



Singapore Business Tax developments Committed to your success

Greetings from your Tax & Legal team at Deloitte Singapore. We hope that you and your loved ones are staying safe and healthy despite these challenging times. As we navigate ourselves through this trying period, we are committed to giving you the support you need.

We are pleased to share the following with you.

IRAS publishes summary of advance ruling on source of franchise income

The Inland Revenue Authority of Singapore (IRAS) has been publishing summaries of advance rulings applied for on or after 1 May 2019 to enhance taxpayers' understanding of the IRAS' interpretation and application of the tax legislation in specific scenarios. The summaries are published in a redacted form that does not identify the applicant, the arrangement, any other parties to the arrangement, the date of the transaction, or the transaction values. The first summary was issued on 30 April 2020 and the IRAS has since issued further summaries on a periodic basis.

This newsletter considers an advance ruling published on 1 April 2021 on the important topic of the source of franchise income.

Background to the ruling

The IRAS was requested to issue an advance ruling on the source of franchise income derived by a newly incorporated Singapore company (Company A) under a franchise agreement with a non-Singapore resident affiliated company (Company C).

The brief background is as follows:

Group X is one of the world's largest technology suppliers in certain industry. Company B, a company incorporated and operating outside Singapore, is a subsidiary within the group. Company B owns the legal and economic rights to certain intellectual property

(IP) and other intangible assets. In addition, Company B has entered into a franchise agreement with a related company (Company C), and both Company B and Company C are incorporated and operate outside Singapore. Under the agreement, Company C will have the rights to operate certain elements of the group's business model and the use of Company B's IP rights.

As the result of an internal organisational restructuring, Company A will be incorporated in Singapore to assume the role of Company B. Company A will acquire the legal and economic rights to the IP and other intangible assets from Company B, as well as all the rights related to Company B's franchise agreement signed with Company C.

Company A will replace Company B and be responsible for all activities currently conducted by Company B as the owner of the IP rights, including activities related to the franchise agreement. Following the restructuring, Company A will derive franchise income from Company C under the franchise agreement.

To enable Company A to replace Company B in its role and responsibilities without disrupting the global relations and transactions of Group X, the activities of Company A will include the following:

Outside Singapore	In Singapore
<ul style="list-style-type: none"> • Company A will maintain similar contracts to those that Company B has with affiliated and unaffiliated companies necessary to carry out its activities as the owner of the IP rights. All significant operational management and decision making as the owner of the rights will be performed outside Singapore by nonresident employees. • All management activities with regard to portfolio evaluation and adjustment, process improvement, asset enhancement, business development, sales and marketing, etc. will be performed outside Singapore by affiliated entities. • All contracts relating to the IP rights will be negotiated and executed outside Singapore. 	<ul style="list-style-type: none"> • Company A will establish Singapore tax residency by ensuring that its board of directors (board), a majority of whom will be Singapore residents, will hold their meetings in Singapore where all material strategic decisions regarding the direction of Company A's activities conducted outside Singapore will be made. • Company A will employ a managing director (MD) in Singapore, together with a small number of supporting staff. The MD's main responsibilities will include: <ul style="list-style-type: none"> – Monitoring the franchisee's compliance with the terms and conditions of the franchise agreement and reporting any noncompliance to the board; – Providing regular reports to the board and the board's designated agents outside Singapore responsible for the day-to-day management of the company's operations; – Providing quarterly updates to the board and monthly updates to the board's designated agents outside Singapore responsible for the day-to-day operations with regards to the franchisee's performance;

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- Ensuring that the company meets the required performance standards under all agreements with its affiliates and third parties, including by monitoring and reporting on contract performance and immediately notifying the board or the board's designated affiliate outside Singapore tasked with addressing noncompliance and contract enforcement of any issues;
 - Maintaining the company's books and records;
 - Establishing annual budgets and the company business plan; and
 - Developing long-term staffing plans, as required.
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IRAS ruling

The IRAS is of the view that the franchise income derived by Company A is sourced in Singapore and taxable on an accrual basis. Relevant factors considered by the IRAS in reaching its decision include:

- Company A intends to establish Singapore tax residency by ensuring that the board holds its meetings in Singapore where all material strategic decisions regarding the direction of its activities carried out outside Singapore will be made;
- The active management of the franchise agreement, regular monitoring of the agreement, and provision of updates to Company A's board will be performed in Singapore by Company A's MD supported by the Singapore staff;
- Company A will be the legal and economic owner of the IP rights; and
- Company A will be the entity that signs the franchise agreement, although the contract will be signed outside Singapore.

Deloitte Singapore's views

Determining the source of income is important as this will affect the time at which the income becomes taxable. Singapore-sourced income is taxed on an accrual basis; whereas foreign-sourced income is not taxed until the income is remitted or deemed remitted to Singapore.

Nevertheless, establishing where income is sourced may be subject to significant uncertainty in practice. The "operations test" generally is used to determine whether income from a business is sourced in Singapore; if business operations are conducted in Singapore, income from such operations generally is considered sourced in Singapore.

The IRAS' ruling may be particularly relevant for multinational enterprises (MNEs) with a significant operational presence outside Singapore that are looking to relocate their IP rights to Singapore.

One of the key takeaways from the advance ruling is that if a Singapore company is treated as resident in Singapore for tax purposes, and the top-level management activities relating to the IP rights are performed in Singapore, franchise income from the exploitation of the IP rights may be considered "sourced in Singapore." Consequently, such income would be subject to Singapore tax on an accrual basis as opposed to a remittance basis.

However, what is not clear from the ruling is whether these criteria apply equally both to companies that are in the active business of managing IP and companies that are merely holding the IP rights to derive passive income, although in this case, it appears that Company A would more likely than not be considered as being in the active business of managing the IP rights. The ruling also does not address whether Company A would be eligible to claim writing-down allowances under section 19B of the Income Tax Act in respect of capital expenditure incurred on the qualifying IP rights.

MNEs with IP holding companies in Singapore that derive passive IP income and conduct limited activities in Singapore may wish to review the tax filing position they have adopted in respect of that income (e.g., whether such passive-sourced income can be considered as being sourced outside Singapore and hence taxable on a remittance basis). Going forward, the IRAS may seek more information on the actual management and decision making process undertaken in relation to IP rights held, as well as the geographic location of those management and decision making processes so as to determine whether the IP income should be considered sourced in Singapore. Whilst the IRAS' ruling is not binding on other taxpayers, taxpayers potentially affected by the ruling may wish to assess whether their IP holding activities in Singapore are aligned with the expected tax outcome.

Contacts

For more information on the above or any other matters, please contact any of the listed contacts below, or any member of the [Singapore Tax & Legal team](#).

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