

Goods and Services Tax (GST)

Special input tax recovery method for banks

This update provides a summary of the IRAS e-Tax Guide *GST: Special input tax recovery method for banks* published on 6 March 2024 explaining the special input tax recovery method that licensed banks may opt to apply with effect from 1 April 2025.

Background

The fourth schedule to the GST Act provides for the exemption of prescribed financial services. The exemption, however, is not extended to any services consisting of arranging, broking, underwriting or advising on such financial services. Consequently, many banks in Singapore make both taxable supplies and exempt supplies and are subject to input tax credit restrictions.

Under the standard input tax recovery rules, entities that make both taxable supplies and exempt supplies will be required to attribute their input tax to the respective supplies and where necessary, perform apportionment to exclude claims on input tax that is attributable to the making of exempt supplies.

To alleviate the challenges of performing attribution and apportionment, licensed banks in Singapore are currently allowed to apply a fixed input tax recovery rate for the purpose of claiming input tax on their business expenses. The fixed rate is computed based on annual proxy statistics provided by the Monetary Authority of Singapore (MAS) and is reviewed yearly. It also varies by the type of banking license.

The Inland Revenue Authority of Singapore (IRAS) has since received feedback from some banks that a single fixed input tax recovery rate may not be appropriate whilst others may still prefer to retain the single fixed input tax recovery rate method.

To address the diverse industry needs, the IRAS has published an e-Tax Guide *GST: Special input tax recovery method for banks* on 6 March 2024 explaining the special input tax recovery method that licensed banks may opt to apply with effect from 1 April 2025.

Update to input tax recovery method for banks

With effect from 1 April 2025, banks other than newly set-up banks and digital banks may opt between either of the following input tax recovery methods:

- ▶ Option 1: Single fixed input tax recovery rate to be applied by the entire bank based on its banking license type (the FITR).
- ▶ Option 2: Special input tax recovery method which allows input tax attribution and apportionment, based on a sectoral method or outputs-based method (the Special Method).

Banks registered as a GST group must opt for the same method.

Banks that wish to opt for the Special Method must seek the Comptroller's approval. Once approved, the FITR will no longer be available as an option for input tax recovery.

Newly set-up banks and digital banks

Banks that obtain their banking license from the MAS on or after 1 April 2025 must agree with the Comptroller on the input tax recovery method they wish to adopt. To opt for the FITR, the bank will need to show that its actual and intended activities and customer profile are typical of those of incumbent banks with the same banking license type.

For banks granted with a digital full bank license or digital wholesale bank license by the MAS, adoption of the FITR will be granted by the IRAS only on a case-by-case basis.

Input tax on imported services

Banks that opt for the FITR will be required to apply the FITR to all of their allowable input tax claims, including imported services subject to reverse charge. Banks that had previously been allowed to perform direct attribution under Option 1 of the reverse charge interim solution will no longer be allowed this option if they opt for the FITR.

Overview of the Special Method

Banks adopting the Special Method will be required to segregate and attribute their input tax to the respective supplies they make. Where the input tax is directly attributable to the making of both taxable supplies and exempt supplies or for the overall running of the business (residual input tax), apportionment should be performed.

Banks with single business sector – outputs-based method

For banks with a single business sector, the residual input tax (RIT) may be apportioned using an outputs-based method. Under this method, the apportionment formula will be based on the value of supplies made by the bank.

$$\text{RIT recovery rate} = \frac{\text{Value of taxable supplies}^{N1} + \text{Value of exempt supplies made to GST-registered Singapore persons}}{\text{Total value of supplies}^{N1}}$$

^{N1} The value of relevant supplies received from your supplier that are subject to customer accounting and imported services and low-value goods that are subject to reverse charge should be excluded from the numerator and denominator of the apportionment formula.

Banks with more than one business sector – sectoral method

Banks that operate through business sectors that are segregated for financial or management reporting purposes will be required to apply the sectoral method. Under the sectoral method, the RIT is first allocated to each business sector based on an appropriate cost-allocation driver. An appropriate input tax apportionment method is then applied to each sector to apportion the RIT allocated to that sector.

Appropriate cost-drivers

For residual expenses that are incurred across more than one sector, the following cost-drivers may be considered (non-exhaustive):

- ▶ Outputs-based allocation
- ▶ Headcount allocation
- ▶ Direct costs allocation
- ▶ Floor space

The e-Tax Guide provides further details on when each of the above cost-drivers may be most appropriate.

Banks may propose the use of alternative cost-drivers if the method results in a more accurate basis of allocating the RIT. The cost-driver may also be based upon the cost allocation methodology used by the bank for financial or management reporting purposes.

Appropriate input tax apportionment method

The RIT to be claimed by each sector should be calculated based on the following formula:

$$\text{RIT claimable} = \text{Allowable RIT} \times \text{Input tax recovery ratio computed based on the relevant input tax apportionment method}$$

The IRAS will allow banks to propose different input tax apportionment methods for the various sectors as long as the use of RIT by the sector in making taxable supplies and exempt supplies is best reflected by the proposed method. Methods that may be used include:

- ▶ Outputs-based
- ▶ Transaction count
- ▶ Inputs-based
- ▶ Headcount and staff time

The e-Tax Guide provides further details on when each of the above input tax apportionment methods may be most appropriate and the specific formulas to be used under each method to perform the apportionment.

Reasonable proxies

To ease adoption of the Special Method, the Comptroller is prepared to allow for reasonable proxies to be used for determining the value of zero-rated supplies and exempt supplies and the proportion of exempt supplies made to GST-registered persons. The e-Tax Guide provides for certain acceptable proxies in this regard although the bank may also propose for other reasonable proxies.

Applying for the Special Method

Banks that wish to opt for the Special Method from the tax year beginning 2025 should have submitted their application to the Comptroller by 30 June 2024. Banks that want to adopt the Special Method from 1 April, 1 May or 1 June 2025 may also seek the Comptroller's approval for a 12-month extension to implement the Special Method if the bank needs additional time for implementation.

For use of the Special Method from tax years beginning 2026, the bank may submit the application between 1 January to 31 March of each calendar year.

Key considerations

For banks that make significant taxable supplies, the adoption of the Special Method could result in a higher input tax recovery rate than the current FITR provides. Banks that wholly or primarily serve corporate customers could also benefit from adopting the Special Method as exempt supplies to GST-registered persons will be treated similarly to taxable supplies for RIT apportionment purposes.

The use of the Special Method will require banks to undertake significant changes to their IT infrastructure and systems such that they can accurately record and track the input tax incurred and correctly attribute and apportion the same to its supplies. As a result, banks will face greater compliance costs.

The extent to which banks need to update their systems and processes will depend on their current profile and operations. Banks that operate regionally or globally and perform similar apportionment calculations in other Value Added Tax (VAT) or GST jurisdictions may be able to leverage on their existing capabilities to implement the Special Method.

Notwithstanding the fact that the Special Method may, in some circumstances, provide a higher input tax recovery rate, given the complexities of adopting the Special Method, many banks may want to continue using the FITR. These banks should however expect a lower FITR percentage. At the time of publication, it is to be noted that the revised FITR rates have not yet been released which makes it challenging to carry out a cost benefit analysis as to whether a bank will adopt the Special Method or remain on the revised FITR.

It is also important to note that the IRAS has confirmed that banks which opt to use the Special Method cannot later choose to revert to the FITR, in other words, the election to use the Special Method is irrevocable.

Next steps

The introduction of the Special Method will impact all GST-registered licensed banks in Singapore irrespective of whether the bank opts for the Special Method or chooses to continue with the revised FITR.

If not already started, banks should review the merits of staying with the revised FITR (albeit the revised rates are not yet released) versus electing to use the Special Method in the context of their business and make a decision as to the recovery method to be applied from 1 April 2025. For businesses that intend to adopt the Special Method from 1 April 2025, there is little time left to submit their proposals to the IRAS and to implement the changes.

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