Singapore Income Tax Implications of the Adoption of FRS 115

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Background

- On 19 November 2014, the Accounting Standards Council issued Singapore Financial Reporting Standard (FRS) 115, Revenue from Contracts with Customers.
- On 12 October 2015, IRAS published a consultation paper (*Income Tax Implications Arising from the Adoption of Financial Reporting Standard 115 – Revenue from Contracts with Customers*):
  - To set out the guidance on IRAS' *proposed* position on the income tax implications arising from the adoption of FRS 115; and
  - To seek for public comments on the paper with a closing date of submission of 11 November 2015.

FRS 115

- FRS 115 will have effect from annual periods beginning on or after 1 January 2018.
- The core principle set out in FRS 115 is that "an entity is required to recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services".
- It means that revenue should be recognised by the entity when it has performed the necessary obligations.
- A five-step approach for revenue recognition is introduced by FRS 115.

FRS 115

- According to FRS 115, in determining the amount of revenue to be recognised, an entity should apply the following steps:
  - Step 1: Identify the contract(s) with a customer;
  - Step 2: Identify the performance obligations in the contract;
  - Step 3: Determine the transaction price;
  - Step 4: Allocate the transaction price to the performance obligations in the contract; and
  - Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation.

IRAS’ Proposed Tax Positions

- Tax revenue recognition is in line with the accounting principle under FRS 115.
  - A shift away from the “entitlement to income” principle;
  - Income could be subject to tax earlier, leading to cash flow impact.

IRAS' Proposed Tax Positions

- In the following situations the revenue recognition for tax purposes will *not* be in line with the accounting principle:
  - Specific tax treatment has been established through case law or provided under the law (e.g. income from certain public-private partnership arrangements);
  - The accounting treatment deviates significantly from tax principle (e.g. contracts with significant financing components);
  - Property developers (the profits are recognised for tax purposes when the Temporary Occupation Permit is granted);
  - Construction companies (the percentage of completion method).

IRAS' Proposed Tax Positions

- In respect of contracts with significant financing components:
  - The full amount of payment from the customer shall be recognised as revenue, regardless of the effect of financing;
  - Tax adjustments shall be carried out to exclude the interest income/expenses presented for accounting purposes;
  - Such interest income/expenses will not be taxable/deductible for tax purposes.

IRAS' Proposed Tax Positions

- Expenses can only be deductible if they are incurred by the entity:
  - Notwithstanding the accounting treatment, if the "estimated expenses" are expenses that have not been incurred by the entity, tax principles should prevail and a tax deduction would *not* be allowed;
  - Mismatch of income and expenses recognition for tax purposes, leading to cash flow impact

IRAS' Proposed Tax Positions

- Transitional tax adjustments
  - IRAS will treat the profit/loss arising from transitional adjustments as income/loss subject to tax in the YA relating to the year in which FRS 115 is first adopted;
  - Such income/loss will be subject to tax at the same tax rate(s) that apply to the income derived during the basis period for that YA;
  - This is notwithstanding that the adjustments may pertain to a prior year in which the entity was enjoying incentives.

Comments

- We will pay a close attention to further details to be released by IRAS.
- We would advise you to understand the potential tax implications of FRS 115 on your company specifically and to prepare for the potential tax matters in advance.

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