Budget Commentary

2004 Singapore

27 February 2004

(Re)enter the Dragon

Little was expected of this year's Budget in terms of fiscal handouts, although there was some surprise that the reduction in the top tax rate to 20 per cent for individuals was mothballed for the time being. The recommendations of the Economic Review Committee (ERC) in 2002 were already largely in place and all that was anticipated was a bit of tinkering around the edges to make sure things kept on course.

It was not all gloom and doom for individuals however, as they now enjoy full tax exemption for foreign-sourced income as well as exemptions on a significant array of financial instruments and investment products in Singapore.

On the corporate side, the financial services sector probably enjoyed the greatest attention although that would not have been evident from the Budget Speech. Most of the detail was consigned to the Appendices. The unit trust industry will have done particularly well in the context of an increase in the scope of exempt transactions and in the tax exemptions for individuals, and much needed special provisions to cater for securitisations must be applauded.

The real thrust of the Minister for Finance's message however was the dwindling population. With a mere 36,000 Singaporean births last year, the younger generation is finding itself numerically challenged, and drastic action is needed to return to the replacement level that even the Dragon year spike of 2000 could not quite reach. No specific measures were outlined in the Speech, however suggestions were made as to how the issue might be tackled on a number of fronts. A working committee has been lined up to report back by National Day with its recommendations. Its job will be to see that 2012 produces a raging dragon, not a tiny lizard.

Budget Commentary

2004 Singapore

27 February 2004

Contents

2004 Budget changes

Corporate and personal tax rates 3
Exemption of foreign-sourced income for Singapore resident individuals 3
Exemption of Singapore-sourced investment income for individuals 4
The entrepreneur 6
Financial services incentives 6
Other incentives 8
Reduction in royalty withholding taxes 9
Topping up the top-up 9
Estate Duty enhancements 9
Building the next generation 9
Goods and Services Tax round up 10
Other changes 12

Appendices

A. Comparison of Asia-Pacific corporate tax rates 13
B. Comparison of Asia-Pacific individual tax liabilities 14
C. Resident individual tax rates 15

2003 in retrospect

Foreign currency matters 16
Clarification on the one-tier taxation system 16
Financial Sector Incentive Scheme 17
2003 in snapshot 18

Corporate and personal tax rates

The corporate tax rate is reduced to 20 per cent from the year of assessment 2005, as affirmed by the Minister in his Budget Speech last year. Although the same promise was made in respect of the top marginal personal tax rate, the Minister has decided to defer the reduction for the time being. The reasons given were the need to preserve tax revenues in the light of increased spending commitments and the delay in the increase in the Goods and Services Tax (GST) rate (which was originally due to increase to 5 per cent on 1 January 2003, but was subsequently deferred to 1 January 2004).

In addition, the uncertainty of the economic outlook over the next 3 years, despite the strong growth expected in the current year, called for additional caution. This is somewhat disappointing for those who were looking forward to a personal tax rate cut, but the Minister did however reassure taxpayers that the Government's target of a top marginal personal tax rate of 20 per cent remains.

Exemption of foreign-sourced income for Singapore resident individuals

Currently, Singapore resident individuals are subject to tax on foreign-sourced income received in Singapore other than foreign dividends and service fee income which meet certain prescribed conditions.

The Minister has decided that all foreign-sourced income received in Singapore by resident individuals will be exempt from tax with effect from year of assessment 2005. This move was recommended by the ERC in 2002 to boost Singapore's private wealth management industry.

At first glance, the exemption appears to be straightforward but a few interesting questions arise.

Does the new exemption supplant or add to the existing exemption of dividends and service fee income?

In 2003, the Minister introduced the foreign-sourced income exemption regime which took effect from 1 June 2003. In the case of dividends, the exemption applies only if the following conditions are met:

- The dividend is subject to tax (withholding tax or tax on the underlying profits out of which the dividend is paid) under the law of the territory from which the dividend is received;
- At the time the income is received in Singapore by the person resident in Singapore, the headline tax rate in the territory from which the income is received is not less than 15 per cent; and
- The Comptroller of Income Tax ("Comptroller") is satisfied that the exemption would be beneficial to the person resident in Singapore.

The Minister declared that all foreign-sourced income would be exempt from tax for resident individuals with effect from year of assessment 2005. What is not clear at this stage is whether individuals would still have to satisfy the above conditions to claim the exemption or whether these requirements are now overridden.

The additional difficulty with service fee income is the requirement to satisfy the Comptroller that the income is foreign-sourced (see below). This is less of a difficulty for dividend income.

If no conditions are imposed, the result is that Singapore resident individuals will be exempt from tax on all dividends received, even those from tax haven countries. Income from services performed in tax haven locations e.g. UAE, are now tax exempt whereas previously they were not. This leads one to ask whether Singapore resident individuals would be better off incorporating a Singapore company to hold their overseas investments.

Use of Singapore holding company

Under the existing rules, there would be no Singapore tax on foreign dividends received by a Singapore holding company if the conditions described above are met. Dividends paid by the Singapore holding company out of this income would also be tax-free to a Singapore resident individual shareholder.

Under the proposed rules, an individual is always better off holding offshore investments directly. If held through a Singapore holding company, any foreign income not covered by the existing exemptions (e.g. income from low tax jurisdictions, royalties or interest) would be taxed upon remittance, in the hands of the company.

Partnership holdings

Curiously, the exemption of foreign-sourced income for individuals does not apply if the foreign-sourced income is received through a partnership in Singapore. Partners of professional services firms would be better off investing overseas personally, in their capital ratios, than through the partnership.

Do the changes achieve their objective?

The exemption has been given to encourage Singapore resident individuals to remit their offshore funds to Singapore for investment and management in the hope that it will boost the private wealth management industry.

In the absence of other measures, the exemption of foreign income would not necessarily meet the objective, since the income remitted back to Singapore for investment would generate Singapore-sourced income. To address this, the Minister also announced an exemption of Singapore-sourced investment income from financial instruments to complement the exemption of foreign-sourced income. Singapore resident individuals now have a wider array of investment options in Singapore which will give tax-free returns (see "Exemption of Singapore-sourced investment income for individuals").

Round-tripping risks

In the past, the Government resisted the ERC recommendations to exempt offshore income because of a fear of round-tripping, that is, putting what might have been regarded as Singapore-sourced income offshore and recycling it as exempt. This fear appears to have been put aside or at least ignored in the interest of the Singapore wealth management industry.

What is foreign-sourced?

This is not a new question but is of great importance, since all foreign-sourced income is now exempt from tax for resident individuals. The issue has been particularly difficult in the case of individuals who provide professional, consultancy and other services overseas.

This issue is compounded by drafting inconsistencies in the Income Tax Act. Under the existing foreign income exemption provisions, the Comptroller must be satisfied that any relevant service income is derived outside Singapore before allowing the exemption. In the Inland Revenue Authority of Singapore (IRAS) Circular published on 21 May 2003, the IRAS stated its view that it would regard service income as foreign-sourced only if the service is rendered through a fixed place of operation in a foreign jurisdiction.

It is interesting to note, however, that in granting unilateral tax credit relief, the relevant provisions do not require the Comptroller to be satisfied that the income is sourced outside Singapore. It merely requires that the services be rendered outside Singapore.

Exemption of Singapore-sourced investment income for individuals

Given that the aim of the exemption of foreign-sourced income for individuals was to encourage them to remit their capital and thus stimulate the private wealth management industry in Singapore, it was inevitable that the income generated by that capital in Singapore also had to be exempted to a large extent.

Typically there is a list of income that qualifies for the exemption. This is as follows:

(i) Interest from debt securities;

(ii) Discount income from debt securities, the tenure of which is 1 year or less;

(iii) Annuities;

(iv) All payments on life insurance policies, including interest from insurance benefits that have not been drawn and investment income on investment-linked policies (but excluding sums realised or interest from insurance benefits that have not been drawn under any insurance against loss of profits);

(v) Distributions from unit trusts and real estate investment trusts that are authorised under Section 286 of the Securities and Futures Act (excluding distributions out of franked dividends); and

(vi) Borrowing fees, loan rebate fees, price differential and compensatory payments arising from securities lending and repurchase arrangements.

A number of interesting questions are raised however.

Does the exemption apply to residents only?

It is certainly not clear from the heading in the Budget Speech, which only refers to "individuals", whether non-resident individuals are included under the exemption. Whilst the section on the exemption of foreign-sourced income specifically mentions resident individuals, this is to be expected since non-resident individuals are not taxable in respect of foreign-sourced income anyway. This may be clarified in due course. However, the exclusion of non-residents would appear to run counter to the desire to stimulate the wealth management industry.

How are debt securities defined?

A definition of debt securities exists in the Income Tax Act under Section 43N in relation to qualifying debt securities (QDS). These are defined as any "bonds, notes, commercial papers, treasury bills and certificates of deposit". This is narrower than the definition found in the Fourth Schedule of the GST Act which defines a debt security as being "any interest in or right to be paid money that is, or is to be, owing by any person or any option to acquire any such interest or right...". The distinction may be an interesting one in practice although the general tendency is to use the one found nearest in the legislation. Probably the point to make is that it is unlikely to include straight loans.

How do investment-linked products and designated unit trusts now compare?

As payouts from both investment-linked products and designated unit trusts (DUT) are now exempt, the difference between the two is likely to be minimal. However, because the DUT still allows tax credits on Singapore dividends to flow through for unitholders (and investment-linked products do not), the DUT still has an edge on that score. However, with the gradual phasing out of the franked Singapore dividend under the one-tier taxation system, this advantage will be short-lived. What the change does however, is enhance the appeal of the DUT since distributions out of income (other than gains on the disposal of securities and exempt Singapore dividends) were previously all taxable in the hands of resident individuals. The playing field has been at least levelled.

Is this the end of the Supplementary Retirement Scheme (SRS)?

There is no doubt that the proposed changes will have a dampening effect on the appeal of the SRS. Whilst tax deductions are available for contributions to the SRS, half of what is withdrawn on retirement is taxable. This is despite the fact that the return may be largely made up of investment income that, had it been earned directly, would now be exempt.

Does the exemption help the entrepreneur?

Interestingly, the exemption may help determine how the entrepreneur sets himself up in business. With the help of the $100,000 exemption for new companies (see "The entrepreneur"), it is possible to earn something in the region of $400,000 and suffer an effective tax rate of less than 9 per cent, as the following example shows:

Company A (new company), set up by Mr Ee, is financed with a subscription for a notes issue of $800,000, with a coupon of 6 per cent, and share capital of $200,000. Mr Ee is an employee of the company and pays himself a salary of $252,000. The company earns $400,000 before interest and salaries in its first year.

The tax position of the company is as follows:

	$
Net income	400,000
Salaries	(252,000)
Interest expense	(48,000)
Exempt amount	(100,000)
Taxable income	NIL

His personal tax position (assuming personal allowance only) is as follows:

Salary	$252,000
Tax at current rates	$33,890

This equates to an effective rate of 8.5 per cent ($33,890 / $400,000). The interest on the notes (debt securities) are now exempt, and the $100,000 exempt amount can be paid out as an exempt one-tier dividend.

The entrepreneur

The Government continues to strive to find new ways to help entrepreneurs kick-start their ideas and convert them to commercial ventures. This year, two new measures have been put forward.

The first of these is a tax exemption for the first $100,000 of chargeable income of a new company. This will apply for each of the first 3 years of assessment that fall between year of assessment 2005 and 2009. Businesses considering starting later this year may therefore wish to consider deferring until the following year, so as not to waste the benefit of the exemption, although this decision will depend on projected profitability. As noted under the section on the exemption of Singapore-sourced investment income for individuals, arrangements could be put in place in conjunction with this exemption that significantly reduce the overall rate of tax for the successful entrepreneur.

For the not-so-successful, the second initiative that the Minister introduced extends the current Technopreneur Investment Incentive Scheme from high-tech businesses to all forms of start-up operations. Essentially, investors in relevant companies will enjoy tax deductions for losses incurred if the company fails or is sold at a loss. This will help reduce the risks faced by venture capital providers in assisting new businesses get off the ground. The new scheme is known as the Enterprise Investment Incentive or EII.

Financial services incentives

As part of the Government's strategy to grow the services sector and to position Singapore as an international financial centre, various changes have been proposed in relation to the financial services sector tax incentives. Some of these changes are introduced to enhance existing incentives, while others are proposed to ensure the continued relevance of Singapore's incentive regime in light of developments in the global market place.

Qualifying debt securities

The QDS regime was introduced in 1998 as part of the Government's efforts to develop an active debt capital market in Singapore. A principal feature of the regime was the introduction of concessionary tax treatment for interest derived by investors. To encourage further development of the short-term debt markets, it is now proposed that discount income in relation to QDS, the tenure of which is 1 year or less, be accorded similar treatment as that applicable to interest under the QDS regime.

Economically, a discount is equivalent to interest, although as a matter of law, it is not regarded as such. It appears that the change is aimed at short-term debt instruments only. This leaves the position for discount on long-term instruments (i.e. those with over 1 year maturity) unchanged, and hence does not fully align the tax treatment of discount and interest within the QDS regime. The differences in tax treatment are in turn likely to reduce flexibility in terms of the pricing of debt instruments.

Wealth management incentives

The proposed changes to the wealth management industry are essentially an enhancement of the existing incentives, in keeping with the development of new financial instruments as well as an attempt to take into account changes in other tax incentives like the QDS regime.

Under the existing regime, specified income of foreign investors whose funds are managed by Singapore fund managers is exempt from tax. It is proposed that the scope of specified income qualifying for this exemption be expanded. In turn, this would give the fund managers wider discretion to invest in new classes of instrument on behalf of these foreign investors without exposing them to Singapore tax.

Under the existing DUT regime, only gains from the disposal of securities, interest and foreign-sourced dividends are exempt from tax at the trust level. Securities are defined to mean debentures, stocks, shares, bonds and notes as well as any right or option in relation to these instruments and unit trusts. Innovation in the fund structures to cater for investors with different risk profiles means that they are no longer simply vehicles for pooling resources for investments in “plain vanilla” instruments. In recognition of the fact that the nature of investments by funds has expanded beyond the scope of traditional securities, and that funds do deal in foreign exchange and derivative transactions in order to enhance their yield or to protect their capital, it is proposed that income derived from these transactions also be exempted from tax at the trust level. This is a welcome relief for the unit trust industry.

Asset securitisation

Securitisation is increasingly seen by many as a preferred source of financing.

The key tax objective in relation to asset securitisation is to achieve tax neutrality. This means to ensure as far as possible that the securitisation transaction does not lead to any additional tax liabilities, nor to any acceleration of tax liabilities other than those that would have been the case had the securitisation not taken place.

The various sources of tax leakage in a securitisation transaction could include tax on the transfer of assets into a special purpose vehicle (SPV), withholding taxes on interest payments to bond holders, and taxation of the SPV itself. While the issue of withholding tax has been addressed by the QDS regime, there is a risk that the SPV could be subject to significant taxation if there is no proper matching of income and expenses for taxation purposes. To promote certainty in this respect, it is proposed that a special tax regime be accorded to SPVs used in securitisations. Although details of the regime have not been announced, it is widely expected that flow-through treatment will be conferred at the SPV level, so as to preserve tax neutrality.

Withholding tax exemption for payments on over-the-counter (OTC) financial derivatives

In line with the Government’s aim to promote Singapore as a financial centre, and in particular to encourage the trading of financial derivatives, various incentives have been introduced in recent years to give withholding tax exemption for payments under financial derivatives contracts with non-residents.

Although it is doubtful if payments under such contracts constitute payments in connection with indebtedness in the first place, given that these are typically notional principal contracts, the introduction of exemptions would provide the certainty in treatment that the financial markets have demanded.

In this regard, interest and currency swap payments by financial institutions to non-residents (other than permanent establishments in Singapore) are already exempt from withholding tax. To enjoy a withholding tax exemption for payments under other types of financial derivatives, financial institutions would need to apply for the Financial Sector Incentive (Derivatives Markets) award, for which they would need to have at least 6 professional staff in Singapore covering origination, structuring and trading activities.

It is proposed that the withholding tax exemption on payments on over-the-counter (OTC) financial derivatives now be extended to all financial institutions. It is expected that the current compliance requirement as regards transactions between related parties will similarly apply.

Commodity derivatives trading

Currently, banks and companies approved under the global trader programme (GTP) or approved oil trader (AOT) scheme enjoy a concessionary tax rate at 10 per cent on income from commodity derivatives. In the case of the companies under the GTP and AOT scheme, the OTC derivative trades must be done in connection with hedging physical trading before the 10 per cent tax treatment applies.

Although these incentives work reasonably well for companies in the petroleum industry, they are not truly designed with non-bank financial institutions acting as market makers in mind. In addition, income from certain futures trading derived by GTPs or AOTs from trades with banks could qualify for the 10 per cent tax concession. However, banks which trade with GTPs or AOTs do not enjoy the same treatment under existing regulations. Even with the removal of the counter-party or currency restrictions under the Financial Sector Incentive, asymmetry persists because of the need to apply the Qualifying Base calculation. It is hoped that the proposed incentive on commodities trading, details of which will be introduced at a later date, will address these areas given the vital role that market makers play in this industry.

Members of Singapore Exchange

Whilst not specifically stated in the Budget Speech, it is believed that the proposals affecting the Singapore Exchange (SGX) relate only to futures members.

The expansion of the 5 per cent and 10 per cent tax concessions to Singapore dollar trades done on the SGX should be welcomed by the industry. In addition to reduced compliance burden in tracking a particular class of contracts, the removal of the tax rate asymmetry between the derivative contracts and the underlying securities (where they are QDS) means that these derivative contracts can now be employed as effective hedges for underlying QDS on a post-tax basis.

Processing services provided to financial institutions

Leveraging off the advancement in information technology, there is a global trend for companies to centralise certain business processes in a particular location so as to achieve efficiency and cost savings. The development of Singapore as a processing centre is integral to the various initiatives in positioning Singapore as a global business hub. Hence it is proposed that a 5 per cent concessionary tax rate be applied to income derived by approved companies providing such services to financial institutions.

Other incentives

Incentive for shipping companies

Currently, under the Approved International Shipping (AIS) Scheme, the charter fee income of an AIS company derived from chartering foreign-flagged vessels to Singapore-based customers (other than another AIS) is not exempt from Singapore tax. The proposal laid out in the Budget Speech is that, with effect from year of assessment 2005, all such onshore charter income received by an AIS company will be tax exempt. This broadly exempts practically everything an AIS company can do, from Singapore tax.

Regional Headquarters award

When the EDB first introduced the Regional Headquarters (RHQ) award in January 2003, few had found the incentive attractive. This was mainly because the incentive period covered only 3 years and a 15 per cent rate was not sufficiently low, in this context, and in the context of the investment requirements that needed to be met, to merit the commitment.

It is comforting to note that the Government has reviewed the RHQ award by extending the qualifying period from 3 to 5 years.

Pioneer incentive

With immediate effect, the maximum qualifying period for the pioneer incentive which confers tax exemption on profits from qualifying activities is extended to 15 years from the current 10. This is likely to give a significant facelift to the incentive for new entrants and may entice existing pioneer businesses to bring in new products and services.

Reduction in royalty withholding taxes

The ERC had recommended the setting up of a panel to review Singapore's withholding tax system with a view to assessing its impact on the cost of importing vital technology into, and doing business with, Singapore. It is not clear where this process is at, however, it is not surprising to see a unilateral reduction in withholding tax rates applicable to royalties paid for the use of intellectual property held outside Singapore. There is no doubt that this is one of the fundamental ingredients needed for the continuing development of Singapore as a knowledge-based economy.

Whilst the reduction from the standard rate of 15 per cent to 10 per cent may seem significant, this does not better the rate already available in most of Singapore's double taxation agreements. On the other hand, payments to what is probably the country's most prolific supplier, the US, will benefit from the reduction since there is no treaty between the two countries even in the shadow of a Free Trade Agreement; and potentially, the need for administrative procedures and verification (as to the residence of the provider) will be reduced.

Topping up the top-up

One of the measures introduced to help Singaporeans build up their Central Provident Fund (CPF) account for retirement is the CPF Minimum Sum Topping-Up Scheme. Under this scheme, if an individual wishes to bring his own balances up to the minimum sum or help a family member, i.e. a spouse, parent or grandparent, increase their CPF retirement savings, he can "top up" his or their accounts. This simply means that he either makes a cash payment directly into the relevant CPF account, or he transfers a cash amount from his own CPF savings to a family member's CPF account.

There are conditions and limitations to doing this, but where the top up is a direct cash contribution, i.e. not a transfer from another CPF fund, there is a personal tax relief which is currently capped at $6,000 per annum. However, from year of assessment 2005, this will be increased to $7,000.

Top-ups made to non-working spouses who are 55 years old or more, and who earned not more than $2,000 in the preceding year, will also qualify for the tax relief.

Estate Duty enhancements

Somewhat alarmingly, interest on Estate Duty payable to the IRAS starts to run from the date of death, when the executors may have no idea as to what the liability might be. The only way to stop the interest from running was to make a payment on account as soon as possible based on best estimates. Even then, any shortfall would still attract interest until paid.

The Minister has now decided to make life easier for executors (and cheaper for beneficiaries) by allowing a 6-month period in which to complete and submit the Estate Duty return. They will then have a 30-day grace period following the issue of the notice of assessment, before interest starts to run again. This can only be seen as a fair move to iron out a historical anomaly.

Building the next generation

The Minister has indicated that there is a need to simplify and enhance tax incentives to encourage couples to have babies in order to build the next generation. A Working Committee has been set up and will make recommendations by, appropriately, National Day 2004.

Currently, Singapore citizens are eligible for a Special Tax Rebate in respect of the second child born on or after 1 January 1990. The size of the rebate depends on the age of the mother at the time she has the second child, and is as follows:

Age of mother	Tax Rebate
Before 31 years of age	$ 5,000
Before 30 years of age	$ 10,000
Before 29 years of age	$ 15,000
Before 28 years of age	$ 20,000

In today's environment, where couples have babies later in life or not at all, increasing the age limit for mothers having a second child may be a useful means of enticing mothers who have had a chance to establish their careers back to the joys of parenthood. The age limit of 31 could be increased, for example, to 35 to capture that group. Additionally, to encourage couples to start a family, the Special Tax Rebate could also be extended to couples having a first child – probably the most difficult hurdle conceptually.

Another area that could be considered is the Enhanced Child Relief which is currently available to all working mothers with the requisite qualifications in Singapore, whether they are citizens or not. Currently, the reliefs for the first three children are 5 per cent, 10 per cent and 15 per cent of earned income respectively, subject to a maximum relief of $10,000 per child (for a child below 12 years, the maximum relief is $15,000 per child) including the basic qualifying child relief amount of $2,000.

The basic qualifying amount of $2,000 is claimable by either parent. In a similar manner, the Enhanced Child Relief could, once calculated by reference to the mother's income, be claimed by the parent with the higher marginal tax rate. This would be available only to Singapore citizens and would operate as a form of group relief.

Another area which could be considered is to exempt the income of childcare centres from corporate tax. This would facilitate the spirit of entrepreneurship among Singaporeans looking to start up new businesses, while at the same time creating enhanced opportunities for working couples to keep their babies at these childcare centres.

Alternatively, or in addition, employers could be given double tax deductions for payments made to approved childcare centres on behalf of the employees.

All of the above put together could make the tax incentives more accessible and attractive to couples.

Goods and Services Tax round up

Rate change

No changes were proposed for GST. This should not be surprising and would seem to confirm that little else needs to be done following the second hike in the standard rate of GST to 5 per cent from 1 January 2004. Yet, with the one-point hike from 3 per cent to 4 per cent on 1 January 2003, the GST revenue surged by 30 per cent to $2.7 billion. In the 2004 Budget Speech, the Minister estimated a further increase of $700 million as a result of the increase in the GST rate from 4 per cent to 5 per cent. Such increases in the revenue collection from GST are therefore difficult to ignore and it would be interesting to see if this is a growing trend. One could also speculate, on the strength of this, when the Government might decide to raise the GST rate again. We have at least a year's reprieve.

In the meantime, businesses should not see the increase in the GST rate from 1 January 2004 as simply a case of changing the tax rate in the accounting system and invoices to 5 per cent from midnight on 31 December 2003. The fact is that there are special transitional rules to ensure that the time of supply rules are not circumvented. The IRAS is aware of this and have been known to ask questions about transactions in the transitional quarters of October to December and January to March, to see if businesses have been following the rules correctly. For a start, businesses should ask themselves if they are aware of the following:

- It is not sufficient to issue a tax invoice before 1 January 2004 to charge and account for GST at the rate of 4 per cent. On the other hand, you cannot issue a tax invoice before 1 January 2004 to charge GST at the rate of 5 per cent.
- If no payment has been received nor any goods or services supplied before 1 January 2004, you have to issue a credit note by 14 January 2004 to cancel the old invoice and raise a new tax invoice to charge GST at the rate of 5 per cent.
- An apportionment is required to determine supplies that straddle over 1 January 2004 to see how much of the supplies are liable at the rate of 4 per cent and 5 per cent.
- Only cheque payments that were successfully presented to the bank by 5 January 2004 can be treated as payments received before 1 January 2004.
- Any credit notes issued for goods returned or services cancelled would have to give credit for the tax rate applicable to the original supply.
- Even if your customer refuses to pay the additional one per cent increase in GST, the liability to charge and account for the higher rate of tax still falls on you as the supplier.

Other areas that need attention

The increase in the GST rate was the most significant recommendation in the ERC report in early 2002 that has been implemented by the Government. However, there were also other recommendations endorsed by the ERC report that have not seen the light of day and which continue to be the bane of businesses. Specifically, the recommendations relating to Government grants and zero-rating provisions require some serious study.

On the matter of grants, the current position is that where grants are given for no specific supplies of goods or services, the grants do not attract GST. However, the IRAS holds the view that where the grants are not subject to GST, it must mean that the recipient is involved in non-business activities. As a result, the recipient's input tax claims cannot be claimed in full and must be restricted. This has caused a lot of pain especially for those businesses and entities (in particular new entrepreneurs), who receive grants as part of the Government's efforts to promote certain economic activities, or grants that are provided to enable the entity to provide low cost services. Not only would such businesses have to spend time and resources to deal with IRAS audits on grants but also to negotiate an 'appropriate' apportionment of input tax claims. It is hard to see how this would help keep entrepreneurial costs down especially when most may think that it is just a case of money going from one pocket to the other.

The other recommendation on GST in the ERC report to improve Singapore's competitiveness was the call for the Government to review the zero-rating provisions or at least, the way the zero-rating provisions have been interpreted. To explain, the popular view is that all recharges or billings to an overseas person would be liable to GST at the rate of 0 per cent. The problem is that where the services are seen to be for the 'benefit' of a person or persons in Singapore, the IRAS takes the view (which is contrary to case law precedent) that the services should be subject to the standard rate of GST. The issue then is to determine the extent to which the services 'benefit' a person in Singapore. If GST were to apply to billings to an overseas person under a global contract arrangement where services may be provided to a local person, it is not clear that this helps promote Singapore's international competitiveness as a global services hub.

As the above matters were not addressed in the 2004 Budget Speech, we would need to wait yet again for the Government's response to them.

Other changes

Motor vehicle taxes

The Additional Registration Fee (ARF) is reduced to 110 per cent from 130 per cent of the open market value (OMV) for cars. This new ARF will apply to Certificates of Entitlement (COE) obtained from the first COE bidding exercise in March 2004.

In line with the Government's effort to harmonise the excise duties and ARF of taxis and cars, the excise duty for taxis is increased to 20 per cent from 10 per cent of the OMV.

Liquor duties

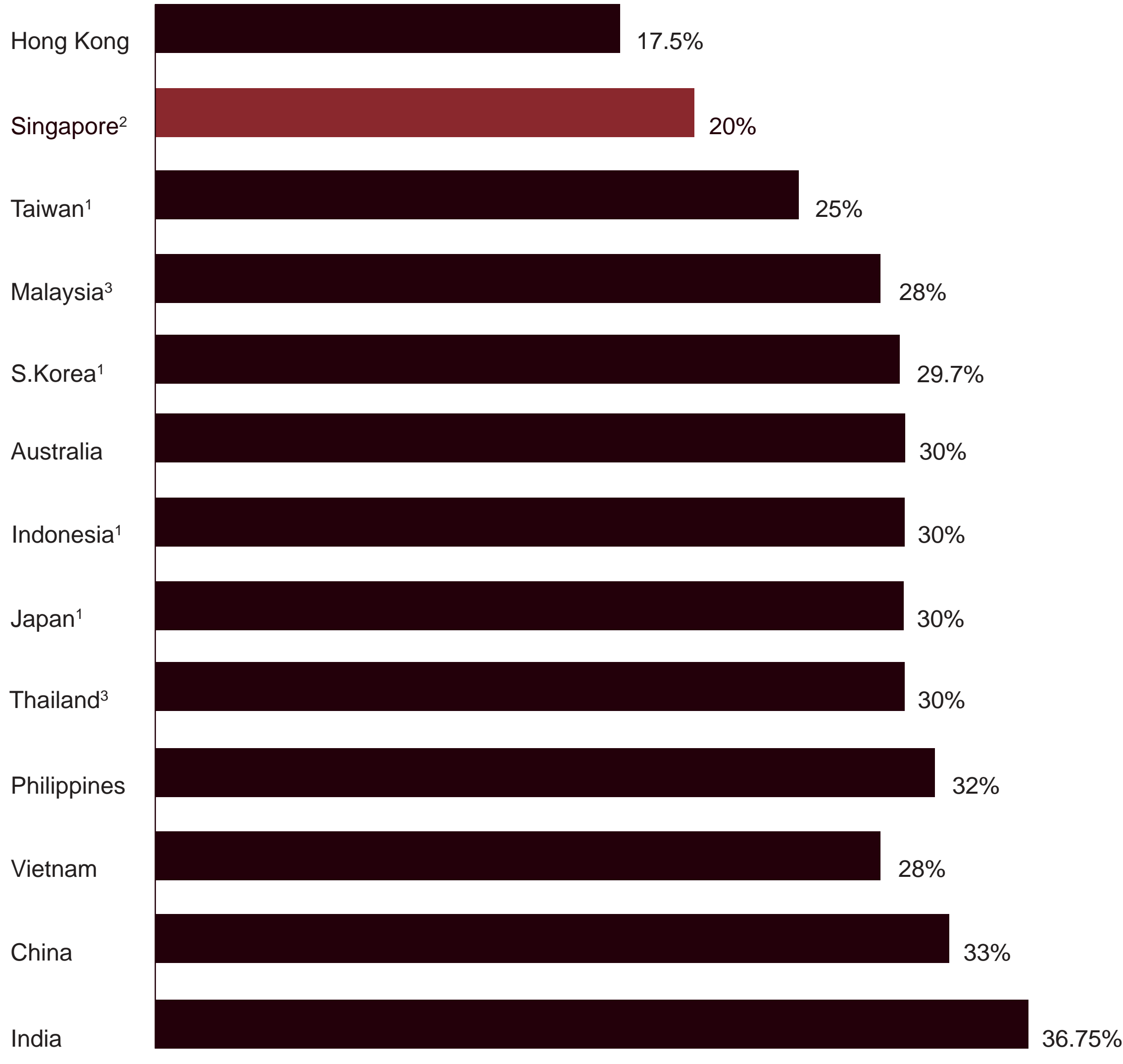
With effect from 27 February 2004, excise duties for certain types of liquor are increased whilst others are reduced. In addition, liquor duty is now assessed based on exact volume and not standard bottle sizes.

Tobacco duties

With effect from 27 February 2004, excise duties on all tobacco products are increased and harmonised with the duty on cigarettes.

Appendix A

Comparison of Asia-Pacific corporate tax rates (for income year 2004)



Note: Certain rates include local/resident surtax or surcharge (e.g. China, India & 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.
[1] Lower rates of tax apply to income below certain levels.
[2] Partial exemption of up to $52,500 applies to the first $100,000 of chargeable income.
[3] Lower rate of tax apply to small and medium-sized enterprises.

Appendix B

Comparison of Asia-Pacific individual tax liabilities (a married man with two dependent children for income year 2003)

	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	5,265	7	9,015	9	28,022	14
Australia[3]	27,602	37	39,978	40	89,477	45
China	15,867	21	23,727	24	65,099	33
Hong Kong	5,847	8	10,472	10	28,972	14
India	23,968	32	32,218	32	65,218	33
Indonesia	21,573	29	30,195	30	64,684	32
Japan	6,260	8	11,993	12	50,578	25
Malaysia	15,720	21	22,720	23	50,720	25
Philippines	22,840	30	30,840	31	62,840	31
S.Korea	12,534	17	21,009	21	58,629	29
Taiwan	10,473	14	17,973	18	55,914	28
Thailand	17,170	23	24,670	25	61,198	31
Vietnam	17,846	24	28,615	29	78,615	39

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.
3. Based on new tax rates for year ending 30 June 2004.

Appendix C

Resident individual tax rates for year of assessment 2005 (income year 2004)

	Chargeable Income	Year of assessment 2005	
		Rate	Tax
	$	%	$
On the first	20,000	0	0.00
On the next	10,000	4	400.00
On the first	30,000		400.00
On the next	10,000	6	600.00
On the first	40,000		1,000.00
On the next	40,000	9	3,600.00
On the first	80,000		4,600.00
On the next	80,000	15	12,000.00
On the first	160,000		16,600.00
On the next	160,000	19	30,400.00
On the first	320,000		47,000.00
On income above	320,000	22	

2003 in retrospect

2003 was a busy year on the tax scene with the IRAS, MAS, EDB, IE Singapore and the MOM[1] all issuing guidelines, clarification and comments on the various tax changes that had been predicated in the 2003 Budget. The more significant of these are discussed below. This is followed by a table setting out the calendar of events that has occurred throughout the year.

Foreign currency matters

Two changes introduced during the year had impact on foreign currency transactions. The first of these was an announcement by the IRAS that they would allow corporate entities to deal with their foreign exchange differences for tax in the same way that banks have been allowed to since 1993. What this means is that foreign exchange gains or losses on revenue account will be given tax effect irrespective of whether they have been realised during the year. Essentially, tax will follow accounting treatment.

The change is automatic and takes effect from year of assessment 2004. Taxpayers can stay with the old system if they want to, however the election is irrevocable. The new system only applies where the taxpayer's accounting system does not differentiate the treatment of revenue gains or losses.

The second, and perhaps more controversial change, affects the filing requirements for companies that have a functional currency other than the Singapore dollar. Under the new procedures that came into effect for accounting periods beginning on or after 1 January 2003, a company has to file its tax computations in its functional currency (though the tax return Form C will be in Singapore dollars). There is no choice in the matter, even if the company continues to produce its statutory accounts in Singapore dollars. The controversy comes from the limited options that the taxpayer has for converting his brought forward tax balances (losses, allowances, tax written down values) from Singapore dollars to his functional currency. Essentially there are only two arbitrary options. One effects a one-time conversion, the other uses a rolling average which changes each year until the balances are used up. Whilst the limited options may make life easier for the IRAS, the limitation may turn out to be unfair for some taxpayers.

Clarification on the one-tier taxation system

During the year, the IRAS brought out a clarifying statement in relation to the one-tier taxation system. This covered the following:

- A decision to scrap the idea of treating normal exempt dividends on preference shares as interest. Whilst the reason given related to the interaction with the exemption of certain types of foreign income, it is more likely that the concept made no sense in the first place.
- Confirmation that the IRAS do not consider dividends paid out of unremitted foreign-sourced income to constitute a remittance of that income. Whilst at a technical level this was always clear, it was comforting to note the IRAS's agreement.
- Clarification on Section 46(1A). This section had created concern and confusion as it sought to restrict the set-off of tax deducted at source where dividends were paid that were disproportionate to the shareholder's stake in the company. The clarification suggested that it should be looked at by reference to each class of shares and not by reference to the entire share capital of the company. In the absence of dividend streaming motives, the section would have no effect. Concern and confusion still surrounds the section.
- Concessions for companies caught out of place through the introduction of the one-tier taxation system. These concessions essentially allowed holding companies that could not restructure themselves out of trouble in time, to set off interest expenses on borrowings to acquire subsidiaries, against their other income. Alternatively, they could apply group relief to set off against the subsidiary's income. On the other hand, where the equity in the subsidiary was converted to debt, the concession allowed deductions for the interest expense which may not otherwise have been available. Finally, where a newly formed company in certain merger arrangements was interposed between the original shareholders and an existing company with section 44 franking balances, the concession allowed a flow through of those balances to the original shareholders.

  The above concessions are on a case by case basis and carry with them certain restrictions and sunset clauses.

[1] MAS - Monetary Authority of Singapore
EDB - Economic Development Board
IE Singapore - International Enterprise Singapore
MOM - Ministry of Manpower

Financial Sector Incentive Scheme

The incentive regime for banking and capital markets has undergone many changes over the years. However, it may be analysed in 3 phases. In the first phase, which began in the 1970s, the tax incentives focused primarily on the development of the offshore markets and were usually given in relation to inter-bank transactions and transactions with other non-residents in foreign currencies. Over time, many new qualifying activities were added, in keeping with market developments.

In the late 1990s, a new set of incentives were introduced to promote the development of Singapore's debt and equity capital markets. Among other things, these incentives sought to promote the growth of an active bond market in Singapore, as well as to encourage initial public offerings of equity securities on the Singapore Exchange. Some of these activities need not be denominated in foreign currencies or transacted with non-residents.

The final phase of the development, which came into effect on 1 January 2004, has seen the streamlining and consolidation of the various tax incentives into a single concept known as the Financial Sector Incentive Scheme. The scheme has introduced further relaxations to the existing currency and counter-party restrictions.

Qualifying activities under the scheme are divided into 2 groups: the Standard Tier and the Enhanced Tier. Income from Standard Tier activities will be taxed at 10 per cent, whereas income from Enhanced Tier activities will be taxed at 5 per cent.

Enhanced Tier activities cover various high-growth, high value-add activities which the authorities seek to promote, and hence a lower tax rate is offered. They are:

- Bond market activities
- Derivatives market activities
- Equity market activities
- Credit facilities syndication

Under the scheme, currency and counter-party restrictions have been removed for most Standard Tier activities. For example, in respect of lending activities, the counter-party restriction will be lifted. Therefore, interest from a foreign currency loan to a Singapore borrower may be taxed at 10 per cent.

As a result of the above, a larger income base may be subject to tax at 10 per cent than was previously the case. To preserve revenue neutrality, a qualifying base (QB) was introduced. Broadly, the QB refers to the ratio of income that previously fell outside the incentive because of the restrictions, and which now falls in to be taxed at 10 per cent, over total income taxable at 10 per cent. This ratio is determined based on average income figures for the 3 years preceding 2004. Only income from Standard Tier activities that exceed the QB will be taxed at 10 per cent.

2003 in snapshot

For more details, visit our Singapore tax website at http://www.pwctax.com, or call your usual PricewaterhouseCoopers Services Pte Ltd contact.

Month	Item	Details
January	Headquarters Incentive	The EDB releases details of a new enhanced headquarters programme to replace the existing Operational Headquarters (OHQ) incentive. The new programme consists of : • a simplified Regional Headquarters Award where a preferential tax rate of 15% will be applicable for the first 3 years; and • an International Headquarters Award where preferential tax rates could range from 0% to 10%, and covers a wider range of service and trading activities.
February	Financial Sector Incentive (FSI) Scheme	See "2003 in Retrospect".
March	Withholding Tax	• Extension of due date to 15th of month following date of payment • Deemed payment is date of invoice in the absence of an agreement to the contrary.
	Non-Resident Professionals	Deadline for election for tax to be withheld at 22% on net income is extended to 45 days from 30 days from 1 April 2003 and concession for multiple payments under a single engagement is introduced.
April	Integrated Industrial Capital Allowance (IICA) Incentive	The EDB releases details on the IICA incentive which allows Singapore entities (which engage in high value-added or knowledge-intensive activities) to claim capital allowances on assets that are used by their wholly-owned overseas subsidiaries.
May	Foreign-Sourced Income	The IRAS releases qualifying criteria for tax exemption on foreign-sourced dividends, branch profits and service income effective 1 June 2003. Regulations still awaited.
	Interest Income For Individuals	The IRAS releases details on the tax exemption of interest income for individuals. The full tax exemption will apply from 1 January 2005 whilst qualifying interest income received by individuals in calendar years 2003 and 2004 will be subject to (now simplified) partial exemption rules.
	Overseas Talent Expenses	Further tax deduction guidelines produced by MOM.
	Foreign-Sourced Royalties & Interest	The EDB releases details of the tax exemption for foreign-sourced royalties and interest - used for research & development (R&D).

June	Foreign Trusts & Eligible Holding Companies	The MAS releases details on the tax exemption for the income of designated investments (for foreign trust income) with took effect from 1 June 2003. The 2003 Budget Speech had proposed an exclusion list but the MAS ended up retaining the current inclusion list (but with expanded scope).
	One-Tier Taxation System	See "2003 in Retrospect".
	Approved Third Party Logistics (3PL) Company Scheme	The IRAS releases details of the new approved 3PL company where the import or movement of certain goods will not be subjected to GST with effect from 1 January 2004.
July	Patenting costs	The EDB releases guidelines for the tax deduction scheme for patenting costs. Available for 10 years from 1 June 2003.
	Group Relief	IRAS confirmation that group relief-compensatory payments are not subject to GST . However, a supply of services in exchange for the transfer of group losses will still constitute a supply of services.
	Receipts	The IRAS removes the application requirement for a waiver to issue receipts. The removal took effect from 8 July 2003.
August	Simplification of Procedures	The IRAS simplifies certain income tax rules and procedures for companies, covering: • application to pay normal (tax incentive) exempt dividends before the income is assessed; • application for waiver of shareholders' shareholding test; and • waiver of withholding tax requirement on interest paid to non-resident branches which are not banks.
	Audit Exemption	In view of the audit exemption under the Companies Act, the IRAS issues guidelines on the income tax filing requirements for companies affected by the exemption.
September	Public Sculptures Donation Scheme	The National Heritage Board releases guidelines on the public sculpture donation scheme.
	Indefeasible Rights of Use (IRUs)	Guidelines on writing-down allowances for IRU payments. Effective from Year of Assessment 2004.
	Portable Medical Benefits	The MOM releases details of the new portable medical benefit schemes - i.e. the Portable Medical Benefits Scheme (PMBS) and Transferable Medical Insurance Scheme (TMIS).

October	Overseas Investment Incentive	IE Singapore finally releases details of the revised Overseas Investment Incentive scheme. Effective 1 January 2004 and replaces the existing scheme.
	Writing Down Allowances (WDA) for Intellectual Property	The EDB releases details for auto-WDA for Intellectual Property.
	Statutory Declaration for Real Property Transactions	The IRAS removes the need to make a statutory declaration for real property transactions.
November	Foreign Exchange Differences	See "2003 in Retrospect".
	Designated Unit Trust (DUT)	The MAS issues a circular to fine-tune an earlier qualifying condition for the DUT scheme which allows capital-protected and capital-guaranteed funds the status.
	Hire-Purchase & Other Financing Arrangements	The IRAS issues a circular which sets out the rules for the GST treatment of hire-purchase and other financing arrangements under the expanded gross margin scheme.
	Goods and Services Tax	The Goods and Services Tax (Amendment) Act 2003 is gazetted.
December	Non-Singapore Dollar Functional Currency	See "2003 in Retrospect".
	Income Tax Act	The Income Tax (Amendment) Act 2003 is enacted. No surprises. The Income Tax Act (Revised Edition 2004) is published. Full of surprises.
	Taxpayer Audit	The IRAS issues a circular on taxpayer audit which formalises and clarifies the conduct and process of an IRAS audit.
	Goods and Services Tax	The IRAS releases guidelines on transitional measures for the GST increase to 5% from 1 January 2004.

Your contacts at PricewaterhouseCoopers Services Pte Ltd

For direct dialing, use 6236 plus the extension number shown below.
For Email address, use @sg.pwc.com at the end of the Email ID shown below.
Our Singapore tax website at www.pwctax.com

Tax Directors	Email ID	Ext No.
Corporate Tax		
Chan-Cheng Wei	cheng.wei.chan	3808
Paul Cornelius	paul.cornelius	3718
Paula Eastwood	paula.eastwood	3648
Nicole Fung	nicole.fung	3618
Abhijit Ghosh	abhijit.ghosh	3468
Ho Mui Peng	mui.peng.ho	3838
Khoo Ghee Khong	ghee.khong.khoo	3828
Noris Ong	noris.ong	3688
David Sandison	david.sandison	3675
Florence Tan-Nguyen	florence.nguyen	3868
Peter Tan	peter.tan	3668
David Toh	david.toh	3908
Yip Yoke Har	yoke.har.yip	3938
Personal Tax		
Richard Schulte	richard.schulte	3528
Jenny Goh	jenny.goh	3638
Goods & Services Tax		
Koh Soo How	soo.how.koh	3600

PricewaterhouseCoopers (www.pwc.com) provides industry-focused assurance, tax and advisory services for public and private clients. More than 120,000 people in 139 countries connect their thinking, experience and solutions to build public trust and enhance value for clients and their stakeholders.

"PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Copyright© 2004 PricewaterhouseCoopers Singapore. All rights reserved.

8 Cross Street, #17-00 PWC Building, Singapore 048424 • Tel 6 236 3388 • Fax 6 236 3715

These notes are designed to keep clients up to date with tax developments. They are of a general nature only and are not intended to be comprehensive.
Readers are therefore advised that before acting on any matter arising from these notes, they should discuss their particular situation with the Firm.
No liability can be accepted for any action taken as result of reading the notes without prior consultation with regard to all relevant factors.