

# Income tax treatment arising from adoption of FRS 109

## Executive summary

FRS 109 - *Financial Instruments* replaces the FRS 39 - *Financial Instruments: Recognition and Measurement* and is applicable to entities for financial periods beginning on or after 1 January 2018. Early adoption is permissible.

On the tax front, a new section 34AA of the Income Tax Act (ITA), which sets out the tax treatment of financial instruments under FRS 109 was legislated on 26 October 2017<sup>1</sup>. The legislation is consistent with the Inland Revenue Authority of Singapore's (IRAS) thinking as set out in their consultation paper and the subsequent e-Tax guide issued on 1 July 2016 and 22 November 2017 respectively.

The IRAS' e-Tax guide provides guidance to entities that are required to comply with FRS 109 and incorporates some of the feedback received from the public previously in July 2016 on the proposed positions for the income tax implications arising from the adoption of FRS 109.

The income tax treatment of gains or losses of financial instruments recognised under FRS 109 under section 34AA of the ITA and the e-Tax guide (known as the FRS 109 tax treatment), largely aligns the tax treatment of financial instruments on revenue account to the accounting treatment. There are exceptions to the FRS 109 tax treatment such as profit, loss or expense that is capital in nature.

Companies that apply FRS 109 for accounting purpose are required to apply the FRS 109 tax treatment from the year of assessment (YA) of the basis period in which FRS 109 is first applied for accounting purpose (Transitional YA). There is no option to opt out of the FRS 109 tax treatment, unlike in the case of FRS 39 tax treatment, i.e., FRS 109 tax treatment is also applicable to companies that are currently applying the pre-FRS 39 tax treatment and required to apply FRS 109 for accounting purposes.

---

<sup>1</sup> See EY tax update "Income Tax (Amendment) Bill 2017" dated 20 September 2017.

## Key implications of the FRS 109 tax treatment

### Tax adjustments for gains and losses under FRS 109

Section 34AA of the ITA sets out specific income tax treatment of gains or losses of financial assets and liabilities recognised under FRS 109 with more detailed guidance provided in the IRAS' e-Tax guide. Similar to the FRS 39 tax treatment, the alignment of the income tax treatment of gains or losses recognised under FRS 109 with the accounting treatment applies if the financial assets and financial liabilities are on revenue account. Where the FRS 109 accounting treatment relates to assets or liabilities on capital account, companies may need to make the necessary adjustments for income tax purposes in their income tax filings.

Notwithstanding the above, there could be other tax adjustments needed. For instance, on disposal of an equity asset on revenue account measured at fair value through other comprehensive income, tax adjustment is required to bring the cumulative gain or loss to tax or allow as deduction in the year of disposal.

Further, companies are required to submit an itemised listing of capital and/or revenue financial assets to the IRAS at certain timings consistent with the income tax treatments of such assets in their income tax filings.

### Impairment losses

Another key tax implication under the FRS 109 tax treatment that companies should take note of is that no tax deduction will be allowed on expected credit loss<sup>2</sup> (ECL) recognised under FRS 109 except in respect of credit-impaired financial instruments on revenue account.

### Companies in specialised sectors

#### Banks and qualifying finance companies

Special rules have been drawn up for the impairment of financial instruments on revenue account for banks (including merchant banks) and qualifying finance companies in certain circumstances.

Impairment losses on non-credit impaired loans and debt securities recognised in the Profit and Loss account of such entities may qualify for deduction under section 141<sup>3</sup> of the ITA. Any subsequent reversal amount of the impairment is taxable (indexation not required) to the extent that the impairment was previously claimed and allowed as a deduction under section 141 of the ITA.

#### Insurers

As insurers are required to apply FRS 109 for annual periods beginning on or after 1 January 2018 before the second phase of the project on insurance contracts is completed, two options are available to insurers when applying FRS 109 with FRS 104 (Financial Reporting Standard 104 - *Insurance Contracts*).

Under the first option, an insurer that applies the temporary exemption from FRS 109 will continue to apply FRS 39 for accounting purpose for annual periods beginning before 1 January 2021. Accordingly, the insurer will continue to apply the FRS 39 tax treatment (or the pre-FRS 39 tax treatment, as the case may be) until it starts applying FRS 109, upon which it must apply the FRS 109 tax treatment including the applicable tax treatment for the transitional accounting adjustments in the Transitional YA.

Under the second option, an insurer that applies the overlay approach must apply the FRS 109 tax treatment, including the applicable tax treatment for the transitional accounting adjustments in the Transitional YA. The insurer can stop applying the overlay approach by de-designating the financial assets or by making an irrevocable election. If so, tax adjustments may be required on the reclassification of cumulative gains or losses on such financial assets.

---

<sup>2</sup> Under FRS 109, impairment losses that represent 12-month ECL or lifetime ECL, are recognised when there is some risk of default or even in the absence of loss events.

<sup>3</sup> Tax deduction under section 141 of the ITA is extended to YA 2024 (for banks and qualifying finance companies with December year-end) or YA 2025 (for banks and qualifying finance companies with non-December year-end).

## Transitional accounting adjustments

Upon transition from FRS 39 to FRS 109, transitional accounting adjustments may arise in the form of unrealised gain or loss recognised in the opening retained earnings at the date of initial application (DIA) of FRS 109 (or other components of equity as appropriate) and/or impairment loss or gain recognised in the opening retained earnings at DIA.

The e-Tax guide sets out the applicable tax treatment of the transitional accounting adjustments for companies transiting from pre-FRS 39 tax treatment or FRS 39 tax treatment to the FRS 109 tax treatment in the Transitional YA.

As a result, some companies may have to pay tax on their cumulative unrealised gains of their financial assets on revenue account in the Transitional YA. Companies that face cash flow issues as a result of having additional tax payable arising from the move from pre-FRS 39 tax treatment or FRS 39 tax treatment to the FRS 109 tax treatment may request from the IRAS for an additional three-month instalment. Requests for longer instalment periods will be handled on a case-by-case basis.

### Subsequent discovery of actual character of a financial instrument

Under section 34AA of the ITA, the IRAS may make tax adjustments in respect of a gain or loss of a financial instrument on revenue account that were previously recognised (whether realised or not), which was not taxed or was allowed previously, in the YA in which the instrument is discovered to be regarded as such.

Similarly, the IRAS may make necessary tax adjustments where there is information showing that a financial instrument ought to have been regarded as on capital account instead of on revenue account in the YA of discovery. However, such additional or amended assessment must be made within a period of four years beginning immediately after the end of the YA of the basis period in which the financial instrument is disposed of.

## Comments

It is imperative that companies assess the income tax effects of FRS 109 and manage the income tax implications by taking into consideration the FRS 109 tax treatment and what may not have been addressed as of now. In particular, they may wish to take note of the following:

- ▶ Companies that have previously opted out of FRS 39 tax treatment, so as not to be subject to fluctuations on the unrealised gains and losses on financial assets held on revenue account, may be unduly burdened by having to pay tax on unrealised amounts when they move to the FRS 109 tax treatment even though there is no actual cash flow derived from the trading of its financial assets. It is imperative that companies should assess the tax impact early so that arrangements can be made as soon as possible to address any cash flow issues that may arise.
- ▶ The e-Tax Guide is silent on how the transitional accounting adjustments that arise when companies move to FRS 109 will be taxed or allowed in the Transitional YA such as when the transitional adjustments relate to a prior reporting period when the company was enjoying one or more concessionary tax rate and/or tax exemption on its income and the entity does not continue to enjoy such tax incentive subsequently after the year of change. It is hoped that more clarifications on such scenarios will be provided by the IRAS in subsequent updates of the e-Tax Guide.
- ▶ Companies should not assume that there is no income tax impact or adopt a “wait-and-see” attitude. They should familiarise themselves with the FRS 109 tax treatment to identify what new documentations, processes and controls are needed to enable the company to determine the proper tax adjustment of its gain or loss on financial assets and liabilities recognised under FRS 109 as well as other tax adjustments such as impairment losses made under the ECL model.
- ▶ For equity instruments measured at fair value through other comprehensive income, as the cumulative gains or losses are not transferred to the Profit and Loss account upon derecognition, tracking is required to determine the appropriate tax adjustments in the tax computation upon derecognition. Cumulative gains or losses of such equity instrument on revenue account will be brought to tax or allowed as a deduction (as the case may be) in the basis period in which an equity instrument is derecognised.

If you would like to know more about EY services or the issues discussed, please contact one of the following or your usual EY personnel:

---

Chung-Sim Siew Moon  
Partner and Head of Tax  
Ernst & Young Solutions LLP  
+65 6309 8807  
[siew-moon.sim@sg.ey.com](mailto:siew-moon.sim@sg.ey.com)

---

Angela Tan  
Partner and EY Asean Business Tax Services Leader  
Ernst & Young Solutions LLP  
+65 6309 8804  
[angela.tan@sg.ey.com](mailto:angela.tan@sg.ey.com)

---

Soh Pui Ming  
Partner and EY Asean Global Compliance and Reporting Leader  
Ernst & Young Solutions LLP  
+65 6309 8215  
[pui.ming.soh@sg.ey.com](mailto:pui.ming.soh@sg.ey.com)

---

Chai Wai Fook  
Partner, Tax Services  
Ernst & Young Solutions LLP  
+65 6309 8775  
[wai-fook.chai@sg.ey.com](mailto:wai-fook.chai@sg.ey.com)

---

Ivy Ng  
Partner, Tax Services  
Ernst & Young Solutions LLP  
+65 6309 8650  
[ivy.ng@sg.ey.com](mailto:ivy.ng@sg.ey.com)

---

Lim Gek Khim  
Partner, Tax Services  
Ernst & Young Solutions LLP  
+65 6309 8452  
[gek-khim.lim@sg.ey.com](mailto:gek-khim.lim@sg.ey.com)

---

Amy Ang  
Partner and EY Asean and Singapore Leader,  
Financial Services Tax  
Ernst & Young Solutions LLP  
+65 6309 8347  
[amy.ang@sg.ey.com](mailto:amy.ang@sg.ey.com)

---

Stephen Bruce  
Partner, Financial Services Tax  
Ernst & Young Solutions LLP  
+65 6309 8898  
[stephen.bruce@sg.ey.com](mailto:stephen.bruce@sg.ey.com)

EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organisation, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organisation, please visit [ey.com](http://ey.com).

© 2018 Ernst & Young Solutions LLP.  
All Rights Reserved.

APAC no. 12001469  
ED None

Ernst & Young Solutions LLP (UEN T08LL0784H) is a limited liability partnership registered in Singapore under the Limited Liability Partnerships Act (Chapter 163A).

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.

[ey.com](http://ey.com)