

Tax Bulletin

Update on current tax developments in Singapore

Editor's Note

It has been a year since our last issue of Tax Bulletin. Due to some significant tax changes that had arisen recently, we thought it timely to come up with an issue now to highlight some of them which could be of relevance to you.

This issue of the Tax Bulletin provides a summary of the more significant aspects of:

- The Income Tax (Amendment) Act 2000, which was passed by Parliament on 25 August 2000 and gazetted on 7 September 2000;
- The Income Tax (Exemption of Interest and Other Payments for Economic and Technological Development) Notification 2000 gazetted on 15 September 2000;
- Taxation guidelines on Electronic Commerce published on the website of the Inland Revenue Authority of Singapore (IRAS) on 30 August 2000;
- Stamp Duty relief announced in the press statement dated 30 June 2000 issued by the IRAS; and
- the Malaysian High Court case of SGSS (Pte) Ltd v. Ketua Pengarah Hasil Dalam Negeri dealing with Malaysian section 4A income which is subject to withholding tax.

Income Tax Changes

The Income Tax (Amendment) Act 2000 gazetted on 7 September 2000 deals mainly with tax changes introduced in the year 2000 Budget. The bulk of the amendments focused on special trading counter for share buybacks, the entrepreneurial stock ownership plan and the reduction in corporate tax rate to 25.5 per cent from 26 per cent with effect from year of assessment 2001.

Special trading counter

When the government introduced measures to deal with changes to the Companies Act where share buybacks were permitted, it was noted that tax arbitrage opportunities could exist if the buybacks were effected through Special Trading Counter or STC (i.e., trading counters which any locally-listed company can set up at the Singapore Exchange (SGX) and dedicate for the purpose of buying back its own shares). Due to this possibility, the amendment of the tax treatment for share buybacks through STC was partially delayed until 28 February 2000 when the IRAS released a press statement that sets out the tax treatment. The Income Tax Act (Act) was recently amended to formalise that statement which was introduced to remove any tax arbitrage possibilities.

Normally when a Singapore resident company buys back its shares (pursuant to the Companies Act) through the STC, it will be regarded as having paid dividends to the holders of the shares it has bought back to the extent that the payment is not made out of the contributed capital of the company. Tax imputation credits (known in Singapore as section 44 credits) would have to be computed in such circumstances as dividends must have such credits attached as tax charges under section 44 would otherwise apply. The dividend statement issued to the shareholder in such a case must specify that the dividend is in respect of a share buyback through a STC.

The tax treatment for shareholders must satisfy additional conditions before the proceeds received could be treated as a dividend (where the tax imputation credits could be claimed by the shareholders). Otherwise, the amount will be treated as proceeds of disposition which may represent a capital receipt for persons who are not share traders.

The conditions that a shareholder must satisfy to have the receipt treated as a dividend are:

- The shareholder must have beneficially owned the shares continuously for at least 183 days, before the day of sale through the STC. There are special rules relating to calculating the period of beneficial ownership.
- The shares being sold have not been acquired under a securities lending or repurchase arrangement.
- The shareholder must submit to the IRAS a declaration stating the holding period, basis for acquisition and other relevant particulars.

When the above requirements are satisfied, the amount is deemed to be a dividend and the proceeds would have to be re-grossed to arrive at the gross dividend and the tax credits could be computed accordingly. Tax credits in excess of the shareholders' tax payable would be disregarded and the shareholders would not be allowed a deduction of the cost of the shares sold back through the STC. Furthermore, any provision for diminution in value of the shares that has been allowed as a deduction previously must be brought back to tax as a trading receipt to the extent it was not previously written back. It would appear that the intention of denying share traders any arbitrage benefits under this programme has been realised.

Entrepreneurial Employee Stock Option Plan

Under this incentive scheme, a 50 per cent income tax exemption will be granted on gains derived by qualifying employees from exercising, assigning or releasing a right or benefit to acquire ordinary shares in a qualifying company (or its holding company) incorporated in Singapore under an employee stock option scheme provided certain criteria are met. The 50 per cent tax exemption would be granted to gains of up to S\$10 million over a 10-year period.

This incentive is available for all stock options granted on or after 1 June 2000 by a qualifying company to a qualifying employee where the option can be exercised to acquire ordinary shares of the qualifying company. For further details, please refer to the June 2000 issue of *The Executive*, a publication of our Personal Tax Solutions group.

Other changes

- Certain sections (in relation to payment of tax) were amended to permit the Comptroller to defer the collection of tax and to charge interest when the actual payment of tax has been deferred

under a section of the Act. This was introduced to accommodate the tax deferral provisions of the Qualified Employee Stock Option scheme where qualifying taxpayers can opt to defer payment of their tax relating to gains from a qualifying employee stock option scheme for up to five years.

- The annual limits (qualifying profits and percentage of qualifying loans and investments) applying to banks when claiming a tax deduction for general provisions for doubtful debts and diminution in value of investments for years of assessment 1998 and 1999 have been reinstated.
- Income derived by a financial institution in relation to interest rate or currency swaps either by acting as intermediary or trading is assessable at the rate of 10 per cent. This applies from the first day of the basis period for the year of assessment 2001 to 27 February 2003. In addition, effective 25 February 2000, payments made to non-residents under interest rate or currency swap transactions involving financial institutions are exempted from withholding tax (see next section).
- Amendments are made to various provisions to reflect the reduction in tax rate to 25.5 per cent from 26 per cent. In particular, all Singapore dividends received in calendar year 1999 are taxed at 26 per cent irrespective of the fact that some of these dividends may be treated as income from a trade or business falling into the basis period for year of assessment 2001.
- Due to the restructuring of the Singapore Exchange (SGX), Singapore International Monetary Exchange Limited (SIMEX) is now known as Singapore Exchange Derivatives Trading Limited (SGX-DT). The change in name is applied to the relevant sections of the Act. SGX-DT is given the exemption that previously applied to SIMEX and the ability to distribute the exempt income (including amounts earned when it was known as SIMEX) is expressly set out.
- The incentive for royalties derived by an author, composer or choreographer is expanded to include payments derived from a Singapore publishing, music recording, film or drama business. The incentives for royalties derived by inventors and innovators (in relation to approved inventions and innovations) are extended to non-residents when a substantial part of the work in developing the invention or innovation is undertaken in Singapore.

The approval is limited to 5 years but appears to be able to be extended. Under each incentive the income subject to tax is deemed to be the lesser of 10 per cent of gross royalties or the net amount after allowable deductions.

- The expanded aged dependant reliefs announced in the 2000 Budget were enacted. Other benefits include the 5 per cent tax rebate and the continuation of the S\$500 GST rebate for individuals.
- Other technical amendments included:
 - ~ The removal of the exemption from tax for distributions made by CPF approved unit trusts out of interest and dividends to resident unit holders.
 - ~ The extension of the research and development deduction to businesses providing specified services.
 - ~ The elimination of an anomaly in relation to a replacement vehicle (incentive to renew diesel-powered vehicles) by deeming the new goods vehicle to have the same index mark as the replaced vehicle where each vehicle has a maximum laden weight of between 3 and 3.5 metric tons.

Withholding Tax Exemption Notice dated 15 September 2000

This Notice refers to interest rate and currency swaps entered into by a financial institution in Singapore. Financial institution is defined to mean any institution licensed or approved by the Monetary Authority of Singapore (MAS) and specifically includes any company that enjoys the Approved Fund Manager and the Finance and Treasury Centre incentives.

As a result of this notice which is deemed to be in effect from 25 February 2000, payments made by a financial institution to a person who is neither a resident nor a permanent establishment in Singapore will not be subject to withholding tax or any other tax in Singapore. There are restrictions if the counterparty is related to the financial institution. External auditor's certificate and other information must be submitted with the financial institution's tax return for such related party transactions and the transaction must be carried out under arm's length terms. However, no prior approval is required from the IRAS or MAS for the tax exemption in related party transactions.

Electronic Commerce Publications

On 30 August 2000, the IRAS posted a series of tax guides on EC transactions on their website (<http://www.iras.gov.sg/>). These provide general guidance on the Singapore tax treatment and procedures which will be applied by the IRAS with respect to taxation of EC transactions. They also provide guidelines for record keeping.

These guidelines were entitled:

- Income Tax Guide on E-Commerce
- GST Guide on E-Commerce
- Guide on Keeping of Records in Imaging Systems
- Guide on Keeping Machine-Sensible Records and Electronic Invoicing

Most of the focus was on the first publication.

Basically, the IRAS applies the basic tax principles for EC transactions and agrees that the mere presence of a server does not amount to trading in Singapore such that the business income would be liable to Singapore tax. Various scenarios were discussed and relevant factors employed in determining whether an EC transaction would be taxable in Singapore were identified. The guideline however does not deal with the tax implications of overseas countries although cross-border scenarios are described. The focus is mainly on Singapore tax.

Emphasis is set out in relation to the importance of complying with the withholding tax requirements on payments to non-residents made for the use or right to use of digitised products.

As for GST implications on EC transactions, the IRAS views EC as just a medium through which transactions occur and should not change the taxability of the transaction. Hence, the IRAS would apply basic principles in determining whether GST is chargeable. Therefore, a supply of goods or services made in Singapore would attract GST unless zero-rated (i.e. exported supplies).

Physical goods imported by air or post would be subjected to GST if the value exceeds S\$400. The importation of digitised goods is not subjected to GST. As for services, they are not subject to GST when provided by a supplier not belonging in Singapore.

The IRAS initially presumes everyone to belong in Singapore for GST and EC purposes. When the

consumer's address ends with ".sg", the presumption is irrefutable. For those addresses that do not end with ".sg", the consumer would be required to make a residency declaration (i.e. usual place of residence) that his/her residence is outside Singapore to enable the transaction to be zero-rated. Otherwise the transaction would be standard rated (i.e. subject to 3 per cent GST).

The last two guidelines are meant to assist businesses which wish to keep records in imaging system, or keep machine-sensible records or which wish to issue electronic invoices. The IRAS requirements are clearly stated in the guidelines and business entities would have to ensure that they can comply with them before the IRAS would approve of such record-keeping or invoice methods.

Stamp Duty Changes

In the 2000 Budget, Dr Richard Hu announced the following:

- stamp duty relief for transfer of assets between associated companies where the transfer results in no change in the ultimate beneficial ownership of the property or stock; and
- elimination of certain restrictions in section 15 of the Stamp Duties Act. These steps were taken to remove impediments to the continued development of our stock exchange and the current trend of corporate reorganisations. However, at that time, no specific details were announced.

The IRAS issued a press statement on 30 June 2000 setting out the qualifying conditions (see Annex A for a summary of the conditions) for the above relief. The stamp duty relief would only apply to instruments executed on or after 1 July 2000 and a written application with all the required details must be submitted to the Commissioner of Stamp Duties before the relief can be granted.

It is also important to note that companies are deemed associated if:

- transferor/transferee is the beneficial owner of at least 75 per cent of the issued ordinary share capital of the other; or
- a third party is the beneficial owner of at least 75 per cent of the issued ordinary share capital of the transferor and the transferee.

The beneficial ownership may either be held directly or indirectly, by one or more companies in the group. If the holding is indirect, the interest held in any intermediate company must be at least 51 per cent.

Malaysian Tax Case SGSS (Pte) Ltd v. Ketua Pengarah Hasil Dalam Negeri

This High Court decision had been long awaited by overseas companies providing independent services to companies in Malaysia. The decision was rendered on 20 March 2000. In practice, the Malaysian tax authorities argue that regardless of whether a service (falling within the ambit of the "catch-all" Malaysian withholding section, section 4A of the Malaysian Income Tax Act) is performed overseas or in Malaysia, it would be subject to a 10 per cent withholding tax. Non-resident service providers argue that the protection under the "Business Profits" Article (in the treaty between Malaysia and their country) is available especially when the services are not management services and are rendered overseas. However, in relation to most treaties, the Malaysian tax authorities disagree and would interpret such income to fall outside the scope of the "Business Profits" Article due to the definition of "income or profits" which excludes income from "the management, control or supervision of the trade, business or other activity".

In this case, the taxpayer was a Singapore incorporated and resident company providing third party inspection and expediting services for a particular project that was carried out by a Malaysian company. The services in question were rendered by the taxpayer outside Malaysia. The High Court disagreed with the Special Commissioners' (SC) decision and held that the relief under Article IV (i.e. "Business Profits" Article) in the Singapore-Malaysia Tax Treaty should be granted as the taxpayer fulfilled all the conditions set out in that article. The SC's interpretation of the exclusionary meaning of "income or profits" was found to be incorrect and the SC's decision was set aside as the SC failed to fully examine the contract between the taxpayer and the Malaysian company.

The contract clearly stated the scope of services to be provided by the taxpayer which acted as an independent contractor providing "inspection and expediting services". They were not acting as project management contractor exercising "management, control or supervision" which the tax authorities had claimed

to be within the exclusionary meaning. Therefore, the taxpayer was able to rely on Article IV of the Singapore-Malaysia treaty given the services were rendered overseas. The Malaysian tax authorities are required to refund to the taxpayer the tax improperly withheld.

Obviously, this case deals with situations where technical services are rendered outside of Malaysia to a Malaysian company. It does not deal with management fees, as such income would prima facie be excluded from the definition of business "income or profits". Strictly speaking, the case does not deal with services provided on site in Malaysia. Where services are provided in Malaysia, one would also need to deal with contentious issues relating to the presence of a permanent establishment which issues in the current case were dealt with by the taxpayer and the tax authorities by agreement. The Malaysian tax authorities may attempt to unduly restrict this case due to the location where the services are provided. Taxpayers should hope that the tax authorities will apply the approach taken by the judge in this case.

Annex A

Transfer of Assets Between Associated Companies

SUBJECT MATTER	CONDITIONS (to be fulfilled by subject matter)
Instruments Chargeable	<ul style="list-style-type: none">• The instrument must relate to assets such as immovable property or stocks;• The beneficial interest must either be disposed of, transferred or conveyed from one party to the other;• The transfer must be for bona fide commercial reasons;• The instruments of transfer are to be executed within 12 months of the transfer; and• The stamp duty on the instruments of transfer must be adjudicated under section 37 of the Stamp Duties Act.
Transferee Company	<ul style="list-style-type: none">• It must be incorporated in Singapore or be a Singapore tax resident;• If it is not newly incorporated for the sole purpose of this transfer, it must be associated to the transferor company for not less than one year before the transfer takes place;• It must acquire the entire interest in the assets held by the transferor;• Valuable considerations must be paid by the transferee company in cash or through the issuance of shares to the transferor;• It must not cease to be associated to the transferor within two years of the transfer unless the cessation is, itself, due to a reconstruction, amalgamation or an initial public offering of not more than 25 per cent of the existing issued share capital of the company making the public offering; and• It must not dispose of the beneficial interest in the acquired assets within two years from the time of acquisition unless such disposal is due to reconstruction, amalgamation or liquidation (in relation to which, the assets must be distributed in specie).

<p>Transferor Company</p>	<ul style="list-style-type: none"> • It must be associated with the transferee company for not less than one year unless the transferee company was newly incorporated solely for this transaction; • It must dispose of its entire interest in the assets held; • Valuable considerations must have been received in the form of cash or the transferee company's shares; and • It must not cease to be associated within two years of the transfer unless this result is due to a reconstruction, amalgamation or an initial public offering of not more than 25 per cent of the existing issued share capital of the company making the public offering.
<p>Outsider (not associated to either transferor or transferee)</p>	<ul style="list-style-type: none"> • It must not be involved in the payment of the consideration unless it is a financial institution acting in the capacity of a lender; and • It must not have previously been involved in the transfer of these assets unless the stamp duties requirements on such a transfer had been complied with.
<p>Parent Company of Transferee</p>	<ul style="list-style-type: none"> • If the transferee company is liquidated within two years after the transfer, the assets must be distributed in specie and the parent company must retain them until the expiry of the two-year period that was otherwise applicable to the transferee company.

Annex B

Extended Relief for Corporate Restructuring under Section 15 of the Stamp Duties Act

2-YEAR MORATORIUM RESTRICTION	CONDITIONS
IPO Restructuring or Floating of Shares (after restructuring)	<p>Transferee or existing companies can obtain relief from this restriction if:</p> <ul style="list-style-type: none"> the company's float shares does not exceed the SGX's minimum requirement for a mainboard listing; and the shares are floated on the SGX or are dual listed on the SGX and on a foreign exchange.
Consideration Shares Issued by Transferee Company	<p>Recipients of the consideration shares on a restructuring will not be required to hold them for the full two year period if they are public shareholders of listed companies undergoing restructuring. However, this does not apply to shareholders who held their shares in the transfer company before the IPO or further listing.</p>

Your contacts at PricewaterhouseCoopers Services Pte Ltd

Laurence Chan	236 3888	Doug Morgan	236 3948
Chan-Cheng Wei	236 3808	Noris Ong	236 3688
Paula Eastwood	236 3648	David Sandison	236 3675
Nicole Fung	236 3618	Martin Scully	236 3658
Jenny Goh	236 3638	Florence Tan-Nguyen	236 3868
Ho Mui Peng	236 3838	Peter Tan	236 3668
Khoo Ghee Khong	236 3828	David Toh	236 3908
Kung Wai Ming	236 3678	Michael Velten	236 3858
Anne K Lee	236 9888	Yip Yoke Har	236 3938
Bill Lexmond	236 3848		

PricewaterhouseCoopers (www.pwcglobal.com) is the world's largest professional services organisation. Drawing on the knowledge and skills of more than 150,000 people in 150 countries, we help our clients solve complex business problems, and measurably enhance their ability to build value, manage risk and improve performance in an internet-enabled world.

PricewaterhouseCoopers refers to the member firms of the worldwide PricewaterhouseCoopers organisation.