

Updates to the e-Tax Guide on "Income Tax Treatment of Foreign Exchange Gains or Losses for Businesses (Fourth Edition)"



Introduction

On 31 March 2021, the Inland Revenue Authority of Singapore (IRAS) issued the e-Tax Guide on "Income Tax Treatment of Foreign Exchange Gains or Losses for Businesses (Fourth Edition)" (hereinafter "the Guide"), with the following updates:

- a) Updated definition of "Translation foreign exchange differences"¹; and
- b) Included a list of Frequently Asked Questions (FAQs) to provide clarity on the designated bank account treatment and the application of the de-minimis limit.

This Tax Alert summarises the updates and provides practical guidance for Singapore taxpayers that are considering the application of the de-minimis limit.

Background

Since Year of Assessment (YA) 2004², all foreign exchange gains/losses arising on revenue accounts are taxable/ deductible regardless whether such differences are realised or unrealised³, unless an election is made by the taxpayer to opt out of this tax treatment.

Whether foreign exchange differences arose from a capital or revenue account is however a question of fact and is typically determined based on the specific facts and circumstances of a case. As a general rule of thumb, cash balances maintained by businesses are treated as being held on capital account⁴. Correspondingly, any foreign exchange gains/losses arising from foreign currency bank balances are generally not taxable/not deductible, being regarded as capital in nature.

¹ Defined as "exchange differences arising from translating the financial statements prepared in one currency (need not be the company's functional currency) to another currency for presentation purposes."

² The said tax treatment is automatically applied to banks from 2 November 1993 without an election to opt out of the treatment.

³ Prior to YA 2004 (2 November 1993 for banks), only realised foreign exchange gains/losses that are revenue in nature are brought to tax/allowed tax deduction.

⁴ The capital treatment does not apply to cash balances held by banks and insurance companies, unless proven to the IRAS' satisfaction that such bank accounts are used principally for capital transactions.

Where businesses maintain specific foreign currency bank account(s) solely for the purposes of receiving trade receipts and paying revenue expenses (question 6 in the FAQ summary below refers), the IRAS is prepared to regard such designated bank account(s) as revenue in nature. Consequently, any foreign exchange gains or losses arising from such designated bank account(s) would be brought to tax or allowed a tax deduction, as the case may be [hereinafter referred to as “designated bank account treatment”]. Where the designated bank account is not used solely for designated revenue purposes (even though most of their transactions in that currency is revenue in nature), any foreign exchange differences arising from such bank accounts would have been treated as capital in nature, and would not have been taxable nor tax deductible.

Taking into account feedback by businesses that they would be required to maintain at least two different bank accounts in the same currency to qualify for the designated bank account treatment, the IRAS had in August 2020 introduced a de-minimis limit to ease the administrative burden and compliance costs associated with maintaining two different bank accounts. Under the de-minimis limit, the IRAS is prepared to allow businesses

to treat foreign exchange differences arising from the revaluation of designated bank accounts as revenue in nature with effect from the YA 2020 provided:

- a) The total number⁵ of capital transactions is not more than 12 transactions a year; and
- b) The total value of capital transactions is not more than S\$500,000 a year. (Question 6 in the FAQ summary below refers)

Businesses adopting the de-minimis limit treatment are required to maintain proper controls and retain relevant documentation in support of the nature of the transactions through the designated bank account(s). In addition, such businesses would need to reflect the total number and value of capital transactions in their income tax computations to demonstrate that the de-minimis threshold has been met.

Further to the introduction of the designated bank account treatment in March 2019 and the de-minimis limit (with effect from YA 2020), the IRAS has provided further clarifications on the designated bank account treatment and the application of the de-minimis limit by way of an FAQ, broadly summarised in the next page:



⁵ Aggregate of both the inflow and outflow of funds within the designated bank account.

S/N	Frequently Asked Questions	IRAS' Clarifications
1	When the de-minimis limit can be adopted	The de-minimis limit may be adopted with effect from YA 2020 provided that the de-minimis thresholds can be met.
2	Whether the election must be undertaken annually	No. Election is once-off. Once elected, businesses must continue with the adoption of the de-minimis limit unless the de-minimis thresholds can no longer be met or if the business decides not to continue with the application of the de-minimis limit.
3	Can the de-minimis limit be applied to a pre-existing bank account that was not previously identified as a designated bank account?	Yes, the de-minimis limit can be elected with effect from YA2020, if the stipulated conditions can be met.
4	Whether the de-minimis threshold is required to be met on a per bank account basis	Yes, it is to be applied on a per bank account basis.
5	Whether foreign exchange differences arising from capital transactions (e.g. purchase of fixed asset) paid out of designated bank accounts can be treated as revenue in nature	No, the de-minimis limit is applied only on exchange differences arising from the revaluation of foreign currency denominated bank account to be treated as revenue in nature, if businesses decide to adopt the designated bank account treatment.
6	For the purposes of computing the de-minimis limit for the designated bank account, are capital transactions limited to items such as purchase of fixed assets/purchase of long-term investments?	No. Any capital transactions, even if not related to sales or purchases of goods or services for the business, should be included in the total number and value of capital transactions for the purposes of computation the de-minimis limit. Such transactions include, but are not limited to, the payment of income taxes, purchase of capital items, used for investment purposes, transfer of funds to/from Group cash pooling account or transfer of funds to another non-designated bank account of the business. Any GST and withholding taxes incurred (in relation to business expenses such as interest expenses, royalties, technical fees) may be regarded as purchases on revenue account, if they were incurred as part of the payment of goods or services by the company.
7	Whether the designated bank account tax treatment is eligible to enjoy Section 14U concessions	Yes, if the foreign currency bank account is designated solely for the purpose of paying revenue expenses or the total number or value of capital transactions is within the de-minimis limit.
8	What is the exchange rate to be used to convert transaction to S\$ for the purpose of computing the total value of capital transactions under the de-minimis limit?	Either the spot rate or the MAS average month-end exchange rate for the basis period. The same rate should be consistently applied for subsequent YAs. For any changes, businesses should declare the change in the income tax computation, including the reason for switching the rates.



Our comments

This fourth edition of the IRAS e-Tax Guide on "Income Tax Treatment of Foreign Exchange Gains or Losses for Businesses" reflects the IRAS' continued commitment to refine and clarify their tax policies taking into account public feedback. This latest edition specifically included a list of FAQs to provide clarity on the designated bank account treatment and the application of the de-minimis limit.

While the FAQs do provide more clarity on the application of the de-minimis limit, it remains to be seen if the de-minimis limit does provide practical solutions to ease the administrative burden and compliance costs

associated with businesses having to maintain two different bank accounts. Taxpayers opting for the application of the designated bank account treatment and the de-minimis limit should ensure that the stipulated conditions have been met and continue to be met over time. This is to ensure accurate segregation of foreign exchange gains or losses for the correct tax treatment to be adopted, failing which there may be potential penalty exposure.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

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