

IRAS SUPPLEMENTARY CIRCULAR

ONE-TIER CORPORATE TAX SYSTEM



**INLAND REVENUE
AUTHORITY
OF SINGAPORE**

Published by
Inland Revenue Authority of Singapore

Published on 27 June 2003

© Inland Revenue Authority of Singapore

All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, including photocopying and recording without the written permission of the copyright holder, application for which should be addressed to the publisher. Such written permission must also be obtained before any part of this publication is stored in a retrieval system of any nature.

IRAS SUPPLEMENTARY CIRCULAR

ONE-TIER CORPORATE TAX SYSTEM

INTRODUCTION

This circular is to supplement the IRAS circular dated 15th August 2002 on “New One-Tier Corporate Tax System” (referred to hereafter as “the main circular”). This supplementary circular contains three main parts, namely:

- a) Announcement of the Government’s decision to revoke the deeming of tax exempt (1-tier) dividends paid out of exempt income to owners of shares of a preferential nature (referred to hereafter as “preference shareholders”) as interest income of the preference shareholders [see paragraphs 2 to 5];
- b) Clarifications on the tax treatment of certain situations under the one-tier corporate tax system (referred to hereafter as “one-tier system”) in response to enquiries received since the main circular was released on 15th August 2002 [see paragraphs 6 to 17]; and
- c) Announcement of the Government’s decision to grant, on a case-by-case approval basis, tax concessions to mitigate the unfavourable tax effects faced by holding companies due to the introduction of the one-tier system [see paragraphs 18 to 29].

REVOCATION OF THE DEEMING OF TAX EXEMPT (1-TIER) DIVIDENDS PAID OUT OF EXEMPT INCOME TO PREFERENCE SHAREHOLDERS AS INTEREST INCOME OF THE PREFERENCE SHAREHOLDERS

2 Under the imputation system, dividends paid to preference shareholders out of the exempt profits of resident companies cannot be considered as normal exempt dividends but are treated as dividends subject to the provisions of section 44 of the Singapore Income Tax Act (“SITA”). With the introduction of the one-tier system, dividends paid out of the exempt profits of companies under the one-tier system to their preference shareholders are deemed as interest income in the hands of these shareholders. In addition, such companies are given an option to elect to deem the amount paid out as a payment of interest (instead of a dividend payment) for the purposes of claiming a tax deduction.

3 The Government has reviewed this tax treatment in light of its recent decision to grant tax exemption on foreign-sourced dividends, foreign branch profits or

foreign-sourced service income¹. It has decided to revoke the deeming of tax exempt (1-tier) dividends paid out of the exempt profits of companies under the one-tier system to their preference shareholders as interest income in the hands of these shareholders.

4 With this change, dividends paid out of the exempt profits of companies under the one-tier system to their preference shareholders will be treated as tax exempt (1-tier) dividends, and thereby not subject to tax in the hands of these shareholders. Consequently, the option granted to such companies to elect to deem the amount paid out as payment of interest for the purposes of claiming a tax deduction is also revoked.

5 These changes will take effect retrospectively from 1st January 2003. Preference shareholders previously subjected to tax on their dividends which were paid out of the exempt profits of resident companies under the one-tier system as deemed interest income, may request for a revision of their tax assessment and, if applicable, for a refund of the tax paid on the deemed interest income.

CLARIFICATIONS

(A) Choice for companies under the one-tier system to pay tax exempt (1-tier) dividends [instead of normal exempt dividends] out of their exempt profits

6 Following the change as stated in paragraph 4 above, preference shareholders receiving dividends paid out of the exempt profits of resident companies under the one-tier system will not be subject to tax on such dividends. As a consequence of this change, the issue of whether companies under the one-tier system can pay tax exempt (1-tier) dividends [instead of normal exempt dividends] out of their exempt profits to their shareholders has also been resolved. Since preference shareholders receiving dividends paid out of the exempt profits of resident companies under the one-tier system are treated as receiving tax exempt (1-tier) dividends, it follows that companies under the one-tier system can now pay tax exempt (1-tier) dividends [instead of normal exempt dividends] out of their exempt profits to preference shareholders, if they wish to do so. Such companies can also pay tax exempt (1-tier) dividends [instead of normal exempt dividends] out of their exempt profits to all their other types of shareholders, if they wish to do so.

¹ With effect from 1st June 2003, tax exemption will be granted to all resident persons in Singapore on their foreign-sourced dividends, foreign branch profits or foreign-sourced service income received in Singapore on or after 1st June 2003 provided that:

- a) in the year of remittance, the headline tax rate of the foreign jurisdiction from which the income is remitted is at least 15%; and
- b) the income has been subjected to tax in the foreign jurisdiction from which the income was remitted.

For full details of the tax exemption, please refer to the IRAS circular dated 22nd May 2003 on "Tax Exemption for Foreign-sourced dividends, Foreign branch profits and Foreign-sourced service income".

(B) No more requirement to maintain specified accounts after 31st December 2007

7 In paragraph 61 of the main circular, it was stated that “unless otherwise advised”, the requirement to maintain specified accounts would cease to apply from 1st January 2008. The qualification “unless otherwise advised” was included as it was not entirely certain that after 31st December 2007, the policy position on the deeming of tax exempt (1-tier) dividends received by preference shareholders as interest income would change².

8 Consequent to the revocation of the deeming of tax exempt (1-tier) dividends paid out of the exempt profits of companies under the one-tier system to their preference shareholders as interest income in the hands of these shareholders (as stated in paragraph 4 above), the qualification referred to above will no longer be required. Hence all companies with exempt profits will no longer need to maintain the specified accounts for the purposes of tracking the amount of normal exempt dividends paid there from after 31st December 2007.

(C) Foreign-sourced income kept offshore and used for payment of exempt (1-tier) dividends to shareholders, without bringing back to Singapore for this purpose, is not income remitted into Singapore

9 Enquiries have been received on whether foreign-sourced income kept offshore and used for payment of exempt (1-tier) dividends to shareholders, without bringing back to Singapore for this purpose, are caught under the provisions of section 10(19) of the SITA as income remitted to Singapore. Section 10(19) of the SITA clarifies the circumstances under which income derived from outside Singapore (i.e. foreign-sourced income) shall constitute income received in Singapore from outside Singapore, whether or not the source from which the income is derived has ceased. Under section 10(19) of the SITA, income derived from outside Singapore shall constitute income received in Singapore if the income is:

- (a) remitted to, transmitted or brought into Singapore;
- (b) applied in or towards satisfaction of any debt incurred in respect of a trade or business carried on in Singapore; and
- (c) applied to purchase any movable property which is brought into Singapore.

10 It is hereby clarified that the use of foreign-sourced income kept offshore to pay tax exempt (1-tier) dividends to shareholders, without bringing back to Singapore for this purpose, does not come within the provisions of section 10(19) of the SITA. Therefore, the offshore income used in this manner will not constitute income received in Singapore from outside Singapore.

² If the policy position were to remain the same as at 31st December 2007, there would then be a need to maintain the specified accounts. Otherwise, it would not be possible to deem the dividend as interest income.

(D) Payment of both tax exempt (1-tier) dividends and franked dividends allowed on the day of exercising an irrevocable option to move to the one-tier system

11 In paragraphs 19 to 21 of the main circular, it was stated that on the date companies exercise an irrevocable option to move to the one-tier system for the purposes of paying dividends, the companies shall henceforth no longer be allowed to pay franked dividends by utilising their section 44 balances as at 31st December 2002. Section 44(6A) of the SITA also stipulates that such companies shall not be entitled to pay franked dividends from the date of the exercise of such an option. The effect of both paragraphs 19 to 21 of the main circular and section 44(6A) of the SITA is that for companies that exercise an irrevocable option to move to the one-tier system for the purposes of paying dividends, they may not pay franked dividends on the day they exercise such an option.

12 It is hereby clarified that on the day any company exercises such an irrevocable option, it may pay franked dividends followed by tax exempt (1-tier) dividends so long as it has sufficient section 44 balance as at 31st December 2002 on the day immediately before the date of the franked dividend payment. Section 44(6A) will be amended to effect this position and the amendment will take retrospective effect from 1st January 2003.

(E) Tax effect on a company under the one-tier system when normal exempt dividends it paid previously ought not have been so exempted

13 In paragraph 43 of the main circular, it was stated that the section 44 balances as at 31st December 2002 of resident companies (i.e. companies that remain on the imputation system or have moved to the one-tier system) shall be subject to downward adjustments when it is determined that any normal exempt dividend paid by the resident companies ought not to have been so exempted³.

14 It is hereby clarified that the abovementioned downward adjustments are only applicable to companies that have moved to the one-tier system and the normal exempt dividends previously paid by these resident companies were paid prior to their moving to the one-tier system. In other words, if a company paid a normal exempt dividend (say, on 4th May 2003) after it has moved to the one-tier system (say, on 25th April 2003) and subsequent to the payment of the normal exempt dividends (say, on 19th May 2003), it is determined that the company should have no exempt profit for the payment of the normal exempt dividend (i.e. the normal exempt dividend ought not have been so exempted), this company would not be subjected to a downward adjustment of its section 44 balance as at 31st December 2002 remaining on the day immediately before the date of the dividend payment (i.e. on 3rd May 2003). This is because on the date of paying the normal exempt dividend (i.e. on 4th May 2003), this company was already on the one-tier system. The dividend that was paid previously (i.e. paid on 4th May 2003) will be treated as tax exempt (1-tier) dividend.

³ This arises when there is a revision to the company's tax assessment, resulting in a reduction in the company's exempt profit.

15 For companies that have moved to the one-tier system but the normal exempt dividends were previously paid by these resident companies prior to their moving to the one-tier system, and for companies that remain on the imputation system for the purposes of paying dividend, they shall be subject to downward adjustments when it is determined that the normal exempt dividend paid by them ought not to have been so exempted.

(F) Interpretation and application of section 46(1A) of the SITA

16 Section 46(1A)⁴ of the SITA was introduced in the year 2002. The objective of this section is to limit the tax credit attached with a franked dividend, which is available for set-off against the tax charged on the chargeable income of a person, to the actual tax deducted from the dividends or the tax deducted from an amount of dividends in proportion of the person's shareholding in the company, whichever is the lower. The following paragraph provides clarifications on how section 46(1A) of the SITA is to be applied.

17 For the purposes of section 46(1A) of the SITA, the tax credit attached with a franked dividend proportionate to a person's shareholding in a company is to be computed based on his shareholding of the class of shares he holds in the company. This is provided that there was no restructuring of the classes of shares in the company prior to the payment of the dividend, with the intent⁵ to stream its tax credit to only a particular shareholder or certain shareholders. The following example illustrates the application of section 46(1A) in a situation where there was no restructuring of the classes of shares for the purpose of streaming the tax credit of the company to only a particular shareholder or certain shareholders:

Example showing application of section 46(1A):

On a certain date, a company decides to pay the following dividends:

- franked dividends to Class A preference shareholders (say, total of 100 shares at \$1 each held by a total of 20 shareholders); and
- normal exempt dividends to Class B ordinary shareholders (say, total of 50 shares at \$1 each held by a total of 10 shareholders).

The limitation of tax credit under section 46(1A) in respect of a Class A shareholder would be applied based on the proportion of his holding of Class

⁴ Section 46(1A) reads:

“ For the purpose of subsection (1), the amount of tax deducted from a dividend under section 44(1) to be set-off for the purpose of collection against the tax charged on the chargeable income of any person shall not exceed –

(a) the actual amount of tax deducted from the dividend received by that person; or
(b) the amount of tax to be deducted from the dividend in accordance with the proportion of his shareholding in the company,

whichever is the lower.”

⁵Whether a company has restructured its classes of shares for the purposes of streaming its tax credit to only a particular shareholder or to certain shareholders is a question of fact.

A shares (say, 20 shares) only, and not the total of both Class A and Class B shares, even though he may also hold Class B shares (say, 5 shares). The tax credit to be allowed to this shareholder for set-off against the tax charged on his chargeable income is the lower of the actual amount of tax deducted from the dividend of Class A shares he received, or the amount of tax deducted from the dividend in accordance with the proportion of his holding of the Class A shares in the company (i.e. limited to 20/100 of the total dividends of Class A shares, and not 25/150).

CONCESSIONS

18 Since the release of the main circular, the Government has received representations from some holding companies of corporate groups regarding the unfavourable tax effects they face as a consequence of the introduction of the one-tier system (as explained in paragraphs 19 and 20 below).

19 Under the imputation system, franked dividends received by holding companies from their subsidiary companies are taxable. If the holding companies incur expenses (e.g. interest expenses) to earn such franked dividends, these expenses are allowable as a tax deduction against the taxable dividend. As a result, the holding companies can claim back the tax credits attached with the franked dividends.

20 With effect from 1st January 2003, if any of the subsidiary companies of such holding companies were to move to the one-tier system for the purposes of paying dividends, the dividends paid by such a subsidiary company would then be tax exempt (1-tier) dividends, and would not be subject to tax in the hands of the holding companies. As a result, such holding companies would no longer be able to claim back any tax credit of the subsidiary company.

(A) Concession 1: Concession for holding companies which have difficulties restructuring their investments

21 Some holding companies have represented to the Government that the issue of not being able to claim back the tax credit because their subsidiary companies have moved to the one-tier system could be addressed if the holding companies restructure their operations or their investments in the subsidiary companies. However, they might face difficulties doing so before 1st January 2003 (i.e. the effective date of the one-tier system).

22 In recognition of such difficulties, the Government has decided to grant the following concessions, on a case-by-case approval basis⁶, with effect from 1st January 2003, to existing holding companies that have difficulties restructuring their operations/investments within the tight timeframe:

⁶ For an approval to be given, applicant companies have to substantiate that they have difficulties restructuring their operations.

- (a) holding companies that incur expenses to earn tax exempt (1-tier) dividends paid out of taxed/taxable income of subsidiary companies will be allowed to deduct the expenses against their other income or against the income of their subsidiary companies⁷. The deduction will be subject to a cap that is reduced proportionately over 5 years⁸ [i.e. 100% deduction of the dividend-related expenses incurred in the basis period of Year of assessment (YA) 2004, 80% deduction for YA 2005, 60% deduction for YA 2006, 40% deduction for YA 2007, 20% deduction for YA 2008 and nil thereafter];
- (b) holding companies that have issued bonds to fund the acquisition of the dividend-paying shares in subsidiary companies will be allowed to deduct in full the expenses incurred to earn tax exempt (1-tier) dividends, paid out of taxed/taxable income of subsidiary companies, against their other income or against the income of their subsidiary companies⁷ during the period the redemption of the bond is not permitted. Thereafter, the deduction of the expenses incurred to earn such tax exempt (1-tier) dividends will be subjected to a cap that is proportionately reduced over 5 years [i.e. 100% deduction of the dividend-related expenses incurred in the basis period of first YA subsequent to the YA relating to the basis period in which the bond is fully redeemed, 80% deduction for second YA, 60% deduction for the third YA, 40% deduction for fourth YA, 20% deduction for the fifth YA and nil thereafter]. However, the total concession period will not exceed the life of the bond issue, subject to a maximum of 10 years⁹.

⁷ The deduction against its subsidiary companies' income is allowable only in cases where the holding company and the subsidiary companies qualify as a group for group relief purposes, and under the circumstances permitted for a transfer to the subsidiary companies (see IRAS circular dated 23rd October 2002 on the "Loss Transfer System of Group Relief" for the full details on what is considered a group for group relief purposes, and when a transfer is allowable).

⁸ The proportionate reduction in the deduction cap is intended by the Government to spur companies to undertake their restructuring as rapidly as possible.

⁹ For example, a holding company with an accounting year end of 31st December was set up on 1st June 1999. On 2nd January 2000, the holding company issued \$50 million 4% bonds which are only redeemable on 2nd January 2010. In turn, the holding company used the \$50 million from the bond issue, together with a bank loan of \$20 million, to invest in a wholly owned subsidiary company on 1st July 2000. On 1 January 2003, the wholly owned subsidiary moved to the one-tier system as it has no section 44 balance as at 31st December 2002. If the concession is granted to this holding company, the bond interest and the bank loan interest paid by the holding company for each of the years ended 31st December 2003 to 31st December 2010 will be allowed in full as tax deductions in each YA, against the holding company's other income or against the income of the subsidiary companies which are held by the holding company (if the holding company and the subsidiary companies qualify for the group relief transfer). Thereafter, the holding company will be allowed deduction of the following expenses against its other income or against its subsidiary companies' income (if the holding company and the subsidiary companies qualify for the group relief transfer):

- a) YA 2012 : 100% of the bank loan interest incurred for the year ended 31st December 2011;
- b) YA 2013 : 80% of the bank loan interest incurred for the year ended 31st December 2012;
- c) YA 2014 onwards : No expense relating to the investment in the wholly owned subsidiary is allowable. This is because the 10-year concession period has expired with effect from year ended 31st December 2013.

23 The amount of expenses incurred to earn the tax exempt (1-tier) dividends paid out of taxed/taxable income of subsidiary companies that qualifies for deduction in each YA subject to the declining cap, shall be limited to the amount of such tax exempt (1-tier) dividends the holding company receives for the same YA.

(B) Concession 2: Concession for companies that restructured their equity investment to debt or debt instruments

24 In the event of a holding company restructuring its equity investment into debt or debt instruments, the subsidiary company (i.e. the payer company) that was previously paying dividends would now make interest payments to the holding company. However, based on normal tax principles¹⁰, such interest expenses are not tax deductible in the hands of the payer company.

25 As a concession, on a case-by-case approval basis, the Government has decided to allow tax deduction of such interest expenses in the hands of the payer company if the restructuring of an equity investment into a debt or debt instrument is carried out before 1st January 2008.

(C) Concession 3: Concession for companies undergoing merger or 100% acquisition

26 One of the effects of the transitional provisions introduced for resident companies with unutilised section 44 balances as at 31st December 2002 that choose to remain on the imputation system for the purposes of paying franked dividends, is that the companies' section 44 balances as at 31st December 2002 can only be claimed back by their immediate shareholders which these companies make payment of franked dividends to.

27 In the event of a merger of two existing companies or a 100% acquisition of an existing company by another, involving the setting up of a new holding company (referred to hereafter as "newly incorporated company") that is wholly owned by the shareholders of the existing companies, the existing shareholders of the existing companies would not be able to claim back the section 44 balances as at 31st December 2002 of the existing companies when dividends are paid to them through the newly incorporated company.

28 The Government has recognised that this effect may discourage such mergers and acquisitions of companies that are carried out for commercial reasons and has therefore decided to grant a concession, on a case-by-case approval basis, to such companies undergoing mergers or 100% acquisition by allowing:

¹⁰ Set out in the Court of Appeal case of *Andermatt Investments Pte Ltd v CIT* [1995] 1 SLR 66 (High Court), [1995] 3 SLR 451 (Court of Appeal).

- a) during the period from 1st January 2003 to 31st December 2008, tax assessed on franked dividends received by the newly incorporated company from the existing companies, to form part of the newly incorporated company's section 44 balance as at 31st December 2002;
- b) during the period from 1st January 2003 to 31st December 2007, the newly incorporated company to pay franked dividends out of its section 44 balance as at 31st December 2002 remaining on the day immediately before the date of the dividend payment, and in the event that there is an insufficient section 44 balance, be subjected to a section 44 charge; and
- c) during the period from 1st January 2003 to 31st December 2008, the newly incorporated company's section 44 charge to be set off only against tax assessed by 31st December 2008 on the franked dividends it receives before 1st January 2008 from the existing companies.

29 Companies granted this concession are required to comply with requirements, including the following:

- a) the newly incorporated company to maintain a section 44 account;
- b) the tax assessed on franked dividends received from the existing companies to be computed based on the amount of such franked dividends less expenses allowable in accordance with the provisions of the SITA; and
- c) the newly incorporated company and the existing companies be subjected to all existing rules under the imputation system, and the transitional provisions of the one-tier system etc.

Application process for the concessions

30 The three concessions (stated in paragraphs 21 to 29) are administered by the Ministry of Finance. Application for any of the three concessions must be made in writing, with full facts and relevant details to -

The Ministry of Finance,
Economic Programmes Directorate,
The Treasury
100 High Street #06-03
Singapore 179434.

ENQUIRIES

- 31 For any enquiries or clarification on:
- (a) the three concession (stated in paragraphs 21 to 29), please call the Ministry of Finance at 63328928.
 - (b) the other details provided in this circular, please call IRAS at 1800-3568622.

Inland Revenue Authority of Singapore