

# Tax Alert

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In this issue of the *Tax Alert*, KPMG Tax Services highlights two of the circulars issued by the Inland Revenue Authority of Singapore in the last two months of 2003. The circular, dated 31 December 2003 (revised on 2 March 2004), deals with the filing of income tax computations in functional currencies other than in Singapore dollars; while that of 28 November 2003 covers the concessionary treatment of foreign exchange differences to all businesses other than banks.



## **FILING OF INCOME TAX COMPUTATIONS AND FINANCIAL STATEMENTS IN FUNCTIONAL CURRENCIES OTHER THAN SINGAPORE DOLLARS**

Prior to the Companies (Amendment) Act 2002, Singapore-incorporated companies were required to present their financial statements in Singapore dollars. The Companies Act was amended in 2002, and with effect from January 2003, Singapore-incorporated companies with accounting period beginning from 1 January 2003 are required to comply with the requirements under the Financial Reporting Standards (FRS) and Interpretation of Financial Reporting Standards (INT FRS). Accordingly, companies now have to determine the appropriate functional currency (also referred to as measurement currency) to measure their transactions. However, the FRS does not specify what the reporting currency should be, and a company may present its financial statements in its functional currency or in a currency that is different from its functional currency.

With effect from the Year of Assessment (YA) 2004, the Inland Revenue Authority of Singapore (IRAS) requires companies which maintain their financial accounts and prepare their financial statements in non-Singapore dollar functional currencies to file their income tax computations and the accompanying financial statements in their non-Singapore dollar functional currencies. In the revised circular of 2 March 2004, the IRAS has clarified that in the case where the company's financial statements are presented in a currency other than its functional currency, the company must still file its income tax computations and the accompanying financial statements in its non-Singapore dollar functional currency. This article summarises the rules and requirements for preparing income tax computations in non-Singapore dollars as spelt out in the IRAS circulars.

### **Specific rules for existing companies with brought forward Singapore dollar balances/items**

The IRAS has specified that only two methods of computing exchange rates can be used in translating certain items/balances, and they are defined as follows:

#### **Average Exchange Rate (AER)**

This represents the average of the exchange rates of the accounting period that constitutes the basis period for that YA. For example, for a company with accounting year ended 31 December 2003 (YA 2004), the AER is the average of the month-end exchange rates of January 2003 to December 2003. The end of month exchange rates for commonly used foreign currencies are available on the MAS website at [www.mas.gov.sg](http://www.mas.gov.sg)

### **Change-Over Rate (COR)**

This represents the average of the exchange rate over the 12 months of the last accounting period in which the financial accounts were submitted in Singapore dollars. For example, the accounting year-end of a company is 31 December and YA 2004 is the first YA it submits its tax computation in non-Singapore dollars. The COR would be the average exchange rate of the 12 months from 1 January 2002 to 31 December 2002.

Companies incorporated prior to 1 January 2003 and which had, prior to YA 2004, submitted financial statements and income tax computations in Singapore dollars, may have the following brought forward balances/items:

- Unabsorbed tax items (including unabsorbed capital allowances, industrial building allowances, trade losses, donations, investment allowances, further tax deductions);
- Cost and tax written-down values of existing assets qualifying for capital allowances; and
- Prior year income/expenses which have yet to be taxed or deducted, for example, provisions, unrealised exchange gains/losses deemed realised in the subsequent year.

### **Election**

Existing companies with such brought forward Singapore dollar balances can elect to translate the balances using either the AER or the COR. The election is irrevocable and must be made in writing in their return when tax computations and financial statements are first submitted in their non-Singapore dollar functional currencies.

When the balances are translated using the COR, any remaining balances not utilised will be carried forward to subsequent YAs in their non-Singapore dollar functional currencies. For translations made using the AER, any unutilised balances will be carried forward in Singapore dollars to subsequent YA using the same average exchange rate for that YA.

The treatment for translating unrealised exchange differences which are realised or deemed realised in the subsequent year will follow the option made in translating the brought forward balances, that is, either using the AER or COR.

### **General rules for companies preparing their income tax computations in non-Singapore dollars**

1. The tax computation must show all items up to the chargeable income in the non-Singapore dollar functional currency.
2. The partial tax exemption up to the first S\$100,000 chargeable income will be translated into the company's non-Singapore dollar functional currency using the AER for that YA.
3. The amount of tax payable must be in Singapore dollars which is to be computed by multiplying the company's chargeable income (in non-Singapore dollars and after applying the partial tax exemption) with the corporate tax rate and the AER.
4. Where a company is granted tax incentive and the incentive is computed using a preferential rate applied on a specified amount denominated in Singapore dollars, that amount will be translated into the non-Singapore dollar functional currency using the AER for the relevant YA.
5. The amount of double taxation relief (DTR) or unilateral tax credit (UTC) allowed is based on the amount of Singapore tax on the net foreign income (after deducting allowable expenses) or the foreign tax paid, whichever is lower. For the purposes of computing the allowable DTR or UTC, the Singapore tax on the net foreign income is computed by multiplying the quantum of net foreign income by the corporate tax rate and the AER of the same YA. The foreign tax is based on the actual amount paid or reflected in its non-Singapore dollar functional currency and translated using the AER of the same YA.
6. For Singapore dollar dividends received from Singapore resident companies and any Singapore dollar interest from loan stock where Singapore tax has been deducted at source, the recipient company, for the purposes of preparing its income tax computation, has to translate them to its functional currency using the AER for the YA concerned.

7. For franked Singapore dividends or interest from loan stock paid in non-Singapore dollar functional currency, the payer company has to state the Singapore dollar equivalent amounts using the exchange rate prevailing at the date of payment. The recipient company has to translate the Singapore dollar equivalent of the dividends/interest as stated in the tax voucher using the AER even if its non-Singapore dollar functional currency is the same as that of the payer company. Tax deducted at source in respect of Singapore franked dividends or interest loan stocks will be declared based on the actual Singapore dollar amount withheld by the payer company, as shown on Singapore tax vouchers.
8. For transfer of loss items under group relief, the AER will be used to translate the loss items if the functional currencies of claimant and transferor companies are different.
9. Exchange gain or loss arising from a change of functional currency as a result of compliance with the FRS, will not be taxable or deductible for income tax purposes.
10. Where the sale of assets is between related persons, an election can be made under section 24 of the Income Tax Act to effect the transfer for tax purposes using the tax written down value of the assets transferred. If the buyer and seller use different functional currencies, the values must be translated to the buyer's functional currency using the exchange rate prevailing at the date of sale.
11. For the purposes of the company's income tax return, the relevant items to be declared should be translated to Singapore dollar equivalents using the AER or COR, whichever is applicable.



## INCOME TAX TREATMENT OF FOREIGN EXCHANGE GAINS OR LOSSES FOR BUSINESSES

Concessionary tax treatment for foreign exchange gains or losses of all businesses to follow the accounting treatment was announced by the IRAS in a circular on 28 November 2003. This means exchange gains or losses from revenue transactions are taxable or deductible on an accrual basis instead of the realised basis. This concession takes effect from the YA 2004 for all businesses other than banks which have been given the concession since 1993.

### Option

The concession outlined in the above-mentioned circular applies to all businesses other than banks. Taxpayers who do not wish to avail themselves of the concession must opt out (of the concession) when submitting their tax returns for the YA 2004 to the IRAS. The decision to opt out is irrevocable and businesses doing so will be taxed or allowed deduction on foreign exchange gains or losses on revenue transactions on a realised basis.

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KPMG's *Tax Alert* highlights the latest tax developments, impending changes to laws or regulations, current practices and potential problem areas that may impact your company. Some of the content is time sensitive.

The information herein is based on the circulars issued by the IRAS on 28 November 2003 and 31 December 2003 (revised on 2 March 2004).

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