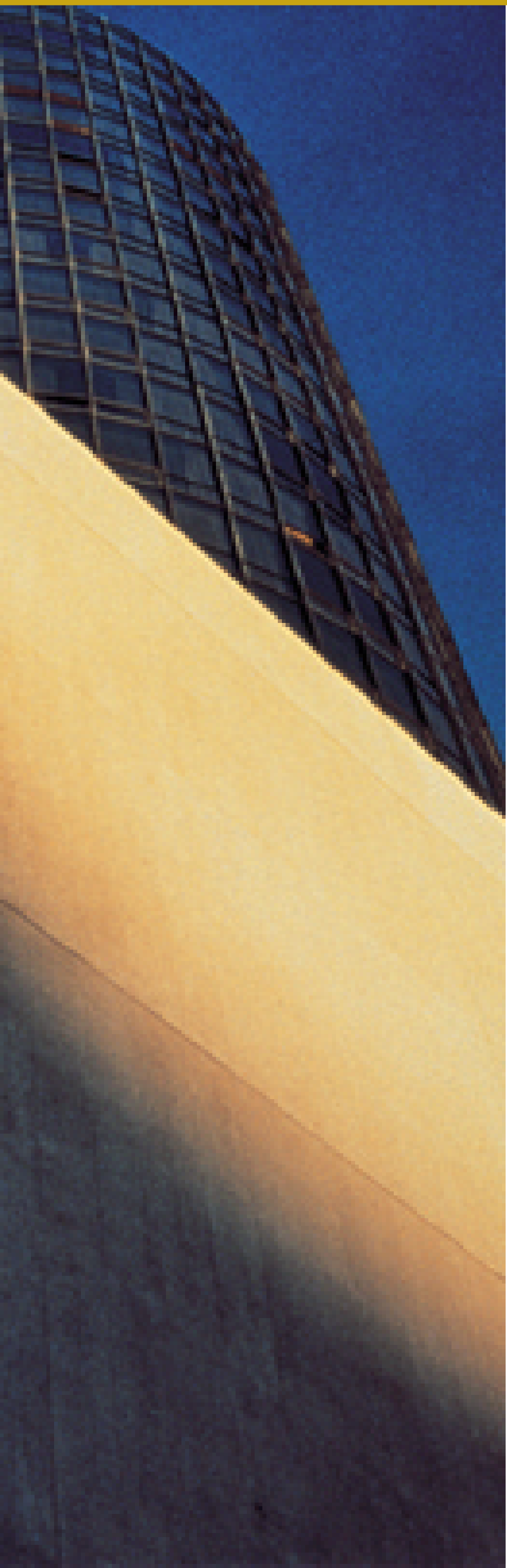
2001 Singapore

Budget Commentary

24 February 2001



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PRICEWATERHOUSECOOPERS

Introduction

A reduction of personal and corporate tax rates. Tax concessions for chargeable income of businesses below $100,000. A 10 per cent rebate on personal taxes. Largest ever rebates on utilities and rents for Housing & Development Board (HDB) flat dwellers. Tax benefits on Central Provident Fund (CPF) contributions for the self-employed. A reduction in the property tax rate. Help for HDB shopkeepers to upgrade. In total, the Government expects to forgo over $2 billion in taxes. Singapore will be an even better place to do business in, invest in, work in and live in.

Election watchers point to this as an Election Budget. This may be so, but it is much more than that. Whilst the Government is prepared to forgo over $2 billion as a result of its pro-business and pro-people Budget, this should be viewed in conjunction with the Government's intention to contribute another $500 million to its Lifelong Learning Endowment Fund, to increase its spending on education by almost the same amount, and to spend $625 million on its research and development programme.

To quote Dr Richard Hu, the Minister for Finance, the objective of the 2001 Budget is, "at the micro level, to give every individual the wherewithal to weather this difficult but necessary period of transition to this new stage of economic growth, to assist promising business enterprises in getting established, and to help businesses in dying trades shift to other industries".

Education and re-training is the key.

At the macro level, the main thrust of the Budget is "to position Singapore for a new era of growth", and for the challenges of the global economy in the new millennium. With competitiveness a recurring theme, we should be mindful that the global economy is not some place overseas, but already at our doorstep, if not in our living room.

Company and Business Taxation

Changes to the corporate tax regime

In accordance with the Government's commitment to promote the growth of private enterprises, and quite against pre-Budget expectations, the Minister for Finance announced the introduction of a new corporate tax regime.

Whilst Singapore has in recent years enjoyed a comparatively low corporate tax rate, it was noted that many developing countries have been gradually lowering their rates in order to stimulate and attract investment. Singapore needs to follow suit in an attempt to retain its competitive edge.

The principal thrust of the changes is a reduction in the basic corporate tax rate to 24.5 per cent from the current 25.5 per cent. This change will take effect from year of assessment 2002. A comparison of Asia-Pacific corporate tax rates is shown in Appendix A.

The Minister has gone further than a simple rate cut, however. With effect also from year of assessment 2002, three-quarters of the first $10,000 and one half of the next $90,000 of a company's chargeable income will be exempt from tax entirely. Dividends from Singapore companies will continue to be taxable at the basic corporate rate – 24.5 per cent going forward. It should be noted that, while the target of these changes is the small local business, they apply to all companies across the board.

The new rate of 24.5 per cent will also apply in the following situations:

a) income earned by non-residents (other than those subject to the 15 per cent final withholding tax); and

b) income of trustees (other than trustees for incapacitated persons) and executors.

Dividends paid by Singapore companies in the period between 1 January and 23 February 2001 where tax was deducted at 25.5 per cent will need to be regrossed at the new rate, with corresponding adjustments to the company's dividend franking account.

A simple example to demonstrate how the tax will be computed when a taxable Singapore dividend is received is given below:

Example

Company XYZ Pte Ltd has trading income of $30,000, rental income of $40,000, a gross dividend of $2,000 and attributable expenses of $250.

Computation of tax payable for Company XYZ for year of assessment 2002 would be as follows:

	$	$
Trade income		30,000
Gross dividend (Singapore)	2,000	
Less:		
Allowable expenses	(250)	
		1,750
Rental income		40,000
		71,750
Less:		
Exempt amount (see note)		(37,500)
Chargeable income		34,250
Tax assessed at 24.5%		8,391.25
Less: Tax deducted at source		(490.00)
Net tax payable		7,901.25

Note: Computation of exempt amount for normal chargeable income, excluding Singapore dividends (i.e. $30,000 + $40,000 = $70,000).

On the first $10,000, 75% of the income	*7,500*
On the next $60,000, 50% of the income	*30,000*
Total exempt amount	*37,500*

The computation becomes significantly more complex when tax losses and other allowances are introduced, because of the need to apportion these against the dividends. The IRAS has produced an array of examples demonstrating the various permutations. These can be accessed at their website at *http://www.iras.gov.sg.*

The changes raise a number of interesting issues. Prior to the Budget, commentators had been widely convinced that a basic rate reduction was unlikely, and a stepped exemption was not even considered. A reduction was thought unlikely for two main reasons.

The first was that the Singapore tax system operates on a full imputation basis, which is to say that corporate tax is merely a prepayment of a shareholder's tax liability on the corporate profits when distributed as dividends. Thus, a simple rate reduction would do nothing more than reduce the amount of that prepayment, and it would be neutralised as soon as a dividend was paid.

For shareholders in small companies - the principal target of the changes - there would be little advantage in a straight rate cut if profits had to be extracted anyway for survival purposes. On the assumption, however, that the exempted profits will remain exempt from Singapore tax through into the hands of the shareholder (a fair assumption given ample precedent in existing legislation relating to exempt profits), the stepped exemption neatly resolves the issue.

The annual tax savings in the company, assuming chargeable income in excess of $100,000, will be $12,862.50 per annum. The annual tax savings for the shareholder ultimately of course will depend on his marginal rate of personal tax.

The second reason for scepticism over a rate reduction was that an effective corporate rate of 25 percent or below would mean that Singapore subsidiaries would become Controlled Foreign Corporations (CFCs) in relation to their overseas shareholders, most notably in Japan.

CFC legislation is designed essentially to ensure that residents of that country cannot defer home-country taxes by placing assets offshore, and sheltering the income from them, at lower tax rates, in a foreign jurisdiction. The principal effect of the rules, where they apply, is that home-country tax will be imposed on the income earned by the CFC as it arises (known as income attribution). This accelerates the imposition of home-country taxes, which in the absence of such rules would not be chargeable until the income was brought home in the form of dividends, or capital gains from the disposal of the investment. With current corporate tax rates in Japan running at a little over 42 percent, being caught under CFC legislation could have quite a dramatic impact.

At a practical level, however, although the changes may mean that all subsidiaries of Japanese companies will become CFCs, attribution of income is not automatic. Provided the subsidiary is carrying on bona fide trading transactions within Singapore, and subject to certain other conditions in particular cases, attribution will not occur.

Nevertheless, by bringing all subsidiaries within the ambit of the rules, where they are "guilty until proven innocent", a significant additional layer of reporting and administration is likely to result. The Minister may have decided, however, that the long-term benefits of lowering tax rates, overall, outweigh the short-term disadvantages. This bold step may have been taken in the light of expected tax rate reductions amongst the developed nations going forward.

One notable feature left out of the announcement was whether there would be any associated company rules that would prevent income splitting to take advantage of the exemption bands. These may be worked into the legislation when it is produced.

On a comparative basis, chargeable income of about $150,000 can now be earned by a Singapore company before the effective tax rate reaches the 16 per cent imposed on corporate profits in Hong Kong.

Exemption from withholding tax for software payments

Software payments are generally treated as royalty payments by the IRAS. Hence, where such payments are made to non-residents, they are generally subject to Singapore withholding tax at 15 per cent or a lower rate if provided for under any applicable Double Taxation Agreement.

However, where the agreement between a local purchaser and a non-resident vendor provides that the purchaser should bear all taxes, then any withholding tax due will significantly increase the cost of the software.

Currently, local businesses are not required to withhold tax on payments for "shrink-wrap" software made to non-residents on or after 1 January 2001, in accordance with guidelines issued by the IRAS on 29 December 2000.

In order to create a conducive environment for the growth of e-commerce in Singapore, encourage businesses to make use of the best technology available, and lower the cost of operating in the new economy, the Minister for Finance has proposed an extension to the scope of the withholding tax exemption to include other categories of software payments made to non-residents on or after 23 February 2001.

Payments for the following now qualify for exemption:

- site licences, including payments for maintenance and support services incidental to the purchase of the software;
- software downloaded from the Internet by end-users; and
- software bundled with computer hardware.

Payments made to non-residents for the right to reproduce the software will continue to be subject to Singapore withholding tax.

Based on a reading of guidelines issued by the IRAS following the Budget speech, the qualifying criteria for exemption appears to be that the software payments in question do not give the user the right to copy the software, modify or "reverse engineer" the program. They are, in essence, an extension of the "shrink-wrap" concept.

Whilst the exemption will cover payments made for the support and maintenance of the installed software, it will not apply to additional services acquired to customise the software, develop applications using it, or for subsequent maintenance contracts. Generally speaking, this may not be an issue if the services are performed outside of Singapore, or under the protection of a Double Taxation Agreement.

As the exemption will be given under Section 13(4) of the Singapore Income Tax Act, generally, there should be no requirement for prior approval.

Further details in this respect are provided in the IRAS guide available at *http://www.iras.gov.sg*.

Writing-down allowances for intellectual property

Currently, any person carrying on a manufacturing trade is eligible to claim writing-down allowances at 20 per cent per annum, straight line, over a five-year period on capital expenditure incurred in acquiring any approved know-how or patent rights for the purpose of the trade. These allowances are given under Section 19B of the Singapore Income Tax Act.

To boost Singapore's competitiveness in a knowledge-based economy through the acquisition and increased exploitation of various types of intellectual property, the Minister for Finance has proposed an extension to the current tax incentive scheme. Writing-down allowances will now also apply to the following categories of intellectual property acquired on or after 23 February 2001:

a) Patents;

b) Copyrights and Related Rights;

c) Trade Marks;

d) Registered Designs;

e) Geographical Indications[1];

f) Layout Designs of Integrated Circuits; and

g) Protection of Confidential Information[2].

The allowances will also be available to a wider range of industries and not restricted, as at present, to the manufacturing sector.

The scheme has been announced as an extension to the scope of the current incentive, and will likely involve an extension to the list of approved categories in Section 19B, with a broadening of the industry range to which that Section will apply. On this basis, it is likely that approval will be required for the allowances to apply, as was previously the case. Details of the industries that will qualify for this incentive will be released shortly.

1 This means any indications that identify goods as originating from a particular territory, or a region or locality in that territory, where a particular quality, reputation or other characteristic of the goods is essentially attributable to its geographical origin.

2 Confidential information includes trade secrets, privileged information and other materials exempted from disclosure under the domestic laws of any particular country.

Personal Taxation

Tax rebate for year of assessment 2001

The individual income tax rates for year of assessment 2001 remain unchanged. However, a one-off tax rebate of 10 per cent has been announced. This is up from the 5 per cent rebate for the previous year of assessment. A comparison of Asia-Pacific individual tax liabilities is shown in Appendix B.

Changes for year of assessment 2002

Reduction in tax rates

To encourage individual effort and help Singapore retain its local talent and attract new foreign talent, the Minister for Finance proposed a reduction in personal income tax rates with effect from year of assessment 2002. These changes apply to tax residents only. The tax rates for all bands will be reduced by between two and five percentage points. The top marginal tax rate will be reduced to 26 per cent from 28 per cent. The reduction in tax rates will benefit both the low and high income earners. In percentage terms, lower-income and middle-income taxpayers are likely to benefit most as the reduction in tax rates has the greatest impact on taxpayers up to the chargeable income of $150,000. Thereafter, the tax rate reduction settles at 2 per cent per chargeable income band. Nevertheless, a 2 per cent reduction in the top marginal rate still represents a welcome respite for high income earners. A comparison of resident individual tax rates for years of assessment 2001 and 2002 is shown in Appendix C.

GST rebate

The GST rebate will, however, be reduced to $250 from $500 for year of assessment 2002.

Tax deduction for donations of shares

Under current Singapore tax law, cash donations made to an approved institution of a public character in Singapore are allowable as a tax deduction. To encourage greater sharing of wealth, the tax deduction has been extended to charitable donations made by individuals in the form of shares which are listed on the Singapore Exchange (SGX) and unit trusts readily marketable in Singapore. The concession will apply to donations made from January 2001.

Changes to Central Provident Fund contributions

Contributions by the self-employed

The employer's CPF contribution rates were increased to 16 per cent from the current 12 per cent with effect from 1 January 2001. The CPF contribution rates with effect from 1 January 2001 for employees aged 55 and below are summarised in the following table:

	Employer %	Employee %	Total %
Singapore citizens and permanent residents	16	20	36
New permanent residents			
First year	4	5	9
Second year	12	15	27
Third year	16	20	36

To encourage self-employed persons to save more for old age, the tax exemption for CPF contributions has been increased to 36 per cent from the current 20 per cent of their trade income subject to certain income limits. This change takes effect from year of assessment 2002.

The change means that tax deductions available to the self-employed will be brought more in line with those of employees. However, there is as yet no bonus component built in which is an advantage the employee still enjoys over his self-employed counterpart. Employee contributions of 20 per cent and employer contributions of 16 per cent are not taxable. Under the current rules, the maximum deduction available to the self-employed persons is 20 per cent of their trade income or $14,400, whichever is lower. With this change, the maximum relief will be increased to 36 per cent of their trade income or $25,920, whichever is lower.

Top-Up Scheme

Eligible Singaporeans received the first payment of the $500 to $1,700 CPF Top-Up in January 2001. The second payment will be given out within the next 12 months.

Company Stock Option Plan

In an effort to help companies in Singapore succeed in attracting, motivating and retaining talent, the Singapore Government has been gradually introducing and enhancing qualifying employee incentive schemes to make performance-linked compensation more attractive.

In May 2000, the Minister announced the "Entrepreneurial Employee Stock Option Plan" (EESOP) where 50 per cent of stock option gains is exempted from income tax for employees of certain qualifying companies. In his Budget Speech, the Minister for Finance introduced an additional scheme known as the "Company Stock Option Plan" (CSOP). The purpose of this scheme is to extend the partial tax exemption on stock option gains to a greater range of qualifying companies.

Under the CSOP, income tax exemption will be granted for up to $1 million worth of stock option gains arising from the exercise of the employee's options over a 10-year period. Of the $1 million, the first $2,000 and 25 per cent of the remainder per annum will be granted tax exemption.

Subject to certain conditions being met, the CSOP will be available to all companies. One of the key conditions for qualifying for the scheme is that companies have to offer the stock options to at least half of their employees. The scheme will be available to options granted with effect from 1 April 2001.

A table comparing the EESOP and CSOP is provided on page 8.

Property Tax

Reduction of rate

In an attempt to contain business costs, and in conjunction with the removal of the 25 per cent tax rebate for commercial and industrial properties on 1 July 2001, a reduction in the property tax rate to 10 per cent from 12 per cent was announced.

The main beneficiaries of this change will be landlords of non-owner occupied residential properties. They will enjoy the full effect of the change. Landlords of industrial and commercial properties will see their effective rates rise by 1 per cent, compared with 2000/2001, from 9 per cent (12 per cent rate less 25 per cent rebate) to 10 per cent.

The 4 per cent rate for owner-occupied residential properties remains unchanged.

Recent Developments

The last year has seen some significant tax changes and guidelines issued by the IRAS which included :

a) Income tax and GST changes
- Share buybacks through a special trading counter;
- Entrepreneurial Employee Stock Option Plan:
- Impact on e-commerce transactions;
- Withholding tax exemption for shrink-wrap software payments; and
- Supplementary Retirement Scheme.

b) Stamp duty changes
- Relief for the transfer of assets between associated companies; and
- Elimination of certain restrictions under Section 15 of the Stamp Duties Act.

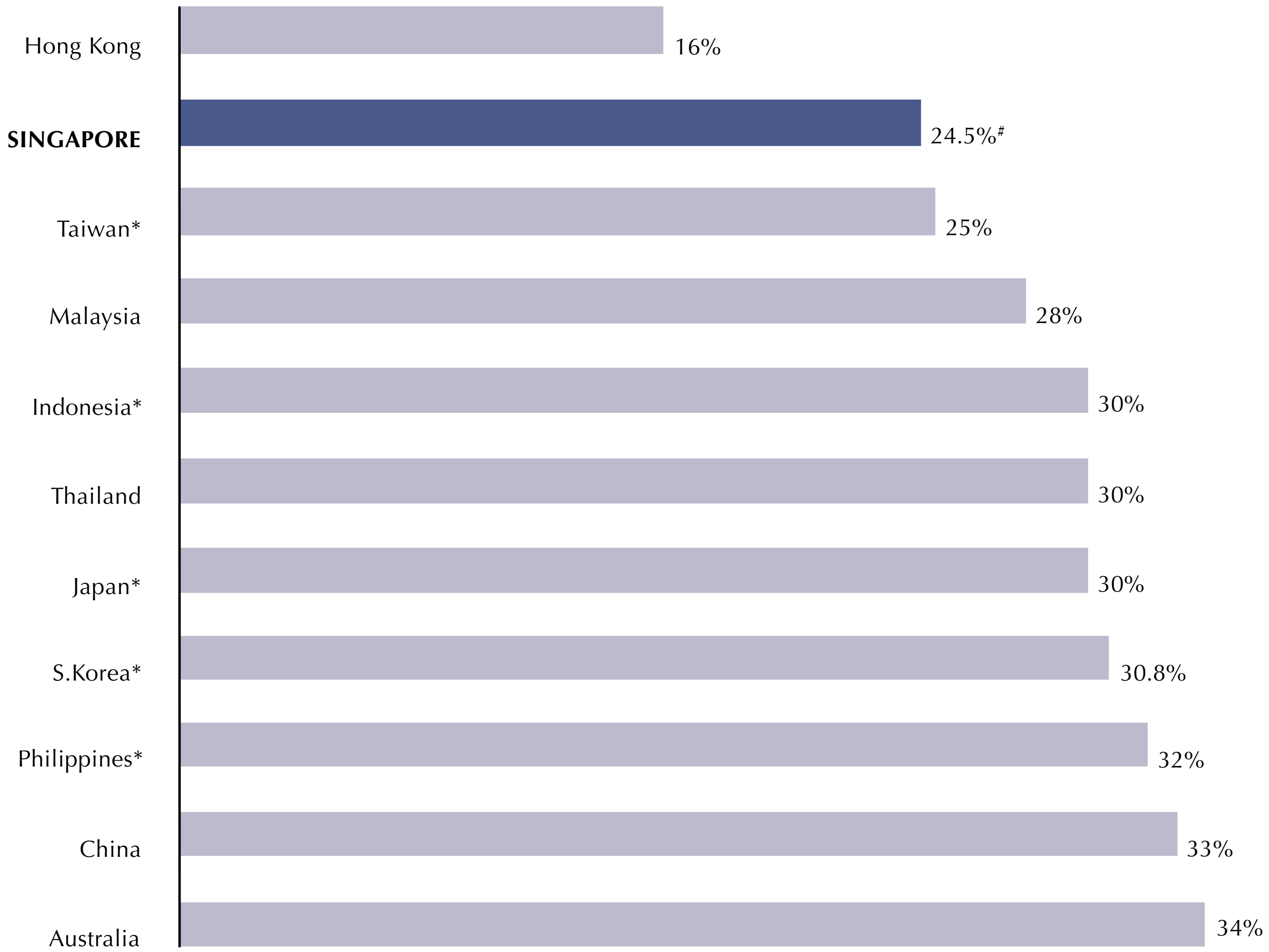
For details on the above, please refer to our recent publications or articles which can be found at *http://www.pwctax.com* or contact us directly.

A comparison of the EESOP and CSOP

	EESOP	CSOP
Tax Implications	50 per cent tax exemption on stock option gains up to $10 million over a period of 10 years for options with exercise price pegged to market value at date of grant. 50 per cent tax exemption less the amount of discount enjoyed for options with exercise price less than market value at date of grant.	Up to $1 million of gains from the exercise of CSOP over 10 years with 100 per cent exemption on the first $2,000 and 25 per cent of the remainder per annum.
Effective Date	For options granted on or after 1 June 2000.	For options granted on or after 1 April 2001.
Conditions		
(a) Share Scheme	– Must satisfy SGX vesting period requirement. Exercise price = market value at date of grant: 1 year vesting Exercise price < market value at date of grant: 2 year vesting	– Same as EESOP.
(b) Qualifying Company	– Must be Singapore incorporated company with gross assets not exceeding $100 million at date of grant.	– Company need not be incorporated in Singapore and there is no capital size restriction. – Must offer CSOPs to at least 50 per cent of staff in the company.
(c) Qualifying Employee	– Must be exercising employment with the qualifying company at grant of option. – The total committed working time per week with the qualifying company must be at least 30 hours or 75 per cent of his total working time per week at time of grant. – Must not have effective control of the company at time of grant.	– Can be any employee of the company including part-time employees and executive and non-executive directors. (Full details will be released by the IRAS at a later date.)

Appendix A

Comparison of Asia-Pacific corporate tax rates (for income year 2001)



Note: Certain rates include local/resident surtax (e.g. China & S. Korea). In addition to the basic corporate tax, some of the countries (e.g. Japan) have additional income related taxes such as provincial, inhabitants, enterprise or municipal tax and undistributed income tax.

* Lower rates of tax apply to income below certain levels

\# Certain tax exemptions apply (refer to main commentary)

Appendix B

Comparison of Asia-Pacific individual tax liabilities (a married man with two children for income year 2000)

	Total Remuneration US$75,000 **Tax Liability US$**	**Effective Tax Rate** **%**	**Total Remuneration US$100,000** **Tax Liability US$**	**Effective Tax Rate** **%**	**Total Remuneration US$200,000** **Tax Liability US$**	**Effective Tax Rate** **%**
Singapore	6,987	9	11,937	12	34,538	17
Hong Kong	5,383	7	9,633	10	26,633	13
India	25,652	34	34,427	34	69,527	35
Indonesia	20,970	28	28,361	28	57,923	29
S. Korea	14,460	19	24,314	24	68,314	34
Malaysia	16,795	22	24,045	24	53,045	27
Myanmar	11,250	15	15,000	15	30,000	15
China	15,869	21	23,730	24	65,104	33
Philippines	22,991	31	30,991	31	62,991	32
Taiwan	9,458	13	16,759	17	53,483	27
Thailand	17,456	23	24,956	25	61,802	31
Vietnam	16,604	22	26,604	27	76,431	38

Notes

1. *Deductions for Social Security are not taken into account unless the contributions are compulsory by law.*
2. *Standard deductions are taken into account.*

Appendix C Comparison of resident individual tax rates

	Chargeable Income	Year of assessment 2001		Year of assessment 2002		Tax Savings
		Rate	Tax[1]	Proposed Rate	Tax[2]	
	$	%	$	%	$	$
On the first	7,500	2	0.00	0	0.00	0.00
On the next	12,500	5	197.50	3	125.00	72.50
On the first	20,000		197.50		125.00	72.50
On the next	15,000	8	1,080.00	6	900.00	180.00
On the first	35,000		1,277.50		1,025.00	252.50
On the next	15,000	12	1,620.00	9	1,350.00	270.00
On the first	50,000		2,897.50		2,375.00	522.50
On the next	25,000	16	3,600.00	12	3,000.00	600.00
On the first	75,000		6,497.50		5,375.00	1,122.50
On the next	25,000	20	4,500.00	15	3,750.00	750.00
On the first	100,000		10,997.50		9,125.00	1,872.50
On the next	50,000	22	9,900.00	18	9,000.00	900.00
On the first	150,000		20,897.50		18,125.00	2,772.50
On the next	50,000	23	10,350.00	21	10,500.00	(150.00)
On the first	200,000		31,247.50		28,625.00	2,622.50
On the next	200,000	26	46,800.00	24	48,000.00	(1,200.00)
On the first	400,000		78,047.50		76,625.00	1,422.50
On income above	400,000	28		26		-0.8% of the excess over $400,000.

[1] *Net of one-off 10% rebate and GST rebate of $500.*
[2] *Net of GST rebate of $250.*

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