IRAS Consultation

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

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OF SINGAPORE

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Abbreviations

AFS	Available-for-sale
C&M	Classification and measurement
CIT	Comptroller of Income Tax
ECL	Expected credit loss
FRS 17	Financial Reporting Standard 17 *Leases*
FRS 39	Financial Reporting Standard 39 *Financial Instruments: Recognition and Measurement*
FRS 109	Financial Reporting Standard 109 *Financial Instruments*
FVOCI	Fair value through other comprehensive income
FVTPL	Fair value through profit or loss
ITA	Singapore Income Tax Act
OCI	Other comprehensive income
P&L	Profit or loss account
SPPI	Solely payments of principal and interest
YA	Year of Assessment

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

1 Invitation to comment

1.1 The Accounting Standards Council issued FRS 109 in December 2014. FRS 109 applies to entities for their annual periods beginning on or after 1 January 2018. An entity can choose to –

(a) apply early the entire completed version of FRS 109 before that day; or
(b) apply early only the requirement to present in OCI the effects of changes in its own credit risk on financial liabilities designated as FVTPL, without applying the other requirements in FRS 109.

1.2 IRAS has examined the income tax implications that would arise from entities adopting FRS 109. This consultation paper sets out the IRAS' proposed tax treatment and guidance for entities adopting FRS 109 (hereafter called "FRS 109 tax treatment").

1.3 We seek your comments on the proposed FRS 109 tax treatment, and in particular, the questions set out in the following paragraphs.

<u>Financial asset measured at FVOCI</u>

(a) For equity instruments measured at FVOCI, you are to furnish a list of such instruments on revenue and capital account, for the following YAs:

(i) the YA relating to the basis period in which you transit from FRS 39 to FRS 109;
(ii) the YA relating to the basis period in which you acquire or dispose of any equity instruments measured at FVOCI.

The list is to enable you and CIT to determine the appropriate tax adjustments.

How easy would it be for you to provide such a list to CIT? If there is any difficulty, please elaborate and suggest how the issue might be addressed. What other methods may be used to identify the equity instruments on revenue and capital account for tax purposes?

<u>Impairment under the ECL model</u>

(b) What challenges do you anticipate with regard to the tax adjustments and disclosure requirements for entities accounting for the credit loss provisions under the ECL model, and how would you address these challenges?

(c) Bank or finance company - If you are a bank or finance company, what is your view on the credit loss provision under the ECL model vis-à-vis the requirement provided for under MAS Notices 612, 1005 and 811? Do you agree with the view that the credit loss provision under the ECL model is expected to be higher than that under regulatory requirement? Please provide your explanation on your views. If the credit loss provision under the ECL model is expected to be higher than the regulatory requirement, is there any specific issue if the deduction under section 14I of the ITA is to be discontinued with the adoption of FRS 109?

Transitional tax adjustments

(d) What specific issues or problems would you face in respect of the tax adjustments that would have to be made as a result of the transitional rules set out in paragraph 9? With respect to the impairment losses claimed under FRS 39 for equity instruments which are designated as measured at FVOCI under FRS 109, do you agree with the proposed tax treatment adopted in the transitional year? Please state the reason for your view.

(e) For an entity that has to move from the pre-FRS 39 tax treatment to the FRS 109 tax treatment, what is the impact on the entity if all the unrealised fair value gains or losses on revenue account are assessed to tax or are allowed in the transitional year, and how could the impact be mitigated?

Reclassification of debt instruments after FRS 109 is adopted

(f) After FRS 109 is adopted for accounting purposes, under what circumstance will a debt instrument be reclassified from one measurement category to another measurement category? Does paragraph 10 cover all the likely scenarios where reclassification can arise and address the tax implications? If not, please provide the scenario and tax implication.

Others

(g) Are there any other tax implications relating to FRS 109 that are not addressed in the paper? If so, please provide an analysis using examples to illustrate the tax implications and your recommendation.

(h) Which do you think are the sectors that would be most impacted by FRS 109? Please elaborate and state whether, in your view, special tax rules are necessary to cater to these accounting changes for the specific sector(s). If yes, please furnish details of your specific proposal.

2 Submission

2.1 To facilitate our review of your comments, please state clearly whether your comments are given in the context of:

(a) a company that has adopted or has not adopted FRS 39 tax treatment;
(b) a company that will be or will not be adopting FRS 109 for accounting purposes.

Please use examples to illustrate your basis and rationale where possible. Please also indicate the specific section of the consultation paper to which your comments relate. Your response should preferably not be more than four pages long.

2.2 We reserve the right to make public all or parts of any written submission made in response to this consultation paper and to disclose the identity of the contributor. We may also contact the contributor if we need further clarification on any comments provided. All comments received will be considered.

2.3 The closing date to submit your comments is 1 August 2016. Your submission should include your name, the organisation you work for or represent, your email address and telephone number. Please address your submission to:

Comptroller of Income Tax
Inland Revenue Authority of Singapore
Tax Policy & Ruling Branch
55 Newton Road
Singapore 307987

Or Email to: public_consultation@iras.gov.sg

3 Aim

3.1 This consultation paper is on IRAS' proposed FRS 109 tax treatment and guidance.

3.2 It will be relevant to you if you are required to comply with the requirements in FRS 109 for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items.

4 At a glance

4.1 The Accounting Standards Council issued FRS 109 in December 2014. FRS 109 applies to entities for their annual periods beginning on or after 1 January 2018. Earlier application is permitted.

4.2 To minimise tax adjustment, the FRS 39 tax treatment is currently the default tax treatment for all taxpayers who adopt FRS 39 for accounting purposes, unless a taxpayer opts out of FRS 39 tax treatment. Similar to the approach taken for the adoption of FRS 39 for accounting purposes, if a taxpayer adopts FRS 109 for accounting purposes, the income 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 the tax principles (called in this document "FRS 109 tax treatment").

4.3 FRS 109 tax treatment does not apply to taxpayers that do not need to comply with FRS 109 for accounting purposes[1].

5 Current tax treatment

5.1 Where FRS 39 tax treatment applies to a taxpayer, the income 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.

5.2 Under FRS 39 tax treatment, for financial assets classified as held-to-maturity and loans and on revenue account, the interest income that is subjected to tax is that shown in P&L, and is calculated using the effective interest method. On the other hand, for debt securities and negotiable certificates of deposits on capital account, the interest income assessable to tax will be that based on coupon / contractual rate and the provisions of section 10(12) of the ITA respectively.

5.3 If CIT agrees that the financial assets are on capital account, any gains or losses from such assets are neither taxed nor allowed.

5.4 Under FRS 39 tax treatment, for financial liabilities that do not constitute accretion to capital and that 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, tax adjustment is required. Only interest expenses incurred, and specified borrowing costs that are incurred as a substitute for interest expense or to reduce interest cost, may be allowed for tax deduction.

[1] For example, taxpayers who qualify for and have elected to comply with SFRS for Small Entities.

5.5 For hedging instruments where the underlying asset or liability is on revenue account, unrealised gains are taxed and unrealised losses are allowed as a deduction. However for hedging instruments where the underlying asset or liability is on capital account, unrealised gains or losses are not taxed nor allowed as a deduction.

5.6 More details on FRS 39 tax treatment can be found in IRAS' e Tax Guide on "Income tax implications arising from the adoption of FRS 39 – financial instruments: recognition & measurement".

6 Fundamentals and principles of FRS 109

6.1 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. There are no more categories of held-to-maturity, loans and receivables and AFS under FRS 109. The standard also introduces the requirements related to the fair value option for financial liabilities to address an issuer's own credit risk. Any change in the fair value of financial liabilities attributable to such risk shall be presented in OCI unless there is an accounting mismatch. Under the impairment requirement in FRS 109, it is no longer necessary for a credit event to have occurred before credit losses are recognised. Instead, an entity always accounts for expected credit losses and changes in those expected credit losses. There are also some changes to hedge accounting under FRS 109 as compared to FRS 39.

6.2 A brief overview of the FRS 109 accounting treatment is provided in Annex A.

7 Proposed FRS 109 tax treatment

7.1 To minimise tax adjustments, if a taxpayer adopts FRS 109 for accounting purposes, the income 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.

(A) Financial assets

<u>Financial assets measured at FVTPL</u>

7.2 For financial assets measured at FVTPL and are on revenue account, similar to FRS 39 tax treatment, the income tax treatment will be aligned with the accounting treatment under FRS 109. This means that all gains or losses recognised in P&L will be taxed or allowed as a deduction even though they are not realised.

7.3 In the event the taxpayer claims that the financial assets are on capital account, the taxpayer should submit a list of those financial assets to the CIT for his determination whether they are indeed financial assets on capital account. Similar to the FRS 39 tax treatment, where the CIT has agreed that they are assets on capital account, the gains will not be taxed and the losses will not be allowed as a deduction. In such a case, the taxpayer will have to track the gains or losses reflected in the P&L and make the necessary tax adjustments.

Financial assets measured at FVOCI

7.4 For equity instruments that are not held for trading, taxpayers may make an irrevocable election to present the fair value changes in OCI at initial recognition. If a taxpayer has made such an election, the taxpayer is to submit a list of such instruments to the CIT upon adoption of FRS 109 for accounting purposes, and segregate the instruments for capital and revenue account. This list is to enable the taxpayer and CIT to determine the appropriate tax adjustments. For subsequent YAs after the initial application of the FRS 109, the taxpayer will have to update the list with any addition or disposal of equity instruments measured at FVOCI that are on capital and revenue account. For any equity instruments that are on revenue account, the gains or losses recognised in OCI will be brought to tax or allowed a deduction upon derecognition (such as disposal) of such instruments.

7.5 The table below shows the tax treatment for debt instruments measured at FVOCI:

Debt instrument on revenue account	Debt instrument on capital account
• any fair value changes of such instruments accumulated in OCI and recycled to P&L will be taxed or allowed upon derecognition of the instruments.	• any fair value changes of such instruments accumulated in OCI and recycled to P&L will not be taxed nor allowed upon derecognition of the instruments • tax adjustment is required
• interest income, based on the amount shown in P&L, which is calculated using the effective interest method under FRS 109, will be taxed	• interest income reflected in P&L will be adjusted to that based on the coupon /contractual rate[2] and that based on the provisions of

[2] This is because the interest income under FRS 109 is computed using effective interest method. Under the effective interest method, the effective interest rate is applied to gross carrying amount of the financial assets. In calculating effective interest rate, the calculation includes all fees and points paid or received between parties to the contract, transaction costs and all other premiums or discount.

Debt instrument on revenue account	Debt instrument on capital account
	section 10(12) of the ITA respectively. In the case of discount/premium, adjustment will have to 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). • tax adjustment is required
• foreign exchange gains or losses, impairment losses and reversal of impairment losses, that are recognised in P&L, will be taxed or allowed as a deduction	• foreign exchange gains or losses, impairment losses and reversal of impairment losses, that are recognised in P&L, will not be taxed or allowed as a deduction • tax adjustment is required.

7.6 For debt instruments measured at FVOCI, the taxpayer is to submit a list of the debt instruments which are on capital account to the CIT upon adoption of FRS 109 for accounting purposes. For subsequent YAs after the initial application of the FRS 109, the taxpayer has to update the list with any addition or disposal of debt instruments measured at FVOCI that are on capital account.

Financial assets measured at amortised cost

7.7 The tax treatment for debt instruments measured at amortised cost will be the same as that for debt instruments measured at FVOCI. If the debt instruments measured at amortised cost are on revenue account, any gains or losses of such debt instruments will be taxed / allowed upon derecognition of such debt instruments.

Financial assets designated at FVTPL

7.8 Notwithstanding that the criteria for a financial asset to be classified at amortised cost or FVOCI are met, taxpayers may at initial recognition, irrevocably designate such financial asset as measured at FVTPL if in doing so, it eliminates or significantly reduces an accounting mismatch. In such a case, the same tax treatment as stated in paragraphs 7.2 and 7.3 will apply to such an asset.

(B) Financial liabilities

7.9 Apart from the requirement to record in OCI, changes in an issuer's own credit risk on financial liability designated to be measured at

FVTPL, there is no other change to the classification of financial liabilities for accounting purposes under FRS 109 vis-à-vis FRS 39. The tax treatment of financial liabilities under FRS 109 is as follows:

Financial liabilities used for revenue purpose	Financial liabilities used for capital purpose
If the financial liabilities are measured at FVTPL, all gains or losses will be taxed or allowed as a deduction even though they are unrealised. If the liabilities are measured at amortised cost using the effective interest method, the qualifying interest expense computed under FRS 109 will be allowed as a deduction	The following items will be allowed only when they are incurred: • interest expenses based on the contractual rate; • borrowing costs (other than interest expense) which are incurred as a substitute for interest expense or to reduce interest cost Tax adjustment is required.
For convertible debt securities, the discount/premium attributable to equity component or embedded derivative (which is the option to convert debt securities into equity) is not allowable as there is no cash outlay and such premium/discount is capital in nature.	

7.10 Where a financial liability is designated at FVTPL, the change in the fair value of the financial liability that is attributable to changes in the issuer's own credit risk that is presented in OCI will not be brought to tax or allowed a deduction. As the amount is presented in OCI, no tax adjustment is required.

7.11 However, where the presentation of the effects of changes in the liability's credit risk in OCI creates or enlarges an accounting mismatch, then all gains or losses on that liability (including the effects of changes in the credit risk of that liability) is presented in P&L. In such a scenario, tax adjustment will be required not to tax / not to allow the fair value that is attributable to changes in the credit risk of that liability presented in P&L.

(C) Impairment under the ECL model

7.12 Under FRS 109, the impairment of financial assets are determined based on a three-stage model since initial recognition. For financial assets that are on revenue account, only the impairment loss under stage 3 of the ECL model will be allowed and any reversal of such loss will be subjected to tax. This is in view that the credit event has not occurred under stage 1 and stage 2 of the ECL model. For the impairment loss under stage 3 to be tax deductible, they must be made with reasonable and supportable objective evidence.

(D) Hedging instruments

7.13 For derivatives that are used for hedging purposes and where the underlying asset or liability of the hedge is on revenue account (e.g. trade receivables), unrealised gains and losses as reflected in P&L will be taxed or allowed as a deduction, as the case may be. However, for derivatives that are used for hedging purposes and where the underlying asset or liability of the hedge is on capital account, unrealised gains or losses reflected in P&L will not be taxed or allowed as a deduction.

7.14 Under FRS 109, for transaction-related hedged item, the time value of an option or the forward points of a forward contract could result in the recognition of a non-financial asset or non-financial liability. In the case of options, the hedge accounting rules in FRS 109 provides that the change in fair value arising from the time value of the option be recognised in OCI. As the recognition is in OCI, no tax adjustment is required.

7.15 The change in fair value stated in paragraph 7.14 is subsequently removed from equity and adjusted against the initial cost or other carrying amount of the non-financial asset or non-financial liability. Where the underlying non-financial asset is plant and machinery for which a taxpayer has claimed capital allowances, any change in value arising from the time value of the option made against the initial cost or carrying cost, being a hedging or financing cost, would be disregarded (i.e. capital allowances will be computed based on the actual purchase cost).

(E) Interest-free, interest below market rate and non-arm's length loans

7.16 For any interest-free loan, any "discount" of the loan recognised in P&L will not be allowed as a deduction and any "imputed interest income" recognised in P&L will not be taxed because these are merely book entries with no actual liabilities involved. Any expense or deemed expense in connection with "imputed interest income" will also be disregarded. Hence, tax adjustments are required to exclude the "discount", imputed interest, expense or deemed expense mentioned above.

7.17 For any loans provided to employees at interest rate that is below the market interest rate, the deferred staff benefit amortised to P&L will not be allowed as a deduction since this is a book entry.

7.18 For any non-arm's length loans measured at amortised cost, only interest income based on contractual rate will be taxed.[3] Tax adjustment is required to disregard the following:

(a) any discount of the loan recognised in P&L at initial recognition of the loan;
(b) any "income" recognised over the life of the loan.

The same treatment also applies to any borrower of such loan.

8 Valuation of assets in the computation of interest adjustment

8.1 Currently, with the adoption of FRS 39 for accounting purposes, financial assets are shown at fair value, cost or amortised cost. For tax purposes, the treatment of financial instruments on revenue account is aligned with the accounting treatment of FRS 39. In making the interest adjustment on non-income producing assets, the value of these assets is the value reported in the statement of financial position without any adjustment for any provisions made and valuation surplus or deficit. However, taxpayers may use the historical cost to value the financial assets in making the interest adjustment if they have made an election in writing at the time of submitting their tax returns.

8.2 For taxpayers who have made such an election referred to in paragraph 8.1, they are allowed to use or continue to use the historical cost to value the assets for making the interest adjustment when they remain under FRS 39 or move to FRS 109, for accounting purposes. They must track the historical cost of all assets separately and keep proper records on the cost of the assets. However they can opt to use the value of the financial assets shown in the statement of financial position under FRS 39 or FRS 109 at any time after that. The option, once exercised, is irrevocable.

8.3 For taxpayers who remain in the pre-FRS 39 tax treatment on or after 1 January 2018, the historical cost will be used to compute the value of the assets for making the interest adjustment.

8.4 For new taxpayers who prepare their first set of financial accounts in accordance with FRS 109 beginning on or after 1 January 2018, and wish to use historical cost to value the assets for making interest

[3] Notwithstanding this tax treatment with the adoption of FRS 109, the CIT is not precluded from making further adjustments to the interest income to be subject to tax based on the arm's length principle.

adjustment, they must make an election in writing, when they submit their first set of tax returns. They must track the historical cost of all the financial assets separately and keep proper records on the cost of those assets. Once the election is made, the treatment of using historical cost will have to be applied consistently.

8.5 For all other taxpayers, i.e. those who do not elect to use historical cost or opt to use the value of financial assets shown in the balance sheet under FRS 39 or FRS 109 (as the case may be), the option to use historical cost to value the financial assets for interest adjustment purposes will not be available. For the purpose of making interest adjustment using total assets method, the value of the assets as reported in the statement of financial position without any adjustment for any provisions made and valuation surplus or deficit will be used for the numerator (i.e. the non-income producing assets) and the denominator (i.e. total assets) of the method.

9 Transitional tax adjustments

9.1 When FRS 109 is initially applied, a taxpayer will have to reclassify its financial assets and financial liabilities and remeasure its carrying amount in accordance with FRS 109. Any difference between the remeasured amount and the previous carrying amount is recognised as an adjustment to the balance of the opening retained earnings (or other components of equity as appropriate) at the beginning of the financial year in which the FRS 109 is initially applied or are restated as comparatives in prior years.

9.2 For financial assets on revenue account, **subject to the paragraphs below**, the adjustments recognised in the opening balance of retained earnings (or other components to equity) or are restated as comparatives in prior years will be taxed or allowed as a deduction in the first YA that the FRS 109 tax treatment is applicable, i.e. the YA relating to the basis period in which the taxpayer is required to adopt FRS 109 for accounting purposes. Taxpayers must furnish details showing how the tax adjustments are arrived at and maintain relevant documents relating to such tax adjustments.

9.3 The table below presents the proposed tax treatment when a financial asset or financial liability under one measurement category in FRS 39 transits to another measurement category in FRS 109:

Financial instruments	C&M under FRS 39	C&M under FRS 109	Proposed tax treatment
Financial asset - equity not held for trading	AFS	FVTPL	<u>On revenue account</u> In transitional year, to tax/allow unrealised gain/loss reversed from equity and adjusted

Financial instruments	C&M under FRS 39	C&M under FRS 109	Proposed tax treatment
			against retained earnings. Thereafter to align with accounting treatment. In transitional year, impairment loss allowed previously under FRS 39 will be taxed fully. <u>On capital account</u> In transitional year, as the unrealised gain/loss is adjusted against retained earnings, no tax adjustment is required.
Financial asset - equity not held for trading	AFS	FVOCI	<u>On revenue account</u>[4] In transitional year - - to tax impairment loss allowed previously under FRS 39. - not to allow additional impairment loss upon transition to FRS 109. - to tax/allow foreign exchange loss/gain previously recognised in P&L now reversed to OCI (if applicable) In year of disposal, to tax/allow realised gain/loss. The realised gain/loss is computed based on inter alia the historical cost of the equity investment. Tracking of historical cost is required. <u>On capital account</u> No tax adjustment is required in transitional year.
Financial asset - debt instrument	AFS	FVTPL	<u>On revenue account</u> In transitional year, to tax/allow unrealised gain/loss reclassified within equity to

[4] Unlike debt instrument, any changes in the fair value for equity instrument measured at FVOCI are not recycled to P&L.

Financial instruments	C&M under FRS 39	C&M under FRS 109	Proposed tax treatment
			retained earnings. Thereafter to align with accounting treatment. Impairment loss allowed previously under FRS 39 is not taxed upon transition, unless there is a reversal. <u>On capital account</u> In transitional year, no tax adjustment is required for any unrealised gain/loss reclassified within equity to retained earnings.
Financial asset - debt instrument	AFS	FVOCI / amortised cost	<u>On revenue account</u> In transitional year - - impairment loss allowed previously under FRS 39 is not taxed unless there is a write back. - additional impairment loss upon transition to FRS 109 is not allowed. In year of disposal - (a) for debt instrument measured at FVOCI, to tax/allow cumulative gain/loss in OCI transferred to P&L. (b) for debt instrument measured at amortised cost, to tax/allow the gain/loss on disposal reflected in the P&L. <u>On capital account</u> No tax adjustment is required in transitional year. In year of disposal: (a) for debt instrument measured at FVOCI, the cumulative gain /loss in

Financial instruments	C&M under FRS 39	C&M under FRS 109	Proposed tax treatment
			OCI transferred to P&L will not be taxed/allowed. (b) for debt instrument measured at amortised cost, the gain/loss on disposal reflected in the P&L will not be taxed/allowed.
Financial asset - debt instrument	Amortised cost	FVTPL	<u>On revenue account</u> In transitional year, to tax/allow the difference between the carrying amount (under FRS 39) and fair value (under FRS 109).
Fair value change due to own credit	P&L	OCI	In transitional year, no tax adjustment is required if such fair value change has not been allowed/taxed under FRS 39.

9.4 At the date of initial application of FRS 109, taxpayers will have to determine whether there have been significant increases in credit risk since initial recognition of financial instruments, and to recognise the impairment provisions based on the ECL model. Impairment provisions under ECL model are applicable to lease receivables and certain loan commitments which are previously not within scope of FRS 39 for impairment provisions. Hence, under the ECL model, the recognition of credit losses is expected to be accelerated and enlarged, as compared to the incurred loss model under FRS 39.

9.5 Given that the impairment losses under stage 1 and stage 2 of the ECL model are not yet incurred, only the additional impairment provisions made under stage 3 of the ECL model in the transitional year for financial assets on revenue account will be allowed. Such impairment provision must be supported by reasonable and objective evidence. The deduction will be given in the first YA the FRS 109 tax treatment is applied upon adoption of the FRS 109 accounting treatment.

10 Reclassifications of debt instruments after FRS 109 is adopted

10.1 Where there are reclassifications of financial assets, being debt instruments on revenue account, after the taxpayer has moved into FRS 109 tax treatment, the following tax treatment is to apply in the year of reclassification:

C&M at initial recognition	New C&M	Proposed tax treatment in year of reclassification
FVOCI	Amortised cost	The deferred gain/loss recognised in OCI will be taxed or allowed.
FVOCI	FVTPL	The gain/loss in OCI reclassified to P&L will be taxed or allowed.
Amortised cost	FVTPL	The difference between the carrying amounts under 2 measurement categories will be taxed or allowed.

10.2 Taxpayers have to furnish details showing how the tax adjustments in the year of reclassification are arrived at and maintain relevant documents relating to such tax adjustments.

11 Taxpayers not required to comply with FRS 109

11.1 For taxpayers who do not need to comply with FRS 109 for accounting purposes or companies that are temporarily exempt by Accounting and Corporate Regulatory Authority from complying with FRS 109 for accounting purposes, the pre-FRS 39 tax treatment or FRS 39 tax treatment (as the case may be), continues to apply to them.

11.2 In the case where pre-FRS 39 tax treatment applies and the taxpayers derive gains or incur losses from financial assets held on revenue account, unless otherwise specified, generally any realised gains or losses arising from the disposal of such financial assets are subject to tax or allowed as a deduction. As an exception, where the financial assets on revenue account are carried at the lower of cost and market value, and a provision for diminution in value has been made in the accounts, the provisions may be allowed as a deduction for income tax purposes while any write back up to the cost brought to tax. In the case of financial liabilities that are for revenue purposes, only realised gains or losses are taxed or allowed as a deduction. In the case where FRS 39 tax treatment applies, please refer to IRAS' e Tax Guide on "Income tax implications arising from the adoption of FRS 39 – financial instruments: recognition & measurement".

12 No option to remain in pre-FRS 39 tax treatment

12.1 For all other taxpayers, for simplicity and to reduce compliance cost, they are to adopt the FRS 109 tax treatment upon their adoption of FRS 109 for accounting purposes (i.e. there will be no option to remain in the pre-FRS 39 tax treatment).

13 Summary of proposed FRS 109 tax treatment

13.1 A summary of the proposed FRS 109 tax treatment is in Annex B.

Annex A

Measurement of financial instruments

Financial Assets

1. Financial assets should be measured at amortised cost, FVOCI or FVTPL based on the following tests:

   (a) Business model test

   This refers to how an entity manages its financial assets in order to generate cash flow i.e. whether cash flows result from collecting contractual cash flows, selling the financial assets or both;

   (b) Contractual cash flow characteristics test

   Under this test, the assets will need to give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding. Where financial assets have features that do not represent payments of principal and interest, e.g. a conversion option into shares of the issuer, a link to a commodity price or leverage, such assets would fail the SPPI test.

2. A financial asset should be measured at amortised cost if both of these conditions are met:

   (a) the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows; and
   (b) the contractual terms of the financial asset gave rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

3. A financial asset should be measured at FVOCI if both of these conditions are met:

   (a) the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
   (b) the contractual terms of the financial asset gave rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

4. A financial asset should be measured at FVTPL if it does not meet the conditions for measurement at amortised cost or FVOCI. However, a taxpayer may make an irrevocable election at initial recognition for a particular equity instrument to be measured at FVOCI provided that equity instrument is neither held for trading nor a contingent consideration recognised by an acquirer in a business combination.

5. Notwithstanding paragraphs 2 and 3, an entity may irrevocably designate a financial asset as measured at FVTPL if doing so eliminates or significantly reduces a measurement or recognition inconsistency ("accounting mismatch").

Financial Liabilities

6. All financial liabilities should be measured at amortised cost except for:

   (a) financial liability that is held for trading, including derivatives;
   (b) financial liability that is designated as at FVTPL on initial recognition;
   (c) financial guarantee contracts;
   (d) commitments to provide a loan at below market interest rate; and
   (e) contingent consideration recognised by an acquirer in a business combination.

Embedded Derivatives

7. For a hybrid contract that contains a host that is an asset within the scope of FRS 109, the entire hybrid contract, like any financial asset, will be classified in accordance with the entity's business model and the contractual cash flow characteristics.

8. The embedded derivative shall be separated from the host that is not an asset within the scope of FRS 109 and accounted for as a derivative under FRS 109 if and only if –

   (a) the economic characteristics and risks of the embedded derivatives are not closely related to the economic characteristics and risks of the host;
   (b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
   (c) the hybrid contract is not measured at fair value with changes in fair value recognised in P&L.

Impairment – recognition of expected credit losses

9. A loss allowance is recognised for expected credit losses on financial assets based on the ECL model. The ECL model applies to debt instruments measured at amortised cost or at FVOCI, lease receivables that are within the scope of FRS 17, trade receivables, contract assets and loan commitments and financial guarantee contracts that are not FVTPL.

10. Under the general impairment model, FRS 109 provides for a three-stage model to determine impairment based on changes in credit quality since initial recognition. Where financial instruments have not had a significant

increase in credit risk since initial recognition or have low credit risk at the reporting date, a **12-month expected credit losses** are recognised. Interest revenue will still be calculated on the gross carrying amount of the asset (i.e. without deduction for credit allowance).

11. Where credit risk on financial instruments are assessed to have increased significantly since initial recognition, a loss allowance **equal to the lifetime expected credit losses** will need to be recognised.

12. In addition, FRS 109 provides for a simplified approach to measure the loss allowance at an amount equal to lifetime expected credit losses for trade receivables, contract assets and lease receivables. On the other hand, for purchased or originated credit-impaired financial assets, an entity recognises only the cumulative changes in lifetime expected credit losses since initial recognition as a loss allowance. At each reporting date, the amount of change in lifetime expected credit losses will be recognised as an impairment gain/loss in the P&L.

<u>Hedging instruments</u>

13. Under FRS 109, qualifying hedging instruments may be derivatives measured at FVTPL or non-derivative financial asset or non-derivative financial liability measured at FVTPL.

Annex B

Summary of proposed FRS 109 Tax Treatment

No	FRS 109 Accounting treatment of Financial Assets / Financial liabilities	Proposed FRS 109 Tax Treatment
1. Financial Assets – Subsequent measurement of **(a) Financial assets at FVTPL** **(b) Financial assets at FVOCI** **(c) Financial assets at Amortised Cost**		
1a	Fair value changes at each year end for financial assets measured at FVTPL or designated as FVTPL are recognised in P&L	For assets on revenue account, to align with accounting treatment and tax or allow the unrealised gains/losses. For assets measured at FVTPL, the presumption is that the assets are on revenue account.
1b	Fair value changes at each year end for financial assets measured at FVOCI are recognised in OCI.	For debt instruments on revenue account, to tax or allow upon derecognition of such instruments, the fair value changes of such instruments that are accumulated in OCI and recycled to P&L. For equity instruments on revenue account, to tax or allow upon derecognition, the realised gains/losses (from derecognising the equity instruments). The realised gains/losses are computed based on the difference between historical cost and sales price.
1c	Debt instrument measured at amortised cost or FVOCI using the effective interest method. The amortised amount, transaction cost and discount/premium (using effective interest method) are reflected as interest in the P&L.	For assets on revenue account, to align with accounting treatment, i.e. to tax the interest income calculated using effective interest method. For assets on capital account, to tax interest income

No	FRS 109 Accounting treatment of Financial Assets / Financial liabilities	Proposed FRS 109 Tax Treatment
		based on contractual rate. Tax adjustment will be required.
1d	Debt instrument measured at FVTPL where cash interest is presented in the P&L.	For assets on revenue account, to align with accounting treatment, i.e. to tax the interest income reflected in the P&L without adjustment.
2. Impairment of financial assets **(a) For general taxpayers** **(b) For banks and finance companies**		
2a	Impairment losses (using the ECL model) in respect of assets such as: - investments in debt instrument measured at amortised cost - investments in debt instrument measured at FVOCI - all loan commitments not measured at FVTPL - financial guarantee contracts to which FRS 109 is applied but not accounted for FVTPL - lease receivables within the scope of FRS 115	For assets on revenue account, to allow a deduction for impairment losses made under stage 3 of the ECL model (provided that they are made with reasonable and supportable objective evidence) and to tax the reversal amount of such impairment losses.
3. Interest-free loans and Non-arm's length loans		
3a	Loans are measured at amortised cost using the effective interest method and the "interest income" is recognised in P&L	For interest-free loans, to disregard the "imputed interest / discount" and corresponding "expense" as they are merely book entries with no liabilities involved. For non-arms' length loans, to tax interest income or allow qualifying interest expenses, based on the

No	FRS 109 Accounting treatment of Financial Assets / Financial liabilities	Proposed FRS 109 Tax Treatment
		contractual rate.
4. Financial liabilities – subsequent measurement of (a) Financial liabilities designated at FVTPL (b) Financial liabilities at amortised cost		
4a	Unrealised gains/losses from the fair valuing of the financial liability (other than those attributable to changes in the credit risk of that liability).	For financial liabilities (other than that attributable to changes in the credit risk) that are for revenue purpose, to align with accounting treatment and to tax or allow the unrealised gains/losses. For financial liabilities designated at FVTPL (other than that attributable to changes in the credit risk), the presumption is that the financial liabilities are for revenue purpose.
4b	Unrealised gains/losses from the fair valuing of the financial liability that is attributable to changes in the credit risk of that liability are recognised in OCI unless the presentation of the effects of changes in the liability's credit risk in OCI creates or enlarges an accounting mismatch, then all gains or losses on that liability (including the effects of changes in the credit risk of that liability) is presented in P&L.	No tax adjustment is required if the unrealised gains /losses are recognised in OCI. Otherwise, tax adjustment will be required not to tax or not to allow the fair value that is attributable to changes in the credit risk of that liability presented in P&L.
4c	The amortised amount, transaction cost and discount /premium (using effective interest method) are reflected as “interest” in P&L.	If the borrowing is for capital purpose, to only allow interest expense based on contractual rate, and borrowing cost (other than interest expense) incurred as a substitute for interest expense or to reduce interest cost.

No	FRS 109 Accounting treatment of Financial Assets / Financial liabilities	Proposed FRS 109 Tax Treatment
		If the borrowing is for revenue purpose, to align with accounting treatment, i.e. to allow the interest expense based on effective interest method. In the case of convertible debt securities which give the holder an option to convert the debt securities into the issuing company's shares, to disallow the discount/premium attributable to embedded derivative (which is the option to convert the debt securities into equity).
5. Hedging		
5a	Unrealised gains/losses on derivatives that are used for hedging purposes written off to P&L unless the derivatives meet the conditions for hedge accounting. Where taxpayers apply hedge accounting: - for fair value hedges, the gain/loss on the hedging instrument is either recognised in P&L or OCI if the derivative hedges an equity instrument which has been designated as FVOCI. The hedging gain/loss on the hedged item is recognised in P&L or OCI as the case may be. - for cash flow hedges, the hedge ineffectiveness is recognised in P&L.	If the underlying assets or liabilities are on revenue account (e.g. trade receivables), to tax or to allow the unrealised gains/losses recognised in P&L. If the underlying assets or liabilities are on capital account, the unrealised gains/losses are not taxed or allowed. Tax adjustment is required unless the underlying hedged item is an equity instrument which has been designated as FVOCI.
5b	For transaction-related hedged item, the time value of an option or the forward points of a forward contract could result in the recognition of a non-financial asset or non-	Where the underlying asset is plant and machinery for which a taxpayer has claimed capital allowances, to disregard the change in fair value of the time

No	FRS 109 Accounting treatment of Financial Assets / Financial liabilities	Proposed FRS 109 Tax Treatment
	financial liability. In the case of options, the hedge accounting rules provide that the change in fair value of the time value of the option be recognised in OCI and subsequently removed from equity and included in the initial cost or other carrying amount of the non-financial asset or non-financial liability.	value of the option made against the initial cost or carrying cost (i.e. capital allowances will be computed based on the actual purchase cost).
6. Transitional Rules (a) Transitional impairment loss (b) Impairment loss for equity instruments designated as FVOCI (c) Unrealised gains/losses arising from transitional adjustments		
6a	Additional impairment provisions recognised using the ECL model will be adjusted against the opening balance of retained earnings at the beginning of the financial year in which FRS 109 is initially applied.	To allow only the additional impairment loss made under stage 3 of the ECL model provided that they are made with reasonable and supportable objective evidence.
6b	For equity instruments designated as FVOCI, the impairment provision recognised under FRS 39 and any reversal of the impairment provision is recognised in OCI and will not be recycled to PL.	For equity instruments designated as FVOCI and are on revenue account, to tax the impairment loss allowed under FRS 39 tax treatment. Any additional impairment provision made upon transition to FRS 109 is not allowed.
6c	Unrealised gains/losses arising from transitional adjustments: - any difference between the remeasured amount under FRS 109 and previous carrying amount under FRS 39 could either be recognised as an adjustment of the balance of the opening retained earnings at the beginning	Where the financial assets and financial liabilities are on revenue account, to align with accounting treatment and tax or allow amounts recognised either in the opening retained earnings or are restated as comparatives. For other details, refer to paragraphs 9.3 of the main

No	FRS 109 Accounting treatment of Financial Assets / Financial liabilities	Proposed FRS 109 Tax Treatment
	of the financial year in which FRS 109 is initially applied or comparatives are restated. - for the cumulative change in fair value presented as AFS reserve in OCI upon adoption of FRS 109, the adjustment could be against opening retained earnings or comparatives are restated. Where the investment is classified as FVTPL, the change in fair value in each of the prior periods is recognised in the P&L in the respective prior periods presented.	paper.
6d	-	There will be no option for taxpayers to remain in the pre-FRS 39 tax treatment or to opt out of FRS 109 tax treatment unless paragraph 7 below applies. All other taxpayers are required to move to the FRS 109 tax treatment once they have adopted FRS 109 for accounting purposes.
7. Taxpayers not required to comply with FRS 109		
7a	Tax treatment of financial assets and financial liabilities for taxpayers who are not required[5] to comply with FRS 109 for accounting purposes.	To continue to allow such taxpayers to remain in the pre-FRS 39 tax treatment or FRS 39 tax treatment (as the case may be).

[5] Such as sole-proprietors or partners of a partnership, or those that are granted exemption by Accounting and Corporate Regulatory Authority from complying (if applicable)