4 of FRS 109). Hence, equity instruments cannot be reclassified after adoption of FRS 109.

is no restatement of any previously recognised gains, losses (including impairment gains or losses) or interest<sup>34</sup>.

9.2 Where the reclassification of debt instruments under FRS 109 results in the recognition of a gain or loss in the OCI<sup>35</sup>, there will be no tax adjustment required. However, where the reclassification results in a gain or loss being recognised in the P&L at reclassification date, the gain or loss may be taxable or allowable as a deduction in the YA of the basis period in which the reclassification applies (“reclassification YA”).

9.3 The table below shows the applicable tax treatment for gains or losses on debt instruments that are recognised in the P&L at reclassification date. Taxpayers are required to show the details of how each tax adjustment is arrived at in their tax computations and must keep sufficient documents to support the tax adjustments. Taxpayers are not required to submit the documents with their income tax returns but must do so upon the CIT’s request.

FRS 109		Tax treatment in reclassification YA
C&M at Initial Recognition	C&M at Reclassification Date	
Amortised Cost <sup>36</sup> / FVOCI <sup>37</sup>	FVTPL	<u>Financial asset on revenue account</u> <ul style="list-style-type: none"> <li>To tax or allow as a deduction, the unrealised gain or loss, recognised in the P&amp;L at reclassification date</li> </ul> <u>Financial asset on capital account</u> <ul style="list-style-type: none"> <li>No tax adjustment is required</li> </ul>
FVTPL	Amortised Cost <sup>38</sup> / FVOCI <sup>39</sup>	<u>Financial asset on revenue account</u> <ul style="list-style-type: none"> <li>To allow as a deduction, the impairment loss recognised in the P&amp;L at reclassification date, to the extent that the</li> </ul>

<sup>34</sup> Paragraph 5.6.1 of FRS 109.

<sup>35</sup> See paragraphs IE111 (Reclassification from Amortised Cost to FVOCI – Any gain or loss arising from a difference between the previous amortised cost and the fair value at reclassification date is recognised in OCI) and IE112 (Reclassification from FVOCI to Amortised Cost – Accumulated impairment previously recognised in OCI is reclassified from OCI to Loss Allowance in the Balance Sheet) of FRS 109 (Illustrative Examples).

<sup>36</sup> See paragraph IE109 of FRS 109 (Illustrative Examples).

<sup>37</sup> See paragraph IE114 of FRS 109 (Illustrative Examples).

<sup>38</sup> See paragraph IE110 of FRS 109 (Illustrative Examples).

<sup>39</sup> See paragraph IE113 of FRS 109 (Illustrative Examples).

FRS 109		Tax treatment in reclassification YA
C&M at Initial Recognition	C&M at Reclassification Date	
		<p>amount is in respect of a credit-impaired debt instrument</p> <p><u>Financial asset on capital account</u></p> <ul style="list-style-type: none"> <li>• No tax adjustment is required</li> </ul>

## 10. Taxpayers Not Required to Comply with FRS 109

- 10.1 Taxpayers that do not need to comply with FRS 109 for accounting purposes<sup>40</sup> will continue to apply the pre-FRS 39 tax treatment or FRS 39 tax treatment (as the case may be). They may refer to the IRAS e-Tax Guide “Income Tax Implications arising from the Adoption of FRS 39 – Financial Instruments: Recognition & Measurement” for guidance on the pre-FRS 39 tax treatment (at paragraphs 2 to 5 of the e-Tax Guide) and the FRS 39 tax treatment. However, should they wish to apply FRS 109 tax treatment, they may make a written application to the CIT to be a qualifying person for FRS 109 tax treatment. Once the CIT approves the application, they can apply FRS 109 tax treatment from the YA of the basis period in which the CIT grants the approval or such later YA as the CIT may approve.
- 10.2 Financial Reporting Standard 104 *Insurance Contracts*<sup>41</sup> (“FRS 104”) specifies the financial reporting for insurance contracts by any entity that issues such contracts (“insurer”) until the second phase of the project on insurance contracts is completed. FRS 104 does not apply to other assets and liabilities of an insurer, such as financial assets and financial liabilities within the scope of FRS 39 and FRS 109<sup>42</sup>. As insurers are required to apply FRS 109 for annual periods beginning on or after 1 Jan 2018 before the adoption of the forthcoming insurance contracts standard, the Accounting Standards Council issued Amendments to FRS 104: *Applying FRS 109 Financial Instruments with FRS 104 Insurance Contracts* (“Amendments to FRS 104”) on 23 Dec 2016 to provide two options to insurers when applying FRS 109 with FRS 104 for annual periods beginning on or after 1 Jan 2018. The two options available to an insurer are summarised below.

<sup>40</sup> For example, taxpayers who qualify for and have chosen to comply with the Singapore Financial Reporting Standards for Small Entities.

<sup>41</sup> FRS 104 specifies the financial reporting for insurance contracts by any entity that issues insurance contracts (an insurer). It is an interim standard pending the completion of Phase 2 of the International Accounting Standards Board (“IASB”)’s project on insurance contracts. IASB has since published the IFRS 17 on insurance contracts in May 2017.

<sup>42</sup> See paragraph IN3 of FRS 104 and paragraph C8(IN3) of Appendix C of FRS 109.

- a. Temporary exemption from FRS 109<sup>43</sup>

An insurer whose activities are predominantly connected with insurance may elect to apply the temporary exemption from FRS 109. An insurer that applies the temporary exemption from FRS 109 will continue to apply FRS 39 for accounting purpose for annual periods beginning before 1 Jan 2021.
- b. The overlay approach<sup>44</sup>

An insurer that first applies FRS 109 may elect to apply the overlay approach to designated financial assets. A financial asset is eligible for designation if it is measured at FVTPL under FRS 109 but would not have been measured at FVTPL under FRS 39, and if it is held in respect of an insurance activity. Designation of eligible financial assets is on an instrument-by-instrument basis. An insurer that applies the overlay approach will reclassify, from the P&L to OCI, an amount of gain or loss (called “overlay adjustment”) equal to the difference between:

  - i. the amount reported in the P&L, at the end of the reporting period, for the designated financial assets applying FRS 109; and
  - ii. the amount that would have been reported in the P&L, at the end of the reporting period, for the designated financial assets if the insurer had applied FRS 39.

The overlay approach is applied retrospectively. An insurer recognises as an adjustment to the opening balance of accumulated OCI, an amount equal to the difference between the fair value of the designated financial assets determined applying FRS 109 at DIA and their previous carrying amount determined applying FRS 39.

10.3 An insurer that applies the temporary exemption from FRS 109 will continue to apply the FRS 39 tax treatment (or the pre-FRS 39 tax treatment, as the case may be). However, when the insurer stops applying the temporary exemption from FRS 109 and starts applying FRS 109 (but without applying the overlay approach<sup>45</sup>), it must apply the FRS 109 tax treatment including the applicable tax treatment for the transitional accounting adjustments in the transitional YA at paragraph 8.4 (or at Annex C, as the case may be).

10.4 An insurer that applies the overlay approach must apply the FRS 109 tax treatment including the applicable tax treatment for the transitional

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<sup>43</sup> See paragraph 20A of Amendments to FRS 104.

<sup>44</sup> See paragraph 35B of Amendments to FRS 104.

<sup>45</sup> If the insurer elects to apply the overlay approach, the tax treatment at paragraphs 10.4 and 10.5 will apply.

accounting adjustments in the transitional YA at paragraph 8.4 (or at Annex C, as the case may be). In addition, where the designated financial assets are on revenue account, any gain or loss due to the overlay adjustment presented in the P&L, will be taxable or allowable as a deduction and thus no tax adjustment is required. However, where the designated financial assets are on capital account, any gain or loss due to the overlay adjustment presented in the P&L will not be taxable or allowable as a deduction and thus tax adjustment is required.

#### 10.5 An insurer can stop applying the overlay approach.

- a. By de-designating a financial asset because it is no longer held in respect of an insurance activity<sup>46</sup>. The insurer stops applying the overlay approach to that financial asset and reclassifies from accumulated OCI to the P&L, the cumulative gains or losses relating to that financial asset. For tax purposes, the cumulative gains or losses presented in P&L will be taxable or allowable as a deduction where that financial asset is on revenue account and thus no tax adjustment is required. However, where that financial asset is on capital account, the cumulative gains or losses presented in P&L will not be taxable or allowable as a deduction and thus tax adjustment is required.
- b. By making an irrevocable election, at the beginning of any annual period, to stop applying the overlay approach to all designated financial assets<sup>47</sup>. Cumulative gains or losses relating to all those financial assets will be reclassified from accumulated OCI to the opening retained earnings or the P&L (as the case may be). For tax purposes, where the financial assets are on revenue account, the cumulative gains or losses presented in the opening retained earnings or in the P&L (as the case may be) will be taxable or allowable as a deduction. Tax adjustment is required for those gains or losses that are presented in the opening retained earnings. Where the financial assets are on capital account, the cumulative gains or losses presented in the opening retained earnings or in the P&L (as the case may be) will not be taxable or allowable as a deduction. Tax adjustment is required for those gains or losses that are presented in the P&L.

## 11. Effective Date of FRS 109 Tax Treatment

- ### 11.1 Taxpayers who apply FRS 109 for annual periods beginning on or after 1 Jan 2018 must apply FRS 109 tax treatment from the YA of the basis period in which FRS 109 is first applied for accounting purpose.

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<sup>46</sup> See paragraphs 35I(a) and 35J of Amendments to FRS 104.

<sup>47</sup> See paragraphs 35I(b) and 35K of Amendments to FRS 104.

No option to remain in pre-FRS 39 tax treatment

- 11.2 The FRS 109 tax treatment will be the only tax treatment once taxpayers adopt FRS 109 for accounting purpose. There will be no option to opt out of the FRS 109 tax treatment. This is to keep our tax system simple and reduce compliance cost, as well as ensure a consistent tax outcome for all taxpayers applying the same accounting standards.

Early application of FRS 109 for accounting purpose

- 11.3 For a taxpayer that applies FRS 109 in its entirety before 1 Jan 2018, the FRS 109 tax treatment will apply from the YA relating to the financial period in which FRS 109 is first applied. For example, a taxpayer first applied FRS 109 to its financial statements beginning on 1 Jan 2015, the taxpayer will have to apply FRS 109 tax treatment with effect from YA 2016 (inclusive).
- 11.4 For a taxpayer that applies, before 1 Jan 2018, only the FRS 109 accounting requirement to present in OCI the effects of changes in the credit risk of financial liabilities that are designated at FVTPL, the FRS 109 tax treatment will apply only to the gain or loss on the effects of these changes from the YA relating to the financial period in which FRS 109 accounting requirements is first applied.

**12. Contact Information**

- 12.1 For general enquiries or clarifications on this e-Tax guide, please call 1800 356 8622.

## **Annex A – Brief Overview of FRS 109 Accounting Treatment**

### **Classification and Measurement of Financial Instruments**

1. Financial assets are measured at their fair value<sup>48</sup> at initial recognition, and subsequently measured at amortised cost (using the effective interest method), FVOCI or FVTPL.
2. All financial liabilities are classified as subsequently measured at amortised cost (using the effective interest method), except for certain financial liabilities (including derivatives liabilities) which are measured at FVTPL.

### **Impairment – Recognition of ECL**

3. An entity recognises a loss allowance for ECL on a financial asset (being a debt instrument) that is measured at amortised cost or at FVOCI, a lease receivable, a contract asset or a loan commitment and a financial guarantee contract.
4. At each reporting date, an entity assesses whether the credit risk on a financial instrument has increased significantly since initial recognition and recognises ECL as follows:
  - a. 12-month ECL  
Where the credit risk on a financial instrument has not increased significantly since initial recognition or if the financial instrument is determined to have low credit risk at the reporting date, the loss allowance for that financial instrument is measured at an amount equal to 12-month ECL.
  - b. Lifetime ECL – Not a credit-impaired financial asset  
Where the credit risk on a financial instrument has increased significantly since initial recognition before the financial asset becomes credit-impaired at the reporting date, the loss allowance for that financial instrument is measured at an amount equal to lifetime ECL.
  - c. Lifetime ECL – Credit-impaired financial asset<sup>49</sup>  
Where the credit risk on a financial instrument has increased significantly since initial recognition and the financial asset is credit-impaired at the reporting date, the loss allowance for that financial instrument is measured at an amount equal to lifetime ECL.

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<sup>48</sup> The term fair value is defined in FRS 113 as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

<sup>49</sup> The term credit-impaired financial asset is defined in Appendix A of FRS 109. A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Please refer to Appendix A of FRS 109 for more details.



5. For loan commitments, an entity considers changes in the risk of a default occurring on the loan to which a loan commitment relates. For financial guarantee contracts, an entity considers the changes in the risk that the specified debtor will default on the contract. The loss allowance for loan commitments and financial guarantee contracts is recognised as a provision.
6. If the loss allowance for a financial instrument is measured at an amount equal to lifetime ECL in the previous reporting period, but it is determined at the current reporting date that the credit risk on the financial instrument has not increased significantly since initial recognition, the loss allowance for that financial instrument is measured at an amount equal to 12-month ECL at the current reporting date.
7. The amount of ECL (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognised under FRS 109 is recognised in the P&L as an impairment loss or gain.
8. For trade receivables or contract assets that result from transactions that are within the scope of FRS 115 and lease receivables that result from transactions that are within the scope of FRS 116, FRS 109 provides for a simplified approach to always measure the loss allowance at an amount equal to lifetime ECL.

### **Gains and losses**

9. For a financial asset or financial liability that is measured at FVTPL, the unrealised gain or loss is recognised in the P&L.
10. For a financial liability designated as at FVTPL, the unrealised gain or loss representing the effects of changes in the credit risk of that financial liability is presented in OCI. However, if the presentation in OCI would create or enlarge an accounting mismatch in the P&L, all unrealised gain or loss (including the effects of changes in the credit risk of that financial liability) on that financial liability is recognised in P&L. The presentation of the effects of changes in a liability's credit risk in OCI is not applicable to loan commitments and financial guarantee contracts that are designated as at FVTPL, all gains and losses on such loan commitments and financial guarantee contracts are recognised in the P&L.
11. For an investment in equity instrument that is designated at FVOCI, the unrealised gain or loss including any related foreign exchange gains or losses is recognised in OCI. Amounts presented in OCI are never transferred to the P&L, not even when the equity instrument is derecognised. However, the cumulative gain or loss may be transferred within equity.
12. For an investment in debt instrument that is measured at FVOCI, the unrealised gain or loss is recognised in OCI. However, impairment gains or losses and foreign exchange gains and losses are recognised in the P&L. When the debt

instrument is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from OCI to the P&L. Interest calculated using the effective interest method is recognised in the P&L.

13. For a financial asset or financial liability that is measured at amortised cost, a gain or loss is recognised in the P&L when the financial asset or financial liability is derecognised and through the amortisation process. Impairment gains or losses and foreign exchange gains and losses are recognised in the P&L. Interest calculated using the effective interest method is recognised in the P&L.

**Annex B – Summary of FRS 109 Tax Treatment**

	FRS 109 accounting treatment	FRS 109 tax treatment
1.	Financial Assets – Subsequent measurement at: a. FVTPL b. FVOCI c. Amortised cost	
i.	Fair value changes including the related exchange differences at each year end for financial assets measured at or designated as at FVTPL are recognised in the P&L	For financial assets on revenue account, to align with the accounting treatment, to tax or allow as a deduction, the unrealised gains or losses recognised in the P&L.
ii.	Fair value changes and the related exchange differences at each year end for financial assets (being equity instruments) designated as at FVOCI are recognised in OCI  On derecognition of equity instruments, cumulative gains or losses presented in OCI are never transferred to P&L, though may be transferred within equity	For equity instruments on revenue account:  <ul style="list-style-type: none"> <li>▪ Not to tax or allow as a deduction, the unrealised gains or losses recognised in OCI.</li> <li>▪ On derecognition, to tax or allow as a deduction, the cumulative gains or losses previously recognised in OCI which may or may not be transferred within equity. Tax adjustment is required.</li> </ul>
iii.	Fair value changes at each year end for financial assets (being debt instruments) measured at FVOCI are recognised in OCI  Foreign exchange gains or losses at each year end are recognised in P&L  On derecognition of debt instrument, cumulative gains or losses presented in OCI are reclassified from OCI to P&L	For debt instruments on revenue account:  <ul style="list-style-type: none"> <li>▪ Not to tax or allow as a deduction, the unrealised gains or losses recognised in OCI.</li> <li>▪ To align with the accounting treatment, to tax or allow as a deduction, the foreign exchange gains or losses recognised in the P&amp;L.</li> <li>▪ On derecognition, to tax or allow as a deduction, the cumulative gains or losses reclassified from OCI to P&amp;L.</li> </ul>

	FRS 109 accounting treatment	FRS 109 tax treatment
iv.	<p>Foreign exchange gains or losses at each year end for financial assets (being debt instruments) measured at amortised cost are recognised in P&amp;L</p> <p>Gains or losses on derecognition of debt instrument are recognised in P&amp;L</p>	<p>For debt instruments on revenue account:</p> <ul style="list-style-type: none"> <li>▪ To align with the accounting treatment, to tax or allow as a deduction, the foreign exchange gains or losses recognised in the P&amp;L.</li> <li>▪ On derecognition, to tax or allow as a deduction, the realised gains or losses recognised in the P&amp;L.</li> </ul>
v.	<p>Interest revenue calculated using the effective interest method is recognised in the P&amp;L</p>	<p>For debt instruments on revenue account, to align with the accounting treatment, to tax interest income recognised in the P&amp;L.</p> <p>For debt instruments on capital account, to tax interest income computed based on contractual interest rate. Tax adjustment is required.</p>
<p>2. Financial Liabilities – Measurement at:</p> <p>a. FVTPL</p> <p>b. Amortised cost</p>		
i.	<p>Fair value changes, including the related exchange differences and the effects of changes in the credit risk of the financial liabilities, at each year end for financial liabilities measured at or designated as at FVTPL are recognised in the P&amp;L</p>	<p>For financial liabilities on revenue account, to align with the accounting treatment, to tax or allow as a deduction, the unrealised gains or losses recognised in the P&amp;L.</p>
ii.	<p>Fair value changes on the effects of changes in the credit risk of the financial liabilities designated as at FVTPL are recognised in OCI</p> <p>On derecognition of financial liabilities, cumulative gains or losses on the effects of changes in the credit risk of those financial liabilities presented in OCI will not</p>	<p>For financial liabilities on revenue account:</p> <ul style="list-style-type: none"> <li>▪ Not to tax or allow as a deduction, the unrealised gains or losses recognised in OCI.</li> <li>▪ On derecognition, to tax or allow as a deduction, the cumulative gains or losses presented in OCI which may or may not be transferred</li> </ul>

	FRS 109 accounting treatment	FRS 109 tax treatment
	be transferred to P&L, though may be transferred within equity	within equity. Tax adjustment is required.
iii.	<p>Foreign exchange gains or losses at each year end for financial liabilities measured at amortised cost are recognised in P&amp;L</p> <p>Gains or losses on derecognition of financial liabilities are recognised in P&amp;L</p>	<p>For financial liabilities on revenue account:</p> <ul style="list-style-type: none"> <li>▪ To align with the accounting treatment, to tax or allow as a deduction, the foreign exchange gains or losses recognised in the P&amp;L.</li> <li>▪ On derecognition of financial liabilities, to tax or allow as a deduction, the realised gains or losses recognised in the P&amp;L.</li> </ul>
iv.	Interest calculated using the effective interest method is recognised in the P&L	<p>For financial liabilities on revenue account, to align with the accounting treatment, to allow as a deduction, interest expense recognised in the P&amp;L.</p> <p>For financial liabilities on capital account, to only allow as a deduction, interest expense computed based on contractual interest rate under section 14(1)(a)(i) of the ITA and prescribed borrowing cost under section 14(1)(a)(ii) of the ITA, both on incurred basis. Tax adjustment is required.</p> <p>In the case of convertible debt securities which give the holder an option to convert the debt securities into the issuing company's shares, the discount/ premium attributable to the embedded derivative (which is the option to convert the debt securities into equity and is known as the equity component) is not allowed as a deduction.</p>

	FRS 109 accounting treatment	FRS 109 tax treatment
	<p>3. Impairment</p> <p>a. For general taxpayers</p> <p>b. For banks (including merchant banks) and finance companies</p>	
i.	<p>Impairment gains or losses on the following financial instruments are recognised in the P&amp;L:</p> <ul style="list-style-type: none"> <li>▪ Debt instruments measured at FVOCI</li> <li>▪ Debt instruments measured at amortised cost</li> <li>▪ Trade receivables, lease receivables and contract assets</li> <li>▪ Loan commitments</li> <li>▪ Financial guarantee contracts</li> </ul>	<p>For financial instruments on revenue account:</p> <ul style="list-style-type: none"> <li>▪ To allow as a deduction, only impairment losses on credit-impaired financial instruments recognised in the P&amp;L.</li> <li>▪ To tax impairment gains on credit-impaired financial instruments recognised in the P&amp;L. Indexation is not required.</li> </ul>
ii.	<p>Banks, merchant banks and qualifying finance companies may provide for an additional impairment amounts for non-credit-impaired exposures as required by the MAS on prudence grounds</p>	<p>For financial instruments on revenue account, in respect of banks, merchant banks and qualifying finance companies only:</p> <ul style="list-style-type: none"> <li>▪ To allow as a deduction, the sum of impairment losses on non-credit-impaired financial instruments recognised under FRS 109 in the P&amp;L plus any additional impairment amounts for non-credit-impaired exposures as required by the MAS, up to the maximum amount as allowable under section 14I of the ITA</li> <li>▪ To tax impairment gains on non-credit-impaired financial instruments to the extent that the amount was previously allowed as a deduction. Indexation is not required.</li> </ul>

	FRS 109 accounting treatment	FRS 109 tax treatment
4.	Interest-free loans, loans at below-market interest rate and non-arm's length loans	
i.	Loans are measured at amortised cost using effective interest method and "interest" calculated using the effective interest method is recognised in P&L	<p>For interest-free loans, not to tax or allow as a deduction, the imputed "interest income" or "interest expense" and the corresponding "loss" or "gain" recognised in the P&amp;L as they are merely book entries with no actual receipts and payments.</p> <p>For loans at below-market interest rate:</p> <ul style="list-style-type: none"> <li>▪ Not to tax or allow as a deduction, the "interest income" and corresponding "deferred staff cost" recognised in the P&amp;L.</li> <li>▪ To tax interest income computed based on contractual interest rate. Tax adjustment is required.</li> </ul> <p>For non-arms' length loans:</p> <ul style="list-style-type: none"> <li>▪ Not to tax or allow as a deduction, the imputed "interest income" or "interest expense" and the corresponding "loss" or "gain" recognised in the P&amp;L.</li> <li>▪ To tax or allow as a deduction, interest computed based on contractual interest rate. Tax adjustment is required.</li> <li>▪ CIT is not precluded from making further adjustment to the interest income and interest expense based on arm's length rate.</li> </ul>
5.	Hedging	
i.	Gains or losses on hedging instruments, which are acquired under a bona fide commercial arrangement for the sole purpose of	For underlying assets and underlying liabilities that are on revenue account (e.g. trade receivables or trade payables):

	FRS 109 accounting treatment	FRS 109 tax treatment
	hedging against any risk associated with underlying assets or liabilities, are recognised in the P&L or in OCI (as the case may be)	<ul style="list-style-type: none"> <li>▪ To align with the accounting treatment, to tax or allow as a deduction, the unrealised gains or losses on hedging instruments recognised in the P&amp;L.</li> <li>▪ Not to tax or allow as a deduction, the unrealised gains or losses on hedging instruments recognised in OCI.</li> </ul>
ii.	Option premium, which was paid under an option agreement entered into for the purpose of hedging against the cost of the acquisition of machinery or plant, is recognised in the initial cost of the machinery or plant	For machinery or plant that qualifies for capital allowance, to exclude the amount of option premium from the initial cost of the machinery or plant when computing capital allowance (i.e. capital allowance will be computed based on the actual purchase cost of the machinery or plant). Tax adjustment is required.



### Annex C – Transitional Tax Adjustments for Taxpayers Transiting from Pre-FRS 39 Tax Treatment to FRS 109 Tax Treatment

The tables below show the tax treatment applicable to a taxpayer transiting from the pre-FRS 39 tax treatment to the FRS 109 tax treatment. Specifically, they show the tax adjustments to be made when a financial asset on revenue account under one measurement category in FRS 39 transits to another measurement category in FRS 109.

**Table A: Financial asset – Equity instrument**

	C&M under		Tax treatment
	FRS 39	FRS 109	
i.	FVTPL/ AFS	FVTPL	<p>In the transitional YA, to tax the positive amount or to allow as a deduction the negative amount, computed on an instrument-by-instrument basis, in accordance with the formula:</p> $A - B + C$ <p>where A is the remeasured amount at DIA,</p> <p>B is the cost of financial instrument, and</p> <p>C is any unrealised loss or impairment loss previously allowed under pre-FRS 39 tax treatment, net of any amount written back and previously taxed under pre-FRS 39 tax treatment.</p> <p>Thereafter, the tax treatment will be aligned with the accounting treatment under FRS 109.</p>
ii.	FVTPL/ AFS	FVOCI	<p>In the transitional YA, to tax the positive amount or to allow as a deduction the negative amount, to be computed, on an instrument-by-instrument basis, in accordance with the formula:</p> $A - B + C$ <p>where A is the remeasured amount at DIA;</p> <p>B is the cost of financial instrument; and</p> <p>C is any unrealised loss or impairment loss previously allowed under pre-FRS 39 tax treatment, net of any amount written back</p>

	C&M under		Tax treatment
	FRS 39	FRS 109	
			<p>and previously taxed under pre-FRS 39 tax treatment.</p> <p>Thereafter, when any of the equity instrument is derecognised, the gain or loss on derecognition will be computed in accordance with the formula:</p> $\text{Disposal proceeds} - A$ <p>where A is the remeasured amount at DIA.</p>

**Table B: Financial asset – Debt instrument**

	C&M under		Tax treatment
	FRS 39	FRS 109	
i.	FVTPL/ AFS/ Amortised cost	FVOCI/ Amortised cost	<p>In the transitional YA,</p> <ul style="list-style-type: none"> <li>To tax the positive amount or to allow as a deduction the negative amount, computed on an instrument-by-instrument basis, in accordance with the formula:</li> </ul> $A - B + C - D$ <p>where A is the remeasured amount at DIA (before deducting accumulated impairment for debt instrument measured at FVOCI or loss allowance for debt instrument measured at amortised cost),</p> <p>B is the cost of financial instrument,</p> <p>C is any unrealised loss or impairment loss previously allowed under pre-FRS 39 tax treatment, net of any amount written back and previously taxed under pre-FRS 39 tax treatment, and</p> <p>D is the impairment loss recognised in the opening retained earnings at DIA, to the extent that the amount is in</p>

	C&M under		Tax treatment
	FRS 39	FRS 109	
			<p>respect of a credit-impaired financial instrument; and</p> <ul style="list-style-type: none"> <li>To tax the positive amount or to allow as a deduction the negative amount, to be computed, on an instrument-by-instrument basis, in accordance with the formula: <math display="block">X - Y</math> <p>where X is the sum of interest income previously recognised in the P&amp;L under FRS 39, and</p> <p>Y is the sum of interest income previously taxed under the pre-FRS 39 tax treatment.</p> <p>Thereafter, the tax treatment will be aligned with the accounting treatment under FRS 109.</p> <p>For gains or losses on impairment, only impairment losses in respect of lifetime expected credit losses of credit-impaired financial assets will be allowed as a deduction and gains on the subsequent reversal of the impairment will be taxed.</p> </li> </ul>
ii.	FVTPL/ AFS/ Amortised cost	FVTPL	<p>In transitional YA,</p> <ul style="list-style-type: none"> <li>To tax the positive amount or to allow as a deduction the negative amount, computed on an instrument-by-instrument basis, in accordance with the formula: <math display="block">A - B + C</math> <p>where A is the remeasured amount at DIA,</p> <p>B is the cost of financial instrument, and</p> <p>C is any unrealised loss or impairment loss previously allowed under pre-FRS 39 tax treatment, net of any amount written back and previously</p> </li> </ul>

	C&M under		Tax treatment
	FRS 39	FRS 109	
			<p>taxed under pre-FRS 39 tax treatment; and</p> <ul style="list-style-type: none"> <li>To tax the positive amount or to allow as a deduction the negative amount, to be computed, on an instrument-by-instrument basis, in accordance with the formula: <math display="block">X - Y</math> <p>where X is the sum of interest income previously recognised in the profit or loss under FRS 39, and</p> <p>Y is the sum of interest income previously taxed under the pre-FRS 39 tax treatment.</p> <p>Thereafter, the tax treatment will be aligned with the accounting treatment under FRS 109.</p> </li> </ul>