



INLAND REVENUE
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IRAS e-Tax Guide

Tax Treatment Arising from Adoption of Financial
Reporting Standard 116 or Singapore Financial
Reporting Standard (International) 16 – Leases
(Third Edition)



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1. Aim

- 1.1 This e-Tax guide provides guidance on tax treatment for entities adopting Financial Report Standard 116 or Singapore Financial Reporting Standard (International) 16 (“FRS 116 / SFRS(I) 16”).
- 1.2 It will be relevant to you if you are required to comply with the requirements in FRS 116 / SFRS(I) 16 for the recognition, measurement, presentation and disclosure of leases within the scope of FRS 116 / SFRS(I) 16.

2. At a Glance

- 2.1 The Accounting Standards Council issued FRS 116 on 30 Jun 2016 and SFRS(I) 16 on 29 Dec 2017. FRS 116 / SFRS(I) 16 applies to entities with effect from annual reporting periods beginning on or after 1 Jan 2019. Early application is permitted with application of FRS 115 / SFRS(I) 15 *Revenue from Contracts with Customers*.
- 2.2 With the adoption of FRS 116 / SFRS(I) 16 for accounting purposes, the Comptroller of Income Tax (“CIT”) will apply the following tax treatment:

Lessor

- (a) The existing tax treatment for lessors is retained given that there is no change in accounting treatment for lessors. This means that the tax treatment for lessors would depend on whether the relevant lease is classified as operating lease or finance lease.

Lessee

- (b) A lessee is allowed tax deductions on the contractual lease payments incurred, except under circumstances where a sale is regarded to have taken place.
- (c) Where a lease arrangement giving rise to a Right-Of-Use (“ROU”) asset meets the definition of a finance lease under Section 10C(3) of the Income Tax Act 1947 (“ITA”) and is to be regarded as a sale agreement, the lessee is eligible to claim interest expense and capital allowances (“CA”) on the relevant asset instead of a deduction on the contractual lease payments. To determine if a finance lease for tax purposes is to be regarded as a sale agreement, reference should be made to the conditions in paragraphs (a) to (e) of Regulation 4(1) of the Section 10C Regulations.

Withholding tax

- (d) Withholding tax obligations would continue to be determined based on the legal characterisation of the payment, and subject to the provisions in Sections 12(6) and (7) of the ITA, notwithstanding the change in the accounting treatment.

- 2.3 The tax treatment in paragraph 2.2 would apply regardless of whether the relevant lease is accounted for in accordance with FRS 116 / SFRS(I) 16 or the FRS for Small Entities.

3. Glossary

3.1 Finance Lease ("FL")

For the purpose of section 10C of the ITA, a FL means a lease of any machinery or plant (including any arrangement or agreement in connection with the lease) which has the effect of transferring substantially the obsolescence, risks or rewards incidental to ownership of such machinery or plant to the lessee.

3.2 Operating Lease ("OL")

For the purpose of section 10C of the ITA, an OL means the leasing of any machinery or plant, other than finance leasing.

3.3 Section 10C Regulations

Section 10C Regulations refer to the Income Tax (Income from Finance Leases) Regulations.

4. Background

- 4.1 Lessors and lessees account for leases as either OL or FL under the previous accounting standard FRS 17.

- 4.2 Under FRS 116 / SFRS(I) 16, a lessor would continue to classify leases as OL or FL. However, a lessee would apply a single lessee accounting model. Unless exemption applies, a lessee is required to recognise: (i) a ROU asset representing its rights to use underlying leased assets, and (ii) a lease liability representing its obligation to make lease payments. Subject to an election by the lessee, short-term leases and leases for which the underlying asset is of low value may be exempted from the requirement.

- 4.3 For more details on FRS 116 / SFRS(I) 16, please refer to the Standard available on the Accounting Standards Council website at www.asc.gov.sg.

5. Tax Treatment under FRS 17

5.1 The tax treatment of leases under FRS 17 for a lessor is as follows:

Classification of leases for tax purposes in accordance with Section 10C(3), read with Section 10C(1) of the ITA	Tax treatment for a lessor
OL	<ul style="list-style-type: none"> • Lease income received by a lessor under an OL is subject to tax when the lease income accrues to the lessor under the lease arrangement. • The lessor can make an irrevocable election in writing, to be taxed on income from the OL as determined using the effective rent method under FRS 17 (referred to as “FRS 17 tax treatment”), subject to conditions. • CA is given to the lessor in respect of the leased asset, if the leased asset qualifies as a machinery or plant.
FL not treated as a sale agreement	<ul style="list-style-type: none"> • Where a FL is not treated as a sale agreement, the lessor is taxed on the full amount of lease income (i.e. interest and principal repayment). • The lessor is entitled to claim CA on the leased asset if it qualifies as a machinery or plant. However, CA on such FL is allowed to be offset against income from finance leasing only. An offset against other income and transfer under the group relief system is allowed only upon cessation of the finance leasing activities which give rise to the CA.
FL treated as a sale agreement ¹	<ul style="list-style-type: none"> • Where a FL is treated as a sale agreement, CA in respect of the leased asset would be made to the lessee if the leased asset qualifies as a machinery or plant. The lessor is not allowed CA. • Under such circumstances, the lessor is taxed on the interest income on an accrual basis. Principal repayment is not taxable.

¹ A FL that satisfies any of the conditions listed under paragraphs (a) to (e) of Regulation 4(1) of Section 10C Regulations would be treated as a sale of asset by the lessor to the lessee.

5.2 With the adoption of FRS 116 / SFRS(I) 16 for accounting purposes, the election that was previously available to a lessor under the FRS 17 tax treatment, i.e. to be taxed on the effective rent method basis, continues to be available to the lessor. That is, where the lease concerned is regarded as an OL, a lessor who is not on the FRS 17 tax treatment can elect to be taxed on income from the OL as determined using the effective rent method under FRS 116 / SFRS(I) 16 (referred to as “FRS 116 / SFRS(I) 16 tax treatment”). This is subject to the condition that the application of the FRS 116 / SFRS(I) 16 tax treatment is made consistently every year and across all OLs. The election, once made, is irrevocable. Lessors who were already under the FRS 17 tax treatment will continue to be taxed on the effective rent method under the FRS 116 / SFRS(I) 16 tax treatment (unless it falls within the exception in paragraph 11.5 below). The FRS 116 / SFRS(I) 16 tax treatment is applicable to all leases, including leasing of an asset which is not regarded as a machinery or plant, such as leasing of an office space.

Similar to FRS 17 tax treatment, lease expenses that are not deductible are to be disallowed upfront.

5.3 The tax treatment of leases under FRS 17 for a lessee is as follows:

Classification of leases for tax purposes	Tax treatment for a lessee
OL	<ul style="list-style-type: none"> • In accordance with Section 14(1) of the ITA, a lessee is allowed to claim the contractual lease payments as deductions against his income in the basis period in which such payments are incurred, provided the lease expenses are wholly and exclusively incurred in the production of income. • No CA is allowed on the leased asset.
FL not treated as a sale agreement	<ul style="list-style-type: none"> • Where a FL is not treated as a sale agreement, the lessee is allowed a deduction on the full amount of lease payments (i.e. interest and principal repayment). • No CA is allowed on the leased asset.
FL treated as a sale agreement ²	<ul style="list-style-type: none"> • Where a FL is treated as a sale agreement, CA in respect of the leased asset, which qualifies as a machinery or plant, would be given to the lessee. • In this case, the lessee is also allowed a deduction of the interest expense on an incurred basis. Principal repayment is not deductible.

² Similar to the tax treatment of FL for a lessor, if a FL satisfies any of the conditions listed under Regulation 4(1) of the Section 10C Regulations, the FL would be treated as a sale agreement.

6. Tax Treatment with the Adoption of the FRS 116 / SFRS(I) 16

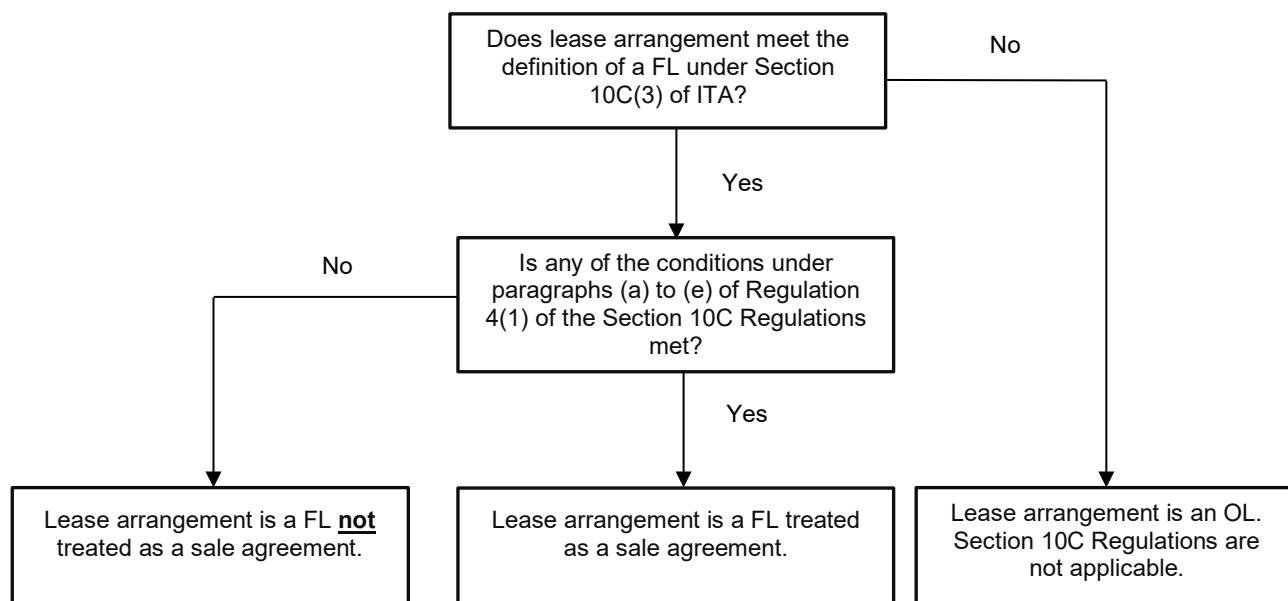
- 6.1 Under the FRS 116 / SFRS(I) 16, lessors and lessees will adopt different classifications for leases. Unlike lessors for whom the accounting treatment largely remains unchanged, lessees will no longer classify their leases into OL and FL.

Tax treatment for a Lessor

- 6.2 Given that lessor accounting remains substantially unchanged, the existing tax treatment for lessors as set out in paragraphs 5.1 and 5.2 will be retained.

Tax treatment for a Lessee

- 6.3 Notwithstanding the accounting changes, a lessee would be allowed to claim tax deductions in the tax computation based on the contractual lease payments incurred, except under circumstances when a sale is regarded to have taken place. Interest expense and depreciation charged to the profit and loss account would have to be added back in the tax computation. This tax treatment is also applicable to leasing of an asset which is not regarded as a machinery or plant, such as leasing of an office building.
- 6.4 Where a lease arrangement giving rise to a ROU asset meets the statutory definition of a FL under Section 10C(3) of the ITA and is regarded to be a sale agreement, the lessee would be eligible to claim interest expense and CA, but not the lease payment.
- 6.5 To determine whether the lease arrangement should be regarded for tax purposes as a sale agreement, reference should be made to the conditions listed in paragraphs (a) to (e) of Regulation 4(1) of the Section 10C Regulations.
- 6.6 A lease arrangement that does not meet the definition of a FL will be regarded as an OL. Please refer to the diagram below for a summary of how to determine the classification of a lease arrangement.



6.7 In determining if a lease arrangement giving rise to a ROU asset is an OL or FL for tax purposes, the same examples and indicators as provided in paragraphs 63 and 64 of the FRS 116 / SFRS(I) 16 for lessors may be applied. Examples of situations that individually or in combination would normally lead to a lease being classified as a FL are:

- (a) the lease transfers ownership of the underlying asset to the lessee by the end of the lease term;
- (b) the lessee has the option to purchase the underlying asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception date, that the option will be exercised;
- (c) the lease term is for the major part of the economic life of the underlying asset even if the title is not transferred;
- (d) at the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the underlying asset; and
- (e) the underlying asset is of such a specialised nature that only the lessee can use it without major modifications.

6.8 The examples and indicators as provided in paragraphs 63 and 64 of FRS 116 / SFRS(I) 16 are not always conclusive. If it is clear from the facts of the case that the lease does not transfer substantially the obsolescence, risks or rewards incidental to ownership of the asset, the lease arrangement will be treated as an OL for tax purposes.

- 6.9 Please refer to **Appendix 1** for the example to illustrate the application of the tax treatment for leases.

7. Tax Treatment of Subleases

- 7.1 A sublease is a transaction for which an underlying asset is re-leased by a lessee (an intermediate lessor or “IL”) to a third party, and the lease between the head lessor and IL (“head lease”) remains in effect. Where the IL subleases or expects to sublease the underlying asset, the head lease does not qualify as a low-value asset for accounting purposes.
- 7.2 Under FRS 116 / SFRS(I) 16, for accounting purposes, an IL shall classify the sublease as a FL or OL in the following manner:
- (a) If the IL has elected to treat the head lease as a short-term lease (as mentioned in paragraph 4.2 above), the sublease shall be classified as an OL.
 - (b) Otherwise, the sublease shall be classified by reference to the ROU asset arising from the head lease resulting in an OL or a FL, as the case may be.
- 7.3 For tax purposes, the classification of the sublease for the IL is to be determined by reference to the underlying asset instead of the ROU asset. This is to align with the existing treatment applied for the purpose of classifying leases for tax purposes. For example, if the useful life of an asset is 20 years and is leased by the IL for 8 years and is immediately subleased out for 8 years, the sublease will be classified as a FL under the accounting treatment, as determined by reference to the ROU asset (i.e. 8/8 years). However, for tax purposes, such a lease will be treated as an OL as the lease term is not for the major part of the economic life of the underlying asset (i.e. 8/20 years).
- 7.4 In the event that the sublease is regarded as a FL for tax purposes and a sale is regarded to have taken place, only the interest expense of the IL would be deductible. Similarly, the IL would only be taxed on the interest income.
- 7.5 Based on the tax treatment set out in paragraph 5.1 above, the tax treatment for the IL is as follows:
- (a) If the sublease, classified by reference to the underlying asset, is regarded as an OL, the IL would be taxed on the lease income;
 - (b) If the sublease, classified by reference to the underlying asset, is regarded as a FL and a sale is not regarded to have taken place, the IL would be taxed on the lease income;

- (c) If the sublease, classified by reference to the underlying asset, is regarded as a FL and a sale is regarded to have taken place, the IL would be taxed on the interest income on an accrual basis.
- 7.6 For cases falling under paragraphs 7.5(a) and (b) above, the IL would be allowed either a deduction on the contractual lease payments incurred or CA on the leased asset, as the case may be. This is because the IL or lessee of the head lease would have been relieved on the capital cost of the leased asset either through a tax deduction given on the lease payments or the CA granted on the leased asset. For cases falling under paragraph 7.5(c), the IL would not be allowed any CA on the leased asset as he is regarded as providing a financing arrangement. Please refer to **Appendix 2** for a summary of the tax treatment for subleases and **Appendix 3** for the illustrations.

8. Withholding Tax Obligations

- 8.1 Notwithstanding the accounting classification of the expenses in the profit and loss account, the withholding tax obligations would be determined based on the legal characterisation of the payments. In other words, it would be based on the statutory description of the payment as provided in Section 12(6) and (7) of the ITA. Withholding tax applies to such payments unless they are granted certain exemptions such as those under Section 13(4) and 13(1)(oa) of the ITA.
- 8.2 Currently, where a FL is treated as a sale agreement under Regulation 4(1) of the Section 10C Regulations, the lessee has to treat the interest portion of the lease payment as a payment falling within the ambit of Section 12(6) of the ITA. For an OL or a FL that is not treated as a sale agreement, the entire lease payment for the use of any movable property is treated as a payment falling within the ambit of Section 12(7)(d) of the ITA.
- 8.3 The lessee is required to withhold tax under Sections 45 and 45A of the ITA on any interest and lease payment (as the case may be) made to a non-resident lessor, unless specific exemption applies.
- 8.4 Where a lessee is required to withhold tax on interest payment in respect of a FL treated as a sale agreement and in cases where the interest rate implicit in the lease arrangement can be readily determined or is clearly stated in the lease agreement, the lessee will compute the interest payment based on such interest rate and withhold the tax accordingly. However, where the lessee has no knowledge of or is not able to compute the lessor's implicit rate, FRS 116 / SFRS(I) 16 requires the lessee to use its own incremental borrowing rate³ to compute the present value of the lease payments. In such

³ The rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment.

a case, the lessee may withhold tax based on the interest expense as recognised by the lessee.

- 8.5 Currently, payments liable to be made to a person not resident in Singapore (excluding any permanent establishment in Singapore) for the charter (including time charter) of any ship under any agreement or arrangement is exempted from tax under Section 13(1)(oa) of the ITA. Waiver of withholding tax obligation is also granted to such payments under Section 45A(2D). The exemption and waiver apply only to payments made under an OL. Payments made under a FL not treated as a sale agreement for any leasing of ship arrangement is deemed to be derived from Singapore under Section 12(7)(d) and such payments are not exempted from withholding tax requirement⁴.
- 8.6 With the adoption of the FRS 116 / SFRS(I) 16, the current withholding tax treatment as set out in paragraphs 8.1 to 8.5 would continue to apply.

9. Application of the Total Asset Method (“TAM”) for Computing Interest Adjustment

- 9.1 At present, where a taxpayer cannot identify and track the use of an interest-bearing loan to specific assets financed by the loan and not all the assets are income-producing, the TAM⁵ may be adopted to attribute the common interest expense to the assets.
- 9.2 Under FRS 116 / SFRS(I) 16, most leases (unless the exemption highlighted under paragraph 4.2 applies) will be accounted for on the lessee’s balance sheet as ROU assets.
- 9.3 Where a lease arrangement giving rise to a ROU asset is treated as a sale agreement for tax purposes, the lessee is eligible to claim interest expense and CA on the asset instead of a deduction on the contractual lease payments. The interest expense incurred on such asset is deductible against the income produced. Where the interest expense is directly identifiable to an income-producing ROU asset, such interest expense is not subject to interest adjustment.
- 9.4 Consequently, in applying the TAM to common interest expense, the total asset base should exclude assets financed by specific interest-bearing loans, ROU assets treated as a sale agreement and ROU assets where contractual lease payments incurred have been allowed as deductions for tax purposes.

⁴ Specified Maritime Sector Incentive (“MSI”) recipients may be eligible for exemption from withholding tax with effect from 12 Dec 2018. Please refer to the relevant shipping circular published on Maritime and Port Authority of Singapore (“MPA”) website for more details.

⁵ Please refer to IRAS e-Tax Guide “Income Tax: Total Asset Method for Interest Adjustment” for more details on TAM.

10. Tax Treatment of Foreign Exchange Differences

- 10.1 Under FRS 116 / SFRS(I) 16, a lessee is required to recognise a lease liability representing its obligation to make lease payments, unless exemption as provided in the accounting standard applies.
- 10.2 When the lease liability recognised by the lessee is in a currency different from the lessee's functional currency (i.e. the currency of the primary economic environment in which the lessee operates), foreign exchange differences would arise from the revaluation of the year-end balances of the lease liability into the functional currency.
- 10.3 As the lease liability is recognised due to the adoption of FRS 116 / SFRS (I) 16, the exchange differences arising from the outstanding lease liability are accounting adjustments and such notional exchange gains or losses would be disregarded for tax purposes.
- 10.4 There may be situations where a foreign currency denominated contractual lease payment incurred (in Year 1) was settled only in the subsequent year (in Year 2). There would be exchange gain or loss arising from the revaluation of outstanding contractual lease payment incurred at end of Year 1 and at settlement in Year 2. Such exchange gains or losses would be taxable or deductible if they arose from deductible contractual lease payments for operating leases or finance leases not treated as sale agreements for tax purpose.
- 10.5 However, where the lease arrangement is treated as a sale agreement for tax purposes, the lessee is eligible to claim interest expense and CA on the asset instead of a deduction on the contractual lease payments. In such a case, the exchange gains or losses would be taxable or deductible on the portion arising from the deductible interest expenses.

11. Transitional Tax Adjustments

- 11.1 There is no need to provide for transitional tax adjustments upon the changeover of accounting rules. According to the FRS 116 / SFRS(I) 16, a lessee shall apply FRS 116 / SFRS(I) 16 using one of the following methods:
- (a) retrospectively to each prior reporting period presented applying FRS 8 Accounting Policies, Changes in Accounting Estimates and Errors; or
 - (b) retrospectively with the cumulative effect of initially applying the Standard recognised at the date of initial application (i.e. the start of the reporting period in which an entity first applies FRS 116 / SFRS(I) 16).

Lessor

- 11.2 Generally, a lessor is not required to make any adjustment on transition to the FRS 116 / SFRS(I) 16. A lessor will account for leases in accordance with the FRS 116 / SFRS 16 from the date of initial application (paragraph C14 of FRS 116 / SFRS(I) 16 refers). For tax purposes, no tax adjustment is needed since the existing tax treatment for lessors is retained.

Subleases

- 11.3 The FRS 116 / SFRS(I) 16 requires the lessor of a sublease (i.e. IL) to re-assess the classification of the sublease. Any sublease to be re-classified as a FL under the FRS 116 / SFRS(I) 16 will be accounted for as a new FL at the date of initial application of FRS 116 / SFRS(I) 16 (paragraph C15 of FRS 116 / SFRS(I) 16 refers). For tax purposes, no tax adjustment is required as the sublease will be re-classified as a new FL at the initial application date, based on the remaining terms and conditions.
- 11.4 There could be situation where the sublease is classified as a FL under FRS 116 / SFRS(I) 16 but is treated as an OL for tax purposes (paragraph 7.3 of the e-Tax Guide refers). If, before and after the adoption of FRS 116/ SFRS(I) 16, an IL is taxed based on when the lease income becomes due and payable under the lease agreement (referred to as “contractual rent method”), no transitional tax adjustment is required for a sublease re-classified as a FL under FRS 116 / SFRS(I) 16.
- 11.5 However, if an IL was taxed on a sublease on an effective rent method when the IL accounted for the sublease under FRS 17, the IL would not be able to continue to apply an effective rent method on that sublease when it is re-classified as a FL under FRS 116/ SFRS(I) 16. This is because for accounting purposes under FRS 116/ SFRS(I) 16, the lease income from the FL is no longer accounted for using the effective rent method. Only interest income arising from the lease arrangement is reflected in the profit and loss account. Consequently, the IL will need to adopt the contractual rent method (i.e. interest + principal repayment) to account for the income from the sublease for tax purposes.
- 11.6 As a result, the IL will need to make a transitional adjustment in the first year it adopts the contractual rent method for tax purposes. See the example below for illustration.
- 11.7 Assuming that under the contractual arrangement, the sublease, which is treated as OL for tax purposes, is for a term of 5 years, with the first two years rent-free and a lease payment of \$1,000 being charged for the last three years. Under the effective rent method, the IL will bring to tax \$600 (i.e. \$3,000 divided by 5 years) as lease income for each year.

Assuming that the IL adopts FRS 116 / SFRS(I) 16 at the beginning of Year 4, and for accounting purposes, the sublease is to be accounted for as FL. CIT has taxed a total lease income of \$1,800 from Year 1 to Year 3 under the effective rent method. Under the contractual rent method, the lease income will be taxed in the period Year 3 to Year 5 and the amount to be taxed is only \$1,000 in Year 3. The IL will need to make a transitional tax adjustment of -\$800 (\$1,000 - \$1,800) in Year 4 when it moves from effective rent method to contractual rent method. This means that the total amount of lease income to be brought to tax in Year 4 will be \$200 (i.e. -\$800 transitional adjustment + \$1,000 lease income for Year 4).

	FRS 17			FRS 116 / SFRS(I) 16		Total
	Year 1	Year 2	Year 3	Year 4	Year 5	
Contractual rent method	0	0	\$1,000	\$1,000	\$1,000	\$3,000
Effective rent method	\$600	\$600	\$600	\$600*	\$600*	\$3,000

* The effective rent method cannot be applied because the lease income of \$600 will no longer be reflected in the accounts when the IL adopts FRS116 / SFRS(I) 16. If the sublease is re-classified as a FL under FRS116/ SFRS(I) 16, only the interest portion of the lease payment will be reflected in the profit and loss account.

Lessee

- 11.8 No tax adjustment is required in respect of the transitional rules. Despite the application of the FRS 116 / SFRS(I) 16, tax deduction continues to be allowed based on the contractual lease payments except for those lease arrangements that are treated as FL treated as a sale agreement for tax purposes. This is the same as the current tax treatment where a lessee (other than a lessee of a FL treated as a sale agreement) is given a tax deduction based on the lease payments incurred.
- 11.9 Consequently, any adjustment to the opening figures of retained earnings on transition to the FRS 116 / SFRS(I) 16 for existing leases, which are classified as OL or FL under FRS 17, would not be taxable or deductible.

12. Taxpayers Not Required to Comply with FRS 116 / SFRS(I) 16

12.1 For taxpayers that do not need to comply with FRS 116 / SFRS(I) 16 for accounting purposes or are temporarily exempt by the Accounting & Corporate Regulatory Authority from complying with FRS 116 / SFRS(I) 16 for accounting purposes, the tax treatment as set out in paragraph 6 above would still be applicable. For such taxpayers, who are lessees to a lease arrangement, the tax treatment to be applied will continue to follow tax principles and is not aligned with the accounting treatment.

13. Documentation to Support Tax Deductions

13.1 Taxpayers who claimed tax deductions in their tax computations based on contractual lease payments incurred need not submit documentary evidence to support their claims. However, taxpayers should maintain sufficient documentation for submission to the CIT if called upon to do so as part of the CIT's audit or verification process. In addition, a taxpayer, being a lessee, is required to provide in its tax computation:

- (a) a reconciliation of the contractual lease payments and the expenses reflected in the profit and loss account.
- (b) a reconciliation of the amount of contractual lease payment to the cash flow statement.

13.2 For a sample schedule of reconciliation of the contractual lease payments and the expenses related to a lease being recognised in the profit and loss account, please refer to the Example 1 in **Appendix 1** for guidance.

14. GST Treatment

14.1 FRS 116 will not change how leases are regarded for GST purposes.

14.2 For GST purposes, a lease is treated as:

- (a) a supply of goods if the possession of the goods is transferred under an agreement which expressly contemplates that the property (i.e. ownership or title) will pass at some time in the future⁶. For example, goods sold under a hire purchase agreement is regarded as a supply of goods since the property/title to the goods will pass to the

⁶ Paragraph 1(2)(b) of the Second Schedule to the GST Act 1993. As provided for under paragraph 1(1) and 1(2)(a) of the Second Schedule, a supply of goods also takes place if the whole property in goods is transferred or the possession of goods is transferred under an agreement for the sale of goods. Also, paragraph 4 of the same Schedule states that the grant, assignment or surrender of any interest in or right over land or of any license to occupy land is a supply of goods, thus a lease of a land or building will be a supply of goods.

hirer/lessee when he pays the last instalment or exercises the option to purchase (for more information on the GST treatment of hire purchase agreements, please refer to the e-Tax guide “GST Treatment of Hire Purchase Agreements and Financing Instruments (Second Edition)”; or

- (b) a supply of services if only the possession of the goods is transferred, without any provision for possible future transfer of ownership of the goods⁷.

14.3 The above treatment will not change even with the requirement for lessees to apply a single lessee accounting model under FRS 116 / SFRS(I) 16. Although the lessee is required to recognise the leased goods as his assets, if the lease agreement does not contemplate the transfer of property to the lessee, there is no supply made by the lessee when the lessee returns the goods without any consideration to the lessor at the end of the lease term⁸.

15. Contact Information

15.1 For general enquiries or clarifications on this e-Tax guide, please call 1800- 3568 622.

16. Updates and Amendments

	Date of amendment	Amendments made
1	27 Oct 2020	<ul style="list-style-type: none"> Amended paragraphs 5.1 and 5.2 to clarify that the election made to adopt the “effective rent method” is irrevocable Inserted new paragraphs 10.4 to 10.7 to explain the tax treatment in a situation where the sublease is classified as a FL under the FRS 116 / SFRS(I) 16 for accounting purposes but is treated as an OL for tax purposes
2	14 Mar 2023	<ul style="list-style-type: none"> Renumbered Section 10D with Section 10C based on the Income Tax Act 1947 Added Appendix 2 in paragraph 7.6 to summarise the tax treatment for subleases

⁷ Paragraph 1(1)(b) of the Second Schedule to the GST Act 1993.

⁸ That is, the deemed supply under paragraph 5(1) of the Second Schedule to the GST Act 1993 will not arise.

	Date of amendment	Amendments made
		<ul style="list-style-type: none"> • Added footnote 4 to paragraph 8.5 to provide clarity on withholding tax exemption for specific MSI recipients • Inserted a new paragraph 10 to explain the tax treatment of foreign exchange differences • Renumbered paragraphs 10 to 15 to 11 to 16 and Appendix 2 to Appendix 3 • Numbered the requirement to provide a reconciliation of the contractual lease payment and expenses reflected in profit and loss account in paragraph 13.1 as part (a) and added in part (b) the requirement to provide a reconciliation of the amount of contractual lease payment to the cash flow statement • Added footnotes 9 and 10 in Appendix 1, Example 1 to clarify how the figures should reconcile to audited accounts • Inserted the tax treatment on the interest expense and depreciation in Appendix 1, Example 1 to make clear that they are not tax deductible

Appendix 1 - Example to Illustrate the Application of the Tax Treatment for Leases

Example 1

- A enters into a 5-year lease for a piece of equipment.
- The annual lease payments are \$60,000 payable at the end of each year.
- The interest rate implicit in the lease cannot be readily determined.
- A's incremental borrowing rate at the commencement date is 6% per annum.
- A measures the lease liability at the present value of the 5 payments of \$60,000 discounted at the interest rate of 6% per annum, which is \$252,742.

	Lease payment ⁹	Interest expense (6%)	Principal repaid	Ending balance ¹⁰
Start of year 1				252,742
End of year 1	60,000	15,165	44,835	207,907
End of year 2	60,000	12,474	47,526	160,381
End of year 3	60,000	9,623	50,377	110,004
End of year 4	60,000	6,600	53,400	56,604
End of year 5	60,000	3,396	56,604	0
Total	300,000	47,258	252,742	

Initial recognition and measurement of the lease by A (lessee):

	Accounting entry	Dr	Cr
Start of year 1	Dr ROU asset Cr Lease liability	\$252,742	\$252,742
End of year 1	Dr Interest expense * Dr Lease liability Cr Cash (1 st lease payment)	\$15,165 \$44,835	\$60,000
	Dr Depreciation (252,742/5) * Cr Accumulated depreciation	\$50,548	\$50,548

* charged to the profit and loss account

⁹ Lease payment comprises interest expense and principal repaid. The lease payment should reconcile with the amount paid per the cash flow statement.

¹⁰ The ending balance should reconcile with the amount of lease liability in the financial statement

Scenario A – Where the lease arrangement is regarded as an OL for tax purposes

Assume that the useful life of the above equipment is 15 years.

The lease does not transfer substantially the obsolescence, risks or rewards incidental to ownership of the equipment to the lessee.

The lease arrangement is regarded as an OL as it does not meet the definition of a FL under Section 10C(3) of the ITA.

Tax treatment for lessor

- Taxed on lease income of \$60,000 each year during the 5-year lease period
- CA is allowed to the lessor on the equipment

If the lessor is a non-resident for tax purposes, the lessee will withhold tax based on the lease payment of \$60,000 each year when the amount is due and payable.

Tax treatment for lessee

- Lease payment of \$60,000 is deductible each year on an incurred basis during the 5-year lease period
- No CA is allowed to the lessee on the leased equipment of \$252,742
- No deduction is allowed on the interest expense and depreciation that are charged to the profit and loss account

Scenario B – Where the lease arrangement is regarded as a FL for tax purposes and a sale is regarded to have taken place

Assume that the useful life of the equipment is 5 years.

The equipment is a limited use asset.

The lease transfers substantially the obsolescence, risks or rewards incidental to ownership of the equipment to the lessee.

The lease arrangement meets the definition of a FL under Section 10C(3) of ITA.

The lease arrangement is a FL treated as a sale agreement since it meets the condition under paragraph (b) of Regulation 4(1) of the Section 10C Regulations (i.e. the machinery or plant which is leased is a limited use asset).

Tax treatment for Lessor

- Taxed on interest income as computed based on the lessor's implicit interest rate
- Principal repayment is not taxable
- No CA is allowed to the lessor on the equipment

If the lessor is a non-resident for tax purposes, the lessee will withhold tax based on the interest expense of \$15,165 in year 1 as recognised by the lessee. This is because the lessee has no knowledge of the lessor's implicit interest rate.

Tax treatment for Lessee

- Interest portion of lease payment is deductible (i.e. \$15,165 is deductible in year 1, \$12,474 is deductible in year 2 and so on)
- Principal repayment is not deductible
- CA is allowed to the lessee on leased equipment of \$252,742, over the tax writing-down period for the equipment
- No deduction is allowed on the depreciation that is charged to the profit and loss account

Appendix 2 – Tax treatment for Subleases

Tax classification	Head lease	OL	FL not treated as a sale agreement	FL not treated as a sale agreement	FL treated as a sale agreement	FL treated as a sale agreement	FL treated as a sale agreement
	Sublease	OL	OL	FL not treated as a sale agreement	OL	FL not treated as a sale agreement	FL treated as a sale agreement
Tax treatment	Head Lessor	<ul style="list-style-type: none"> Lease income from head lessee (IL) taxed CA allowed 	<ul style="list-style-type: none"> Lease income from head lessee (IL) taxed CA allowed but quarantined and offset against finance lease income only¹¹ 	<ul style="list-style-type: none"> Lease income from head lessee (IL) taxed CA allowed but quarantined and offset against finance lease income only¹¹ 	<ul style="list-style-type: none"> Interest income from head lessee (IL) taxed CA not allowed 		
	Head lessee (IL)	<ul style="list-style-type: none"> Lease income from sublease lessee taxed Contractual lease payments made to head lessor allowed CA not allowed, since lease payments have been allowed to head lessee (IL) in his capacity as the head lease lessee 			<ul style="list-style-type: none"> Lease income from sublease lessee taxed CA allowed Interest expense paid to head lessor allowed 	<ul style="list-style-type: none"> Lease income from sublease lessee taxed CA allowed but quarantined and offset against FL income only¹¹ Interest expense paid to head lessor allowed 	<ul style="list-style-type: none"> Interest income from sublease lessee taxed CA not allowed Interest expenses paid to head lessor allowed
	Sublease lessee	<ul style="list-style-type: none"> Contractual lease payment paid to head lessee (IL) allowed CA not allowed 					<ul style="list-style-type: none"> Interest expense paid to head lessee (IL) allowed CA allowed

¹¹ Section 10C(2) of the ITA

Appendix 3 - Examples to Illustrate the Application of the Tax Treatment for Sublease under Different Classifications

Example 2

- Head lease is an OL.
- Sublease, classified by reference to the underlying asset, is regarded as an OL.
- The IL would continue to be taxed based on the lease income.

	Head lease lessor	Head lease lessee	IL	Sublease lessee
Accounting treatment	OL	Short-term lease and accounted for as such	OL	Short-term lease and accounted for as such
Tax treatment	OL – <ul style="list-style-type: none"> • Taxed on lease income; • CA allowed 	OL – <ul style="list-style-type: none"> • Deduction of contractual lease payments allowed 	OL – <ul style="list-style-type: none"> • Taxed on lease income; • Since lease payments have been allowed to IL in his capacity as the head lease lessee, no CA will be granted. 	<ul style="list-style-type: none"> • Deduction of contractual lease payments allowed

Example 3

- Head lease is a FL treated as a sale agreement.
- Sublease, classified by reference to the underlying asset, is regarded as a FL and a sale is not regarded to have taken place.
- The IL would continue to be taxed based on the lease income.

	Head lease lessor	Head lease lessee	IL	Sublease lessee
Accounting treatment	FL	ROU asset (to be de-recognised)	FL	ROU asset
Tax treatment	FL treated as a sale agreement – <ul style="list-style-type: none"> • Taxed on interest income; • CA not allowed 	FL treated as a sale agreement – <ul style="list-style-type: none"> • Deduction of interest expense allowed; • CA allowed 	FL not treated as a sale agreement – <ul style="list-style-type: none"> • Taxed on lease income; • CA allowed but quarantined and offset against FL income only; • CA will be allowed once to head lease lessee / IL 	FL not treated as sale agreement - <ul style="list-style-type: none"> • Deduction of contractual lease payments allowed

Example 4

- Head lease is a FL treated as a sale agreement.
- Sublease, classified by reference to the underlying asset, is regarded as a FL and a sale is regarded to have taken place.
- The IL would continue to be taxed on the interest income on an accrual basis.

	Head lease lessor	Head lease lessee	IL	Sublease lessee
Accounting treatment	FL	ROU asset (to be de-recognised)	FL	ROU asset
Tax treatment	FL treated as a sale agreement – <ul style="list-style-type: none"> • Taxed on interest income; • CA not allowed 	FL treated as a sale agreement – <ul style="list-style-type: none"> • CA not allowed; • Deduction of interest expense allowed 	FL treated as a sale agreement – <ul style="list-style-type: none"> • Taxed on interest income; • CA not allowed 	FL treated as a sale agreement – <ul style="list-style-type: none"> • Deduction of interest expense allowed; • CA allowed