

1. Subject:

The taxability of the additional founding shareholder consideration received by the sellers from the disposal of the company's shares.

2. Relevant background and facts:

- a. The Singapore company, Co A, was founded by three individuals who were major equity shareholders. The three founding shareholders together with the company's institutional and individual investors entered into a Sale and Purchase Agreement ("SPA") with a company (the "Buyer") incorporated overseas. Pursuant to the SPA, the founding shareholders and other shareholders transferred all the equity shares and preference shares held by them in the company to the Buyer.
- b. The total consideration for the takeover was based on a valuation up to \$M, consisting of an initial payment and additional founder consideration of \$X. According to the SPA, the additional founder consideration of \$X is divided into eight equal tranches, each tranche is contingent upon meeting specific quarterly gross sales value over the next two years following the takeover. For example, if Co A achieves target sales of \$Y million for a specific quarter, the founding shareholders will be entitled to 1/8 of \$X. Subsequently, the founding shareholders will be entitled to an additional 1/8 of \$X for each subsequent quarter in which the company meets a specific incremental of \$Y million in sales, and so on.
- c. In connection with the share transfer from the founding shareholders to the Buyer, the Buyer had paid stamp duty based on the total consideration i.e. the founding shareholders' share of initial payment and additional founder consideration \$X.
- d. Under the SPA, the founding shareholders are subject to additional representations and warranties and restrictive covenants (non-compete clauses).
- e. To ensure a smooth transition and continuity of operations, a 2-year new employment contract was entered into by Co A with each of the founding shareholders. They were appointed as directors of the company with a remuneration package that was adjusted higher than the compensation paid to them by the company before the takeover. The adjustment of salaries was to align with the salary range of other employees in the same rank within the group companies of the Buyer.

- f. Over the 2-year period, Co A met the gross sales target for two relevant quarters. As a result, the founding shareholders are entitled to a total one-quarter of \$X, while the remaining three-quarters of \$X are forfeited.
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3. Relevant legislative provisions:

- a. Income Tax Act 1947 (Revised Edition 2020) ("ITA") – Section 10(1)
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4. The ruling:

- a. The one-quarter of \$X received by the founding shareholders is part of the sales consideration for the transfer of shares in Co A and it is capital in nature.
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5. Reasons for the decision:

- a. The terms of the Sale & Purchase Agreement demonstrate that \$X is part of the valuable consideration given for equity shares in Co A.
 - b. The documents of negotiation between the seller and buyer indicate the relevant quarterly gross sales targets for the payment of \$X.
 - c. The stamp duty paid for the transfer of shares was based on the total consideration which includes \$X.
 - d. The founding shareholders would still be entitled to part of \$X if certain conditions stipulated in the SPA were breached, regardless of whether the gross sales targets were met.
 - e. The founding shareholders were separately remunerated at arm's length for their services under the 2-year employment contract. There was no personal performance targets incorporated in the payment of additional founder consideration.
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