IRAS e-Tax Guide

Writing-Down Allowance on Payment for Indefeasible Right of Use

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Writing-Down Allowance on Payment for Indefeasible Right of Use

1 Aim

This e-Tax Guide[1] provides details on the writing-down allowance ("WDA") granted for the purchase of Indefeasible Right of Use ("IRU") to use an international submarine cable system.

2 At a glance

2.1 A person who has incurred capital expenditure on the purchase of an IRU can claim WDA where the international telecommunications submarine cable system is in use as at the end of the basis period for the Year of Assessment ("YA") concerned.

2.2 The WDA for each YA is computed as follows:

WDA = A/B

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

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

2.3 A balancing allowance ("BA") or balancing charge ("BC") will be determined for the YA relating to the basis period in which any of the following events occur:

(a) Where any IRU comes to an end without subsequent renewal;

(b) Where the person permanently ceases to carry on the trade, business or profession or permanently ceases to use the IRU for the trade, business or profession; or

(c) Where the person sells, transfers or assigns all or any part of the IRU.

[1] This e-Tax Guide replaces IRAS' e-Tax Guide, "Writing-Down Allowance on Payments for Indefeasible Rights of Use", published on 7 Oct 2003.

3 Glossary

3.1 Indefeasible Right of Use

This refers to an indefeasible right to use an international telecommunications submarine cable system.

3.2 International telecommunications submarine cable system

This refers to 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.

3.3 Open-market price

This refers to :

(a) the price which the IRU would have fetched if sold in the open market at the time of sale, transfer or assignment of the IRU; or

(b) such other value as appears to the Comptroller to be reasonable if he is satisfied by reason of the special nature of any IRU that it is not practical to determine the open-market price.

3.4 Person

A person includes companies, sole proprietors and partners.

3.5 Writing-down period

This refers to the number of years for which an IRU is acquired commencing with the YA relating to the basis period in which the capital expenditure for the acquisition of the IRU is incurred.

4 Background

4.1 An international telecommunications submarine cable system is often built and owned by a consortium of members (i.e. the grantor of an IRU).

4.2 The grantor may grant the right to use the 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.

4.3 The right is usually granted for a period of 10 to 25 years, often with an up-front lump sum payment.

4.4 Generally, an IRU agreement confers usage right 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.

4.5 The purchaser may be required to pay for operation and maintenance services. Depending on the terms of the contract, he may also be required to bear some of the decommissioning costs of the international telecommunications submarine cable system.

4.6 The periodic payments for the operation and maintenance services are generally revenue expenditure. These payments qualify for tax deduction in the same year they are incurred.

5 Tax treatment

5.1 The expenditure incurred by the grantor to develop and build the system qualifies for capital allowances under section 19 or section 19A of the Income Tax Act ("ITA").

5.2 The purchaser, on the other hand, is not able to claim tax deduction on the up-front lump sum payment as it is capital in nature. He is also not able to claim capital allowances as the payment does not confer the right of ownership of the international telecommunications submarine cable system. Instead, he will be able to claim WDA under section 19D of the ITA on the expenditure incurred for the purchase of IRUs over the number of years for which the IRUs are acquired.

6 How to calculate WDA on IRU payment

6.1 A person who incurs capital expenditure on the purchase of an IRU can claim WDA from the YA relating to the basis period the payment was made. This is provided that the international telecommunications submarine cable system is in use for his trade, business or profession as at the end of the basis period.

6.2 Where the expenditure is incurred before the commencement of his trade, business or profession, the expenditure shall be treated as if the person had incurred it on the first day he commences his trade, business or profession.

6.3 The person can claim an amount of WDA equal to the capital expenditure incurred on the purchase of an IRU over the number of years for which the IRU is purchased as long as he continues to hold the IRU.

6.4 The formula for calculating WDA for each YA is as follows:

WDA = A/B

where A is the capital expenditure incurred on the purchase of an IRU. This capital expenditure excludes legal fees, registration fees, stamp duty and other cost related to the acquisition of the IRU; and

B is the writing-down period for the IRU.

6.5 Annex A illustrates the computation of WDA.

7 Deferment of WDA

7.1 A person may choose to defer the WDA. 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 based on the remaining capital expenditure unallowed.

7.2 Annex B illustrates the deferment of WDA.

8 Balancing Allowance and Balancing Charge

8.1 If an IRU comes to an end without subsequent renewal or the trade, business or profession permanently ceases, a BA on the remaining capital expenditure unallowed will be given to the person for the YA relating to the basis year in which the event takes place.

8.2 If the person sells, transfers or assigns all of the IRU that he owns and the remaining capital expenditure unallowed is more than the amount or value of any consideration less any decommissioning cost (hereinafter referred to as consideration), the difference will be treated as BA. This BA will be allowed in the YA relating to the basis period in which the event takes place.

8.3 However, if the person sells, transfers or assigns all of the IRU that he owns and the consideration exceeds the remaining capital expenditure unallowed, the excess amount will be treated as a BC. This BC will be deemed as income in the YA relating to the basis period in which the event takes place. The BC will be restricted to the total WDA made previously.

8.4 Where any of the above events takes place, no WDA will be made to the person for the YA in which the event occurs or for any subsequent YA.

8.5 Partial sale, transfer or assignment of the IRU

If the person sells, transfers or assigns any part of the IRU and the remaining capital expenditure unallowed is more than the consideration, the WDA for the YA relating to the basis period the event takes place and subsequent YAs will be determined as follows:

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

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

D is the consideration of that part of the 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 occurs.

However, if the person sells, transfers or assigns any part of the IRU and the consideration exceeds the remaining capital expenditure unallowed, the excess amount will be treated as BC. This BC will be deemed as income in the YA relating to the basis period in which the event takes place. The BC will be restricted to the total WDA made previously. WDA will not be granted for the basis period in which the event occurs or for any subsequent YA.

8.6 If the person sells, transfers or assigns any part or all of the IRU at a price lower than the open-market price, the open-market price will be used instead.

8.7 Where an IRU remains with the person after the date it permanently ceases to be used for the relevant trade, business or profession, the IRU shall be deemed to have been sold at the open-market price at the date of permanent cessation of use.

8.8 The sale, transfer or assignment of any IRU which occurs after the date on which a relevant trade, business or profession permanently ceases shall be deemed to have occurred immediately before the cessation.

8.9 Annex C illustrates the computation of BA/BC.

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, the buyer and seller can elect for section 24 of the ITA.

9.2 Under section 24 of the ITA, the buyer and seller are considered to be related parties when they are under common control or where one has control over the other. When section 24 is elected, a BA or BC would not be calculated for the seller. The remaining capital expenditure unallowed immediately before the sale and the WDA will continue to be available to the buyer as if no sale had taken place.

10 Effective Date

The WDA is effective from the YA 2004.

11 Frequently asked questions

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

When a person acquires an 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 section 19A of the ITA.

11.2 What is the withholding tax treatment for payment to non-resident person for the use of international telecommunications submarine cable capacity, including payment for IRU?

Payment for the use of international telecommunications submarine cable capacity (except for payments made under IRU agreements) is treated as payment for services. Withholding tax is applicable only if the payment is made to a non-resident person who performs the services in Singapore.

On the other hand, payment for the use of international telecommunications submarine cable capacity under IRU agreement is treated as rent or other payment for the use of any movable property. This is because the payer under such arrangement possesses significant control over the physical cables as well as management and maintenance of the cables. Hence, such payment made to a non-resident person is sourced under section 12(7)(d) of ITA. However, tax exemption has been granted for the period from 28 Feb 2003 to 27 Feb 2018 (both dates inclusive).

11.3 What is the withholding tax treatment for services provided by a non-resident person under IRU agreement?

It is common for the international telecommunications 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 a payment for IRU and exempted from tax.

However, if the 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. These payments are subject to withholding tax at the prevailing corporate tax rate if they are rendered in Singapore and made to a non-resident vendor.

11.4 What is the rationale for the tax change?

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

12 Contact information

If you have any enquiries or need clarification on this Guide, please call 1800-3568622 (Corporate Income Tax).

13 Updates and amendments

	Date of amendment	Amendments made
1	24 Mar 2014	Paragraphs 8.3 and 8.5 are revised to make it clear that the BC computed will be restricted to the WDA made previously. Paragraph 8.7 is inserted to highlight that the IRU shall be deemed to have been sold at the open-market price at the date of permanent cessation of use should it remain with the person after it permanently ceases to be used. Paragraph 8.8 is inserted to highlight that any sale, transfer or assignment of IRU which occurs after the date on which a relevant trade, business or profession permanently ceases shall be deemed to have occurred immediately before the cessation. Paragraph 11.2 is inserted to highlight the withholding tax treatment for payment to non-resident person for the use of international telecommunications submarine cable capacity, including payment for IRU.

Annex A – Computation of WDA

Company Telecom ABC, with accounting year ending 31 December, bought an IRU for a period of 15 years for $1.5 million on 01.02.2014.

Telecom ABC will be able to claim WDA as follows:

WDA with effect from YA 2015	= $1,500,000/15 = $100,000

Telecom ABC will thus be entitled to claim $100,000 for each YA from YA 2015 to YA 2029.

Annex B – Deferment of WDA claim

If Company Telecom ABC (in Annex A) decides to defer WDA claim for YA 2015, YA 2018 and 2019, the WDA will be computed as follows:

Table 1:

Year	YA	WDA claimed $	Remaining Capital Expenditure Unallowed $	BA $
1	2015	-	1,500,000	N.A.
2	2016	100,000	1,400,000	N.A.
3	2017	100,000	1,300,000	N.A.
4	2018	-	1,300,000	N.A.
5	2019	-	1,300,000	N.A.
6	2020	100,000	1,200,000	N.A.
7	2021	100,000	1,100,000	N.A.
8	2022	100,000	1,000,000	N.A.
9	2023	100,000	900,000	N.A.
10	2024	100,000	800,000	N.A.
11	2025	100,000	700,000	N.A.
12	2026	100,000	600,000	N.A.
13	2027	100,000	500,000	N.A.
14	2028	100,000	400,000	N.A.
15	2029	-	-	400,000

Annex C – Computation of BA/BC
(All scenarios make reference to information in Table 1 of Annex B)

<u>Scenario 1</u>

If Telecom ABC permanently ceases business (assuming there is no transfer or sale of IRU) in year 2021 (YA 2022), then BA will be computed as follows:

BA for YA 2022
= Remaining Capital Expenditure on IRU unallowed as at 31.12.2020 (YA 2021)
= $1,100,000

<u>Scenario 2</u>

Supposing Telecom ABC transfers all of the IRU in year 2021 (YA 2022) and the consideration is $1,300,000, BC will be computed as follows:

BC for YA 2022
= Consideration – Remaining capital expenditure on IRU unallowed as at 31.12.2020 (YA 2021)
= $1,300,000 - $1,100,000
= $200,000

<u>Scenario 3</u>

If Telecom ABC transfers all of the IRU in the year 2021 (YA 2022) and the consideration is $600,000, BA will be computed as follows:

BA for YA 2022
= Remaining capital expenditure on IRU unallowed as at 31.12.2020 (YA 2021) – Consideration
= $1,100,000 - $600,000
= $500,000

Annex C (continued)

Scenerio 4

If Telecom ABC transfers only part of the IRU in the year 2021 (YA 2022), the WDA available to Telecom ABC with effect from YA 2022 will be adjusted and computed as follows:

Remaining capital expenditure unallowed as at 31.12.2020	$1,100,000
Consideration of part of IRU	$ 650,000
Number of complete years of the writing-down period remaining at the beginning of the YA in which the transfer takes place	8 years

WDA for YA 2022 to YA 2029
= ($1,100,000 - $650,000)/8
= $56,250 per YA