

# **IRAS CIRCULAR**

## **ONE-TIER CORPORATE TAX SYSTEM**



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[Inserted the last two sentences in paragraph 17 to provide clarity on when a company can utilize its available franking credits.]

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# **IRAS CIRCULAR**

**15<sup>th</sup> AUGUST 2002**

## **NEW ONE-TIER CORPORATE TAX SYSTEM**

### **INTRODUCTION**

On 3<sup>rd</sup> May 2002, DPM/Minister for Finance announced in his Budget Statement for FY2002 that the current imputation system would be replaced by a new one-tier corporate tax system with effect from 1<sup>st</sup> January 2003.

2 A 5-year transitional period (1<sup>st</sup> January 2003 to 31<sup>st</sup> December 2007) is however provided for resident companies with unutilised section 44 balances as at 31<sup>st</sup> December 2002 to remain on the imputation system (before moving to the new one-tier corporate tax system) for the purpose of paying franked dividends (i.e. dividends that carry tax credit). This is to allow resident companies some time to utilise their section 44 balances as at 31<sup>st</sup> December 2002.

3 This circular provides details of the new one-tier corporate tax system (referred to hereafter as “one-tier system”). It also spells out the rules applicable to resident companies during the 5-year transitional period.

### **CURRENT IMPUTATION SYSTEM**

4 Currently, Singapore adopts a full imputation system for taxation of companies. Under the current imputation system, tax payable by a resident company on its chargeable income at the normal company tax rate (such income is referred to hereafter as “normal chargeable income”) is passed on to its shareholders as a tax credit on payment of dividends (other than exempt dividends) to the shareholders. This is achieved through the section 44 account mechanism<sup>1</sup>. Accordingly, the tax payable by a resident company on

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<sup>1</sup> This mechanism is provided in section 44 of the Singapore Income Tax Act (“SITA”). Under section 44 of the SITA, a resident company is required to maintain a section 44 account. Any tax payable on the company’s normal chargeable income (generally termed as “tax assessed”) would be credited to the company’s section 44 account. When the resident company pays any dividend (other than exempt dividend) or when tax assessed earlier is reduced (generally termed as “tax discharge”) due to an amended assessment issued to the company, the tax it is

its normal chargeable income is strictly not a final tax (i.e. the tax payable can be used to pay dividends with tax credit). Dividends that carry such tax credit, also commonly known as franked dividends, are taxable in the hands of the shareholders. Shareholders are taxed on the gross dividends (i.e. inclusive of the tax credit) but can set off the tax credit against their tax payable.

5 On the other hand, as the provisions in section 44 of the Singapore Income Tax Act ("SITA") are not applicable to a non-resident company, tax payable on the normal chargeable income of a non-resident company would constitute a final tax.

## **ONE-TIER CORPORATE TAX SYSTEM AND EFFECTIVE DATE OF IMPLEMENTATION**

6 The one-tier system would be implemented with effect from 1<sup>st</sup> January 2003. Under the one-tier system, tax payable by a company, whether resident in Singapore or not, on its normal chargeable income (including any franked dividends received by the company during the 5-year transitional period) would constitute a final tax. Accordingly any tax assessed on or after 1<sup>st</sup> January 2003 (other than tax assessed to which the concession in paragraph 30 applies and tax assessed relating to certain adjustments<sup>2</sup>) on a resident company in respect of its normal chargeable income (including any franked dividends received by the company during the 5-year transitional period) for any year of assessment (YA) would not form part of its section 44 balance as at 31<sup>st</sup> December 2002.

7 In the absence of any transitional period, all resident companies would not be able to continue to utilise their section 44 balances as at 31<sup>st</sup> December 2002 (also commonly referred to as "franking credits" and hence shall be so used interchangeably hereafter) to pay franked dividends to their shareholders. In other words, in the absence of any transitional period to allow resident companies to pay franked dividends, they would effectively have been required to move to the one-tier system on 1<sup>st</sup> January 2003 and would henceforth no longer be allowed to pay franked dividends by utilising their section 44 balances as at 31<sup>st</sup> December 2002. However, a 5-year transitional period is

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required to deduct at the prevailing company tax rate from the dividend paid or the amount of tax discharge respectively would be debited to the section 44 account. On the date of dividend payment, if the resident company does not have sufficient balance in its section 44 account (i.e. tax to be deducted from the dividends exceeds the section 44 balance on the day immediately before the date of dividend payment), the company has to pay the shortfall (generally termed as "section 44 charge") to the Comptroller within 14 days from the date of dividend payment. Similarly, on the date of tax discharge, if the resident company does not have sufficient balance in its section 44 account (i.e. tax discharge exceeds the section 44 balance as at the date of the tax discharge), the company will also have to pay a section 44 charge. If there is any balance remaining in the section 44 account after a dividend payment or tax discharge, the balance can be used to frank future dividends. Through this section 44 account mechanism, tax assessed on a resident company is passed on to its shareholders as a tax credit to the shareholders on payment of dividends.

<sup>2</sup> as spelt out under paragraph 45.

provided for resident companies with unutilised section 44 balances as at 31<sup>st</sup> December 2002 to remain on the imputation system for the purpose of paying franked dividends (refer to paragraphs 15 to 23 for transitional provisions applicable to resident companies to enable them to utilise their section 44 balances as at 31<sup>st</sup> December 2002).

## **DIVIDENDS PAID BY COMPANIES ON THE ONE-TIER CORPORATE TAX SYSTEM**

8 As the tax assessed on or after 1<sup>st</sup> January 2003 (other than tax assessed to which the concession in paragraph 30 applies and tax assessed relating to certain adjustments<sup>2</sup>) on resident companies in respect of their normal chargeable income (including any franked dividends received by the company during the 5-year transitional period) for any YA constitutes a final tax, companies that have moved to the one-tier system for the purpose of paying dividends can henceforth pay dividends that are exempt from tax in the hands of their shareholders [such dividends are referred to hereafter as tax exempt(1-tier) dividends].

9 As is the case under the current imputation system, dividends payable by any company on the one-tier system out of certain specified accounts would also continue to be exempt from tax in the hands of their shareholders (such dividends are referred to hereafter as “normal exempt dividends”). These include dividends paid out of:

- (a) income that has been exempt from tax, or income net of tax payable at a concessionary rate of tax<sup>3</sup> (collectively referred to hereafter as “tax exempt concessionary income”);
- (b) approved deduction or approved further deduction of expenses<sup>4</sup>;
- (c) foreign tax credit allowed<sup>5</sup>.

10 While shareholders who receive tax exempt(1-tier) dividends or normal exempt dividends would be exempt from tax on such dividends, all companies that have moved to the one-tier system for the purpose of paying dividends are required to distinguish these two types of exempt dividends in the tax vouchers issued to the shareholders during the 5-year transitional period. This requirement is elaborated in paragraphs 63 to 66.

11 Therefore, subject to the transitional provisions spelt out in this circular, with the introduction of the one-tier system, there will essentially be no difference in company taxation between a resident company and a non-

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<sup>3</sup> Payment of exempt dividends out of tax exempt concessionary income is currently provided under sections 13A(6), 13B(4), 13D(3), 13F(5), 13H(11), 13I(2) and 13K(2) of SITA, and sections 14(3), 19, 19F(3), 19L(3), 25(3), 28, 40(3), 44D(2), 53(3), 72, 82, 90 and 97Q(3) of the Economic Expansion Incentives (Relief from Income Tax) Act

<sup>4</sup> Payment of exempt dividends out of approved deduction or further deduction of expenses is currently provided under sections 14B(3C), 14K(5) and 14M(8) of SITA.

<sup>5</sup> Payment of exempt dividends out of foreign tax credit is currently provided under section 13E of SITA.

resident company in Singapore. This is because in either case, any tax payable by any company on its normal chargeable income would constitute a final tax.

### **TAX TREATMENT OF EXPENSES INCURRED TO EARN DIVIDENDS**

12 Although dividends payable by a company that has moved to the one-tier system for the purpose of paying dividends are exempt from tax in the hands of its shareholders, expenses incurred by the shareholders to earn the dividends remain attributable to and hence deductible only against such dividends and not against any other income.

### **TAX TREATMENT OF FOREIGN DIVIDENDS REMITTED TO SINGAPORE**

13 The one-tier system would also not alter the tax treatment of foreign dividends remitted to Singapore. Such foreign dividends remain taxable in the hands of the shareholders. Expenses incurred by the shareholders to earn the foreign dividends would continue to be attributed to and allowed as set off against such dividends only. The applicable foreign tax credit will continue to be granted.

14 The example in Annex 1 illustrates the computation of the tax payable of a company receiving different types of dividends during the year ended 31<sup>st</sup> December 2003 i.e. for the YA 2004.

### **TRANSITIONAL PROVISIONS**

15 During the 5-year transitional period, all resident companies are required to comply with the transitional provisions spelt out in this circular. This is regardless of whether, during the 5-year transitional period, they remain on the imputation system (for the purpose of paying franked dividends) or move to the one-tier system for the purpose of paying dividends (either by requirement or by option). For the purpose of applying the transitional provisions, reference would be made to section 44 balances as at 31<sup>st</sup> December 2002. These balances would include any downward adjustments [i.e. due to payment of franked dividends (if applicable) and certain adjustments spelt out under paragraph 43] and upward adjustments (i.e. due to the concession described in paragraph 30 and certain adjustments spelt out under paragraph 45) made against them during the 5-year transitional period.

16 The transitional provisions spell out, among other things:

- (a) the 5-year transitional period allowed to resident companies to utilise their section 44 balances as at 31<sup>st</sup> December 2002 (explained in paragraphs 17 to 23);
- (b) the rules applicable to payment of franked dividends by resident companies during the 5-year transitional period (explained in paragraphs 24 to 27);

- (c) the tax treatment of shareholders who receive franked dividends during the 5-year transitional period (explained in paragraph 28);
- (d) the determination of resident companies' section 44 balances as at 31<sup>st</sup> December 2002 (explained in paragraphs 29 to 39);
- (e) the rules applicable to the maintaining of section 44 accounts during the 5-year transitional period for tracking companies' section 44 balances as at 31<sup>st</sup> December 2002 and making any adjustment required thereto due to revised assessments made subsequently. This is for purposes of determining, during the 5-year transitional period, the amount of section 44 balances as at 31<sup>st</sup> December 2002 still available at any time for franking of dividends, the tax treatment of any charge (which will continue to be referred to as "section 44 charge") which may arise due to franking of dividends in excess of such franking credits or due to downward adjustments to the section 44 balances as at 31<sup>st</sup> December 2002<sup>6</sup>, and whether or not any discharge of tax previously assessed and included in such balances may be refunded (explained in paragraphs 40 to 54);
- (f) rules applicable to utilisation of section 44 charge remaining as at 31<sup>st</sup> December 2002 and of section 44 charge that may arise during the 5-year transitional period (explained in paragraphs 55 to 58); and
- (g) other consequential/related requirements and details during the 5-year transitional period (explained in paragraphs 59 to 66).

**5-YEAR TRANSITIONAL PERIOD FROM 1<sup>ST</sup> JANUARY 2003  
ALLOWED TO RESIDENT COMPANIES TO UTILISE THEIR SECTION  
44 BALANCES AS AT 31<sup>ST</sup> DECEMBER 2002**

17 Resident companies with unutilised section 44 balances as at 31<sup>st</sup> December 2002 would be given up to 5 years (from 1<sup>st</sup> January 2003 to 31<sup>st</sup> December 2007) to remain on the imputation system (for the purpose of paying franked dividends) before moving to the one-tier system. This is to allow such companies some time to utilise their available franking credits. The utilisation of their available franking credits is, however, only applicable to dividends which are actually paid out to shareholders on or before 31 Dec 2007. Dividends which are declared on or before 31 Dec 2007 but only paid out after that date are not dividends paid on or before 31 Dec 2007 for the purposes of section 44 and will not qualify for the credit under section 46(1)(a).

18 As a corollary, if not for the concession set out in paragraph 30, resident companies with nil section 44 balances as at 31<sup>st</sup> December 2002 are strictly required to move to the one-tier system with effect from 1<sup>st</sup> January 2003 for the purpose of paying dividends. The application of the concession has effectively deferred the earliest date on which such resident companies are

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<sup>6</sup> as spelt out under paragraph 43

required to move to the one-tier system (for the purpose of paying dividends) from 1<sup>st</sup> January 2003 to 31<sup>st</sup> March 2003 in order to take into account the tax to be assessed on companies' estimated normal chargeable income for YA 2003 which is submitted to the Comptroller of Income Tax ("CIT") by 31<sup>st</sup> March 2003 (please refer to paragraphs 30 to 32 for further explanation). After 31<sup>st</sup> March 2003, resident companies with section 44 balances as at 31<sup>st</sup> December 2002 but have fully utilised such franking credits (i.e. section 44 balances as at 31<sup>st</sup> December 2002 become nil) at any time during the 5-year transitional period will move to the one-tier system for the purpose of paying dividends from the date the section 44 balances as at 31<sup>st</sup> December 2002 have been fully utilised, without the need to exercise an option.

**Option to move to the one-tier system earlier (but not before 1<sup>st</sup> January 2003) for the purpose of paying dividends**

19 Although resident companies with unutilised franking credits as at 31<sup>st</sup> December 2002 would be given up to 5 years to move to the one-tier system for the purpose of paying dividends, such companies can opt to move to the one-tier system on 1<sup>st</sup> January 2003 or anytime thereafter within the 5-year transitional period even if they have unutilised section 44 balances as at 31<sup>st</sup> December 2002. They can do this by submitting a duly completed option form (specimen copy is attached at Annex 2<sup>7</sup>) to CIT.

20 On the date companies exercise such an option, they shall move to the one-tier system for the purpose of paying dividends and shall henceforth no longer be allowed to pay franked dividends by utilising their section 44 balances as at 31<sup>st</sup> December 2002.

21 Such an option, once exercised, is irrevocable.

**All companies move to the one-tier system on 1<sup>st</sup> January 2008 for the purpose of paying dividends**

22 During the 5-year transitional period, resident companies with section 44 balances as at 31<sup>st</sup> December 2002 can continue to remain on the imputation system for the purpose of paying franked dividends, as long as they have yet to fully utilise their franking credits. However, any franking credits that could not be utilised by 31<sup>st</sup> December 2007 would no longer be available for payment of franked dividends after this date. The imputation system would cease to exist alongside the one-tier system for the purpose of paying dividends with effect from 1<sup>st</sup> January 2008. All companies in Singapore that have yet to move to the one-tier system for the purpose of paying dividends would therefore do so from this date.

23 Accordingly, from 1<sup>st</sup> January 2008, all dividends payable by companies in Singapore would be exempt from tax in the hands of shareholders. The requirement of companies paying tax exempt(1-tier) dividends or normal exempt dividends during the 5-year transitional period to distinguish these two

<sup>7</sup> The option form will also be available from IRAS website ([http:// www.iras.gov.sg](http://www.iras.gov.sg)) or via fax express service @ 1800-356-8677 (code 209).

types of dividends in the tax vouchers issued to shareholders will no longer be relevant and therefore will cease to apply from that day onwards unless otherwise advised (please also refer to paragraphs 10 and 63 to 66).

### **RESIDENT COMPANIES THAT REMAIN ON IMPUTATION SYSTEM DURING THE 5-YEAR TRANSITIONAL PERIOD FOR THE PURPOSE OF PAYING FRANKED DIVIDENDS**

24 Resident companies that remain on the imputation system during the 5-year transitional period for the purpose of paying franked dividends can utilise their section 44 balances as at 31<sup>st</sup> December 2002 to pay franked dividends to their shareholders. However, at all times during the transitional period, they are only allowed to pay an amount of franked dividends that utilises up to, but not in excess of their section 44 balances as at 31<sup>st</sup> December 2002, as ascertained on the day immediately before the date of dividend payment.

25 If at any time during the transitional period, such resident companies were to pay any franked dividends whose related tax credit is in excess of their section 44 balances as at 31<sup>st</sup> December 2002, as ascertained on the day immediately before the date of dividend payment, they are required to pay over to CIT a section 44 charge equal to the amount of such excess tax credit within 14 days from the date of dividend payment. In such cases, the section 44 charge so paid shall not be available for set off against any tax assessed on the companies for any YA subsequent to the dividend payment (please refer to paragraph 35 for an explanation of how this requirement will apply to resident companies during the interim period from 1<sup>st</sup> January 2003 to 31<sup>st</sup> March 2003 due to the application of the concession set out in paragraph 30).

26 In addition, while resident companies remain on the imputation system for the purpose of paying franked dividends, they are only allowed to pay franked dividends but not tax exempt(1-tier) dividends until such time they have fully utilised their available franking credits (i.e. they are required to move to the one-tier system) or have opted to move to the one-tier system for the purpose of paying dividends. In other words, they are not allowed to pay tax exempt(1-tier) dividends while they remain on the imputation system for the purpose of paying franked dividends. This requirement however does not preclude such companies from paying normal exempt dividends to their shareholders if they are eligible to do so (please refer to paragraph 9 for the meaning of “normal exempt dividends”). Further, resident companies remaining on the imputation system (for the purpose of paying franked dividends) must pay franked dividends to their shareholders based on their respective shareholding proportions<sup>8</sup>. In other words, resident companies are not allowed to stream

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<sup>8</sup> For example, resident Company A (remaining on the imputation system for the purpose of paying franked dividends) has section 44 balance as at 31<sup>st</sup> December 2002 (amounting to \$22,000) remaining on 22 July 2003 and it wishes to pay dividends of \$150,000 to its 10 shareholders on 23 July 2003. Company A is required to first pay out franked dividends of \$100,000 (with related tax credit of \$22,000) to all the 10 shareholders (with each receiving an amount of franked dividends proportionate to their shareholdings) before it can pay tax exempt(1-tier) dividends of \$50,000 on the same day. Company A's shareholders would therefore receive both franked dividends and tax exempt(1-tier) dividends proportionate to their

franked dividends to certain shareholders only.

27 The table below summarises the types of dividends resident companies under different circumstances are allowed to pay to shareholders during the 5-year transitional period (1<sup>st</sup> January 2003 to 31<sup>st</sup> December 2007).

Company	Whether company can pay franked dividends?	Whether company can pay tax exempt(1-tier) dividends?	Whether company can continue to pay normal exempt dividends, if eligible?
<u>Company A</u> Remains on the imputation system for the purpose of paying franked dividends during 1.1.2003 to 31.12.2007 (Note 1)	Yes	No	Yes
<u>Company B</u> Moves to the one-tier system from 1.1.2003 (Note 2)	No	Yes	Yes
<u>Company C</u> Remains on the imputation system for the purpose of paying franked dividends, say from 1.1.2003 to 31.12.2005	Yes (1.1.2003 to 31.12.2005)	No (1.1.2003 to 31.12.2005)	Yes
----- Moves to the one-tier system from 1.1.2006 (Note 2)	No (from 1.1.2006)	Yes (from 1.1.2006)	Yes

Note 1: Companies with section 44 balances as at 31<sup>st</sup> December 2002 which have not opted to move to the one-tier system for the purpose of paying dividends.

Note 2: Companies move to one-tier system either by exercising an option or when they have fully utilised their section 44 balances as at 31<sup>st</sup> December 2002.

### **TAX TREATMENT OF SHAREHOLDERS WHO RECEIVE FRANKED DIVIDENDS DURING THE 5-YEAR TRANSITIONAL PERIOD**

28 Shareholders who receive franked dividends during the 5-year transitional period are liable to tax on the gross dividends (i.e. inclusive of tax credit) but they in turn are entitled to claim the tax credit against their tax payable. Tax assessed on or after 1<sup>st</sup> January 2003 on franked dividends received by any corporate shareholder would constitute a final tax, except where such tax assessed falls within the concession in paragraph 30 or relates to certain adjustments<sup>2</sup>).

### **DETERMINATION OF SECTION 44 BALANCES AS AT 31<sup>ST</sup> DECEMBER 2002**

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shareholdings on 23 July 2003. Nevertheless, Company A can pay out normal exempt dividends, if it is eligible to do so, even before it fully utilises its available franking credits.

29 Subject to the concession in paragraph 30 and the application of certain adjustment rules<sup>9</sup> due to revisions of certain assessments previously made, the determination of section 44 balances as at 31<sup>st</sup> December 2002 available for franking of dividends by resident companies during the 5-year transitional period should be relatively straightforward. One simply needs to refer to the section 44 balances as at 31<sup>st</sup> December 2002 standing in the section 44 accounts on that date. Consequently, any tax or additional tax assessed on or after 1<sup>st</sup> January 2003 on the normal chargeable income (including any franked dividends received during the 5-year transitional period) of such companies for any YA would strictly not form part of their section 44 balances as at 31<sup>st</sup> December 2002.

**Concession – inclusion of tax assessed on estimated normal chargeable income for the YA 2003 which is submitted to CIT by 31<sup>st</sup> March 2003**

30 However, as a concession<sup>10</sup>, the Government has decided that any tax assessed on resident companies' estimated normal chargeable income for the YA 2003<sup>11</sup> which is submitted to CIT by 31<sup>st</sup> March 2003 can be included and form part of their section 44 balances as at 31<sup>st</sup> December 2002. For resident companies' record purposes, CIT will issue them with section 44 statements by 30<sup>th</sup> April 2003 showing their section 44 balances as at 31<sup>st</sup> December 2002 that include such tax assessed. Any tax or additional tax assessed relating to estimated normal chargeable income for the YA 2003 that is submitted to CIT after 31<sup>st</sup> March 2003 shall not form part of the section 44 balances as at 31<sup>st</sup> December 2002. The concession shall be applied in the manner and subject to the requirements detailed in paragraphs 33 to 36 which all resident companies are required to adhere to.

31 Resident companies which do not have any section 44 balances as at 31<sup>st</sup> December 2002 remaining on 31<sup>st</sup> March 2003 would be required to move to the one-tier system from 1<sup>st</sup> April 2003. This is after taking into account the tax assessed or to be assessed on their estimated normal chargeable income for the YA 2003 which is submitted to CIT by 31<sup>st</sup> March 2003 and any applicable adjustments<sup>9</sup> during the period 1<sup>st</sup> January 2003 to 31<sup>st</sup> March 2003.

32 Resident companies determined on 31<sup>st</sup> March 2003 to have section 44 balances as at 31<sup>st</sup> December 2002 can remain on the imputation system for the purpose of paying franked dividends for a period up to 31<sup>st</sup> December 2007, as long as they have not fully utilised the franking credits. The rules set out in paragraphs 17 to 23 shall apply in determining the date on which such

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<sup>9</sup> as spelt out under paragraphs 43 to 46.

<sup>10</sup> The concession is applicable to all companies. It is not limited to companies that carry on or exercise any trade, business, profession or vocation. With this concession, tax assessed on the estimated normal chargeable income (including investment income) for the YA 2003 for all companies would be included and form part of their section 44 balances as at 31<sup>st</sup> December 2002, regardless of their accounting year end and business circumstances.

<sup>11</sup> Estimates of normal chargeable income furnished must be reasonably estimated and supported by a reasonable basis of estimation. Appropriate actions may be taken against companies that furnish estimates of normal chargeable income that are excessive and not supported by a reasonable basis of estimation.

companies would move to the one-tier system for the purpose of paying dividends during this period.

**Requirements of resident companies during the interim period from 1<sup>st</sup> January 2003 to 31<sup>st</sup> March 2003 and the ensuing effects**

33 Since the tax assessed on resident companies' estimated normal chargeable income for the YA 2003 which is submitted to CIT by 31<sup>st</sup> March 2003 can be included in and form part of their section 44 balances as at 31<sup>st</sup> December 2002 by virtue of the concession, CIT or resident companies may not be in a position to ascertain whether the companies actually have such balances until 31<sup>st</sup> March 2003. Accordingly, prior to 31<sup>st</sup> March 2003, CIT or resident companies may not be in the position to establish whether they are required to move to the one-tier system from 1<sup>st</sup> January 2003 for the purpose of paying dividends due to nil section 44 balances as at 31<sup>st</sup> December 2002. Consequently, it is necessary to set out the requirements that resident companies must adhere to during this interim period (i.e. from 1<sup>st</sup> January 2003 to 31<sup>st</sup> March 2003) for payment of dividends (other than normal exempt dividends). These requirements are explained in paragraphs 34 to 36.

34 Except where they have opted to move to the one-tier system for the purpose of paying dividends (see paragraph 36), all resident companies shall remain on the imputation system for the purpose of paying franked dividends during the interim period, regardless of the status of their section 44 balances as at 31<sup>st</sup> December 2002 (i.e. whether or not there is any section 44 balance as at 31<sup>st</sup> December 2002), unless they exercise an option to move to the one-tier system for the purpose of paying dividends. All resident companies that do not exercise such an option and who pay any dividend during this interim period are therefore regarded as having paid franked dividends to their shareholders. Accordingly, they are required to comply with the current requirements for the franking of dividends, including payment of a section 44 charge, in relation to any dividends paid during this period<sup>12</sup>.

35 During this interim period, consistent with the requirement set out in paragraph 24, resident companies are only allowed to pay an amount of franked dividends that utilises up to but not in excess of their section 44 balances as at 31<sup>st</sup> December 2002 as ascertained on the day immediately before the date of dividend payment. To determine whether any resident company has paid franked dividends during this interim period in excess of their section 44 balances as at 31<sup>st</sup> December 2002 as ascertained on the day immediately before the date of dividend payment, as well as the ensuing effects that follow, the following steps shall apply:

**Step 1 Ascertain the company's section 44 balance as at 31<sup>st</sup> December 2002 on the day before dividend payment**

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<sup>12</sup> As a corollary, franked dividends payable by the companies during this period are therefore taxable in the hands of the shareholders. The shareholders in turn can claim the tax credit attached to the franked dividends against their tax payable.

For example, the company's balance is \$22,000. The company is only allowed to pay an amount of franked dividends of up to \$100,000 (i.e. \$22,000/22%) but not more.

**Step 2** Ascertain the amount of franking credit utilised by the company for payment of franked dividends and whether a section 44 charge arises

If the company were to pay franked dividends of say, \$300,000 (inclusive of tax credit of \$66,000) even though its section 44 balance as at 31<sup>st</sup> December 2002 as determined under Step 1 is \$22,000, the company would have to pay a section 44 charge equal to the excess amount (i.e. \$66,000 - \$22,000 = \$44,000) to the CIT within 14 days from the date of payment of dividends.

**Step 3** Ascertain if CIT has raised an assessment on company's estimated normal chargeable income for the YA 2003 (if any) submitted to CIT by 31<sup>st</sup> March 2003

Suppose CIT assesses the company's estimated normal chargeable income for the YA 2003 submitted to CIT by 31<sup>st</sup> March 2003 amounting to \$50,000 (i.e. tax assessed is \$11,000) on say, 8<sup>th</sup> April 2003

**Step 4** Set off section 44 charge (arising under Step 2, if any) against tax assessed on company's estimated normal chargeable income for the YA 2003 (if any) submitted to CIT by 31<sup>st</sup> March 2003

Part of the charge paid to CIT (i.e. \$44,000 as determined under Step 2) shall be set off against the tax assessed of \$11,000 (as determined under Step 3).

**Step 5** Ascertain the portion of section 44 charge (if any) determined under Step 2 which is not available for set off against any subsequent tax assessed

The balance of the section 44 charge of \$33,000 (i.e. \$44,000 - \$11,000) paid to the CIT shall not be available for set off against any tax assessed on the companies for any YA subsequent to the dividend payment.

36 All resident companies (regardless of whether they have any section 44 balances as at 31<sup>st</sup> December 2002) that have opted to move to the one-tier system for the purpose of paying dividends at any time during this interim period are required to submit a duly completed option form (specimen copy at Annex 2) to CIT. The examples in Annex 3 illustrate this requirement.

**Treatment of difference in tax deducted from franked dividends due to change in company tax rate for YA 2003**

37 In his Budget Statement for FY 2002 on 3<sup>rd</sup> May 2002, DPM/Minister for Finance also announced that the company tax rate would be reduced from 24.5% to 22% with effect from the YA 2003. Accordingly, resident companies are only required to deduct tax at 22% instead of 24.5% for any franked dividends paid to shareholders in the year 2002. However, some companies may have paid dividends franked at 24.5% prior to the announcement.

38 In such cases, affected shareholders would be treated as having received gross dividends of an amount equal to the net dividends received grossed up by 22%. The difference between the grossed up dividends and the net amount received by the shareholders would be the amount of tax deducted from the dividend. Under tax rules usually applicable in such cases, the difference in the amount of tax deducted at 24.5% from the gross dividends and the amount of tax deducted at 22% from the grossed up dividends shall only be added to and form part of the companies' section 44 balances on 1<sup>st</sup> January 2003. However, under the transitional provisions for the one-tier system, such difference shall be added to and form part of their section 44 balances one day earlier, i.e. on 31<sup>st</sup> December 2002.

39 Annex 4 provides an overview of the transitional provisions explained above. The effects of these transitional provisions under different scenarios are illustrated in Annex 5.

#### **MAINTAINING OF SECTION 44 ACCOUNTS AND ADJUSTMENTS TO SECTION 44 BALANCES AS AT 31<sup>st</sup> DECEMBER 2002 DURING THE 5-YEAR TRANSITIONAL PERIOD**

##### **Maintaining of section 44 accounts by all resident companies**

40 During the 5-year transitional period, all resident companies are required to continue to maintain section 44 accounts. This requirement applies regardless of whether resident companies have moved to the one-tier system (either by requirement or option) or remained on the imputation system during the transitional period for the purpose of paying franked dividends. It is for the following purposes:

- (a) to determine the amount of section 44 balances as at 31<sup>st</sup> December 2002 available at any time during the 5-year transitional period for paying franked dividends during this period (applicable only to companies remaining on the imputation system); or
- (b) to determine whether adjustments<sup>9</sup> to the section 44 balances as at 31<sup>st</sup> December 2002 are needed during the 5-year transitional period due to revision of certain assessments during this period (applicable to all companies); or
- (c) to determine whether any section 44 charge arises during the 5-year transitional period (applicable to all companies); or

- (d) to determine whether the amount of tax discharged during the 5-year transitional period can be refunded (applicable to all companies).

### **Adjustments to section 44 balances as at 31<sup>st</sup> December 2002**

41 To recapitulate, with the implementation of the one-tier system from 1<sup>st</sup> January 2003, any tax or additional tax assessed on or after 1<sup>st</sup> January 2003 (other than tax assessed to which the concession in paragraph 30 applies and tax assessed relating to certain adjustments<sup>2</sup>) on resident companies in respect of their normal chargeable income (including any franked dividends received by the company during the 5-year transitional period) for any YA would constitute a final tax. In other words, such tax or additional tax assessed regardless of the YA to which the tax relates would not form part of the section 44 balances as at 31<sup>st</sup> December 2002.

42 The section 44 balances as at 31<sup>st</sup> December 2002 of resident companies, as determined in accordance to paragraphs 29 to 39, shall only be available to resident companies remaining on the imputation system for the purpose of paying franked dividends during the 5-year transitional period. The balances shall then be reduced by the amount of franking credits utilised for payment of franked dividends by such resident companies during this period.

43 In addition, the section 44 balances as at 31<sup>st</sup> December 2002 of all 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 under the following circumstances:

- (a) when it is determined that any normal exempt dividends paid by the resident companies ought not to have been so exempted<sup>13</sup>;
- (b) when amended assessments are made on the resident companies during the 5-year transitional period and the amended assessments result in discharge of tax assessed for any YA that has previously been credited to or included in their section 44 balances as at 31<sup>st</sup> December 2002.

For (b), the amount to be debited to the companies' section 44 accounts is limited to the lesser of the amount of such tax discharged or their section 44 balances as at 31<sup>st</sup> December 2002 remaining on the date of the tax discharge<sup>14</sup>.

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<sup>13</sup> In such cases, the company is required to debit its relevant specified accounts (see paragraph 9) with the amount of normal exempt dividends ought not to have been so exempted. If the credit balance in the company's specified account is lower than the amount of exempt dividends ought not to have been so exempted, the company is required to treat the excess as net franked dividends received by the shareholders, and accordingly debit its section 44 balance as at 31<sup>st</sup> December 2002 with the deemed tax deducted at source.

<sup>14</sup> The amount of tax discharge in excess of the companies' section 44 balances as at 31<sup>st</sup> December 2002 remaining on the date of the tax discharge is in effect a section 44 charge as mentioned under paragraph 48. As per the existing treatment of a section 44 charge arising

44 Prior to making an amended assessment on a resident company for a YA, an original assessment or additional assessments for that YA would have earlier been made at different times. The original or additional tax previously assessed for that YA may or may not have been credited to or included in the section 44 balances as at 31<sup>st</sup> December 2002. For the purpose of adjusting the section 44 balances as at 31<sup>st</sup> December 2002 of resident companies due to amended assessments made during the 5-year transitional period, any amount of tax discharged during the transitional period for any YA would first be considered as a discharge of tax which has been previously assessed for that YA but not credited to or included in their section 44 balances as at 31<sup>st</sup> December 2002. Thereafter, any remaining amount of the tax discharged resulting from the amended assessments made within the 5-year transitional period would be considered as a discharge of tax which has been previously assessed and credited to or included in the section 44 balances as at 31<sup>st</sup> December 2002.

45 In cases where downward adjustments have been made to section 44 balances as at 31<sup>st</sup> December 2002 under paragraph 43(b), and additional assessments are subsequently made on the resident companies for the same affected YA, the additional tax assessed up to the amount of the section 44 balance as at 31<sup>st</sup> December 2002 previously reduced by tax discharge from the earlier amended assessment made, may be added back for the purpose of paying franked dividends. This shall however apply only on due request made by companies anytime during the 5-year transitional period and subject to such requirements as CIT may impose. Such requests must be accompanied by proper reconciliation of the additional tax assessed for the YA concerned, showing clearly and accurately the breakdown of any amount of additional tax assessed into the following categories:

- (a) the amount of additional tax assessed relating to the same YA for which tax was previously discharged during the 5-year transitional period but has not been adjusted downwards (debited) against the section 44 balances as at 31<sup>st</sup> December 2002;
- (b) the amount of additional tax assessed relating to the same YA for which tax was previously discharged during the 5-year transitional period and has been adjusted downwards (debited) against the section 44 balances as at 31<sup>st</sup> December 2002; and
- (c) the amount of additional tax assessed relating to the same YA but which does not fall within (a) or (b).

46 Prior to making an additional assessment on a resident company for a YA, an amended assessment for that YA may have earlier been made at

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from an amended assessment, such section 44 charge will also not be refunded to the companies at the point of tax discharge since the excess relates to tax which has been previously assessed, credited to these companies' section 44 accounts and utilised to pay franked dividends. However, such section 44 charge can be used to set off against any tax assessed subsequently, so long as the tax is assessed prior to 1<sup>st</sup> January 2008.

different times. The tax discharged previously for that YA may or may not have been debited to the companies' section 44 accounts. For the purpose of adjusting companies' section 44 accounts, any amount of additional tax assessed for a YA (subsequent to a discharge of tax during the 5-year transitional period for that YA) will first be considered as an additional tax spelt out under paragraph 45(a) and thereafter, as an additional tax spelt out under paragraph 45(b).

### **Section 44 charge that arises during the 5-year transitional period**

47 Resulting from adjustments to the section 44 balances as at 31<sup>st</sup> December 2002, a section 44 charge may arise under certain circumstances<sup>15</sup> during the 5-year transitional period (i.e. when section 44 balances as at 31<sup>st</sup> December 2002 are insufficient for making downward adjustments). This is regardless of whether companies have remained on the imputation system or moved to the one-tier system for the purpose of paying dividends during the transitional period. In such cases, companies would have to pay the amount of section 44 charge to the CIT within 14 days from the date of dividend payment or the date the section 44 charge arises, as the case may be.

48 Any section 44 charge that has arisen under circumstances set out in paragraphs 43(a) and 43(b) can be used to set off against any tax or additional tax assessed on the companies subsequently on their normal chargeable income for any YA, so long as the tax is assessed prior to 1<sup>st</sup> January 2008 (please refer to paragraph 57 for further explanation). In other words, any section 44 charge that arises during the 5-year transitional period that is eligible for use for set off against such future tax assessed but which remains unutilised by the resident companies by 31<sup>st</sup> December 2007 would not be available for setting off against tax/additional tax assessed on or after 1<sup>st</sup> January 2008. On the other hand, any section 44 charge that arises from excess franked dividends paid<sup>16</sup> on or after 1<sup>st</sup> January 2003 shall however not be available for set off against any tax or additional tax assessed on the companies subsequently for any YA (please also refer to paragraphs 25 and 35, which also set out this requirement).

### **Circumstances under which tax discharge resulting from amended assessments made can be refunded at point of tax discharge**

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<sup>15</sup> These circumstances include:

- (a) when there is a tax discharge and the amount of tax discharged relates to tax previously assessed, credited to the companies' section 44 accounts and utilised by companies to pay franked dividends;
- (b) when normal exempt dividends paid by resident companies ought not to have been so exempted and where the balances in the companies' section 44 accounts are lesser than the amount to be debited to their section 44 accounts.
- (c) when companies paid franked dividends with tax deducted in excess of the section 44 balances as at 31<sup>st</sup> December 2002 remaining on the day before the date of dividend payment.

<sup>16</sup> This refers to a case where tax credit relating to a franked dividend is in excess of the companies' section 44 balances as at 31<sup>st</sup> December 2002, as determined on the day immediately before the date of dividend payment.

49 Under certain circumstances, at the point of tax discharge arising from amended assessments made on them, resident companies may not be entitled to refund of the tax discharge. The circumstances under which tax refund can be made at the point of tax discharge or otherwise are explained in the paragraphs below.

50 When amended assessments for any YA are made on resident companies on or after 1<sup>st</sup> January 2003, downward adjustments to their section 44 balances as at 31<sup>st</sup> December 2002 (spelt out under paragraph 43) may be required. Such companies are entitled to refund of the related tax discharge either wholly or in part (net of any tax due to the CIT) in the following circumstances:

- (a) where the amended assessments result in discharge of tax assessed for any YA that has not previously been credited to or included in their section 44 balances as at 31<sup>st</sup> December 2002, an amount equal to the tax discharge (net of any tax due to the CIT) can be refunded to the companies at the point of tax discharge; or
- (b) where the amended assessments result in discharge of tax assessed for any YA that has previously been credited to or included in their section 44 balances as at 31<sup>st</sup> December 2002 and such balances (before adjusting for the tax discharge) available at the time of the tax discharge exceed or are equal to the amount of tax discharge, an amount equal to the tax discharge (net of any tax due to the CIT) can be refunded to the companies at the point of tax discharge; or
- (c) where the amended assessments result in discharge of tax assessed for any YA that has previously been credited to or included in their section 44 balances as at 31<sup>st</sup> December 2002 and such balances (before adjusting for the tax discharge) available at the time of the tax discharge (say, \$10,000) are less than the amount of tax discharge (say, \$15,000), only the amount equal to such balances (i.e. \$10,000) can be refunded to the companies at the point of tax discharge.

51 When amended assessments for any YA are made on resident companies on or after 1<sup>st</sup> January 2003, the companies are not entitled to refund of the related tax discharge either wholly or in part in the following circumstances:

- (a) where the amended assessments result in discharge of tax assessed for any YA that has previously been credited to or included in their section 44 balances as at 31<sup>st</sup> December 2002, and such balances (before adjusting for the tax discharge) available at the time of the tax discharge are nil, the whole amount of the tax discharge would not be refunded to the companies<sup>14</sup> at the point of tax discharge ;
- (b) where the amended assessments result in discharge of tax assessed for any YA that has previously been credited to or included in their section 44 balances as at 31<sup>st</sup> December 2002 and such balances (before

adjusting for the tax discharge) available at the time of the tax discharge (say, \$10,000) are less than the amount of tax discharge<sup>18</sup> (say, \$15,000), the amount in excess of such balances (i.e. \$5,000) would not be refunded to the companies<sup>14</sup> at the point of tax discharge.

52 To determine whether a tax discharge resulting from amended assessments made within the 5-year transitional period is refundable or not at the point of tax discharge, the amount of tax discharged for a YA shall be treated in the manner prescribed under paragraph 44.

53 Annex 6 provides a summary table of the effects of payment of franked dividend (if applicable) and tax discharged, on section 44 balances as at 31<sup>st</sup> December 2002 of companies under different circumstances, as well as whether section 44 charge arises therefrom and the amount of tax to be refunded to them at the point of tax discharge during the 5-year transitional period.

54 The numerical examples in Annex 7 illustrate these effects on resident companies during the 5-year transitional period.

**RULES APPLICABLE TO UTILISATION OF SECTION 44 CHARGE  
REMAINING AS AT 31<sup>ST</sup> DECEMBER 2002 AND OF SECTION 44  
CHARGE THAT MAY ARISE DURING THE 5-YEAR TRANSITIONAL  
PERIOD**

**Utilisation of section 44 charge remaining as at 31<sup>st</sup> December 2002  
during the 5-year transitional period**

55 Currently, any section 44 charge<sup>14</sup> paid by resident companies can be used to set off against any tax assessed on them subsequent to the date the section 44 charge arises. Any section 44 charge remaining as at 31<sup>st</sup> December 2002 will continue to be available for set off against any tax or additional tax assessed subsequent to 31<sup>st</sup> December 2002 on the companies' normal chargeable income for any YA, so long as the tax is assessed prior to 1<sup>st</sup> January 2008. This set-off is available to all resident companies, regardless of whether they remain on the imputation system or have moved to the one-tier tax system for the purpose of paying dividends.

56 For example, if a company has section 44 charge of \$10,000 remaining as at 31<sup>st</sup> December 2002 and is assessed to tax amounting to \$25,000 for YA 2004 on 30<sup>th</sup> November 2004, the company can set off its section 44 charge of \$10,000 against its tax liability of \$25,000. It is only required to pay tax to CIT based on the difference of \$15,000. However, if the tax of \$25,000 is assessed on 30<sup>th</sup> November 2008, the company will not be entitled to set off the section 44 charge of \$10,000, if it remains unutilised by then, against the tax liability of \$25,000. This is because any section 44 charge remaining as at 31<sup>st</sup> December 2002 can only be utilised against tax assessed prior to 1<sup>st</sup> January 2008. In such a case, the company will be required to pay the full amount of tax (i.e. \$25,000) to CIT.

### **Utilisation of section 44 charge that arises during the 5-year transitional period**

57 Please refer to paragraphs 47 and 48 for an explanation of the circumstances under which section 44 charge may arise during the 5-year transitional period and the circumstances under which such section 44 charge can be set off against tax or additional tax assessed subsequently on resident companies on their normal chargeable income for any YA.

58 The flow diagrams in Annex 8 provide an overview of these transitional provisions on resident companies during the 5-year transitional period.

### **OTHER CONSEQUENTIAL/RELATED REQUIREMENTS AND DETAILS FOR THE 5-YEAR TRANSITIONAL PERIOD**

#### **Requirement to maintain specified accounts out of which normal exempt dividends are paid during the 5-year transitional period**

59 From 1<sup>st</sup> January 2003, normal exempt dividends (whether paid by companies which have remained on the imputation system or have moved to the one-tier corporate tax system for the purpose of paying dividends) can be distributed to all tiers of shareholders without restriction on shareholding level. However, the unlimited flow through of normal exempt dividends does not absolve the company from the current requirement to maintain specified accounts<sup>17</sup> to keep track of the balance available for payment of normal exempt dividends and the actual amount of such dividends paid.

60 As resident companies remaining on the imputation system during the 5-year transitional period for the purpose of paying franked dividends are required to fully utilise their section 44 balances as at 31<sup>st</sup> December 2002 before they are allowed to pay tax exempt(1-tier) dividends, it is thus a requirement that these companies must be able to substantiate that the exempt dividends paid by them are normal exempt dividends. To do so, the current requirement for maintaining specified accounts by companies paying normal exempt dividends will continue to apply during the 5-year transitional period.

61 The requirement to maintain specified accounts for tracking of the amount of normal exempt dividends paid therefrom would, unless otherwise advised, cease to apply from 1<sup>st</sup> January 2008 when companies remaining on the imputation system for the purpose of paying dividends in Singapore would also have moved to the one-tier system for same purpose. This is because all dividends payable by companies from 1<sup>st</sup> January 2008 would be exempt from tax in the hands of shareholders, without the need to distinguish whether such dividends are normal exempt dividends or tax exempt(1-tier) dividends.

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<sup>17</sup> The current requirement to maintain specified accounts is specified under sections 13A(6), 13B(2), 13D(2), 13E(2), 13F(5), 13H(9), 13I(1), 13K(1), 14B(3A), 14K(4) and 14M(8) of SITA, and sections 14(1), 19, 19F(1), 19L(1), 25(1), 28, 40(1), 53(1), 72, 82, 90 and 97Q(1) of the Economic Expansion Incentives (Relief from Income Tax) Act.

**Requirements for tax vouchers issued by companies during the 5-year transitional period**

62 During the 5-year transitional period, with the one-tier system operating alongside the imputation system for the purpose of paying dividends, there would basically be three categories of dividend payments. The three categories are namely:

- (a) franked dividends paid by companies that have remained on the imputation system for the purpose of paying franked dividends;
- (b) tax exempt(1-tier) dividends paid by companies that have moved to the one-tier system for the purpose of paying dividends; and
- (c) normal exempt dividends paid either by companies that have remained on the imputation system or have moved to the new one-tier system for the purpose of paying dividends.

63 As mentioned in paragraph 10, companies that have moved to the one-tier system (for the purpose of paying dividends) are required to distinguish between normal exempt dividends and tax exempt(1-tier) dividends in the tax vouchers issued to their shareholders during the 5-year transitional period. On the other hand, companies remaining on the imputation system must continue to distinguish normal exempt dividends from franked dividends in the tax vouchers issued to their shareholders during the transitional period.

64 During the 5-year transitional period, the current form of disclosing franked dividends and normal exempt dividends in the Singapore tax vouchers<sup>18</sup> would continue to apply.

65 For tax exempt(1-tier) dividends paid by companies that have moved to the one-tier system for the purpose of paying dividends on or after 1<sup>st</sup> January 2003, the amount of the dividend payment should be disclosed under the gross dividend and the net dividend columns of the Singapore tax vouchers. For the tax column of the Singapore tax vouchers, companies are required to disclose the words “exempt-1-tier”.

66 From 1<sup>st</sup> January 2008, since the tax treatment of all dividends would be the same, the requirements for tax vouchers set out in the paragraphs above would no longer be applicable then, unless otherwise advised.

**SUMMARY OF TAX EFFECTS OF ONE-TIER SYSTEM ON COMPANIES WITH EFFECT FROM 1<sup>ST</sup> JANUARY 2008**

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<sup>18</sup> The current form of disclosure in the Singapore tax vouchers are as follows:

	<u>Gross dividend</u>	<u>Tax</u>	<u>Net dividend</u>
a) Franked dividend	Amount (X)	Amount(Y)	Amount (X-Y)
b) Normal exempt dividends	Amount (Z)	“Exempt”	Amount (Z)

67 All resident companies that still remain on the imputation system for the purpose of paying franked dividends on 31<sup>st</sup> December 2007 would be required to move to the one-tier system on 1<sup>st</sup> January 2008. Any section 44 balance as at 31<sup>st</sup> December 2002 remaining on 31<sup>st</sup> December 2007 would therefore no longer be available for franking of dividends or for offsetting of any tax discharged subsequently.

68 Accordingly, with effect from 1<sup>st</sup> January 2008:

- (a) all companies in Singapore remaining on the imputation system for the purpose of paying franked dividends during the 5-year transitional period would move to the one-tier system;
- (b) all dividends payable by companies in Singapore would be exempt from tax in the hands of shareholders (there would no longer be franked dividends payable);
- (c) all corporate shareholders receiving dividends paid by companies in Singapore can onward pay the dividends to their shareholders with no restriction on the shareholding and number of tier for which such dividends can be flowed through. Unless otherwise advised, there is also no need to keep specified accounts for such purposes;
- (d) all companies in Singapore would no longer need to maintain section 44 accounts;
- (e) all section 44 charge not utilised by 31<sup>st</sup> December 2007 would not be available for set off against any tax or additional tax assessed on or after 1<sup>st</sup> January 2008; and
- (f) all tax discharged after 31<sup>st</sup> December 2007 (net of any tax due to the CIT) may be refunded to companies at the point of tax discharge without the need to refer to companies' section 44 balances as at 31<sup>st</sup> December 2002.

## **ENQUIRIES**

69 Clarifications on the contents of this circular may be directed to IRAS at 1800-356 8622.

Inland Revenue Authority of Singapore