PRACTICE STATEMENT No. 50
Issued 19/01/2017

SUBJECT	**FIJI REVENUE & CUSTOMS AUTHORITY:** **METHODS OF INCOME TAX ACCOUNTING**
DATE OF EFFECT	1 January 2016
CONFIDENTIALITY STATUS	May be released to the public
LEGISLATIVE REFERENCES	*Income Tax Act 2015 - Section 2 definition of 'received '* *Sections 37, 38, and 39*
PRACTICE CO-ORDINATOR	Deputy Director Revenue Management

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INTRODUCTION

1. This Practice Statement sets out the tax accounting methods for recognizing income and expenditures. It is issued with the authority of the Chief Executive Officer (CEO) of the Fiji Revenue & Customs Authority (FRCA).

2. Generally, for tax purposes, income is included in gross income in the tax year in which it is derived and an expense is allowed as a deduction in the tax year in which the expenditure or loss is incurred.

3. With effect from 1 January 2016, taxpayers will be required to use one of two methods of accounting for income and expenditure; either the cash-basis or the accrual-basis as follows:

Method of accounting	**Who can use this method**
Cash basis	Employees and other persons (except companies)
Accrual basis	Companies Partnerships Registered persons accounting for Value Added Tax (VAT) on an invoice basis and other persons (except employees)
Cash basis or Accrual basis	Other persons such as trustees and individuals who are not employees can use either method, provided the same one is used to account for both income and expenditure.

4. The CEO can specify the accounting basis for a class of persons and also approve a request for a change.

LEGISLATIVE BASIS

5. Sections 37, 38 and 39 of the *Income Tax Act* 2015 (ITA) provides for the two basic financial accounting methods for recognizing income and expenditures - ‘cash-basis’ and ‘accrual-basis’.

6. These Sections set out the rules for determining when income and expenditure should be accounted for.

7. The definition of “received” in Section 2 ITA includes an actual receipt and a receipt of income that is applied towards some other purpose e.g. income that is reinvested, capitalized, credited to an account etc.

8. Specific provisions are contained in Section 47 ITA to prevent double accounting for the same income or expenditure.

9. Extracts of the relevant sections of the ITA are given in the Attachment. Further guidance on the provisions are given in the following paragraphs.

APPLICATION

10. Section 37(1) and (2) specifies the accounting methods to be used for tax purposes. They are as follows-
    a) an employee must account for employment income on a **cash basis** (when received);
    b) companies, partnerships (in calculating chargeable partnership income); must account for income and expenditures on an **accrual basis**;
    c) registered persons accounting for VAT on an *invoice basis* must account for income and expenditures on an **accrual basis**.

11. Other persons (e.g. trustees, sole traders) may use either the cash or accrual accounting basis, provided they use the same method for both income, expenditures and losses (Section 37 (3)).

12. The CEO can determine the accounting basis to be used by any class of persons (Section 37 (4)).

13. A person may also apply for a change in their method of accounting. Application in writing must show that the proposed accounting method can properly measure the person's chargeable income (Section 37 (5)).

14. When a person changes accounting methods, adjustments must be made in the year of change to prevent omissions or double accounting (Section 37 (6)).

Example 1 - Change in accounting basis – Cash to Accrual

Edward uses Cash Method

In 2016, he issues receipts for all cash sales.

The CEO gives Edward permission to use Accrual Method from 2017 because his business expanded.

Generally there may not be any adjustments however, from 2017, Edward must account for any income he has not received.

Example 2 - Change in accounting basis – Accrual to Cash

> *Rohit uses Accrual Method*
>
> *In 2017, the CEO gives Rohit permission to use Cash Method due to a reduction in business.*
>
> *Rohit must make adjustments in the tax year of change (2017). He must exclude from gross income, amounts invoiced (and already accounted for) in the 2016 tax year, which will be received in 2017. The income is accounted for only once.*

15. Section 38 provides that under the **cash basis** of accounting, a person derives an amount at the time the person "receives" the amount and incurs expenditure at the time it is paid. This means that a person accounting for income tax on a **cash basis** reports income in the tax year in which it is received and reports expenditure in the tax year in which it is paid.

Example 3 - Accounting for income on a cash basis

> *Frances carries on business and accounts for income tax on a **cash basis**.*
>
> *Frances has issued invoices in 2016 that are not paid until 2017.*
>
> *She is required to report the income when it is actually received in 2017.*

Example 4 - Accounting for expense on a cash basis

> *Frances carries on business and accounts for income tax on a **cash basis**.*
>
> *Frances has received invoices for business purchases in 2016, that will paid in 2017.*
>
> *She can claim the expenses when it is actually paid.*

16. Sections 39 (1) and (2) provides that when a person uses the **accrual-basis** of accounting, the person derives an amount at the time the amount is due to the person and incurs expenditure when it is payable by the person.

17. This means that a person accounting for income tax on an accrual-basis reports income in the tax year the person is entitled to it even though it will be received

at a future date and reports expenditure when it has been incurred but not actually paid.

Example 5 - Accounting for income on Accrual Basis

XCo sells large electrical goods. XCo's Year ending is 31 December.

A television set is sold to a customer for $500 on 1 December 2016. XCo allows the customer 90 days to pay. The customer pays $500 on 15 February, 2017.

XCo is treated as having derived $500 business income on 1 December 2016. This must be included in XCo's gross income for 2016 tax year even though payment will be received in 2017.

Example 6 - Accounting for expense on Accrual Basis

XCo incurred expenses for repairs to building ($5000) on 16 December 2016, which will be paid in 2017.

XCo's Year Ending is 31st December.

The expense is claimed in the return for 2016 even though XCo has not paid the supplier.

18. When a person has deducted expenditure (because it has been incurred) but does not actually pay the amount due **within one year** after the end of the tax year in which the expenditure was incurred, the amount remaining unpaid is included in the person's gross income. (Section 39 (3)).

Example 7 Accounting for expense on Accrual Basis not paid within one year after end of tax year

XCo incurred $5000 expenses for repairs on 16 October 2016. The expense is claimed as a deduction in XCo's 2016 return.

XCo's Year Ending is 31st December.

If the $5000 is not paid to the supplier by 31 December 2017, XCo will include $5000 in gross income for 2017.
The effect is that the deduction in 2016 is reversed in 2017.

19. The amount that is included in gross income takes the character of the income to which the deduction relates. For example, if the expenditure relates to the derivation of business income, the amount included in gross income is business income. (Section 39 (4)).

20. If the amount due is subsequently paid, a new deduction is allowed in the tax year in which it is paid (Section 39 (5)).

Example 8 – Accounting for subsequent payment of unpaid expenses previously treated as income

*XCo runs a supermarket business and also has a rental property. The company uses Accrual basis to account for income and expenses. Year Ending is 31st December. The income and expenses for **2016** are as follows:*

	Supermarket	*Rental Business*
Income	*$50,000*	*$12,000*
Expenses:		
Salary	*$7,000*	*$0*
Rates	*$300*	*$300*
Interest	*$2,000*	*$500*
Other	*$700*	*$2,200*
Net Profit	*$40,000*	*$9,000*

Assume:

1. *The city rates ($300) for rental business remains unpaid at end of 2017.*
2. *Rental business net profit for 2017 is $10,000.*
3. *2018 net profit for rental business is $9,500.*
4. *City rates for 2016 is paid in full in 2018.*

The adjustments will be as follows:

	Rental Business		
	2017	*2018*	
Net Profit	*$10,000*	*$9,500*	
Add : 2016 unpaid city rates	*$300*		*The unpaid amount is included in rental income for 2017 as required under Section 39 (4)*
Less; 2016 city rates		*$300*	*A new deduction is allowed in the tax year in which the city rates is paid (Section 39 (5)).*
Adjusted Net Profit	*$10,300*	*$9,200*	

Rules to prevent double accounting of income /expenditure

21. Under Section 47, income that is taxable because it has become receivable (accruals basis) cannot be taxed again when it is received. Similarly, an amount that is deductible because it is payable (accruals basis) cannot be deducted again when it has been paid.

PROCESS

22. A person who is eligible to change accounting methods can write to the CEO. If the application is refused, the person can object within 30 days of issue of the tax decision.

23. For enquiries, please contact Taxpayer Education & Publicity Unit (TEPU) team on e-mail: tepu@frca.org.fj. or info@frca.org.fj or call on telephone number 3243504/3243505.

ATTACHMENT

Extracts from the ITA
Section 2

““received”, in relation to a person, includes—

(a) applied on behalf of the person either at the instruction of the person or under any law;

(b) reinvested, accumulated or capitalised for the benefit of the person;

(c) credited to an account, or carried to any reserve, or a sinking or insurance fund for the benefit of the person; or

(d) made available to the person;”

Method of Income Tax accounting

“37.*—(1) An employee must account for employment income on a cash basis.*

(2) Subject to subsection (4), the following persons must account for gross income, and expenditures and losses on an accrual basis—

(a) a company;

(b) a partnership; and

(c) a person required to account for valued added tax on an invoice basis under section 36 of the Value Added Tax Decree 1991.

(3) Subject to subsections (1) and (4), a person to whom subsection (2) does not apply may account for gross income, and expenditures and losses on a cash or accrual basis, provided that the same basis is used for determining both gross income, and expenditures and losses.

(4) The CEO may specify that any class of persons must account for Income Tax purposes on a cash or accrual basis.

(5) A person may apply, in writing, for a change in the person’s method of accounting for Income Tax and the CEO may, by notice in writing, approve the application but only if he or she is satisfied that the change is necessary to properly compute the chargeable income of the person.

(6) If a person’s method of accounting for Income Tax changes, the person must make adjustments in the tax year of change to items of income, deduction or credit, or to any other items affected by the change so that no item is omitted and no item is taken into account more than once.”

Cash-basis accounting

***"38.** A person accounting for Income Tax on a cash basis derives an amount when it is received by the person and incurs expenditure when it is paid by the person. "*

Accrual-basis accounting

***"39.**—(1) A person accounting for Income Tax on an accrual basis derives an amount when it is due to the person and incurs expenditure when it is payable by the person.*

(2) Subject to this Act, an amount is due to a person at the time the person becomes entitled to receive it even if the time for discharge of the liability is postponed or the amount is payable by instalments.

(3) If—

(a) a person has been allowed a deduction for any expenditure incurred in deriving gross income; and

(b) the person has not paid the liability or a part of the liability to which the deduction relates within one year after the end of the tax year in which the deduction was allowed, the unpaid amount of the liability is income included in the gross income of the person for the first tax year following the end of the one-year period.

(4) An amount to which subsection (3) applies has the same character as the income to which the deduction relates.

(5) If the amount of an unpaid liability is included in gross income under subsection (3) and the person subsequently pays the liability or a part of the liability, the person is allowed a deduction for the amount paid in the tax year in which the payment is made."

Rules to prevent double derivation and double deductions

***"47.**—(1) For the purposes of this Act, if—*

(a) income is included in gross income on the basis that it is due, the income is not included again on the basis that it is received; or

(b) income is included in gross income on the basis that it is received, the income is not included again on the basis that it is due.

(2) For the purposes of this Act, if—

(a) expenditure is deductible under this Act on the basis that it is payable, the expenditure is not deductible again on the basis that it is paid; or

(b) expenditure is deductible under this Act on the basis that it is paid, the expenditure is not deductible again on the basis that it is payable."

=========End of Practice Statement========