Financial Services Tax Bulletin

May 2009

Financial Sector Incentive – Enhancements in 2009

On 12 May 2009, the Monetary Authority of Singapore (MAS) issued two circulars that spell out the enhancements to the credit facilities syndication and commodity trading tax incentives. It also clarified the tax treatment of gain on sale of foreign equity securities by qualifying financial institutions. This Bulletin discusses these developments and their impact.

In the 2009 Singapore Budget, the Finance Minister announced certain refinements to the financial services tax incentives, including enhancements to the Financial Sector Incentive (FSI) scheme and the commodity derivatives trading tax incentives. The MAS has now released details of these changes.

Credit Facilities Syndication

Use of funds

The FSI – Credit Facilities Syndication (FSI-CFS) scheme grants a concessionary tax rate of 5% on income from arranging, underwriting and granting loans under a qualifying syndicated offshore facility which is an offshore credit facility or an offshore guarantee facility. This scheme is now included as a new sub-category within the FSI-Debt Capital Market award.

To be a qualifying syndicated offshore credit facility, among other conditions, the loan, advances or funds made available by the facility must be used outside Singapore. A syndicated offshore credit facility would not be considered a qualifying facility if any part of the proceeds from the facility is used in Singapore. Consequently, the income derived thereof will not be taxed at 5%.

This condition has now been reviewed to include a facility where:

(a) the proceeds from a qualifying syndicated offshore credit facility used in Singapore are solely for the purpose of paying professional fees, such as legal and accounting fees, and the first interest payment; and
(b) the proceeds used in Singapore which are referred to in (a) above cannot exceed 10% of the total proceeds from that qualifying syndicated offshore credit facility.

Arising from this, the FSI-CFS company must apportion the income derived from the qualifying syndicated offshore facility and apply the 5% tax rate only to the income arising from proceeds used offshore.

Timing of syndication

To qualify for the tax concession, a facility must be underwritten and syndicated at the outset. To allow for greater flexibility, a credit facility which is not syndicated at the outset, but the arranger, underwriter or the agent bank has a clear intention to syndicate within six months from the date of the signing of the initial loan agreement, may now qualify. Hence, any qualifying income derived by an FSI-CFS company subsequent to the syndication of such facility will qualify for tax at 5%.

Following this change, the agent bank or arrangers in Singapore are required to submit to the MAS a declaration (Syndication Declaration), within one month from the date of signing of the initial loan agreement, of their intent to syndicate the facility within the prescribed time frame. The latest submission date for the Return on Syndication Offshore Facilities is also extended to seven months after the date of signing of the initial loan agreement.

All lenders in the syndicated facility must be reflected as Lenders on Record in the arranger's or agent bank's records. Hence, sub-participation will not be considered as syndication for the purposes of this incentive.

The above changes will apply to any qualifying syndicated offshore credit facilities signed on or after 1 May 2009. All other conditions under the FSI-CFS scheme remain unchanged. The returns and

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declaration form to be completed by the arrangers in Singapore, syndication declaration, eligibility criteria and the accompanying explanatory notes have all been revised.

The extended timeframe for syndication provides for greater flexibility to arranger banks in selling down their exposure and comes at a very timely juncture given the strains in the current credit markets. This, coupled with the relaxation on the use of funds, should help to preserve the benefits of the FSI-CFS scheme in the current economic downturn.

Income derived from sale of foreign equity securities

Very broadly, income of a FSI-Standard Tier (FSI-ST) company from arranging, managing, underwriting, selling, investing in or providing other services (including services as a broker, nominee or custodian) in respect of foreign equity securities would qualify for 10% tax.

Foreign equity securities refer to stocks, shares or other equity securities issued by companies that are neither incorporated in nor resident in Singapore, as well as those issued by approved Singapore companies which derive at least 50% of their annual turnover from outside Singapore.

This concession for equity capital market activities has had a long history and dates back to the days of the Asian Currency Unit and approved securities company, where both broking and trading constitute qualifying activities for the tax incentive. In response to queries from taxpayers on whether the scope of the incentive remains unchanged following the introduction of the FSI scheme, the MAS has now clarified that the income (net of qualifying base) derived by an FSI-ST company from the sale of foreign equity securities will continue to enjoy the concessionary tax rate of 10% under the FSI scheme. This is regardless whether the company is trading on a proprietary basis or acting as a selling agent.

This clarification will be much welcomed by taxpayers, as it confirms the position that the scope of qualifying activities should not be varied with the consolidation of various tax incentives under the FSI scheme.

Commodity Derivatives Trading

The Commodities Derivatives Trading (CDT) scheme was introduced in the 2004 Budget to encourage the growth of the commodities derivatives market, and to enhance Singapore's position as a commodities trading hub.

Existing scheme

Currently, the CDT scheme provides a 5% concessionary tax rate to an approved company on its income derived from:

(a) trading with and/ or providing services as an intermediary for, qualifying counterparties in over-the-counter (OTC) as well as exchanged-trade commodity derivatives;
(b) trading on or after 24 May 2007 with any person in OTC commodity derivatives where the trade is cleared on or after that date through the SGX AsiaClear Facility of the Singapore Exchange Derivatives Clearing Limited; and
(c) incidental physical trading with qualifying counterparties, provided such physical trades do not exceed 15% of the total trades.

Commodity derivatives covered by this incentive refer to derivatives whose payoffs are linked, in whole, to the payoffs or performance of the underlying commodities and freight rates. Derivatives whose payoffs are linked to the payoffs or performance of any underlying financial instruments such as securities, indices or currencies are excluded.

Enhancements

The CDT scheme has been extended from 27 February 2009 to 31 December 2013. The tax incentive has been enhanced as follows:

(a) 5% tax to an approved company that

(i) trades in exchange-traded commodity derivatives where the

approved company is a member of a qualifying exchange; and

(ii) provides services as an intermediary in connection with transactions relating to exchange-traded commodity derivatives between qualifying persons and a qualifying exchange.

The counterparty requirement that a CDT company has to observe for trading in exchange-traded commodity derivatives has been removed.

(b) The scope of commodity derivatives has been expanded to include emission derivatives.

Emission derivatives are derivatives, whether transacted OTC or on an exchange, the payoffs of which are linked in whole to the payoffs or the performance of underlying emission allowances.

(c) The qualifying conditions for trading in commodity derivatives have been aligned.

With effect from 27 February 2009, new applicants carrying out qualifying activities in relation to exchange-traded commodity derivatives are required to employ and maintain at least three professionals.

(d) The tax concessions for CDT have been subsumed as new sub-categories within the FSI-Derivatives Market (FSI-DM) award.

All companies currently granted the standard or enhanced CDT incentive will be deemed to be granted the FSI-DM incentive with effect from 27 February 2009. The expiry date of the FSI-DM incentive is tied to the expiry date of their original CDT award. The headcount required for the standard and enhanced CDT incentive is three and five professionals respectively.

Companies will have to apply for the FSI-DM (Exchange Traded Commodities Derivatives) award from 27 February 2009 to 31 December 2013. The company is required to employ and maintain at least three professionals.

A new incentive is introduced for trading financial and commodity derivatives. Companies will have to apply for the FSI-DM (Financial OTC & Exchange Traded Commodity Derivatives) from 27 February 2009 to 31 December 2013. The Company is expected to employ and maintain at least 11 professionals.

As an applicant for a new sub-category will only enjoy the tax concession for income from transactions in, or services related to, commodity derivatives, but not necessarily from other types of derivatives, this change is largely of an administrative nature.

Conclusion

Tax concessions have played an integral role in the development of Singapore as an international financial centre. The enhancements made to the FSI-CFS and CDT schemes demonstrate the need to continue to stay relevant and keep pace with changes in the global financial scene.

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