IRAS' AUDIT ON SHIPPING COMPANIES

1. Overview of Shipping Incentives

To promote Singapore as a leading International Maritime Centre, there are various tax incentives available for the maritime sector which accord tax benefits to shipping companies under the Income Tax Act 1947 ("ITA"), including:

Incentive	Tax Benefit
Section 13A of the ITA	Shipping companies operating Singapore registered ships (referred to as Singapore ships) plying in international waters will enjoy tax exemption on qualifying shipping income
Approved International Shipping Enterprise Award (MSI-AIS) under section 13E of the ITA	Approved international shipping companies will enjoy tax exemption on qualifying shipping income

2. Qualifying Income under Sections 13A and 13E of ITA

Generally, the income listed below would qualify for tax exemption as provided for under sections 13A and 13E of the ITA:

(a) Charter fees income (e.g., time charter, voyage charter, slot charter and bareboat charter)
(b) Freight income
(c) Gains on disposal of ships
(d) Income from foreign exchange and risk management activities
(e) Ship management services
(f) Mobilisation & demobilisation income, holding fees & incidental container rental income.

Any other income (e.g., interest income) will be taxable under the normal corporate tax rate ("NTR"). As such, shipping companies that enjoy tax incentives will need to correctly classify its income into the correct tax categories.

Learn more about Tax Treatment for Shipping Income.

3 Audit Review

In 2020, IRAS conducted a targeted compliance review on incentivised companies which had declared substantial losses under the NTR category as compared to the income declared under the exempt or concessionary tax rate ("CTR") category in their Income Tax Returns. It was discovered that 66% of the cases which had applied the wrong tax treatment were shipping companies with incomes exempted under section 13A and/or 13E of the ITA.

Besides the targeted compliance review in 2020, IRAS also conducts regular compliance review to ensure that information declared in the shipping companies' Income Tax Returns is accurate.

4. Audit Observations, Common Mistakes Made by Taxpayers and the Correct Tax Treatment

Based on the audit results from the compliance reviews, the following common mistakes made by shipping companies were observed:

Industry Specific Mistakes

a. Unutilised losses & capital allowances for section 13A shipping company

The unutilised losses & capital allowances pertaining to activities for which the income is exempted under section 13A of the ITA were wrongly classified under the NTR category. Such unutilised losses & capital allowances were also incorrectly carried forward to the subsequent years.

The unutilised losses & capital allowances under section 13A exempt category should be disregarded and cannot be set-off against non-exempt income of the shipping company or carried forward to future years to set-off the company's future income.

b. Incorrect classification of Shipping Income

Charter income derived from foreign ships (including a Singapore ship that has suspended its registration with the Singapore Registry of Ship) and freight income derived from goods uplifted from outside Singapore by foreign ships were wrongly treated as exempt income under section 13A of the ITA.

Only charter income derived from Singapore ships plying outside Singapore waters qualify for exemption under section 13A of the ITA. Hence, charter income derived from the foreign ship is not exempted. Singapore ship that has suspended its registration with the Singapore Registry of Ship and flying a foreign flag will be considered a foreign-flagged vessel and charter income derived therefrom is taxable at the NTR.

For foreign ships, only freight income where the goods are uplifted from Singapore and plying outside Singapore waters is exempt under section 13A of the ITA.

c. Incorrect classification of income from prescribed ship management service

Income derived from providing prescribed ship management services [refer to Income Tax (Prescribed Ship Management Services) Rules 2017] to a non-qualifying company was wrongly classified as exempt income.

For prescribed ship management services income to be exempted from tax under section 13A(1CD) of the ITA, it must be derived from a qualifying company defined under section 13A(16) of the ITA in respect of Singapore ship owned or operated by the qualifying company.

d. Incorrect identification of interest expenses

Interest expenses incurred on foreign-flagged vessel were incorrectly deducted against income under section 13A exempt category instead of NTR category.

The directly identifiable interest expenses should be attributed to income derived by that foreign-flagged vessel. Likewise, interest expense incurred on a loan obtained to finance the purchase of a vessel which derived wholly exempt income under section 13A is deductible only against the section 13A exempt income. It should not be treated as a common expense and apportioned to exempt and non-exempt income.

e. Incorrect classification of expenses

The company only derived section 13A shipping income. It only claimed direct expenses relating to the vessels under section 13A exempt category. The other gains (e.g., revenue exchange gain) and office operating expenses in connection with the company's section 13A shipping operations were wrongly classified under NTR category.

Direct expense incurred for each vessel should be directly identified and attributed to the vessels. However, should the vessel derive both tax exempt and non-exempt income, the direct expenses should be apportioned between the exempt and non-exempt tax categories using the turnover ratio of each vessel.

Common expenses (e.g., office rental, utilities, printing and stationery, audit fees etc.) that are incurred by the company should be apportioned to each income category using an appropriate basis (e.g., turnover ratio). However, common expenses should not be allocated to passive source income such as interest or dividend income.

f. Incorrect classification of capital allowances on common assets

Capital allowances on common assets were not allocated between section 13A exempt and NTR categories but were fully claimed under NTR category. This is incorrect.

Capital allowances for common assets are to be allocated based on the company's turnover ratio. When a ship derives both exempt and non-exempt income, capital allowances claimed in respect of the ship should be allocated based on the vessel's turnover ratio.

g. Incorrect computation of capital allowances on a foreign ship which was formerly registered as a Singapore ship

A company ceased to derive section 13A income as its ship ceased to be a Singapore ship. Capital allowance was computed on the ship which ceased to be a Singapore ship based on the original cost instead of the residue of expenditure ("ROE").

If the company wishes to claim capital allowance on its foreign ship which has been reflagged from a Singapore ship, capital allowance is allowable based on the ROE and not the original cost of the vessel. As provided under section 13A(11) of the ITA, the tax treatment applies notwithstanding that capital allowances had not been claimed on the original cost when the vessel was previously registered as a Singapore ship .

If notional capital allowances are computed under section 19, notional initial allowance and annual allowances must be used to derive the ROE. Capital allowances are to be computed based on the ROE thereafter.

h. Incorrect computation of balancing allowances

The company apportioned the sale proceeds from the sale of a ship to compute balancing allowance on foreign ship which has been reflagged from a Singapore ship. Balancing allowances / charges are computed under section 20(1) of the ITA. There is no specific section of the ITA to allow the apportionment of the sale proceeds.

The tax treatment of balancing allowances is similar to that of claiming of capital allowances and it will be apportioned between exempt and non-exempt income derived during the basis period on a turnover basis. If the income derived from the foreign vessel is fully assessed under the NTR category, the balance allowances computed will be fully allowed against the income under the NTR category.

However, in a scenario where the disposal of the ship resulted in a balancing charge, section 10(4) of the ITA states that the balancing charge will be deemed to be income chargeable to tax at the NTR except for the proportion of balancing charge attributed to the capital allowances that were claimed against exempt income under section 13A, 13E or 13P of the ITA (as the case may be) but only up to the amount ascertained in accordance with the formula below:

$$\frac{X * Z}{Y}$$

Where X = Amount of capital allowances claimed against any income exempt from tax under section 13A, 13E or 13P of the ITA, as the case may be;
Y = Total capital allowances claimed in respect of the ship during the period owned by the shipping enterprise; and
Z = The amount of balancing charge.

Generic Mistakes

a. Excess Medical expenses

The medical expenses in excess of the specified percentage of total remuneration were wrongly added back under the exempt category.

The excess medical expenses should be brought to tax under the NTR category as provided under section 14(6) of the ITA.

b. Incorrect claim for expenses

Wrongful claim for tax deduction on expenses which were not incurred in the production of the company's income. For example, rental expenses relating to office which was occupied by staff of holding company, private car expenses, non-trade exchange losses, provision for non-trade receivables written off and provision for unutilised leave.

5. Keeping Proper Records

It is a requirement for shipping companies to keep separate operational accounts for each of its Singapore ship and foreign ship so that the income and direct expenses of each ship can be separately identified as provided for under sections 13A(2) and 13E(5) of the ITA.

6. Voluntary Disclosures of Errors

IRAS will continue to conduct regular compliance reviews on specific industries as part of our efforts to enhance voluntary compliance of our taxpayers.

Under section 95 of the ITA, any person who negligently or without reasonable excuse makes an incorrect income tax return may be liable to a penalty as high as two times the amount of tax undercharged. Serious cases of omissions or errors may be subject to court prosecution.

Taxpayers are encouraged to voluntarily disclose errors made in their past income tax returns. Under the IRAS Voluntary Disclosure Programme, IRAS will waive the penalty for voluntary disclosures of omissions or errors that meet the qualifying conditions and are made within the 'grace period' of 1 year from the statutory filing date of 30 November. For voluntary disclosures made after the 'grace period', IRAS will impose penalty at a reduced rate of 5% per annum.