

IRAS CIRCULAR

Writing-Down Allowance on Payments for Indefeasible Rights of Use (IRUs) (1st Edition, Revised)



INLAND REVENUE
AUTHORITY
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1 Introduction

- 1.1 On 28 February 2003, DPM and Minister for Finance announced in the 2003 Budget Speech that a deduction for writing-down allowance (WDA) will be granted on expenditure incurred for the purchase of Indefeasible Rights of Use (IRUs) over the number of years for which the IRU is acquired. This is to encourage telecommunication carriers to hub their networks in Singapore. The WDA is effective from the Year of Assessment (YA) 2004.
- 1.2 An “**Indefeasible Right of Use**” or “**IRU**” refers to an indefeasible right to use an international telecommunications submarine cable system¹.
- 1.3 An international telecommunications submarine cable system is often built and owned by a few parties, commonly known as a consortium of members (referred to as “the grantors”). The grantors may grant the right to use international telecommunications submarine cable system through an IRU agreement or arrangement, to a third party (a non-consortium member, referred to as the “purchaser”) for the purpose of acquiring bandwidth capacity. The rights are usually granted for a period of 10 to 25 years, often with an up-front lump sum payment.
- 1.4 Generally, an IRU agreement confers usage rights on the purchaser and the grantor retains the ownership of the facility. The purchaser of an IRU receives an allocation of a cable’s total capacity, expressed in bandwidth, over which voice and data communications could be transmitted. The purchaser may be required to pay for operations and maintenance services. Depending on the terms of contract, the IRU purchaser may also be required to bear some of the decommissioning costs of the submarine cable system.
- 1.5 The purpose of this Circular is to elaborate on the details of the WDA on payments for IRUs.

¹ “international telecommunications submarine cable system” means an international submarine cable that is laid in the sea and includes its cable landing station and any other equipment ancillary to the submarine cable system.

2 Current Tax Treatment

- 2.1 As mentioned in paragraph 1.3, an international telecommunications submarine cable system is often built and owned a consortium of members (i.e. the grantors of IRUs). The expenditure incurred by the consortium members to develop and build the submarine cable system is capital expenditure for the provision of plant. As such, the consortium members are eligible to claim for capital allowances under section 19 or 19A of the Singapore Income Tax Act (SITA).
- 2.2 On the other hand, the purchasers of the IRUs are not able to claim deduction on the payments they made for the purchase of the IRUs. The payments are capital expenditure as they are payments for a right, and hence not tax deductible. The payments also do not come with rights of ownership but only rights to use the capacity. They are therefore not equivalent to payments for the acquisition of plant or machinery. Under the existing provisions of SITA, such payments do not qualify for any capital allowances.
- 2.3 In view of the above, telecommunication companies, which acquire the necessary bandwidth capacity via IRUs, may not be able to claim any expenses for tax purposes compared to those who build their own submarine cable system.

3 Details of the Tax Change and Expenditure Qualifying for WDA

- 3.1 To encourage telecommunications operators to provide international connectivity, expenditure incurred for the acquisition of an IRU for the purposes of a person's trade, business or profession, can qualify for WDA over the number of years for which the IRU is acquired. This change will take effect from YA 2004. Payments for IRUs made under agreements or arrangements prior to YA 2004 will not qualify for WDA.
- 3.2 IRU payments often include an up-front capital payment and periodic amounts for the operation and maintenance of the cable system. The up-front capital payment (excluding legal

fees, registration fees, stamp duty and other cost related to the acquisition of any IRU) qualifies as capital expenditure for WDA over the number of years for which the IRU is acquired. The periodic amounts for operation and maintenance of the cable system are generally revenue expenditure that qualifies for tax deduction in the same year they are incurred.

4 How to Calculate WDA on IRU Payments

- 4.1 For a person² who has incurred capital expenditure on the purchase of an IRU for the use of his trade, business or profession, he can start claiming WDA from the YA relating to the basis period in which he incurred such expenditure, provided that the submarine cable system is in use. Where the expenditure is incurred before the commencement of his trade, business or profession, the expenditure shall be treated as if he had incurred it on the first day he commences his trade, business or profession.
- 4.2 The person can claim an amount of WDA equal to the capital expenditure incurred on the purchase of IRU over the number of years for which the IRU is purchased as long as he continues to hold the IRU. However, in the year that the WDA is claimed, the submarine cable system must be in use as at the end of the basis period for the YA concerned. The formula for calculating WDA for each YA can be expressed as follows:

$$\text{WDA} = A/B$$

Where A is the amount of capital expenditure incurred on the purchase of IRU; and

B is the number of years for which the IRU is purchased

- 4.3 Where WDA has been made to the person previously, a balancing allowance or balancing charge will be determined for the YA relating to the basis period in which any of the following events occurs:

² “person” includes company, sole proprietors and partners.

- i. Where the IRU comes to an end without subsequent renewal (such as when the underlying facilities experience terminal failure);
- ii. Where the person permanently ceases to carry on the trade, business or profession;
- iii. Where the person sells, transfers or assigns all the IRU or so much of it as he still owns; or
- iv. Where the person sells, transfers or assigns part of the IRU and the amount or value of any consideration less any decommissioning cost (hereinafter referred to as consideration) is not less than the amount of capital expenditure remaining unallowed.

In such instances, no WDA will be made to the person for the YA concerned.

5 Balancing Allowance (BA)

- 5.1 If an IRU comes to an end without subsequent renewal or the trade, business or profession permanently ceases and there is no consideration of the IRU, a BA of an amount equal to the capital expenditure remaining unallowed will be given to the person for the YA relating to the basis year in which the event takes place.
- 5.2 If the person sells, transfers or assigns all the IRU that he owns and the consideration is less than the capital allowance unallowed, the BA will be determined by the excess of the amount of capital allowance unallowed over the consideration. BA will be granted for the YA relating to the basis year in which the sale, transfer or assignment takes place.
- 5.3 In the case where a person sells, transfers or assigns any part or all of the IRU he owns at a price lower than the open market value (OMV), the OMV will be used to compute the BA.

6 Balancing Charge (BC)

- 6.1 Under a sale, transfer or assignment of all or any part of IRU, if the amount of consideration exceeds the amount of capital expenditure unallowed, a BC will be determined and deemed as income for the YA relating to the basis period in which the sale, assignment or transfer takes place.
- 6.2 The BC is determined as the excess of the consideration over the capital expenditure unallowed (if any).
- 6.3 Similar to the case in Paragraph 5.3, where a person sells, transfers or assigns any part or all of the IRU he owns at a price lower than the open market value (OMV), the OMV will be used to compute the BC.

7 Deferment of WDA

- 7.1 A person may also choose to defer the WDA for any of the YAs relating to the basis year falling within the number of years for which the IRU is acquired. However, the number of years for which the WDA is allowed is limited to the period for which the IRU is acquired. BA may be computed at the end of the period for which the IRU is acquired.

8 Computation of BA/BC for Partial Sale or Transfer of IRU

- 8.1 Where in the case of a transfer, if the consideration of part of the IRU owned are less than the capital expenditure unallowed for the IRU, the amount of WDA for the YA relating to the basis period for which the event takes place and subsequent YAs will be determined as follows:

$$\frac{C - D}{E}$$

Where C is the amount of the capital expenditure remaining unallowed at the time of the sale, transfer or assignment of IRU;

D is the amount of the consideration of that part of IRU; and

E is the number of complete years of the writing-down period remaining at the beginning of the YA relating to the basis period in which the sale, transfer or assignment of the IRU occurs.

Some examples of how to compute WDA, deferment of WDA, BA and BC for the transfer of IRU or a partial transfer of the IRU are shown in Annex 1 of this Circular.

9 Sale or Transfer of IRU between Related Parties

9.1 In the case of a sale or transfer of an IRU between two related parties, where the buyer and seller are under common control, or where one has control over the other, the buyer and seller can elect under Section 24 of the SITA to have the actual price (at which the IRU is transferred between them) to be substituted by the capital expenditure remaining unallowed in respect of that IRU. Upon such election, no BA or BC would arise to the seller, and WDA shall continue to be available to the buyer as if no sale had taken place.

10 Questions and Answers

10.1 What is the tax treatment for the purchase of ownership interest in an international telecommunications submarine cable system?

When a person acquires ownership interest in an international telecommunications submarine cable system, the person becomes the legal owner of the property. The international telecommunications submarine cable system is treated as a plant owned by the person and thus qualifies for capital allowances under Section 19 or 19A of the SITA.

10.2 What is the tax treatment for services which may be provided under the IRU contracts?

It is common for the telecommunication submarine cable system operator to provide services such as status reports on network performance and other services which are incidental to the grant of the IRU. Where such services are provided at no extra costs to the IRU purchaser, the entire payment made to the non-resident person (not carrying on a business, trade or profession in Singapore) may be treated as payment for IRU and exempt from tax.

However, if services are separately contracted for, and the services provided are not incidental to the grant of the IRU, the payments relating to the provision of services must be identified and subject to withholding tax at the prevailing corporate tax rate if they are rendered in Singapore and made to a non-resident vendor.

10.3 What is the rationale for the tax changes?

The change will align us with other communications hubs in the region and ensure that Singapore remains an attractive location for telecommunication carriers to hub their network from Singapore. Telecommunication services are critical to all businesses in Singapore, especially so for Singapore's information communications industry. A significant portion of the costs of many telecommunication carriers is associated with the acquisition of international connectivity, primarily on submarine cable systems.

If you have any queries, please do not hesitate to email us at iras@iras.gov.sg or

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Examples:

How WDA is calculated:

Company TelecomABC bought an IRU for a period of 15 years for \$1.5million on 01.05.2003.

Telecom ABC will be able to claim WDA as follows:

WDA with effect from YA 2004

= \$1,500,000/15

= \$ 100,000

TelecomABC will thus be entitled to claim \$100,000 for each YA from YA2004 to YA2018.

For deferment of WDA claim:

Alternatively, if Company TelecomABC decides to defer WDA claim for YA2004, YA 2007 and 2008, the WDA will be computed as follows:

Table 1:

Year	Year of Assessment	WDA claimed	Remaining Capital Expenditure Unallowed	Balancing Allowance
1	2004	-	1,500,000	N.A.
2	2005	\$100,000	1,400,000	N.A.
3	2006	\$100,000	1,300,000	N.A.
4	2007	-	1,300,000	N.A.
5	2008	-	1,300,000	N.A.
6	2009	\$100,000	1,200,000	N.A.
7	2010	\$100,000	1,100,000	N.A.
8	2011	\$100,000	1,000,000	N.A.
9	2012	\$100,000	900,000	N.A.
10	2013	\$100,000	800,000	N.A.
11	2014	\$100,000	700,000	N.A.
12	2015	\$100,000	600,000	N.A.
13	2016	\$100,000	500,000	N.A.
14	2017	\$100,000	400,000	N.A.
15	2018	-	-	\$400,000

How to Compute BA/BC:

(All scenarios make reference to information in Table 1 above)

Scenario A

If Telecom ABC permanently ceases business (assuming there is no transfer or sale) in year 2010 (YA2011), then a BA will be computed as follows:

Balancing Allowance (BA) for YA2011

= Remaining Capital Expenditure on IRU unallowed as at 31.12.2009
= \$1.1million

Scenario B

If TelecomABC transfers the IRU in year 2010 (YA2011) and the consideration is \$0.6million, which is less than the capital expenditure remaining unallowed, a BA will be computed as follows:

Balancing Allowance (BA) for YA2011

=(Remaining Capital Expenditure on IRU unallowed as at 31.12.2009)
- (Consideration)
= \$1.1million - \$0.6million
= \$0.5million

Scenario C

Supposing TelecomABC transfer the IRU in year 2010 (YA2011) and the consideration is \$1.3million which is more than the capital expenditure remaining unallowed, a BC will be computed as follows:

Balancing Charge (BC) for YA2011

= (Consideration) - (Capital Expenditure on IRU
remaining unallowed as at 31.12.2009)
= \$1.3million - \$1.1million
= \$0.2million

No WDA for **YA2011** onwards as there is no capital expenditure unallowed w.e.f 31.12.10.

Scenario D

However, if only part of the IRU is transferred by TelecomABC in the year 2010 (YA2011), the WDA available to Telecom ABC with effect from YA2011 will be adjusted and computed as follows:

Capital expenditure remaining unallowed as at 31.12.2009	\$1.1 mil
Consideration of part of IRU	\$0.65 mil
Number of complete years of the writing-down period ³ remaining at the beginning of the YA in which the transfer takes place	8 years
WDA for YA2011 to YA2018	
= (\$1.1 million - \$0.65 million) / 8	
= \$56,250 per YA	

³ “writing-down period” in respect of an IRU is the number of years for which the IRU is acquired commencing with the year of assessment relating to the basis period in which the capital expenditure for the acquisition of the IRU is incurred.