# 1. Subject:

#### Whether:

- a. the compensation income (i.e., Dowry income) received by Company A from its parent company, Company B, qualifies for tax exemption under Section 13E of the Income Tax Act 1947 (2020 Revised Edition) ("ITA"); and
- b. the compensation expense (i.e., Dowry expense) paid by Company A to Company B can be considered a direct expense incurred by Company A under Section 13E of the ITA.

## 2. Relevant background and facts:

- Company A is a wholly owned subsidiary of Company B whose group of companies operate diversified businesses including those in the shipping industry.
- b. Company A carries on business in the shipping industry and has been awarded the Maritime Sector Incentive Approved International Shipping Enterprise ("MSI-AIS").
- c. Company A entered into novation agreements with Company B for the assignment of contractual positions for certain vessels. The novation involves the transfer of Time Charter-in ("**TC-in**") and Time Charter-Out ("**TC-out**") contracts from Company B to Company A.
- d. In connection with the novation, Companies A and B entered into a Dowry Agreement. Under the arrangement, Company A will receive from and pay to Company B, Dowry income and Dowry expenses, respectively.
- e. Company B pays the Dowry for TC-in, and Company A pays the Dowry for TC-out, to compensate the respective parties for any differences in the market rates vis-à-vis the rates stipulated in the TC-in or TC-out contracts (where applicable) listed in the Dowry Agreement. The rates stipulated in the novated TC-in or TC-out contracts are reflective of the market conditions on the contract dates.
- f. The purpose of the Dowry income is to compensate Company A for the higher charter-in expenses that would not have been incurred if not for the fixed rate committed to the vessel owners in the TC-in contracts. The purpose of the Dowry expenses is to compensate Company B for the higher charter-out income that Company A would not have earned if not

for the fixed rate committed to the vessel charterers in the original TC-out contracts.

- g. The Dowry income / expense amount were arrived at using the discounted cash flow method. The computations of the Dowry amounts are based on independent third-party valuation reports which provide approximate time charter market rates for the vessels under normal commercial terms. This is in line with the prevalent industry norm.
- h. The novated vessels that will be TC-in are intended to generate charter hire income (either through TC-out or placement in a pool) which will be recorded in Company A's profit and loss accounts. All the novated vessels are foreign-flagged and will be used by Company A for qualifying activities to derive qualifying income as defined under Section 13E of the ITA.
- i. The purpose for the novation is largely driven by genuine commercial reasons due to the unfavourable market conditions and based on a feasibility analysis conducted where Company B's head office decided to shift a certain line of business out of its country to allocate more resources to their core business. Notwithstanding this, Company B still has some existing TC-in and TC-out contracts which they are unable to terminate or novate and Company B will continue to hold on till the end of such contracts.
- j. The Dowry income and Dowry expenses were entirely received from and paid to Company B within the same financial year in which the novation agreements were entered between Companies A and B and recorded in Company A's audited financial statements for the same financial year. The contractual income and expense amount based on the TC-in and TC-out contracts will be subject to tax and claimed for deduction respectively, in the year they are derived / incurred and as per how they are recorded in the profit and loss account.

## 3. Relevant legislative provisions:

a. Income Tax Act 1947 (2020 Revised Edition) – Sections 13E and 14(1)

\_\_\_\_\_\_

## 4. The rulings:

- a. The Dowry income will be treated as qualifying for tax exemption under Section 13E of the ITA.
- b. To the extent that the income derived from the novated TC-out contracts are shipping profits qualifying for tax exemption under Section 13E of the ITA, the Dowry expense may be treated as a direct expense under Section 13E of the ITA.

c. The tax treatment in paragraphs 4(a) and 4(b) above is subject to Company A meeting all the conditions under the MSI-AIS incentive awarded.

\_\_\_\_\_

#### 5. Reasons for the decision:

- a. The novated TC-in and TC-out contracts are ordinary commercial contracts made in the normal course of Company A's shipping business. The purpose of the Dowry income is to compensate Company A for the higher charter-in expenses committed to the vessel owners in the TC-in contracts. There is a close nexus between the income to be derived from the use of vessels under the novated TC-in contracts and the Dowry income. Company A has represented that the novated vessels will be used by the company for qualifying activities to derive qualifying income as defined under Section 13E of the ITA.
- b. The purpose of the Dowry expense is to compensate Company B for the higher charter-out income that Company A would not have earned if not for the fixed rate committed to the vessel charterers in the TC-out contracts. The Dowry expense was incurred for the purpose of production of income in the course of Company A's existing income-earning operations and hence tax deductible against the income derived from the TC-out contracts.

\_\_\_\_\_\_

#### **Disclaimer**

The published summary of the advance ruling is for general reference only. It is binding only in respect of the applicant of the advance ruling and the specified transaction under consideration of the advance ruling. All taxpayers should exercise caution in relying upon the published summary of the advance ruling, as the Comptroller is not bound to apply the same tax treatment to a transaction that is similar to the specified transaction.

Please note that IRAS will not update the published ruling to reflect changes in the tax laws or our interpretations of the tax laws.