

Summary of Responses – Public Consultation on Income Tax Implications Arising from the Adoption of FRS 116 – Leases

IRAS conducted a public consultation between 8 August 2017 to 29 August 2017 to seek feedback on the income tax implications arising from the adoption of FRS 116. Comments were received from 9 respondents. IRAS wishes to thank all respondents for their comments.

A summary of the key comments received and our responses is provided in the following paragraphs.

1. To provide guidance on the determination of Finance Leases (“FL”) for lessees

Comment:

The concept of operating leases (“OL”) and FL is no longer relevant for lessees under FRS 116. Some respondents would like IRAS to provide more clarity and guidelines on the interpretation of these terms, given that lessees can no longer rely on the accounting classification of FL and OL under FRS 116.

IRAS’ response:

Accepted. IRAS will provide guidance in a e-Tax guide shortly. Lessees may apply the same examples and indicators as provided in paragraphs 63 and 64 of the FRS 116 for lessors in determining if a lease arrangement giving rise to a Right-of-Use (“ROU”) asset is an OL or FL from the perspective of lessees. Nevertheless, these examples and indicators are not always conclusive. If it is clear from the facts of the case that the lease does not transfer substantially the obsolescence, risks or rewards incidental to ownership of the asset, that lease arrangement will be treated as an OL for tax purpose.

2. To allow tax deduction on ROU assets based on accounting treatment (i.e. interest and depreciation) for lessees

Comment:

Some respondents suggested that lessees be allowed tax deduction on ROU assets based on the accounting treatment. In other words, lessees are to be allowed to claim interest and depreciation based on the amounts charged to the profit or loss statement.

IRAS’ response:

Not accepted. We have decided not to follow the accounting treatment for the following reasons:

(a) Adopting the accounting treatment will be a shift away from the current tax principle of allowing tax deduction based on the actual lease payments incurred.

(b) Adopting the accounting treatment will result in allowing front-loaded interest expense as the interest expense will be computed based on the balance of the lease liability which reduces over the lease term, which is not aligned to the principle that tax-deductible expenses should be claimed when they are incurred.

3. To introduce 'safe harbour' rules for lessees, such that leases falling within such rules would not be regarded as FLs for tax purposes

Comment:

Some respondents suggested to introduce “safe harbour” rules for lessees such that leases falling within such rules will not be regarded as FLs for tax purposes. For example, if the lease term is less than x years or if the leased asset costs less than \$Y, to allow lessees to claim tax deduction based on accounting treatment.

IRAS' response:

Not accepted. We have decided not to introduce “safe harbour” rules for lessees as:

(a) Financial statements do not have information on the lease terms for ROU assets. In addition, if the lease term changes to more than x years, tax adjustments will be needed to unwind the interest expense and depreciation previously allowed, and to allow contractual lease payments incurred.

(b) There is difficulty in determining a suitable \$Y across all industries. Besides, the International Accounting Standards Board has indicated in the Basis for Conclusions on IFRS 16 Leases an indicative amount of USD\$5,000 or less for an asset to be treated as low-value asset. In respect of a low-value asset, the lessee can elect to charge the lease payments to the profit or loss statement instead of recognising a ROU asset and a lease liability in the balance sheet.

4. To include examples to illustrate the application of the proposed tax treatment for sublease under different classification

Comment:

The e-Tax guide should include examples to illustrate the application of the proposed tax treatment for sublease under different classification.

IRAS' response:

Accepted. For tax purposes, the determination of the sublease for the intermediate lessor is by reference to the underlying asset instead of the ROU asset. This is to align the treatment with the existing treatment for classification of leases for tax purposes. Please refer to Appendix 2 of the e-tax guide for the illustrations.

5. Withholding Tax

Comment:

To provide more clarity on the characterisation of the payments for withholding tax purpose. In a scenario where the FL is not treated as a sale, for withholding tax purposes, would the nature of the transaction follow the accounting treatment (lease and interest), or is the full amount considered to be rental?

IRAS' response:

Accepted. With FRS 116, there is no change to the existing withholding tax treatment for leases. Nonetheless, IRAS will provide more guidance in the e-Tax guide.

Notwithstanding the accounting classification of the expenses in the profit or loss statement, the withholding tax obligations will be determined based on the legal characterisation of the payments. In other words, withholding tax applies if the payments fall within the scope of Section 12(6) and (7) of the Income Tax Act (ITA) and are not granted exemptions under the Act. For a FL that is not treated as a sale agreement, the entire lease payment for the use of any movable property is treated as a payment falling within the ambit of Section 12(7)(d) of the ITA.