

IRAS CIRCULAR

**SIMPLIFICATION OF
INCOME TAX RULES AND PROCEDURES –
ASSESSMENT OF NON-TRADE INCOME AND
DEDUCTION OF APPROVED DONATIONS
ON AN ACCOUNTING YEAR BASIS**



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SIMPLIFICATION OF INCOME TAX RULES AND PROCEDURES – ASSESSMENT OF NON-TRADE INCOME AND DEDUCTION OF APPROVED DONATIONS ON AN ACCOUNTING YEAR BASIS

INTRODUCTION

As part of Government's continuing efforts to streamline and simplify tax rules so as to reduce taxpayer's cost of compliance, the basis of assessing non-trade income and the basis of allowing deduction for approved donations¹ has been reviewed. This Circular seeks to inform taxpayers of the revised tax treatment.

CURRENT TAX TREATMENT - ASSESSMENT OF NON-TRADE INCOME

2 Section 35(1) of the Singapore Income Tax Act (revised edition 2004) (hereinafter referred to as "SITA") stipulates that all income of a person shall be assessed on a preceding calendar year basis. The only exception to this rule is provided for under section 35(4) of the SITA. Under section 35(4), income from a trade, business, profession or vocation may be assessed on a preceding accounting year basis where the accounting year ends other than on 31 December. This means that non-trade income remains to be assessed on a calendar year basis.

3 The above rule of assessing trade income on an accounting year basis where the accounting year ends other than on 31 December and non-trade income on a calendar year basis could be administratively cumbersome for taxpayers who have both trade and non-trade income and whose accounting period does not end on 31 December of the year. These taxpayers have to refer to 2 sets of accounts in order to prepare the tax computation for any Year of Assessment ("YA"), so as to report the non-trade income on a calendar year basis.

REVISED TAX TREATMENT – CHANGE IN BASIS OF ASSESSMENT OF NON-TRADE INCOME AND DEDUCTION OF APPROVED DONATIONS

4 Arising from the review, the non-trade income of entities² with an accounting year that does not end on 31 December will be allowed to be taxed on an accounting year basis³ with effect from YA2005. In line with the above revised tax treatment, tax deduction for approved donations made in the name of the company, body of persons, partnership or sole-proprietorship will also be allowed on an accounting year basis⁴. This would allow for easy reconciliation of the non-trade income reported in the tax return with the entries in the books of accounts, and avoid the need for re-computations on a calendar year basis.

¹ Sections 37(3)(b) to (f) provide for the deduction of specific types of donations made to specific entities.

² The entities refer to companies, bodies of persons (clubs, charities, associations, etc), sole-proprietorships and partnerships, whether or not they are regarded as carrying on a trade or business.

³ "Accounting year basis" refers only to an accounting year that ends other than on 31 December in the rest of this Circular if it is not stipulated otherwise. For entities with an accounting year that ends on 31 December, the basis of assessment is effectively the calendar year basis.

⁴ Currently, tax deduction for approved donations is allowed on a calendar year basis.

5 The above revised tax treatment however is not applicable to the assessment of Singapore franked dividend income derived by the entities for any period prior to 1 January 2008. In other words, Singapore franked dividends derived prior to 1 January 2008 shall continue to be assessed on the calendar year basis. This is because under the imputation system, Singapore dividends carry an imputation credit which is allowed on a calendar year basis instead of an accounting year basis. However, with the total replacement of the imputation system by the one-tier corporate tax system from 1 January 2008, Singapore dividends derived by the entity on or after 1 January 2008 (i.e. with effect from YA2009) will be exempt from tax in the hands of the shareholders.

Application of the Revised Tax Treatment to Companies and Bodies of Persons

6 In the case of companies and bodies of persons, all income (whether trade or non-trade income except Singapore franked dividends derived prior to 1 January 2008) will be allowed to be assessed to tax solely on the accounting year basis from YA2005 to YA2008. Similarly, tax deduction for approved donations made in the name of the company or body of persons will also be allowed on an accounting year basis.

7 With effect from YA2009, all income (whether trade or non-trade⁵) will be allowed to be assessed to tax on the accounting year basis.

Application of the Revised Tax Treatment to Sole-proprietors and Partners of a Partnership

8 With the revised tax treatment, more than one basis of assessment could still be applicable to sole-proprietors and partners of a partnership (i.e. an accounting year basis for trade income and non-trade income derived through their sole-proprietorships and partnerships, and the calendar year basis for their other non-trade income). This is because such individuals could also have employment income and passive income derived from their personal holdings of assets. These sources of income will continue to be assessable on a calendar year basis. Therefore the following rules shall apply to sole-proprietors and partners:

(i) In the case of Partners of a Partnership

A partnership is not a person for income tax purposes. Individual partners are thus assessed separately on their respective share of profits from the partnership. Partnership profits (both trade and non-trade) will be allowed to be computed on an accounting year basis and allocated to the partners. In other words, any non-trade income that is derived through the partnership will be allowed to be assessed on the accounting year basis in the hands of the partners. Any other source of income that is personal to the individual partner and not derived through the partnership will continue to be assessed on a calendar year basis. Similarly, tax deduction for approved donations made in the name of the partnership will also be allowed on an accounting year basis.

⁵ As stated in paragraph 5, Singapore franked dividends derived prior to 1.1.2008 shall continue to be assessed on a calendar year basis. For example, the Singapore franked dividends derived by the company with accounting period say 1.4.2007 to 31.3.2008 (i.e. YA2009) shall be assessed to tax as follows:

- Singapore franked dividends derived from 1.4.2007 to 31.12.2007 to be taxed in YA2008; and
- One-tier exempt dividend derived from 1.1.2008 to 31.3.2008 (i.e. YA2009) will be exempted.

(ii) In the case of Sole-proprietors

A sole-proprietorship is not a separate legal entity. However, unlike a partnership which has a clearly defined pool of partnership assets and income, it may be more difficult to distinguish between income derived from the assets of the sole-proprietorship and income derived from the assets of the sole-proprietor that are not part of the sole-proprietorship business. This is because the sole-proprietorship, not being a separate legal entity, would, in most if not all cases, have its investment assets registered in the sole-proprietor's name.

In the case of a sole-proprietorship, trade income and only non-trade income that is incidental to the carrying on of the sole-proprietorship business (i.e. derived from the assets of the sole-proprietorship and not from the assets of the sole-proprietor that are not part of the sole-proprietorship business) will be allowed to be assessed to tax on an accounting year basis. All other sources of income of the sole-proprietor will continue to be assessed on a calendar year basis. Similarly, tax deduction for approved donations made out of the assets of the sole-proprietorship will also be allowed on an accounting year basis.

REQUIREMENT TO FURNISH ESTIMATE OF CHARGEABLE INCOME (ECI) UNDER SECTION 63 OF THE SITA

Current Position

9 Currently, only persons carrying on or exercising any trade, business, profession or vocation are required under section 63 of the SITA to furnish an estimate of their chargeable income (ECI) within 3 months after the end of their accounting period relating to that YA.⁶ However, the ECI does not include non-trade income if the person is on an accounting year other than 31 December. The current requirement relating to the furnishing of ECI is summarised as follows:

- for companies and bodies of persons, with accounting year ending other than on 31 December:
to furnish ECI on trade income within 3 months after the end of their accounting period relating to that YA;
- for companies and bodies of persons, with accounting year ending on 31 December:
to furnish ECI on both trade income and non-trade income within 3 months after the end of their accounting period relating to that YA;
- for partners of a partnership and sole-proprietors with accounting year ending other than in the month of December:
to furnish ECI on trade income within 3 months after the end of their accounting period relating to that YA;

⁶ As an administrative concession, if the accounting year of a partnership or sole-proprietorship business is in the month of December, there is no need for the partners of the partnership or sole-proprietorship to furnish an ECI by March as they would have to file their individual income tax return by 15 April.

- for partners of a partnership and sole-proprietors with accounting year ending in the month of December:
no need to furnish ECI (please see footnote 6);
- for entities that do not derive trade income⁷
no need to furnish ECI as they are assessed on the calendar year basis.

Revised Position

10 As stated in the paragraph 4 above, the revised tax treatment to allow assessment of non-trade income and tax deduction of approved donations on an accounting year basis is only applicable to entities with accounting year other than 31 December. It is to be noted that with the introduction of the revised tax treatment, the following conditions regarding the furnishing of an ECI shall apply to entities that want to avail themselves of this revised treatment:

- for companies and bodies of persons that derive trade income with accounting year ending on 31 December or otherwise:
to include non-trade income (except Singapore franked dividends net of expenses) when furnishing ECI within 3 months after the end of their accounting period relating to that YA;
- for partners of a partnership and sole-proprietors with accounting year ending other than in the month of December:
to include non-trade income (except Singapore franked dividends net of expenses) derived through the partnership/sole-proprietorship business when furnishing their ECI within 3 months after the end of their accounting period relating to that YA;
- for partners of a partnership and sole-proprietors with accounting year ending in the month of December:
no need to furnish ECI (please see footnote 6);
- for entities that derive only non-trade income and has accounting year ending other than on 31 December⁸:
to furnish ECI on non-trade income within 3 months after the end of their accounting period relating to that YA.

⁷ E.g. investment holding companies and bodies of persons not deemed to carry on a business under section 11 of the SITA.

⁸ For entities that derive only non-trade income and has accounting year ending on 31 December, the revised tax treatment would not be applicable to them as their basis of assessment is on calendar year basis. That being the case, there is no need for them to reconcile the non-trade income reported in the tax return with the entries in the books of accounts, and hence avoided the need for re-computations on a calendar year basis.

ADMINISTRATION OF THE REVISED TAX TREATMENT

11 As stated above, all non-trade income (with the exception of Singapore franked dividends) of entities will be allowed to be assessed on an accounting year basis and tax deduction for approved donations allowed on an accounting year basis with effect from YA2005. Singapore franked dividends derived prior to 1 January 2008 shall continue to be assessed on the calendar year basis. With effect from YA2009, all income (whether trade or non-trade⁹) of entities will be allowed to be assessed on an accounting year basis.

12 The revised tax treatment from YA2005 to YA2008 will be allowed through an administrative concession granted by IRAS. For YA2009 and thereafter, the revised tax treatment shall be provided for under the law.

Election for the Application of the Revised Tax Treatment

13 Entities can elect for the revised tax treatment to apply to them from any particular YA after YA2004 (i.e. YA2005 to YA2008) by preparing the tax computation of their non-trade income (except Singapore franked dividends) for that YA on an accounting year basis. In other words, entities which prefer that their non-trade income be assessed on a calendar year basis for any YA from YA2005 to YA2008 can continue to do so.

14 However, once an entity has elected for its non-trade income (excluding Singapore franked dividends) to be assessed on an accounting year starting from any particular YA between YA2005 to YA2008, it shall not be allowed subsequently to have its non-trade income assessed on the calendar year basis.

Transitional Rule for Reporting Non-Trade Income on Accounting Year Basis

15 For the first YA¹⁰ where the non-trade income of an entity is taxed on an accounting year basis, part of the non-trade income recorded on an accounting year basis would have already been assessed to tax on the calendar year basis in the previous YA. Similarly, part of the approved donations recorded on an accounting year basis would also have already been allowed on the calendar year basis in the previous YA. In such a situation, the entity is to report the non-trade income for the period 1 January to the end of the accounting year (and not for the whole accounting year) as the non-trade income to be taxed on accounting year basis for that particular YA. Similarly, the entity is to claim the tax deduction for approved donations made for the period 1 January to the end of the accounting year (and not the whole accounting year).

16 As an illustration, assume that company A's accounting year-end is 31 March. For YA2006, the company decided to opt for its non-trade income (excluding Singapore franked dividends) to be taxed on the accounting year basis instead of the calendar year basis. Based on normal rules, Company A would have to include in its ECI (which is to be submitted by 30 June 2005) the amount of non-trade income (excluding Singapore franked dividends) for the accounting year ending on 31 March 2005 (i.e. period 1 April 2004 to 31 March 2005). However, as this is the year of transition the amount of non-

⁹ Please see footnote 5.

¹⁰ First YA refers to the YA where the non-trade income (excluding Singapore franked dividends) is first assessed on an accounting year basis instead of the calendar year basis.

trade income for the period 1 April 2004 to 31 December 2004 would have been subjected to tax for YA2005, Company A should only include the amount of non-trade income for the period of 1 January 2005 to 31 March 2005 in its ECI for YA2006 and Form C and tax computation for YA2006.

Transitional Rule for the Submission of ECI

17 For entities that wish to elect for their non-trade income (excluding Singapore franked dividends) to be assessed on an accounting year basis, they would have to submit their ECI within 3 months after the end of their accounting period relating to that YA in order for the revised tax treatment to apply. This is the condition as stated in paragraph 10.

18 However, to provide entities with more time to make a decision on whether to make such an election, and in view of the fact that entities with accounting year ending in January, February, March and April would have already submitted their ECI for YA2005 based on the old rules by the time this Circular is released, the following transitional rule is put in place for entities which wanted the revised tax treatment to apply with effect from YA2005:

- (i) For companies, bodies of persons, partners of a partnership and sole-proprietors¹¹, they should continue to submit their ECI on their trade income for YA2005 within 3 months after the end of their accounting period relating to that YA.

If the entity wants the revised tax treatment to apply with effect from YA2005 but had not already included its non-trade income in its original ECI for YA2005, it should submit a revised ECI, incorporating its non-trade income (except Singapore franked dividends net of expenses), to IRAS by latest 31 March 2005 in order to avail itself of the revised tax treatment for YA2005.

- (ii) For entities that derive only non-trade income with accounting year ending other than on 31 December, they should submit their ECI on their non-trade income (except net Singapore franked dividends) by latest 31 March 2005 in order to avail themselves of the revised tax treatment for YA2005.

19 For entities making the election for the revised tax treatment to apply with effect from any YA starting from YA2006 to YA2008, the conditions as stated in paragraph 10 shall apply. In other words, such entities have to submit their ECI including their non-trade income (except net Singapore franked dividends) within 3 months after the end of their accounting year relating to that YA in order for the revised tax treatment to apply.

¹¹ Please see footnote 6 for the administrative concession on the furnishing of ECI by partners of a partnership and sole-proprietors.

ENQUIRIES

20 For any clarification on this e-Tax Guide, please call our following helpline:

- For Companies: 1800-3568622; and
- For Sole Proprietors & Partners of a Partnership: 1800-3568611
- Bodies of Persons: 6351 3883

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