

IRAS' AUDIT ON BEAUTY AND WELLNESS INDUSTRY

1. Overview of the Beauty and Wellness Industry

The Beauty and Wellness industry in Singapore is growing and has become an important segment of the tourism and hospitality industry. A 2010 survey¹ revealed that more than 95% of Singaporeans spent more than \$25 on beauty treatments each month while 53% spent between \$25 and \$49. Majority of the survey respondents said that they would continue with this spending pattern and that they had no intention of cutting back on such expenses.

There are more than 18,000 businesses in the Beauty and Wellness industry in Singapore, providing a wide range of services including beauty care, skin care, nail care, slimming and health treatments, massage and spa services. These shops (i.e. beauty salons, slimming centres, SPAs, hairdressing shops, massage parlours, foot reflexology and fitness centres) have opened islandwide. Other than the big operators which operate a chain of outlets, many of them have small scale operations with work force of 5 to 10 employees, in shopping malls and housing estates.

2. Regulatory Environment

For the Beauty and Wellness industry, a massage establishment licence is required if any premises is used or intended to be used for the reception or treatment of persons requiring massage, manicure, chiropody, light, electric, vapour or other baths or other similar treatment. This licence is required under Massage Establishment Act Cap 173 and is issued by the Singapore Police Force. Examples of massage establishments would be those in the business of providing body massage, foot reflexology, physiotherapy, manicure and pedicure.

3. Trade Association and Accreditation Scheme

Trade Associations for the Beauty and Wellness industry are formed to represent its members and to provide assurance to the consumers. Some of the objectives of the associations are: -

- To facilitate the development of member spas and provide the connections for members going abroad;
- To raise standards and good practices within the Beauty and Wellness industry and to ensure that industry standards and practices are met;
- To instill consumer confidence for the Beauty and Wellness industry by adopting good business practices;
- To offer insurance programme to protect consumers where they will be compensated for their unused portion of the prepaid service package should the spa establishment fold its operations.

¹ Reported in www.singaporesetup.com on 24.3.11

Below are the Trade Associations available in Singapore.

- (a) The Spa Association Singapore
- (b) Spa, Beauty and Wellness Alliance 2010
- (c) Spa and Wellness Association Singapore

In October 2008, the Ministry of Trade and Industry appointed The CaseTrust Accreditation for Spa and Wellness Businesses (<https://www.case.org.sg/casetrust/>) as the accreditation body for the spa and wellness industry and mandated CaseTrust to develop an accreditation programme for the spa and wellness industry with the purpose of raising the professional standards of the industry. The primary objective is to instill consumer confidence in this industry by adopting good business practices. One of the requirements is for spa operators to show that they have transparent pricing and a complaint resolution procedure in place. Other requirements include providing customers with a minimum cooling-off period of five working days after buying a package and prohibiting selling in treatment rooms.

4. Industry Size and Players

It is estimated that there are about close to 19,000 of such businesses in Singapore, with the majority formed as sole-proprietorships and partnerships with a small number as companies.

5. Operation models

There are various types of services provided in the Beauty and Wellness industry which include beauty care, skin care, nail care, slimming and healthcare treatments, massage and spa services etc. These services are generally provided to customers in packages specifying the types and number of treatments and the validity period. Payments are to be made upfront or in an agreed number of installments. They are usually non-refundable and non-exchangeable.

To entice customers to stay on, beauty operators would normally allow customers to upgrade to a higher value package by paying a difference between the new package price and the value of their unutilised treatments.

A customer treatment card is maintained for each customer with their personal particulars, payment records and treatment details (i.e. number of treatments entitled, utilized and remainder) and it would be kept at the outlet the customer frequented.

Under the accounting standard FRS 18², when the outcome of a transaction involving the rendering of services can be reliably estimated, revenue associated with the transaction should be recognised by reference to the stage of completion of the transaction as at the balance sheet date.

² Please refer to website at www.asc.gov.sg for more details

The Beauty and Wellness industry operators would generally recognise its income based on the number of treatments utilised as at the balance sheet date. The amount attributable to unutilised treatments is deferred to subsequent periods. For packages with validity period, income attributable to unutilised treatments would be recognised upon expiry.

Not all the Beauty and Wellness industry operators have put in place a computerised system to keep track of the numbers and value of unutilised treatments and the validity period.

6. IRAS' Audit Review

IRAS conducts regular compliance review on taxpayers' Income Tax Returns. We conducted audits on 14 beauty operators incorporated as companies. On-site visits were made by IRAS' auditors to all the selected operators. The visits were pre-arranged with them. Information and documentation on their operations, record keeping practices and accounting systems were gathered during the visits to facilitate our auditors in ascertaining the accuracy of their Income Tax reporting.

Excessive deferment of income is a common mistake in the Beauty and Wellness industry. One case involved excessive deferment of income of \$3.6 million to the subsequent accounting periods. Our auditors also discovered wrongful claims of expenses. In total, the taxes recovered by IRAS were approximately \$1.3 million. After careful consideration of the circumstances surrounding each case, penalties amounting close to \$240,000 were imposed on these beauty operators as they had failed, without reasonable excuse or through negligence, to furnish correct Income Tax Returns to the IRAS.

7. IRAS' Audit Observations and Common Mistakes made by Beauty Operators

In the course of our audit, we discovered that some beauty operators do not have proper internal control system to keep track of the numbers and value of unutilised treatments. This has resulted in understatement of current year income and overstatement of deferred income. Some of the errors that have occurred as a result of the poor tracking system are:

- Double counting of the number of unutilised treatments;
- For inactive customers, income from unutilised treatments continued to be deferred even though the validity period has expired;
- Inconsistency in the computation of the number and value of unutilised treatments by different branches / outlets.

However, subsequent to the completion of our audit review, a few operators have started to computerise their customers' treatment records after realising that their existing manual system was prone to human errors. With these efforts, the operators would be able to account for their deferred income accurately.

We would like to highlight the following common mistakes made by beauty operators, as observed by our IRAS auditors in their audits:

7.1 Errors in accounting for the deferred income as at the year end

- (a) Many beauty operators often asked their customers to convert their treatment package to a higher value package. Those who agreed to do so would pay the difference between the new package price and the value of unutilized treatments. As a marketing strategy to induce customers to convert to higher value packages, treatments previously utilised were treated as complimentary. However, the income for unutilized treatment is based on the new package's price rather than the value of unutilised treatments as at the year end.

Example

Package A (\$100 x 10 treatments)	\$1,000
Utilised 2 treatments	<u>200</u>
Balance	<u>\$ 800</u>
Convert to Package B (\$150 x 10 treatments)	\$1,500
Less: Complimentary treatments from Package A	<u>200</u>
	1,300
Balance of Package A	<u>800</u>
Customer to pay the difference	<u>\$ 500</u>

Assuming 2 treatments were utilised after the conversion to Package B leaving the balance of unutilised treatments of 8 as at the year end.

As at the year end, the beauty operator has wrongly computed the deferred income as follows:-

$$\$1,500 / 10 \times 8 \text{ unutilised treatments} = \$1,200$$

The complimentary treatments from Package A of \$200 would have been accrued to the beauty operator and therefore should not be deferred. The amount of deferred income as at the year end should be computed as follows:-

$$\$1,300 \text{ (i.e. } \$1,500 - \$200) / 10 \times 8 \text{ unutilised treatment} = \$1,040$$

This has resulted in the beauty operator overstating the value of its deferred income by \$160. This amount would need to be adjusted and brought to tax in the current year.

- (b) For some beauty operators, income attributable to the unutilised treatments for promotional packages is deferred based on prices before discount instead of the discounted prices.

Example

Package C (\$100 x 10 treatments)	\$1,000
Discount given	<u>200</u>
Payment by customer	<u>\$ 800</u>

Assuming 2 treatments were utilised in the current year. It would be incorrect to compute the deferred income as follows:-

$$\text{\$1,000} / 10 \times 8 \text{ unutilised treatments} = \text{\$800}$$

The discount of \\$200 would have been taken into account as an expense in the current year Profit and Loss account where tax deduction would be claimed. Hence, the amount of deferred income as at the year end should be computed as follows:-

$$\text{\$800 (i.e. \$1,000 - \$200)} / 10 \times 8 \text{ unutilised treatments} = \text{\$640}$$

This again has resulted in the beauty operator overstating the value of its deferred income by \\$160. This amount would need to be adjusted and brought to tax in the current year.

7.2 Wrongful claims of expenses which are capital in nature

Owing to our small and competitive market, beauty operators have been expanding overseas or looking for new source of income such as franchising. Expenses such as travelling and consultancy fee, incurred for setting up new business or acquiring new source of income were claimed in their Income Tax Return. As these expenses are capital in nature, they were disallowed for deduction for income tax purposes.

7.3 Wrongful claims of private expenses

Another common mistake made by beauty operators is making wrongful claims of private expenses incurred by the directors for themselves and/or their family members who are not employed by the business. Private expenses are specifically prohibited under the law. Examples are private car expenses and directors' personal expenses.

7.4 Claims of expenses without sufficient supporting documents

During the audit review, the IRAS auditors have come across cases where payments such as entertainment and staff taxi claims were supported only by payment vouchers showing rounded figures. As a result, IRAS auditors were unable to ascertain the validity of the transactions in order to allow the claims.

Taxpayers should keep proper documentation and records to substantiate their purchases and expenses. They should also ensure that such claims have economic substance and are justified on a commercial basis. More information on good record keeping standards can be found in the IRAS e-Tax Guides:

- Record Keeping Guide for GST-registered Businesses*;
- Record Keeping Guide for Non GST registered Businesses*; and
- [Tax Guide for Beauty and Wellness Industry](#)

* Please refer to Related Items under [Keeping proper records and time limit to raise assessments](#).

7.5 Wrongful claim of expenses that were not wholly and exclusively incurred in the production of income

It is common that beauty operators advertise the services and packages offered by their group of companies under a well-known brand name. The amount of marketing expenses incurred is likely to be huge and could be charged to one company within the group. Such expenses should be allocated to companies in the group using an acceptable basis of allocation where they also benefited from the marketing efforts.

8. Voluntary Disclosures of Errors

IRAS will continue to conduct regular compliance reviews on various industries as part of our efforts to enhance voluntary compliance of our taxpayers.

Under Section 95 of the Income Tax Act 1947, any person who negligently or without reasonable excuse makes an incorrect Income Tax Return may be liable to a penalty as high as two times the amount of tax undercharged. Serious cases of omissions or errors may be subject to court prosecution.

Taxpayers are encouraged to voluntarily disclose errors made in their past Income Tax returns. Under the [IRAS Voluntary Disclosure Programme](#), IRAS will waive the penalty for any first time voluntary disclosures of omissions or errors which meet the qualifying conditions and are made within the 'grace period' of 1 year beginning from the statutory filing date of 30 November. For voluntary disclosures made after the 'grace period', IRAS will impose a reduced penalty rate of 5% per annum.