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## NEW ONE-TIER CORPORATE TAX SYSTEM

### Introduction

The Deputy Prime Minister and Minister for Finance Lee Hsien Loong announced in his 2002 Singapore Budget Statement that the current imputation tax system will be replaced by a new one-tier corporate tax system (“one-tier system”) with effect from 1 January 2003.

As the new one-tier system has certain impact on existing companies, it is proposed that there will be a 5-year transitional period for companies to move into the one-tier system.

### Current Imputation System

Singapore currently adopts an imputation system under which tax assessed on a resident company in respect of its normal chargeable income (income which is taxed at normal company tax rate) is passed on as tax credit to its shareholders upon distribution of dividends. Dividends that carry such tax credit, known as franked dividends are taxable in the hands of the shareholders. Shareholders are taxed on the gross dividends but they can set off the tax credit against their tax payable. Accordingly, the tax assessed on the resident company on its normal chargeable income is strictly not a final tax.

Illustration on current imputation system:

#### Company level

Company made a profit of \$100, assuming corporate tax rate is 22%.

	\$
Corporate profits	100.00
Corporate tax	<u>(22.00)</u>
Available for distribution	<u>78.00</u>

#### Individual shareholder level

- i. Gross dividend of \$100 declared and received by the shareholder.

	\$
Dividend received (net)	78.00
Imputation credit	<u>22.00</u>
Gross dividend	<u>100.00</u>



ii. Tax payable by shareholder.

	\$
Tax @ say 15%	15.00
Imputation credit	<u>(22.00)</u>
Repayment of tax	<u>( 7.00)</u>

Net cash received by shareholder is \$85 (net dividend of \$78.00 and tax refund of \$7.00).

Section 44 of the Singapore Income Tax Act (“SITA”) provides the mechanism for the payment of franked dividend by resident company. The provisions in Section 44 of the 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.

### **Moving to the One-Tier System**

All resident companies will move to the one-tier system at the earliest of: -

- the complete utilisation of their Section 44 balance as at 31 December 2002 [after adjusting for estimated chargeable income for the Year of Assessment (“YA”) 2003 filed by 31 March 2003] during the 5-year transitional period;
- the date of exercise of option to move to one-tier system at any time during the 5-year transitional period; or
- 1 January 2008.

If the option to move to the one-tier system is exercised, it is irrevocable. After the option, any remaining Section 44 balance will not be available for paying franked dividends.

### **One-Tier Corporate Tax System**

Under the new one-tier system, tax assessed on a company on its normal chargeable income would constitute a final tax. Dividends payable by the companies on the one-tier system are exempt from tax in the hands of the shareholders; such dividends are referred to as tax exempt (1-tier) dividends.

Any tax assessed on or after 1 January 2003 for any YA on a resident company will not form part of a resident company’s Section 44 balance.

The introduction of the one-tier corporate tax system will not alter the tax treatment of foreign dividends remitted back to Singapore. Such dividend will remain taxable in the hands of the shareholders and the applicable foreign tax credit will continue to be granted.



Illustration on one-tier tax system:

Company level

Company made a profit of \$100, assuming corporate tax rate is 22%.

	\$
Corporate profits	100.00
Corporate tax	<u>(22.00)</u>
Available for distribution	<u>78.00</u>

Individual shareholder level

Tax exempt (1-tier) dividends received	<u>78.00</u>
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Dividend received is exempt from tax in the hands of the shareholder. Net cash received by shareholder is \$78.00.

- **5-year Transitional Period**

In the absence of any transitional period, all resident companies would effectively be required to move to the one-tier system on 1 January 2003 and henceforth would not be able to utilise their Section 44 balances as at 31 December 2002 to pay franked dividends to their shareholders.

However, a 5-year transitional period is provided for resident companies with unutilised Section 44 balances as at 31 December 2002 to remain on the imputation system for the purpose of paying franked dividends.

- **Maintaining Section 44 Accounts by All Resident Companies**

During the 5-year transitional period, all resident companies are required to comply with the transitional provisions. Reference will be made to the Section 44 balances as at 31 December 2002 for the purpose of applying the transitional provision.

Companies that remained on the imputation system are required to maintain the Section 44 accounts to determine the amount of tax discharged to be refunded if any, as well as the amount of franked dividend that can be paid.

Companies that have moved to the one-tier system are required to maintain the Section 44 accounts to determine the amount of tax discharged to be refunded by the Comptroller of Income Tax ("Comptroller"). Where the tax discharged arising from an amended assessment relates to the tax assessed that is included in the Section 44 balance as at 31 December 2002 is greater than the Section 44 balance, the tax discharged to be refunded by the Comptroller will be restricted to the Section 44 balance.



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- **Adjustments to Section 44 Balance as at 31 December 2002**

As a concession, the Government has decided that any tax or additional tax assessed on resident companies' estimated normal chargeable income ("ECI") for the YA 2003, which is submitted by 31 March 2003, could be included and form part of the Section 44 balances as at 31 December 2002. This concession also applies for companies with year end earlier than 31 December, if the additional ECI for YA 2003 is submitted by 31 March 2003.

- **Types of Dividend Payable during 5-year Transitional Period**

- Franked dividends
- Normal exempt dividends  
(Out of income exempt from tax or income net of tax payable at concessionary tax rate, approved deduction or approved further deduction of expenses and foreign tax credit allowed)
- Tax exempt (1-tier) dividends

- **Normal Exempt Dividend vs Tax Exempt (1-tier) Dividend during 5-year Transitional Period**

With effect from 1 January 2003, the flow through of normal exempt dividends will be available to all tiers of shareholders and no minimum shareholding is required.

However, companies need to maintain specified accounts to keep track of the balance available for payment of normal exempt dividends. For companies under imputation system, they cannot pay tax exempt (1-tier) dividends until their Section 44 balance is nil or they have opted to move to one-tier system. They must substantiate that the exempt dividends paid by them are normal exempt dividends. There is a need to distinguish normal exempt dividends and tax exempt (1-tier) dividends in the dividend vouchers.



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## What to expect from 1 January 2008

With effect from 1 January 2008:

- All companies remaining on the imputation system for the purpose of paying franked dividends during the 5-year transitional period will move to the one-tier system.
- All Section 44 balance remaining on 31 December 2007 would no longer be available for paying franked dividends.
- All dividends payable by companies will be exempt from tax in the hands of shareholders.
- All companies will no longer need to distinguish normal exempt dividend and tax exempt (1-tier) dividend in the vouchers.
- 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 the number of tier for which such dividends can be flowed through.
- All companies will no longer need to maintain Section 44 accounts.
- All Section 44 charges not utilised by 31 December 2007 would not be available for set-off against tax assessed after 31 December 2007.
- All tax discharged after 31 December 2007 may be refunded to the companies without the need to refer to the companies' Section 44 balances as at 31 December 2002.

## Conclusion

In view of the significance of the change in tax rules, it would be advisable for the management of companies to evaluate carefully the impact of the change on both the companies and shareholders/individuals. Tax planning exercise should be carried out to identify tax planning opportunities for the companies.

<p>Important Note: The contents of this article is based on the results of our research and study and are not intended to be comprehensive. Readers are advised that the contents of this article should not be relied on or acted upon without professional advice. If you need any clarification or advice, please contact the partners, our tax manager Tang See Tha, or our tax supervisor Esther Choo. No liability can be accepted for any action taken as a result of reading this article without prior consultation with regard to all relevant factors.</p>
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