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Budget Commentary

Singapore

An analysis of the main tax proposals presented in Budget 2011

18 February 2011

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Double, bubble, still more trouble?

It was never expected that this would be a spectacular Budget, even in the context of a healthy fiscal surplus available for dishing out, and an election just around the corner. The spectre of inflation – possibly reaching 4% this year – and an economy bouncing along very nicely, thank you, meant that there was no need to pump prime anything. Much needed hand-outs for those at the lower end of the income scale could not be given entirely as free cash, as this would only serve to throw fuel on a fire that needs to be put out.

The approach therefore was to ensure that the bounty ($6.6 billion was earmarked as benefits to households) found its way to the target, but in a way that mostly provided longer term benefits for those most in need, rather than simply cash-in-hand. (Having said that, the $1.5 billion in growth dividends did have the feel of a freebie). In addition, some attempt was made to address the increasing issue of the aging population, by introducing certain measures to incentivise retention of older workers. Though the measures are welcome, it is clear this issue needs to be catapulted up the agenda next time round.

On the corporate tax side, the pickings were slim, and were aimed almost exclusively at the local small and medium enterprises (SMEs). At a general level, a 20% corporate tax rebate was introduced for income earned in 2010 but this was capped at $10,000; and for those not earning enough to benefit fully from this, a cash grant of 5% of turnover is on offer, subject to a cap of $5,000. Perhaps the biggest change came in the shape of enhancements to the Productivity and Innovation Credit (PIC) scheme, introduced last year to provide enhanced tax deductions for investment in productivity enhancing assets and processes. This showed the Government listens, with some quite generous enhancements being offered.

The thorn in the side however came through a continued Government insistence that the continued reliance on foreign workers could be modified if the stick was made bigger – in the form of a re-asserted commitment to gradually increase the foreign worker levy. This is unlikely to be met by enthusiasm in a number of quarters, where technological innovation is not just something that can be dusted down from the shelf and put into action. The inevitable result is simply a cost to business.

For foreign talent and multinationals – a stony silence – almost. There were some small concessions made in relation to stock options, and the biomedical industry, with the only cross-border tax change coming in the guise of a loosening up of the foreign tax credit (FTC) rules, which on the face of it look to add to complexity rather than reduce it. It still eludes many as to why the Government does not just simply exempt all foreign-sourced income and be done with it. Hong Kong and Malaysia seem to live happily with such a regime.

Taking a step back then, this was a very local budget with multinationals and foreign talent being put on the back burner, hopefully until no later than this time next year. While the Budget paid attention to and kept a lid on its own inflationary potential however, the fact that people on the other side of the world are printing money like there is no tomorrow, means the threat of inflation still kind of lingers.

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One-off corporate income tax rebate or cash grant

The corporate income tax rate remains at 17%. This was largely as expected given that the rate is considered competitive globally, and the economy is recovering nicely without the need for any wind-assistance.

A pleasing boon though was the one-off corporate income tax rebate of 20% of Year of Assessment (YA) 2011 corporate income tax payable (capped at $10,000) to help companies cope with rising costs. Since not all SMEs pay taxes or pay little taxes if they do, the Government also introduced a one-off SME Cash Grant based on 5% of the company's revenue for YA 2011 (capped at $5,000). These amounts will certainly be of little interest to sizeable multinationals thus it is clear that the reliefs are aimed at small local businesses.

Companies will automatically receive the higher of the tax rebate or the grant. To enjoy the grant though, companies must have made Central Provident Fund (CPF) contributions in 2010 which means they must have at least one Singaporean or permanent resident employee.

Productivity and Innovation Credit

Coming out of the worst global recession in recent memory, the Government re-focused its efforts in 2010 on steering Singapore towards sustainable growth of the economy and its people. To encourage SMEs to upgrade their workers' skills, invest in innovation and enhance productivity, the Government introduced the PIC scheme in the 2010 Budget which provided enhanced tax deductions for six categories of activities, as well as a cash conversion option.

While the PIC scheme is innovative and definitely an important measure, in its current state it can be quite complex and may deter businesses from claiming fiscal benefits, as the process of making claims can be costly and time consuming for them relative to the benefits which may be enjoyed. Responding swiftly to calls for more benefits and less pain, the Minister announced significant enhancements to the PIC scheme to encourage pervasive innovation and raise productivity efforts.

The enhancements that were announced below are effective immediately from YA 2011 to YA 2015 so that businesses can enjoy the enhanced deductions for YA 2011 for the productivity investments they have already made.

- The amount of tax deduction or allowance is increased to 400% of expenditure (up from 250%), for the first $400,000 spent on each qualifying activity (up from $300,000).

  This means that for every $1 spent on any of the six activities, a business is given a further $3 as a tax deduction. In other words, for every $1 spent, a company is effectively getting a subsidy from the Government of 68 cents ($1 x 400% x 17%). This will go some way to helping businesses raise productivity under the current inflationary environment, and provide a hedge against rising business costs.

- To help SMEs which may require more time and flexibility to plan their investments and benefit from the scheme, businesses will be allowed to combine the $400,000 expenditure cap for YAs 2013 to 2015 into a new ceiling of $1,200,000 over those three years. Businesses will therefore be able to claim a 400% deduction for the first $1,200,000 of expenditure on each activity that they incur for YAs 2013, 2014 and 2015 combined.

  Effectively, the combined expenditure cap for each qualifying activity will be:

  – $800,000 for YAs 2011 and 2012;

  – $1,200,000 for YAs 2013 to 2015.

  For example, if a taxpayer incurred $300,000 on training for employees in YA 2011 but incurred $500,000 on training in YA 2012, the taxpayer is entitled to claim the full $800,000 combined for YAs 2011 and 2012. If simplicity was the name of the game, then it may have been easier to allow businesses a combined cap of $2,000,000 over the five years of assessment.

- A simpler and enhanced cash conversion option, where taxpayers can opt to receive, in lieu of tax deduction benefits, a non-taxable cash payout of 30% of the first $100,000 of qualifying expenditure on total spending of up to $30,000 per year of assessment. Previously the maximum cash payout was $21,000 per year of assessment. This is available from YAs 2011 to 2013. It is suggested that the cash option is probably of appeal only to the desperate, as it does not equate to the tax effect of the primary incentive.

  It is also not clear how appealing the cash conversion option will be as other fairly inflexible criteria need to be met.

  Effectively, the maximum cash payout would be:

  – YAs 2011 to 2012 combined: up to $60,000;

  – YA 2013: up to $30,000.

  All other existing conditions of the current concession apply.

- Businesses will enjoy PIC benefits on research and development (R&D) expenditure incurred for R&D activities performed in Singapore and overseas. Previously, the benefits were only allowed for R&D activities performed in Singapore. This is a welcome change and one that had been lobbied for.

The Inland Revenue Authority of Singapore (IRAS) will release further details by the end of June 2011.

The PIC scheme is not meant to be an end in itself for businesses to enjoy tax benefits. Rather, it provides the means for companies to embark on the challenge to innovate by investing in capital as well as human resources for the long term. The PIC, to a certain extent, alleviates the financial burden that may weigh upon companies, especially SMEs, for which R&D activities and innovative projects would otherwise be too costly to undertake.

Companies should take advantage of the benefits available and identify and invest in the activities that will enable them to be more productive and innovative in the long term. With careful planning, dynamic companies would be well-placed to ride the wave of productivity. Otherwise, they may find themselves gradually being left behind in a re-structured economy of higher-value and more innovative players.

Summary of PIC enhancements

	Current treatment	PIC enhancement announced in Budget 2011
Amount of tax deduction or allowance	250% on the first $300,000 spent on each qualifying activity	400% on the first $400,000 spent on each qualifying activity
Combined expenditure cap	YA 2011 to YA 2012: $600,000 No combined expenditure cap for YA 2013 to YA 2015	YA 2011 to YA 2012: $800,000 YA 2013 to YA 2015: $1,200,000
PIC benefits available for R&D performed in Singapore or overseas	Only applicable for R&D expenditure incurred for R&D activities performed in Singapore	Applicable for R&D expenditure incurred for R&D activities performed in Singapore or overseas
Payment under cash conversion option	YA 2011 to YA 2012 combined: up to $42,000 YA 2013: up to $21,000	YA 2011 to YA 2012 combined: up to $60,000 YA 2013: up to $30,000

Pooling of foreign tax credits

Currently, in certain situations, a Singapore resident corporate taxpayer can claim a credit for foreign tax suffered on its income from foreign sources that is taxable in Singapore when it is remitted here. The amount of tax credit is limited to the Singapore tax payable or foreign tax suffered after setting off relevant expenses. The credit may not use up the full amount of foreign tax suffered, resulting in wastage. This is mainly because:

- Singapore adopts a country-by-country, source-by-source basis in allowing the credit (e.g. dividend withholding tax suffered in China cannot be used against royalty income from Malaysia);
- there can be a debate about the source of the income (if the IRAS is of the view that the income is Singapore-sourced rather than foreign-sourced, FTCs may not be available); and
- FTCs for a given year can never exceed the amount of Singapore tax payable in that year by the Singapore company (e.g. if it is in a loss position overall, the foreign tax it suffers for that year cannot be claimed as credit in Singapore).

Budget 2011 announced the introduction of FTC pooling (to take effect from YA 2012) to give businesses greater flexibility in their FTC claims. Conditions have been specified to enable election for the FTC pooling system. These are:

1. foreign income tax has been paid on the foreign income in the foreign jurisdiction from which it is remitted;

2. the headline tax rate of the foreign jurisdiction from which the foreign income is remitted is at least 15% at the time the foreign income is received in Singapore; and

3. there is Singapore tax payable on the foreign income and the taxpayer is entitled to claim an FTC under Sections 50, 50A or 50B of the Income Tax Act.

Conditions (1) and (2) mentioned above mirror the conditions that are currently applicable for the automatic tax exemption on certain types of foreign income (referred to as the foreign-sourced income exemption [FSIE] system), while the third condition appears to be a mere restatement of the current rules for availability of FTC. The conditions will clearly limit the benefit of the new pooling arrangements and in particular, it is not clear why income such as royalties and interest should have the same conditions applied as those that apply for essentially, dividends under the FSIE.

Where the conditions are satisfied and the eligible taxpayer elects for FTC pooling, using the example of the Chinese dividend and Malaysian royalty above, the Chinese and Malaysian tax will be pooled together and become FTCs against the Singapore tax payable on the sum of the taxable Chinese dividend and Malaysian royalty income. The tax cost of the above can be calculated and contrasted against the alternative of applying FSIE to exempt the Chinese dividend income from Singapore tax (with conditions satisfied) and allowing a smaller (un-pooled) FTC amount against the Malaysian royalty income taxable in Singapore.

Example 1:

Gross Thai dividend $400, Thai withholding tax $60, and direct expenses of $200 (for Singapore purposes)
Gross Malaysian royalty $800, Malaysian withholding tax $64, and direct expenses of $300 (for Singapore purposes)

Current situation (with FTC claim and FSIE)	
	$
Dividend	Exempt
Net taxable royalty (800 - 300)	500
	500
Tax @ 17%	85
Less FTC	(64)
Net Singapore tax payable	21
Total tax cost	145 *

* (21 + 60 + 64)

Election of FTC pooling	
	$
Net taxable dividend	200
Net taxable royalty	500
	700
Tax @ 17%	119
Less FTC pooled	(119) (restricted)
Net Singapore tax payable	0
Total tax cost	124 **

** (0 + 60 + 64)

Example 2:

Gross Chinese dividend $400, Chinese withholding tax $20, and direct expenses of $200 (for Singapore purposes)
Gross Malaysian royalty $800, Malaysian withholding tax $64, and direct expenses of $300 (for Singapore purposes)

Current situation (with FTC claim and FSIE)	
	$
Dividend	Exempt
Net taxable royalty	500
	500
Tax @ 17%	85
Less FTC	(64)
Net Singapore tax payable	21
Total tax cost	105 *

* (21 + 20 + 64)

Election of FTC pooling	
	$
Net taxable dividend	200
Net taxable royalty	500
	700
Tax @ 17%	119
Less FTC pooled	(84)
Net Singapore tax payable	35
Total tax cost	119 **

** (35 + 20 + 64)

As may be evident from the above, it is important to allow the taxpayer to choose between the two alternatives above for each source of income as it is to optimise its overall tax position. The optional nature of FSIE coupled with an FTC pooling election means that this flexibility to choose is likely to be given to the taxpayer (which is good news), although whether an election can be made for each source of income is still unclear.

Although the added flexibility may be welcomed, it is not clear that the new rules will "simplify tax compliance", as the Minister put it.

Nevertheless, the FTC pooling system could be enhanced with features such as:

- making the FTC available against Singapore-sourced income; and
- allowing carry-forward/back of unused FTC.

These features would boost the attractiveness of the FTC pooling system and reduce tax costs for taxpayers (for whom there is often no choice but to remit foreign income into Singapore to alleviate their foreign tax costs). Perhaps we will see some or all of these proposed in future Budgets.

Finally, the fundamental question of what is Singapore-sourced income and what is foreign income (that is within the scope of an FTC system) is often contentious and it would be helpful if the further details, to be released by the IRAS on this pooling system (expected by end June 2011), could provide a more logical and defined approach to resolve this.

Equity-based remuneration schemes

In 2006, after the amendment of the Companies Act to allow Singapore companies to hold treasury shares, the Government decided to grant a deduction for the purchase of treasury shares to facilitate the use of equity-based remuneration schemes (EBRS). The principle underpinning a deduction, as far as the IRAS was concerned, was that a real expense has to be incurred.

Arguably, treasury shares, which are retained as an asset, do not necessarily meet that criterion. Deductions in relation to a fresh issue of new shares to satisfy obligations under EBRS continued to be disallowed on the basis that no actual cost was incurred in using such shares for EBRS.

The specific rules for deduction were thus crafted against the above backdrop. They cater for the basic EBRS under which shares are acquired and held by the ultimate parent company of a group of companies, and transferred to its own employees, or to employees of its subsidiaries on vesting. The key requirements for a deduction to be claimed (as set out in Sections 14P and 15 of the Income Tax Act) are summarised below:

- a deduction is allowed for the cost incurred by a company in acquiring treasury shares that are transferred to its employees under an EBRS. A deduction is also allowed for costs incurred by a company for treasury shares acquired by its holding company that are transferred to its employees under EBRS, provided the cost is charged down to the Singapore company.

- the term "treasury share" is broadly defined to mean a share issued by a company which is subsequently acquired and held by it.

- to avoid companies claiming a deduction for the use of new shares to satisfy obligations under EBRS, a deduction is specifically denied for a company where it is being recharged for costs incurred to acquire shares (other than treasury shares) of its holding company. This effectively means that if the shares used to fulfil obligations under EBRS do not meet the definition of "treasury shares", a deduction will be disallowed to the subsidiary in Singapore even though an actual outlay has been incurred to acquire its holding company's shares from the market.

The above rules, however, failed to take into account the fact that EBRS already existed in Singapore prior to 2006. In fact, a deduction could have been claimed by entities in Singapore that had incurred expenses to satisfy their obligations under such schemes based on general deduction rules. The introduction of the specific rules thus brought about impediments to claiming deductions that were not there before.

Companies in many parts of the worlds use employee benefit trusts or other entities independent from the group to acquire and hold parent company shares on behalf of group employees. The companies in the group, whose employees are eventually entitled to the shares, incur an actual cost in that they have to fund the trustee to enable him to purchase the shares. But for the rules introduced to accommodate a deduction for treasury share acquisitions, those costs would have been deductible according to normal principles, as employment costs (on which the employees paid tax). The changes in this year's Budget effectively reinstate deductions provided:

- the Special Purpose Vehicle (SPV) is set up, as a company or a trust, solely to administer the EBRS for companies within the group; and

- the SPV acquires the parent company's shares from the parent company or the market and holds them in trust for the employees of the companies within the group for the EBRS.

The tax deduction is based on the lower of:

- the amount paid by the company to the SPV for the parent company's shares; and

- the cost incurred by the SPV to acquire the parent company's shares, less any amount recovered from the company's employees for the parent company's shares. This will take effect from YA 2012, which relates to the basis period in which the company is eligible to claim a tax deduction in respect of the shares and:

- applies the parent company's shares for the benefit of its employees under its EBRS through an SPV; or

- is liable to pay the SPV for the shares transferred, whichever is the later.

Pre-commencement expenses

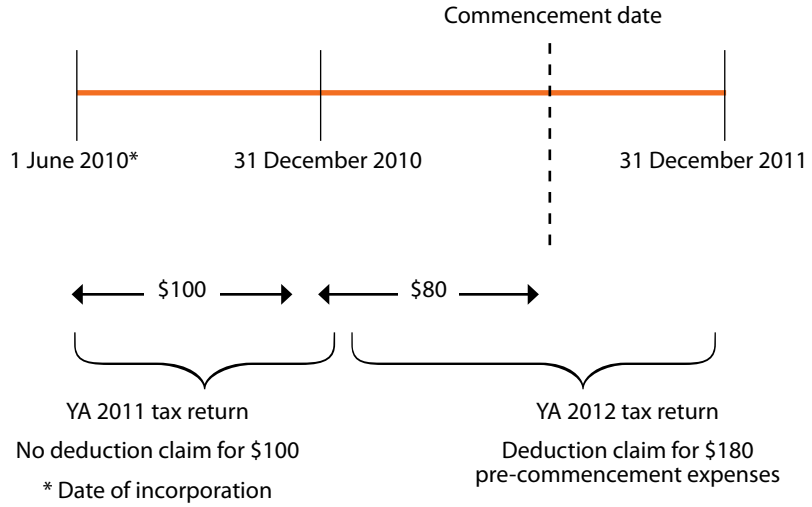
Expenses incurred by a business prior to the commencement of its business do not qualify for deduction. When a business is said to have commenced is a question of fact[1] and in practice, can be sometimes difficult to ascertain. It has often been an area of contention with the IRAS.

To simplify compliance and provide certainty, a concession was introduced in YA 2004, where the first day of the accounting year in which a new business earns its first dollar of income is deemed to be the date on which the business commenced operations. Therefore, revenue expenses incurred between the first day of the accounting year and the day it actually started to earn money is allowed a deduction. This concession applies automatically to new businesses unless an earlier date can be established by the taxpayer. This concession is not available to companies carrying on the business of making investments (Section 10E companies).

In the 2011 Budget, an enhanced concession was announced to allow businesses to claim pre-commencement revenue expenses incurred in the accounting year immediately preceding the accounting year in which they earn the first dollar of income. This deduction is claimed in the tax filing of the commencement year. See illustration below.

Illustration:

A company incorporated on 1 June 2010, with a 31 December year-end.



[1] *In 2008, the IRAS issued a circular providing guidance on the determination of the date of commencement of a business. However, this remains a question of fact and is very dependent on the nature of the business being carried on.*

The net effect is that the expenses for the current and previous accounting periods incurred before actual commencement, are deemed to be incurred on the first day of business. Where a loss results, this can be surrendered to other group companies under group relief.

All other existing conditions of the concession introduced in YA 2004 apply.

This enhancement will support start-up companies which sometimes need more than one accounting year to get off the mark in earning their first dollar although in fact the day the first dollar is earned is taken randomly as being when business is deemed to have commenced, for the sake of simplicity and to avoid further arguments. The IRAS will release further details by end June 2011.

Global Trader Programme

Currently, an approved company under the Global Trader Programme (GTP) is granted a concessionary rate of 5% or 10% on its income from qualifying trades in:

- exchange-traded and over-the-counter (OTC) commodity derivatives where the underlying commodities are within the GTP company's list of approved commodities; and

- freight derivatives.

To encourage risk management activities, the GTP will be expanded to include all derivative instruments such as interest rate swaps and foreign exchange derivatives. This has been in the wish lists of many GTP companies, particularly those which are sophisticated in this area. This enhancement would reduce compliance costs and provide added flexibility and opportunities for GTP companies to manage the risks better. It would also stimulate risk management activities in those which are new to the business. More details will be released by end April 2011.

An unexpected development is that the GTP will have a 31 March 2021 sunset clause. Along with this, the enhancements to the GTP introduced in the past, will be aligned with the 31 March 2021 deadline. While the incentive could be extended or improved after 2021, there is also the possibility that it will be withdrawn. This uncertainty may hinder long-term investment projects in Singapore, particularly as other incentives such as the Development and Expansion Incentive (DEI) and Pioneer Incentive are always subject to sunset clauses.

The question arises as to whether the GTP will be subsumed under an existing wider tax incentive such as the DEI, or replaced by another customised tax incentive for the global trading community. There may be an alternative view that Singapore has developed such an entrenched global trading ecosystem, that it will continue to flourish and grow without having to attract and retain highly global and mobile trading companies with a competitive tax rate.

A key attraction of the GTP is that it offers a long-term, robust and favourable tax environment, which is critical to global trading companies. On this count, Singapore is preferred, by many, to other jurisdictions in the region. With the sunset clause, the long-term certainty of operating under a renewable GTP award will no longer exist. It will be interesting to see whether this could have a negative impact on traders investing in Singapore.

Maritime Sector Incentive

The maritime sector has always been an important part of the Singapore economy. Currently, there is a host of tax incentives supporting the maritime sector as the Government seeks to package a comprehensive suite of tax incentives for the international maritime community, including those providing ancillary maritime services such as ship brokers, ship managers and insurers.

To streamline and simplify the maritime tax incentives, the Minister introduced a new Maritime Sector Incentive (MSI), together with certain enhancements to existing packages. The MSI will take effect from 1 June 2011 and covers three broad categories. Existing incentive recipients will transit automatically to the MSI from 1 June 2011.

MSI will cover the following three categories of shipping and related shipping support services:

International shipping operations

Existing entities enjoying tax exemptions under the current Sections 13A (mainly for Singapore-flagged ships) and 13F (i.e. Approved International Shipping [AIS] Enterprise Scheme - mainly for foreign-flagged ships) of the Income Tax Act will transit into this category.

New entrants granted the MSI under this category will enjoy similar tax benefits to those currently enjoyed by the AIS scheme, except for a change in the qualifying period. The incentive will no longer be granted for up to a maximum period of 30 years. Instead, it will be awarded for a non-renewable period of five years only. It is not clear how the new scheme is thus considered an enhancement and a five-year limitation is hardly likely to be seen as appealing.

Until now, withholding tax on payments incurred on foreign loans taken up to acquire or construct new ships is only exempted if specific approval is granted. In practice, it is difficult to obtain approval for ship construction loans under this concession. A new enhancement under this category is the automatic withholding tax exemption for qualifying payments made in respect of qualifying foreign loans taken up to finance the acquisition or construction of either Singapore-flagged or foreign-flagged ships belonging to approved ship operators under the MSI, provided certain conditions are met. The enhancement will obviate the need to apply for withholding tax exemption for every single loan.

There is a sunset clause and the scheme will expire on 31 May 2016.

Maritime (ship or container) leasing

Existing entities enjoying tax exemption or concessionary tax rates (5% or 10% depending on type of activities) under the current Maritime Finance Incentive (MFI) scheme will transit into this category.

New applicants granted the MSI under this category will enjoy similar tax benefits to those given under the current MFI scheme. The sunset clause for this category will also, unsurprisingly be 31 May 2016.

The automatic withholding tax exemption on charter fee payments or container lease rentals is also extended to approved lessors on qualifying payments made in respect of qualifying foreign loans taken up to finance the acquisition or construction of both Singapore-flagged and foreign-flagged ships, provided, as always, certain conditions are met.

Supporting shipping services

Existing entities enjoying concessionary tax rates under the current Approved Shipping and Logistics (ASL) scheme and Ship Broking and Forward Freight Agreement (FFA) trading incentive scheme will transit into this category.

New applicants granted the MSI under this category will enjoy similar tax benefits to those given under the current ASL and Ship Broking and FFA trading schemes. The concessionary tax rate of 10% is now also extended to income from qualifying corporate services. The sunset clause for this category will also be 31 May 2016.

More details on the MSI and the proposed enhancements will be released by the Maritime and Port Authority of Singapore by end May 2011.

What does this mean for the maritime industry?

Singapore had always wanted to grow itself into a truly leading international maritime centre with a full complement of maritime support service providers.

Granting an outright withholding tax exemption on qualifying payments made on qualifying foreign loans taken to finance the construction of both Singapore and foreign ships without having to apply for the exemption for each loan is definitely a welcome relief. This will encourage more new ships (including those under construction) to be owned and managed from Singapore, thus enhancing our international maritime status.

However, while it is recognised that Singapore sees the importance of expanding the Singapore-registered fleet, the introduction of a non-renewable five-year tenure to the MSI may negate any goodwill created from the simplification of the withholding tax exemption and does little to attract international ship-owners and operators to use Singapore as a base to control and manage their global shipping operations. It is not helpful to ship owners or operators who have to operate foreign-flagged ships to meet cabotage rules introduced in a number of countries in this region (e.g. India and Indonesia) which allow only the use of their local-flagged ships in coastal shipping.

Together with its tax enhancements, these latest changes will give rise to a perceived uncertainty over the duration of the MSI for international entry players operating an international fleet and contemplating using Singapore as a location to base their shipping operations on a long-term basis.

The proposed changes in the Budget therefore only appear to simplify the administrative process for the authorities at the expense of introducing uncertainties to a recovering maritime economy. There is a worry that, by default, Hong Kong may now be viewed as a more tax effective location to house an international shipping operation.

Donations

The current enhanced tax relief of 250% for donations to qualifying charities has been extended for five years and will continue to be available for donations made until 31 December 2015.

Financial services

This year's Budget does not contain many proposals that are specific to the financial sector. This is perhaps not surprising, given the number of measures that have been introduced over the years to boost Singapore's development into an international financial centre. In more recent times, the industry has been asking for simplification of tax rules to ease the burden of compliance, and the Minister has listened. No doubt, financial institutions (or at least those who stand to benefit from the proposed changes) will be pleased with the liberalisation of the withholding tax exemption regime, which will finally address the anomaly of having to observe different sets of conditions when seeking an array of exemptions for various banking products and transactions. The revisions to the deduction rules for employee equity-based remuneration to allow for more flexibility in the way companies structure their equity compensation arrangements should also be welcomed, with equity increasingly forming a larger part of staff bonuses, especially among senior management. It is submitted that, though a step in the right direction, these revised rules are still too prescriptive (see discussion above). Apart from some minor tweaks for trustee companies, there is nothing proposed for fund management. The extension and enhancements of the various measures for insurers very much mirror the other changes in the financial sector, where the Minister is proposing refinements as opposed to suggesting any major revamp.

Details of the changes relevant to the financial sector are set out below.

Withholding tax exemption regime for banks

Banks are given an array of tax concessions as they play an important role in positioning Singapore as an international financial centre. Apart from benefiting from concessionary tax rates for their income under the Financial Sector Incentive (FSI) scheme, they enjoy withholding tax exemptions on interest and related payments made to non-residents provided they are also banks. This is in recognition of the competitive landscape in which banks operate, where the imposition of any withholding tax will wipe out any margins that they may earn.

To facilitate access to a wider range of funding sources and to strengthen Singapore's position as a regional funding hub, the Minister has proposed to exempt withholding tax on interest and related payments by certain financial institutions to all non-resident persons (other than permanent establishments in Singapore) from 1 April 2011 onwards, provided the payments are made for trade or business purposes.

The types of financial institutions covered under this enhancement are:

- banks licensed under the Banking Act or approved under the Monetary Authority of Singapore (MAS) Act (i.e. merchant banks);
- finance companies licensed under the Finance Companies Act; and
- approved financial institutions licensed under the Securities and Futures Act that engage in lending as part of their regulated activity of dealing in securities in Singapore (e.g. investment banks and securities houses).

In line with the Government's intention to review all tax incentives for their relevance, a sunset clause has been inserted. Therefore, the withholding tax exemption will be applicable to:

- payments liable to be made between 1 April 2011 and 31 March 2021, for contracts which take effect before 1 April 2011; and

- payments liable to be made on contracts which take effect on or after 1 April 2011 to 31 March 2021.

The MAS will release further details by March 2011.

The above proposed enhancement will help to streamline the various withholding tax exemptions currently enjoyed by financial institutions and hence reduce their withholding tax compliance costs. These entities will need to continue to withhold tax on interest and related payments to permanent establishments in Singapore (unless the permanent establishment has obtained the necessary waivers from the IRAS). Otherwise, they only need to consider withholding tax implications on royalties, rentals for use of movable property, management fees and technical services fees.

It is unclear what the Minister means by saying the liberalised withholding tax exemption applies to the payments provided they are made for the purpose of "their" trade or business. One would imagine that all borrowings are taken for such purposes, and hence it seems withholding tax should not apply. It may, however, be possible that the phrase "trade or business" takes its meaning from how it is used in the tax legislation to mean income from an active source, as opposed to passive investment income. In that case, the withholding tax exemption is only available if the payments are made in earning trade (i.e. active) income, but not when they are incurred to derive investment income, for example, in the case of borrowings taken to finance the acquisition of a long-term capital investment or a subsidiary company. It is also not clear whose trade or business is being referred to (the bank's or the non-resident, non-bank's). It is hoped that these points could be clarified by the MAS in due course.

Tax exemption scheme for income derived from structured products

Presently, income derived by non-resident non-individuals from any structured product offered by a financial institution in Singapore is exempt from tax, subject to certain conditions. This exemption is applicable on payments made on structured products where the contracts take effect, are renewed or extended during the period between 1 January 2007 and 31 December 2011.

The above concession has now been extended to 31 March 2017.

Perhaps as a measure of the complexity of Singapore's exemption regime, there appears at first instance to be some overlap between this tax exemption and that available for financial institutions under the liberalised withholding tax exemption noted above. However, the two exemptions can be reconciled in that the former exempts the income from structured products from tax in the hands of the recipient, whereas the latter merely exempts the payer (i.e. the financial institution) from the need to withhold tax, and leaves the question of whether there is a tax liability to be determined by the recipient, who is obliged to report tax if he fails to meet the conditions for tax exemption.

Tax incentive for trustee companies

Currently, approved trustee companies (ATC) enjoy a concessionary tax rate of 10% on income derived from the provision of qualifying trustee and custodian services, as well as trust management and administration services. Neither the ATC scheme itself nor the ATC awards have an expiry date. When the rest of the financial sector tax incentive schemes were being consolidated and tagged with a shelf life in the last decade, the ATC scheme was left to run its course.

It has now finally been proposed that the administration of the ATC scheme will be streamlined with that of other financial sector tax incentives with the following changes:

- The ATC scheme will expire on 31 March 2016, at which point, the Government will review its relevance to the industry.

- The ATC awards will be for a 10-year period. All existing ATCs will automatically transit to the new framework from 1 April 2011, with an award expiry date of 31 March 2021.

The good news is that the scope of qualifying activities under the scheme has been expanded to include the provision of trustee and custodian services in respect of the issue of units to foreign collective investment schemes (CIS) and foreign business trusts with effect from 1 April 2011.

A similar expansion in the scope of income from qualifying trust administration services under the FSI scheme was announced in a circular issued by the MAS on 11 May 2010. In that circular, the concessionary tax rate of 12% under the FSI scheme was extended to income from the provision of trustee services in respect of the issue of units of a foreign CIS and a foreign business trust, where the proceeds of the issue of units were used outside Singapore and where the payment for the trustee services were not borne directly or indirectly by a person resident in Singapore or by a permanent establishment in Singapore, other than a permanent establishment created by a Singapore trustee in his capacity as a trustee of a foreign CIS. The circular also defines the terms “foreign CIS” and “foreign business trust”.

These conditions and definitions are expected to be similarly applied to the expansion of scope of qualifying income under the ATC scheme. However, the ATC scheme offers a more attractive tax rate of 10%. Further details will be released by MAS by end April 2011.

Insurance

The Minister has extended the following two insurance incentive schemes:

- captive insurance tax incentive scheme; and

- specialised insurance tax incentive scheme.

In addition, he has introduced a sunset clause for the marine hull and liability insurance tax incentive scheme.

For each of the above schemes, an award renewal framework will be introduced for incentive recipients with effect from 19 February 2011. More details would be released by the MAS by end April 2011.

Captive insurance tax incentive scheme

The captive insurance tax incentive scheme is a scheme whereby an approved captive insurer is entitled to a 10-year tax exemption on specified income earned from writing offshore risks. This scheme, which expired on 16 February 2011, has now been extended for another seven years to 31 March 2018.

A captive is an insurance vehicle set up to insure the group risks of a multinational group. They are typically set up for risk management purposes (e.g. to pool group risks, access the reinsurance market or self insure certain risks that are not insurable) and tax is not usually the driving criteria. However, once a multinational group decides to set up a captive, it makes economic sense to locate this captive in a country that has either low tax or zero tax. It is for this reason that captives are typically located in places like Bermuda or the Cayman Islands.

The extension of the captive insurance tax incentive scheme is much needed to ensure Singapore remains competitive as a captive location when compared against other typically favoured jurisdictions like Bermuda or the Cayman Islands, or even our Asian neighbours like Labuan or Hong Kong. Currently, Singapore has 60 registered captives and the extension of this scheme will help to ensure that Singapore retains them plus attracts new ones to its shores. Singapore is well positioned to be a captive location for Asian multinational companies. It may also have an advantage over a location like Labuan or Bermuda particularly where the multinational group currently has business operations in Singapore and wishes to situate its captive in a location that has people and business substance.

Under the scheme that has just expired, the conditions to qualify for the exemption is not onerous. It is hoped that MAS will keep the qualifying criteria for the extended scheme equally light. Otherwise, it would be difficult for Singapore to compete with the other captive locations.

Specialised insurance tax incentive scheme

The specialised insurance tax incentive scheme, which is due to expire on 31 August 2011 has been extended by another five years to 31 August 2016. This scheme is targeted at growing Singapore as a hub for the writing of certain specialised lines of business, such as terrorism risks, political risks, energy risks, aviation and aerospace risks, and now, agriculture risks. It grants a total exemption to approved insurers on specified income earned from accepting offshore risks of the particular approved specialised line of business.

The addition of "agriculture risks" as a qualifying business line in this year's Budget is timely given that a number of our neighbouring countries have significant agriculture-based economies.

Marine hull and liability insurance tax incentive scheme

The marine hull and liability insurance (MHL) tax incentive scheme grants a tax exemption to approved insurers on specified income earned from accepting both onshore and offshore MHL risks. There was previously no sunset clause for this incentive. One has now been introduced – 31 March 2016 – for the stated purpose of allowing the Government to conduct regular reviews of incentive schemes.

Tweak the schemes

In the past, the take-up of the specialised insurance tax incentive scheme and the MHL tax incentive scheme has been low. The qualifying conditions for the schemes are not easy to meet. In addition, should a loss be made in the incentivised business, that loss is quarantined and cannot be used to offset income arising from other lines of business. The need to segregate the incentivised business from non-incentivised business is administratively cumbersome. It is hoped that MAS will tweak the schemes and render it more user and tax friendly.

Withdrawal of tax exemption scheme for financial guaranty insurers

A financial guaranty insurer typically provides cover against the failure of a borrower to repay a particular loan. It can be used to enhance the credit rating of a bond issue.

Should a claim be paid on a financial guaranty insurance policy issued by a Singapore-based financial guaranty insurer, the claim payment could technically be subject to withholding tax under Section 12(6) of the Income Tax Act if the payment is made to a non-resident. For this reason, the Government had introduced a scheme exempting such claim payments to non-residents from withholding tax. In Budget 2011, this exemption scheme has been discontinued.

The exemption scheme was introduced way back in 2000 when the Government was encouraging the setting up of financial guaranty insurers in Singapore. Since then, all specialised financial guaranty insurers have pulled out of Singapore. The exemption scheme introduced in 2000 is no longer relevant. Its abolition should have no impact for insurers in Singapore.

Finance and Treasury Centre incentive

Under the Finance and Treasury Centre tax incentive, income derived from qualifying services provided to or qualifying activities undertaken with approved network companies and other parties can qualify for a concessionary tax rate of 10%. When the incentive was first introduced, Singapore-based associated companies of Finance and Treasury Centres were not allowed as approved network companies. In recognition of the fact that this unduly restricted the business of Finance and Treasury Centres of multinational groups which may operate in Singapore through several legal entities, this rule was changed in 2005. Associated companies of the Finance and Treasury Centre which are located in Singapore can qualify as approved network companies subject to the condition that the total annual revenue of these Singapore-based companies does not exceed 10% of the global group revenue.

In the 2011 Budget, the Minister announced a tweak to this calculation in that related party transactions can now be excluded from it. The new method of calculation enables a meaningful comparison to be made, since the group will now compare revenue figures which exclude the effect of intercompany transactions at both the local and global levels.

While this change purports to capture a more accurate indicator of comparative size, an incidental, and perhaps deliberate, impact could be to help multinational groups qualify more easily for the tax incentive, since the exclusion of related party transactions could mean that the 10% limit is less easily breached. This enhances the attractiveness of the incentive to both Singapore-based and foreign multinational groups.

In addition, in line with the policy to review tax incentives regularly to ensure their relevance, the Minister has announced that a sunset clause will be introduced for the Finance and Treasury Centre incentive for an initial expiry date of 31 March 2016.

Project finance

A project finance incentive package was introduced in November 2006 to encourage the expansion of the project finance industry through Singapore's capital markets. It provided, among other things, a tax exemption for interest from qualifying project debt securities for investors, exemption for prescribed foreign-sourced interest income of qualifying entities listed on the Singapore Exchange (SGX), and remission of stamp duty payable on instruments that gave effect to the transfer of prescribed assets to entities listed or to be listed on the SGX.

According to the Asian Development Bank, continental Asia needs to invest approximately US$8 trillion in national infrastructure between 2010 and 2020. In addition to national infrastructure, investment in regional infrastructure such as communication and transport will give further impetus to trade and regional integration. Against this backdrop, the Minister has proposed to extend the project finance incentive package, which was due to expire by the end of this year, to 31 March 2017.

The FSI (project finance) company scheme, which provides for a concessionary rate of tax at 5% on qualifying income of financial institutions will, however, not be extended. This is because financial institutions can enjoy similar tax concessions under other FSI schemes, for example the bond market or the credit facilities syndication scheme. Existing FSI (project finance) companies whose awards expire after 31 December 2011 will need to apply for the bond market and the credit facilities syndication schemes to continue to enjoy the 5% tax concession. It remains to be seen whether the qualifying criteria between these incentives will be aligned, for example, the minimum headcount for the bond market scheme is eight professionals whereas that for the project finance scheme is five. The MAS will provide details of these changes by April 2011.

Personal tax changes

The 2011 Budget is likely to be well received by most individuals. The two headline "give-aways" are a reduction in income tax rates at all levels up to $120,000 for YA 2012, and the one-off income tax rebate for YA 2011, which could put up to $2,000 in the hands of each individual immediately. Both measures should represent good news for all.

Tax rates

The Minister announced a reduction in some of the lower marginal income tax rates for YA 2012. This is reflective of the intention announced in last year's Budget to make the personal income tax system more progressive. This step will mean that tax savings will be enjoyed by taxpayers at all income levels. Table 1 below shows that an individual earning salary of $100,000 for calendar year 2011 might see his final YA 2012 tax liability fall from $4,147 to $3,196, which represents a reduction of approximately 23%.

Table 1 Comparison of tax payable for a married taxpayer
Years of Assessment 2011 and 2012

Total Remuneration						
	YA 2011	YA 2012	YA 2011	YA 2012	YA 2011	YA 2012
	$ 100,000		$ 200,000		$ 350,000	
	Computation A		Computation B		Computation C	
	$		$		$	
Gross Income	100,000	100,000	200,000	200,000	350,000	350,000
Less: Personal Reliefs						
Earned Income	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)	(1,000)
Wife	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
Children	(8,000)	(8,000)	(8,000)	(8,000)	(8,000)	(8,000)
CPF	(10,800)	(11,200)	(10,800)	(11,200)	(10,800)	(11,200)
NET CHARGEABLE INCOME	78,200	77,800	178,200	177,800	328,200	327,800
TAX PAYABLE	4,147.00	3,196.00	18,594.00	16,976.00	44,340.00	43,910.00
Tax Saving ($)	951		1,618		430	
Effective Tax Rate	4.15%	3.20%	9.30%	8.49%	12.67%	12.55%

Notes

1. *Standard deductions are taken into account.*
2. *Employee contribution to CPF is based on the maximum ceiling :-*
   January 2010 to December 2010 - $4,500
   January 2011 to August 2011 - $4,500
   September 2011 to December 2011 - $5,000
3. *For comparison purposes, the one-off tax rebate for YA 2011 has not been taken into consideration.*

Although tax liabilities are likely to reduce at all levels, income tax will still begin to be paid at a relatively low income threshold level ($20,000). The Minister could have achieved a similar result by simply abolishing the lowest tax band; this would have had the added advantage of reducing both the employers' and the IRAS' administration for this income group which contributes very little to the tax coffers.

Perhaps surprisingly, the Minister has actually increased tax rates for individuals earning above $120,000, by introducing new 15% and 18% tax brackets. The result is that, at the top end of the tax bracket, the effective tax rates are largely unchanged. For example, a senior executive earning $350,000 might see his effective tax rate reduced by only about 0.1%. This is the first personal income tax rate increase for several years and was largely unexpected in most quarters; in fact many had predicted a rate reduction at the top level. If the projected Budget surpluses do indeed come about, the Minister may wish to consider the elimination of the lower rate band and possibly a reduction in the headline rate in due course.

Tax rebate

The tax rebate will take effect for YA 2011, which means all tax residents will have their final tax liability on income earned during 2010 reduced by 20%, with a maximum rebate of $2,000. There had been similar rebates in prior years, however this was discontinued for YA 2010 as a result of fiscal uncertainty. This reintroduction was also somewhat unexpected, as the Singapore tax structure is already competitive compared to other countries in the region (as shown in Appendix B). The reintroduction of the tax rebate now is presumably to share the stronger than expected tax revenues, but this may have been better received as a more permanent reduction in tax rates rather than a one-off measure.

Central Provident Fund

The need to strengthen provisions for old age retirement and medical care has been recognised by the Government for some time now, and a number of updates to the CPF system have been introduced over the last few years. This was continued in the current Budget, with a further increase in mandatory employer CPF contributions, this time up to 16% with effect from 1 September 2011. This will be in addition to the increase from the current 15% to 15.5% on 1 March 2011, which had been announced previously. The income capping limit will also increase from $4,500 per month to $5,000 from 1 September 2011.

The Government has announced a one-off Medisave top-up for the elderly. Companies will also be incentivised to make voluntary contributions into the Medisave accounts of their employees and self-employed contractors by allowing tax deductions for such contributions (subject to certain capping limits). While Singapore's ageing population will certainly welcome the additional funding, SMEs are unlikely to welcome the increase in employment costs as a result of the rising employer CPF obligations.

Supplementary Retirement Scheme

In line with the increase in the CPF earnings cap, the Supplementary Retirement Scheme (SRS) contribution cap has accordingly increased. SRS plans offer additional income tax relief for contributions made, while building a nest-egg for retirement. Increasing the cap should generally be welcomed, however the take-up for the SRS has not been widespread so it is questionable whether tweaking SRS contribution limits in this way will have a material effect. Section 5 plans are another mechanism for employers to help their employees save for

retirement which have similarly experienced poor participation rates. Rather than rely almost exclusively on the CPF for long-term personal financial planning, it is high time to consider why the SRS and Section 5 plans have proven so unpopular. Simplifying and consolidating the SRS and Section 5 schemes to allow tax deductions for additional voluntary employee and employer contributions, and tax free withdrawal of any capital growth may provide Singaporeans with a greater incentive to save for their future beyond what little the CPF now has to offer.

Foreign Worker Levy

The further increases in the Foreign Worker Levy will apply pressure on companies which employ cheap manual labour from overseas. The Government's measures to up-skill the Singaporean labour force may mean even fewer Singaporeans will look to take these low-paid, labour-intensive jobs; hence care will need to be taken to ensure the employers, such as the construction and hospitality industries, can continue to service their operational requirements.

Tax reliefs

The 2010 Budget focused heavily on updating the system of tax reliefs to help incentivise positive behaviours, such as supporting one's dependant family members and contributing to charities. After a widespread update last year, it was not surprising that the tax relief structure was relatively unchanged this year. The current enhanced tax relief of 250% for donations to qualifying charities has been successful, with charitable contributions reaching record highs during 2010. This enhanced relief will continue to be available for donations made until 31 December 2015. This five-year commitment to supporting philanthropy is commendable; but perhaps it is time to make this enhanced tax relief permanent.

Tax relief will no longer be available in respect of alimony payments made to former spouses. This is aligned with the Government's intention to promote strong family ties. However, there was a missed opportunity to reflect the structure of the modern family unit, as certain reliefs (e.g. Foreign Maid Levy Relief) are still only available to working women.

It may also be difficult to improve the current declining birth rate through fiscal policy, but revamping the Parenthood Tax Rebate or introducing a Married Couple Relief may help encourage couples begin to grow the next generation of Singaporeans.

On the surface, the 2011 Budget appears to give good cheer to all, however closer inspection might suggest it should be regarded as something of a "Robin Hood" Budget: giving to the poor and elderly while not offering too much to the middle and high-income households.

Goods and Services Tax

It would be naive to expect the Government to reduce the Goods and Services (GST) rate as a means to counter inflationary pressures and higher costs (which of course did not happen) as this goes against the Government's traditional approach of using taxation and spending as a means to provide direct assistance to targeted groups such as the lower income households.

Instead, the experience in recent years has seen the Government using GST as a tool to relieve the business costs in sectors or industries that the Government feels require assistance. The following changes to GST that were announced in the Budget are further examples of that.

Measures for the biomedical industry

The import relief announced by the Minister for clinical trial materials (CTMs) overcomes a technical constraint in the current GST legislation which does not allow a local intermediary or research organisation to recover the import GST that is payable when the CTMs are brought into Singapore for local testing in a clinical testing facility.

Further, the current rules could subject an overseas client or principal who owns the CTMs to a liability for GST registration as a result of the supply of CTMs in Singapore. A local clinical research organisation would also have to charge GST at 7% on its supply of value-added services on the CTMs to the overseas client if the goods are disposed of in Singapore.

To encourage clinical research activities in Singapore, import relief will be granted for all CTMs imported into Singapore regardless of whether the CTMs are for local testing, re-export or for disposal in Singapore.

The Approved Contract Manufacturer and Trader (ACMT) scheme which is available only to the semiconductor and printing industries will also be extended to qualifying biomedical contract manufacturers such that the supply of value-added services to the overseas client will be disregarded for GST purposes.

The ACMT scheme will be further enhanced to disregard services rendered by a local contract manufacturer on failed or excess production under the ACMT scheme; and allow the local contract manufacturer to recover GST on local purchases of goods made by the overseas client for use in the contract manufacturing process.

The changes are effective from 1 October 2011 but businesses would need to wait until September 2011 for the IRAS and Singapore Customs to publish circulars to explain the operational details.

The measures are welcome changes to enhance Singapore's efforts to be a vibrant hub for clinical research and further grow our biomedical sciences industry.

Zero-rating of supplies to qualifying ships

As part of the Government's moves to establish Singapore as the leading international maritime centre, changes were also introduced for GST.

At present, the sale and lease of goods for use or installation on a ship (as defined in the GST Act) can be zero-rated provided the supplier of the goods maintains certain documentary proof. A new scheme will be introduced to take effect from 1 October 2011 whereby an "approved maritime customer" can buy or rent goods free of GST as long as the goods are for use or installation on a commercial ship that is wholly for international travel. This change effectively removes the need to maintain the documentary proof for the GST relief to apply.

In addition, the zero-rating of repair and maintenance services will be extended to such services that are performed on ship parts or components which are delivered to an "approved marine customer" or a shipyard in Singapore.

To further ease compliance for ships that visit Singapore for short periods, the need for documentary proof for GST relief is to be removed for a qualifying ship engaged in pleasure, recreation, sports or similar events. Import GST relief (without the need for documentary evidence) is also granted to goods shipped and which remain on board the qualifying ship.

The IRAS and Singapore Customs will publish circulars to explain the above changes and operational details by 1 September 2011.

Promoting the logistics sector

Services that are performed on goods stored in a warehouse in Singapore are standard-rated unless they are supplied to an overseas person and the goods are exported. The difficulty for a business in Singapore is knowing when the goods are to be exported when they bill the overseas customer for goods that are stored for an extended period of time. The treatment of charging GST at 7% on warehouse storage in Singapore also erodes our competitiveness as a logistics hub.

With effect from 1 October 2011, a zero-rating scheme will apply to "specified services" supplied to an overseas person if the services are performed on certain goods that are kept in approved warehouses in Singapore before being exported. Amongst other conditions for the zero-rating treatment, the specialised warehouse must have mostly overseas customers (at least 90%) and the majority of the goods (again at least 90%) removed from the warehouse must be for export.

The above change is not expected to have wide application as the Annex to the Minister's speech refers to an example of specialised warehouses that store high-value goods such as art and antiques and the need to promote the use of such specialised storage facilities and supporting services such as valuation and conservation. However, we will have to wait for circulars to be issued by the IRAS and Singapore Customs by September 2011 to know the details and assess the wider impact.

Stamp duty

Conversion of a company to a limited liability partnership

The limited liability partnership (LLP) was introduced in 2005 to provide a broader range of legal entities available for businesses and investments. An LLP is not limited to use by professional service businesses. It can serve as a joint venture entity for corporate partners pursuing a common objective or venture. Currently, when a company converts into an LLP, its assets will automatically vest in the LLP. Although there is no instrument to effect the transfer of assets (e.g. immovable property) from the company to the LLP, stamp duty is still payable when the notice of registration of the LLP is issued.

The current stamp duty relief rules relating to the conversion of an existing firm (an ordinary partnership) to an LLP is now extended to cover the conversion of an existing company to an LLP. Such relief is subject to the following conditions:

- the shareholders of the existing company remain as the partners ("original partners") of the new LLP as at the date of conversion;
- the assets of the new LLP are those of the existing company as at the date of the conversion;
- the percentage of partnership interest of each of the partners in the new LLP has to remain the same as the shareholding percentages of each of the shareholders in the existing company as at the date of conversion; and
- at least 75% of the composition of the partnership interest in the LLP held by the original partners immediately after the conversion should remain the same for two years from the date of conversion.

With these new stamp duty relief rules, companies with more than one shareholder now have the option to convert into an LLP without the potential stamp duty costs where the company owns dutiable assets such as immovable property.

This extension of relief provides businesses with flexibility in undertaking legal restructuring. Further details can be obtained from the IRAS e-Tax Guide "Stamp Duty: Relief for the Transfer of Assets upon Conversion of an Existing Company to a LLP" released on 18 February 2011.

Other indirect tax measures

Excise duties for tobacco products

To stem the growing consumption of non-cigarette tobacco products, the excise duties on the following classes of tobacco products will be raised with effect from 18 February 2011:

- beedies, ang hoon, and smokeless tobacco – from $181 a kg to $199 a kg (+10%); and
- unmanufactured tobacco, cut tobacco, and tobacco refuse – from $300 a kg to $315 a kg (+5%).

There is no change in excise duties for tobacco products such as cigars, pipe/blended tobacco, snuff, etc., which remain at $352 a kg or $352 for every 1000 sticks for cigarettes.

Extension of Green Vehicle Rebate scheme

It is disappointing that the Budget did not introduce any major "green" incentives except to extend the Green Vehicle Rebate scheme for another year to 31 December 2012 as follows:

- for hybrid and electric passenger vehicles, 40% of the Open Market Value (OMV) of the vehicle at registration;
- for hybrid and electric buses and commercial vehicles, 5% of OMV at registration; and
- for electric motorcycles, 10% of OMV at registration.

The Annex to the Budget Speech did mention that a comprehensive review on the measures to boost the adoption of green vehicles will be undertaken.

2010 in retrospect

Much of the corporate tax buzz in 2010 was about the Productivity and Innovation Credit (PIC) and the mergers and acquisitions (M&A) allowance, both introduced in Budget 2010. There was also the much awaited High Court decision in *ACC v Comptroller of Income Tax*[1].

Productivity and innovation credit

One scheme targeting small- and medium-sized enterprises is the PIC. Whether a company is profitable or loss-making, this scheme should, theoretically, help in some manner. A profitable (and tax-paying) company may decide to claim enhanced tax deductions for expenditure incurred on any number of six prescribed areas: acquisition or leasing of qualifying equipment, acquisition or registration of certain intellectual property rights, research and development expenditure, training as well as design expenditure. The scheme gives an enhanced deduction of up to $300,000 for each category in a year of assessment[2]. A less profitable company, on the other hand, might decide to go for the cash pay-out option, converted at a fixed rate of 7%, giving a maximum non-taxable cash grant of $21,000 ($300,000 x 7%). This is of course assuming that such a company is still prepared to invest, given the less than happy situation it is in.

While a laudable idea, it remains to be seen whether the implementation of the scheme has been smooth-sailing. Already there are concerns that the somewhat complicated conditions imposed for some categories may be deterring the very taxpayer group the scheme is targeted at.

Mergers and acquisitions allowance

The government has been encouraging Singapore home-grown companies to be more efficient and competitive market players. With the aim of helping to defray part of the acquisition cost of what can be an expensive exercise, an M&A allowance was introduced.

The scheme had some rather restrictive rules to start with. But a number of them were fine-tuned after a public consultation in June so as to ensure the scheme stayed relevant in the corporate world. For example, when first announced, only an operating company could qualify for the scheme. After feedback from practitioners and industries alike that the typical practice is to acquire by using a holding company, this rule was tweaked to meet that need.

Industrial building allowance and land intensification allowance

It came as rather a surprise when it was announced in Budget 2010 that the industrial building allowance (IBA) was to be phased out immediately. The even bigger surprise was perhaps the relevant statistics released; the IBA benefited fewer than 200 companies or less than 5% of tax-paying companies.

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[1] *[2010] SGHC 316*

[2] *A combined cap of $600,000 for each category applies for Years of Assessment 2011 and 2012*

With "productivity" being the flavour of the year, the IBA gave way to a new incentive termed the land intensification allowance. Only taxpayers from nine identified industries can apply for the incentive. The business sectors selected were those that typically require large plots of land take but are of high value-add and therefore make more efficient use of the land plot.

Other changes

Found below are some of the other more significant changes in the year:

- After much lobbying by taxpayers over the years, the Inland Revenue Authority of Singapore (IRAS) announced in August that as an administrative concession, it was prepared to accept a reduced withholding tax rate on gross fees paid to a non-resident related party for management services performed in Singapore. Before this, either the payer had to seek approval from the IRAS to apply a reduced withholding rate or the recipient had to file a return in Singapore to claim a refund of any excess tax withheld.

- On the goods and services tax (GST) front, the time of supply rule was changed to align it to business practice. The new rule takes away the need to track the date on which goods are delivered or when services are performed.

- To ease the import GST-cashflow pressure on GST-registered businesses that do not qualify for the Major Exporter Scheme, approved businesses may defer the payment of import GST for at least one month.

- Seller's stamp duty was first introduced in February as one of the residential property cooling measures. This was later revised in August – stamp duty of up to 3% applies depending on the seller's holding period. In less than five months (January 2011), the maximum rate was increased to an eye-popping 16% on a disposal of residential property within one year of purchase.

Tax cases

There were a number of tax cases in the year but one of the more interesting cases must be *ACC v Comptroller of Income Tax*.

The question for the High Court was whether interest rate swap payments made by a Singapore company to its overseas subsidiaries were subject to interest withholding tax. The court held that it was not – the swap payments were not made "in consideration of the forbearance in collecting the principal sum loaned... by the payee." In fact, neither party knew at the start of the swap agreement which of the counterparties would be indebted to the other in relation to the net payment that had to be made under the agreement. There was therefore no loan or indebtedness. It followed that any payment made under this agreement could not be in connection with any loan or indebtedness. While a much welcomed clarification, because of the way the case was argued, it is as yet unclear if similar payments could be caught under another subsection in the Income Tax Act.

The technical issue aside, perhaps the greater significance of the case lies in the need for the courts to reiterate that it is the judiciary, and not the executive, who has the final say in the interpretation of the law. Just because a particular interpretation or practice is widely accepted cannot and does not make it law. In other words, just because swap payments in certain circumstances were given exemption does not allow one to conclude there was a need for an exemption in the first place.

The year came to a close with *ZF v Comptroller of Income Tax*[3]. Here, the taxpayer successfully argued in the Court of Appeal that demountable dormitories constitute plant within the meaning of Sections 19 and 19A of the Income Tax Act.

[3] *[2010] SGCA 48*

2010 in snapshot

As before, 2010 saw various legislative changes introduced and circulars issued by the Inland Revenue Authority of Singapore (IRAS) and other agencies. Primarily, these reflected changes introduced in the 2010 Budget. Some highlights of the year's tax changes are set out below.

General corporate tax changes		
Productivity and Innovation Credit (PIC)	June	The IRAS and DesignSingapore issue circulars detailing the scheme which provides for enhanced tax deductions or allowances for expenditure on design, research and development, acquisition or registration of intellectual property, acquisition of prescribed automation equipment and employee training.
Industrial building allowance	April	The IRAS issues a circular on the phasing out of industrial building allowance with effect from 23 February 2010. The circular also details certain transitional rules.
Corporate amalgamations	January	The IRAS issues a circular on the tax framework for corporate amalgamations.
Financial Reporting Standard (FRS) 39	March	The IRAS revises the circular on FRS 39 tax treatment, allowing taxpayers to elect to use historical costs to value revenue assets for the purpose of interest adjustment calculations.
Withholding tax	February	The withholding tax rate on payments to non-resident public entertainers between 22 February 2010 and 31 March 2015 is reduced to 10%.
	August	The IRAS announces an administrative concession which allows payers to apply a lower withholding tax rate on payments to related parties for routine services performed in Singapore.
	December	The IRAS clarifies that interest withholding tax does not apply to payments for non-financial derivatives where the derivatives do not give rise to the creation of any loan or indebtedness.
Donations	February	The 250% tax deduction for donations to Institutions of a Public Character (IPCs) and other approved recipients is extended to donations made in 2010.
Financial institutions	November	The list of qualifying securities for which banks and finance companies are allowed to claim a deduction for diminution in value is expanded to include securities such as units in registered business trusts and real estate investment trusts (REITs).
Incentives		
Aircraft rotables	April	The Economic Development Board of Singapore (EDB) releases a circular on the extension and enhancement of investment allowances for aircraft rotables.
Legal services	September	The EDB releases a circular detailing the development and expansion incentive for international legal services.
Shipping	February	A tax incentive is introduced for shipbrokers and forward freight agreement traders. The Maritime Finance Incentive is extended from 28 February 2011 to 31 March 2016.

		With effect from 22 February 2010, fees derived from the management of ships owned by special purpose vehicles are tax exempt under sections 13A or 13F of the Income Tax Act.
Land intensification allowance	December	The EDB issues a circular providing details on this incentive.
Mergers and acquisitions	June	The IRAS issues a consultation paper on the mergers and acquisitions allowance and stamp duty relief scheme.
	November December	The allowance and stamp duty relief are legislated in November and December respectively.
Global Trader Programme	May	The Minister for Trade and Industry announces that, with effect from 21 May 2010, the list of qualifying activities is expanded to include structured commodity financing activities.
Fund management	July	The Monetary Authority of Singapore (MAS) issues a circular on enhancements to the Enhanced-Tier Fund Tax Incentive.
	October	The MAS issues a circular introducing a withholding tax exemption for interest payments made by funds managed in Singapore by prescribed fund managers.
Financial sector incentive (FSI)	April	The MAS issues a circular detailing the discontinuation of the tax incentives for futures members of the Singapore Exchange and members of the Singapore Commodity Exchange Limited, and their transition to the FSI scheme.
	May	The MAS issues a circular on enhancements to the FSI-Standard Tier award, including the removal of the qualifying base and increase in the concessionary tax rate to 12% with effect from 1 January 2011.
Insurance	April	The MAS issues a circular detailing changes to the offshore insurance business tax incentive schemes, which include the introduction of a five-year sunset clause, tenure and qualifying conditions.
REITs	April	The MAS issues a circular detailing the extension and liberalisation of the income tax and stamp duty concessions for REITs, and the introduction of a sunset clause for tax exemption given under section 13(12) of the Income Tax Act for foreign-sourced income received by REITs listed in Singapore.
	November	The IRAS also revises its circular on the section 13(12) exemption for foreign-sourced income to incorporate this sunset clause in November.
Sovereign wealth funds (SWFs)	November	An incentive for SWFs is introduced which provides tax exemption for income derived by an SWF from funds managed in Singapore by approved government-owned entities, and for income derived by those entities from managing the funds of the SWF in Singapore and income from their own funds that are managed in Singapore.
Tax administration		
Record keeping	May	The IRAS issues circulars on record-keeping for GST-registered and non-GST registered businesses.
Taxpayer compliance	June	The IRAS revises its circular on the voluntary disclosure programme.
	October	The IRAS announces in October that any revisions to an income tax computation initiated by a taxpayer would be treated as a voluntary disclosure, and would come under this programme.

Tax remission, reduction and refund	November	The scope of section 92(2) of the Income Tax Act is expanded to allow the Minister for Finance to grant a remission, reduction or refund of tax at his discretion. The same (other than refund) applies for tax that has yet to become payable.
Donations	December	The IRAS issues a press release detailing the requirement for donors to provide their Unique Identification Numbers or Unique Entity Numbers to IPCs from January 2011 in order to qualify for a tax deduction on donations made to the IPCs.
Personal tax		
Benefits-in-kind	February	The IRAS introduces an administrative concession which provides for exemption of taxable benefits on staff discounts not exceeding $500 from Year of Assessment 2011.
Central Provident Fund (CPF) contribution rate	May	The Prime Minister announces in May that the employer's CPF contribution rate will be increased from 14.5% to 15%, and to 15.5% in September 2010 and March 2011 respectively.
	November	Consequential amendments to the tax treatment are legislated in November.
Angel investors tax deduction scheme	June	SPRING Singapore releases details of the scheme.
Personal reliefs	February	Changes were made to the following personal reliefs in terms of rates, removal of income threshold or both: • spouse relief/handicapped spouse relief • parent relief/handicapped parent relief • qualifying child relief • handicapped child relief • handicapped brother/sister relief • CPF cash top-up relief • course fee relief.
Goods and Services Tax		
	June December	The IRAS issues for public consultation a draft circular on the GST treatment of the time of supply rules in June. Taking business practices into consideration, the circular is subsequently finalised in December. Consequently, a whole host of GST circulars relating to specific industries were revised in January 2011 (e.g. manufacturing, retailers, travel industry, real estate agencies).
	October	From 1 October 2010, approved GST-registered businesses under the Import GST Deferment Scheme can defer their import GST payments until their monthly GST return due dates. Other circulars issued in the year include: • record-keeping guide for non-GST- and GST-registered businesses; • GST Guide for the Marine Industry following changes introduced in the 2010 Budget; and • GST guide on imports.
	January to December	Throughout 2010, the IRAS also revised circulars or handbooks relating to specific industries: charities and non-profit organisations, the aerospace industry, the freight forwarding industry, motor traders, the travel industry and the fund management industry. Other revised circulars pertain to the GST advance ruling system, treatment of vouchers, Major Exporter scheme, on exports generally and the voluntary disclosure programme.

	May September	The MAS issues a circular in May to make retrospective enhancements to the GST remission scheme for prescribed funds managed by prescribed fund managers in Singapore. It issues another circular in September to prescribe the fixed recovery rate for 2011.
	June	The IRAS updates its website content on when a supply of services may be zero-rated.
	April November	The IRAS publishes website content on the GST Assisted Self-help Kit (ASK). The contents are later updated in November.
Other taxes		
Stamp duties	February	The MOF introduces seller's stamp duty on the sale of residential property in February, and the IRAS issues a circular providing details.
	August	The seller's stamp duty rates and holding period are revised upward in August, and again in January 2011, and the IRAS circular is revised accordingly.
Customs duties	March	Singapore Customs issues a press release detailing changes to the duty-free allowance for travellers.
Casino tax	February	The Casino Control (Casino Tax) Regulations 2010 which prescribe the computation, filing and payment of casino tax is published.
Property tax	January	The IRAS issues a circular on the revision of annual values for HDB flats with effect from 1 January 2010.
	February	The IRAS issues a circular on the progressive property tax rates for owner-occupied residential properties which are effective from 1 January 2011.
	January November	The IRAS revises the circular for hotel owners and operators in January and November.
Agreements for the avoidance of double taxation (DTAs)		
DTAs	January to December	Singapore signs a DTA with Slovenia in January which was ratified and entered into force in November. In addition, new DTAs with Georgia and Libya, and a revised DTA with New Zealand are ratified and entered into force in June, December and August respectively. Singapore also signs DTAs with Saudi Arabia in May, Panama and Ireland in October, and Albania in November. These have not been ratified. Protocols amending DTAs with Norway, Finland, the Netherlands and Austria were ratified in March. Protocols to DTAs with Brunei and Australia were ratified in July and November respectively, and with France, Denmark and the United Kingdom in December. In addition, protocols are signed to incorporate the Organisation of Economic Cooperation and Development's (OECD) standard for the effective exchange of information (EOI) in the DTAs with the following countries: • Japan, protocol signed in February and ratified in June; • South Korea, protocol signed in May; and • China, protocol signed in July and ratified in October.

EOI	August	The IRAS publishes administrative details and the prescribed format in which an EOI request should be submitted so as to facilitate the process.
Tax cases		
Income tax	February	The High Court held that gains from the exercise of share options by the estate of a deceased employee constituted a benefit which arose by reason of his employment, notwithstanding that the options lapsed upon his death and were extended at the discretion of the respective companies.
	April	The High Court agreed with the findings of the Board of Review that club entrance fees should be taxed in the year the fees are earned although the subsequent refunds are not to be allowed a deduction in the year the fees were levied. Further, costs incurred for acquiring the land, building and costs of construction are not tax deductible. Neither are geomancy fees deductible.
	October	The High Court ruled that interest rate swap payments made by a Singapore company to its overseas subsidiaries are not to be deemed sourced in Singapore under the Income Tax Act and therefore not subject to interest withholding tax. This is because there is no loan or indebtedness between the two parties.
	January December	In December, the Court of Appeal reversed the decision handed down by the High Court in January, and held that dormitories erected using pre-fabricated structures were "plant" for capital allowances purposes.
Stamp duties	January August	In August, the Court of Appeal upheld a High Court decision handed down in January, ruling that the Commissioner for Stamp Duties is not obliged to refund stamp duty paid by purchasers on a contract of sale of a property rescinded under the Stamp Duties Act as it was not proven that the vendor did not have good title to the property.
Tax legislation		
	April December	The Stamp Duties (Amendment) Act 2010 and Stamp Duties (Amendment No. 2) Act 2010 are published in April and December respectively.
	September	The Goods and Services Tax (Amendment) Act 2010 is published.
	October	The Economic Expansion Incentives (Relief from Income Tax) Bill 2010 is published. The Act is subsequently published in January 2011.
	November	The Income Tax (Amendment) Act 2010 is published.

For more details, visit our Singapore website at http://www.pwc.com/sg, or call your usual PricewaterhouseCoopers Services LLP contact. A list of useful links is also provided below:

MOF	http://app.mof.gov.sg/
IRAS	http://www.iras.gov.sg/
EDB	http://www.edb.gov.sg/
IE Singapore	http://www.iesingapore.gov.sg/
MAS	http://www.mas.gov.sg/
MPA	http://www.mpa.gov.sg/
MOM	http://www.mom.gov.sg/
STB	http://www.stb.gov.sg/

PwC thought leadership

Here is a collection of PwC's thought leadership articles on current tax issues and our wishes for this year's Budget.

Authored by our tax partners and managers, some of these articles were published in the media as part of the lead-up to the 2011 Singapore Budget.

Encouraging R&D by fine-tuning tax rules

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Singapore's economic success over the next decade, amongst other things, will depend on how successfully local businesses innovate, enhance their productivity and maintain their competitiveness. This can be achieved through continuous investment in research and development (R&D), spending on skill up-grading programmes and gearing up for early adoption of new technologies and know-how.

To encourage local firms to be more competitive and productive, besides making available grants, the government may consider introducing new tax measures to reduce the cost of undertaking innovative activities and fine tune the existing tax incentives to allow broader application and easier administration.

Suggestions for new tax measures

- At least a 100% tax deduction should be allowed for R&D expenses incurred for new business on R&D projects outsourced overseas, provided the resultant benefits of the R&D is owned in Singapore. This would encourage taxpayers to engage in innovative R&D activities, although the relevant research capability may not yet exist in Singapore.

- Introduce a lower corporate tax rate for profits, including royalties derived by businesses from exploitation of self-developed intangible assets. For example, in the Netherlands, such innovation-linked profits are taxed at a lower rate of 5% in lieu of the general corporate tax rate of 25.5%. In addition, foreign taxes suffered on such income should be allowed to be pooled and offset against tax payable on other sources of income, with the excess carried forward for subsequent utilisation.

- Personal tax rates may be calibrated down for highly-skilled qualifying employees (such as scientists, researchers, engineers and other professionals) who are engaged by businesses to drive innovation.

Interestingly, under the current tax regime, only 10% of the gross income (unless net income is lower) earned by an inventor, author, proprietor, designer or creator in their personal capacity (or by a company 100% owned by them) from exploitation of approved intellectual property or approved innovation is subject to tax. For such cases, the effective tax at the maximum marginal rate can work out to be less than 2% (for individuals) and 1.7% (for a company owned by the concerned individual).

Individuals such as scientists, researchers, engineers and other professionals should not be any worse off just because they are employed in a business not owned by them.

Such a measure should not only help to attract more innovators and skilled resources to work for Singapore-based businesses, it would also encourage more businesses to set up their R&D facilities in Singapore.

Fine tuning existing tax incentives

- Currently, a 150% tax deduction is allowed only in respect of consumables and staff costs incurred for qualifying R&D activities. This should be expanded to include other incidental expenses, (such as utilities, rental, professional fees, licence fees, etc) which are incurred for undertaking R&D in Singapore.

- Under the current tax regime, businesses can claim a tax deduction equivalent to 200% of their qualifying R&D costs, after obtaining specific approval from the EDB.

  Given that 150% of the qualifying R&D costs can be claimed automatically, consideration may be given to increase the percentage threshold to, say 250%. This will encourage businesses to apply for this incentive, particularly when they are required to submit various details and forecasted numbers related to their R&D projects to the EDB for approval.

- Increasingly, businesses are sharing their risks in R&D by entering into collaboration agreements and sharing related costs. Against this backdrop, taxpayers would welcome any measure to remove the requirement to obtain EDBs' approval to claim a tax deduction for expenses incurred under R&D cost sharing arrangements. More so, as prior approval is not required to claim a tax deduction for R&D expenses incurred under all other circumstances.

- During Budget 2010, the Government introduced a Productivity and Innovation Credit (PIC) scheme to encourage, particularly the SMEs, to engage in a broader range of innovative activities in Singapore. Under the PIC scheme, businesses are eligible to claim 250% of expenses (with an annual cap of $300,000 per activity) incurred on any of the six qualifying activities. Alternatively, they can opt to convert up to $300,000 (but not less than $1,500) of their enhanced deductions into a cash grant of up to $21,000, subject to certain conditions.

  The PIC scheme is innovative and definitely an important measure to encourage innovation and enhance productivity of particularly the local SMEs.

However, in its current state it appears to be quite complex and may deter businesses from claiming fiscal benefits, as the process of making claims will be costly and time consuming for them. Adhering to the general principles of simplicity and certainty, the PIC scheme should be modified to include, but should not be limited, to the following:

- The current annual cap of $300,000 may be expanded, keeping in view the amount of capital required to innovate and/or raise productivity under the current inflationary environment.

- Per the current incentive, taxpayers are required to identify qualifying automated equipment and claim PIC benefits only with reference to such identified assets. If any of the identified assets are sold within a year from the date of purchase to the date of disposal, PIC benefits will be clawed back without allowing any opportunity to claim PIC benefits with respect to other existing qualifying automated equipment.

This can be an onerous exercise, particularly for the SMEs. This process may be liberalised to allow taxpayers to claim the PIC benefits as long as they can prove that the cost of the aggregate qualifying assets for the relevant year is more than the cap of $300,000.

- The option to elect for cash conversion is irrevocable and this may create problems for taxpayers. For example, a taxpayer is in a tax loss position and elects for cash conversion option at the point of lodgement of tax return. Subsequently, when the assessment is finalised, due to certain tax adjustments, the taxpayer will move into a taxable position.

  The taxpayer will not be able to revoke this cash conversion option and claim a tax deduction per the PIC scheme. This may result in taxpayers paying more taxes than the cash converted in view of the differential rates between the prevailing corporate/individual tax rates and the 7% conversion rate. As such, taxpayers should be given the flexibility to revoke the cash conversion option on a case by case basis.

- Currently, to qualify for the cash conversion option, SMEs are required to prove that they have engaged three local employees and business owners cannot be counted to satisfy this requirement.

  This would prevent many SMEs (whose owners are also key employees) from qualifying for the cash conversion option, even though these businesses are likely to have a greater need for cash. Such a restriction should therefore be liberalised or removed.

Support of other policies

Effectiveness of fiscal measures are dependent on other policies which would influence productivity and innovation, such as direct support measures, education policies influencing the supply of researchers and wider policies towards building up the knowledge infrastructure.

Singapore's policymakers are well aware of this and have already initiated the necessary measures to build the innovation eco-system. This, supported by innovative fiscal measures, will help Singapore to achieve its desired goal of enhancing innovation, raising productivity and attaining future economic success.

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Drawing private equity funds to Singapore

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The year 2010 was a good year for stock markets in Asia. The private equity industry in Asia took the chance to cash out of investments.

According to Reuters ("Analysis: Asia private equity exits outstrip new deals", Jan 11, 2011), about 30% of all initial public offerings in Asia ex-Japan in 2010 were backed by private equity firms.

While growth in the region is expected to ease in 2011, Asia remains an engine of growth and continues to draw interest from private equity funds. Singapore is well placed to capitalise on this trend with its strategic location and accessibility to the rest of the region, established financial infrastructure and its attractive tax regime.

While Singapore already has an array of tax incentives targeted at facilitating the operations of investment managers, there are still several kinks that need to be ironed out to make it a more attractive choice for private equity players.

In this article, we highlight two key issues which we hope will be addressed in the upcoming Budget.

Legal form of private equity funds

The Singapore government has been quick to take on feedback from the industry, and has, in the past few years, announced several tax incentives and introduced fine-tuning measures to make the Singapore tax environment conducive for investment management operations.

However, one aspect that has not been satisfactorily addressed is in relation to the management of funds set up as limited partnerships (LPs). LPs are very commonly used by investment managers, particularly private equity managers, as fund vehicles.

Singapore has several tax schemes that exempt funds managed in Singapore from tax. The tax exemption scheme for offshore funds, however, has been designed to cater for funds set up either as companies or as trusts, but not LPs. This scheme requires the application of two key tests – the "prescribed person" test which is to be applied to the fund vehicle, and the "relevant owner" test which is to be applied to the investors.

As LPs are treated as tax transparent, that is, they are effectively non-existent for Singapore tax purposes, the application of these tests becomes awkward.

Limited partners

The "prescribed person" test is to be applied to the limited partners, while the "relevant owner" test is to be applied to the owners of the limited partners.

This approach results in a number of issues:

- Certain limited partners may not meet the "prescribed person test", for example, Singapore-resident companies which own less than a 30% interest

in the LP. Had the LP been treated as opaque for this test, this issue may not arise.

- If there are limited partners who are not able to meet the "prescribed person" test, the fund manager is required to attribute a portion of the LP's net income to the limited partners, which would have to be reported to tax. This leads to additional administrative burden for the fund manager.

- For the limited partners that qualify as "prescribed persons", the fund manager has to request further information from them to ascertain whether their owners meet the "relevant owner" test. This adds on another hurdle for the application of the tax exemption scheme for offshore funds.

In other words, it is all a bit of a mess, and this failure to recognise an LP as an entity in its own right causes an unnecessary bias away from what is probably the most commonly used fund vehicle type in the investment management world.

The above issues were alleviated with the introduction of the Enhanced-tier Fund Tax Incentive Scheme (ETF Scheme) in 2009. The ETF Scheme removed the "prescribed person" and "relevant owner" tests for LP funds approved under this scheme.

This scheme however comes with the additional requirements of a minimum fund size of S$50 million at the point of application and the filing of a Singapore tax return for the fund.

Many private equity fund managers are not comfortable doing the latter, especially for existing LP funds that are currently managed elsewhere. This increases the inertia for private equity managers to relocate their Asian business to Singapore, and forces them to consider other locations in the region.

The above issues can easily be addressed by tweaking the tax exemption scheme for offshore funds such that the "prescribed person" and "relevant owner" tests are applied at the LP fund and partners' levels respectively. This will then bring the LP form of funds to the same position as other legal forms of funds already covered under the scheme.

Special-purpose vehicles used by Singapore funds:

Another aspect of the Singapore tax incentives that can be enhanced is to recognise the fact that private equity funds typically do not hold investments directly, but hold each investment through a special-purpose vehicle (SPV).

This is done for a number of reasons, including facilitating exit and segregating risks.

In the event that private equity funds set up in Singapore decide to establish SPVs in Singapore to hold investments in the region, these SPVs would each have to be approved under the Singapore-resident Fund Scheme (SRF Scheme) or ETF Scheme in order to be exempt from Singapore tax.

This would mean that each SPV would be considered a "fund" for the incentive schemes, and would be expected to meet conditions (such as the minimum S$200,000 expenditure requirement, and the minimum fund size of $50 million under the ETF) individually, even though they may be investment vehicles held by one private equity fund.

To facilitate the setting up of private equity funds and their SPVs in Singapore,

the SRF and ETF Schemes should be enhanced to allow funds and their wholly owned SPVs to be approved under these schemes as a whole (as opposed to each legal entity being assessed as a "fund" for the incentives).

The SRF and ETF Schemes should also allow subsequent SPVs set up under the same approved fund to automatically qualify for tax exemption without the need to apply for tax exemption status separately.

This approach essentially recognises the fact that all SPVs are part and parcel of the same fund structure, and should not be individually required to meet separate sets of substance conditions when the reasons for the existence of separate SPVs are commercial and not tax avoidance.

Attractive option

This will allow private equity fund managers to move more nimbly in response to investment opportunities and make Singapore a more attractive location for private equity activities.

The fine-tuning measures suggested above will make Singapore's tax regime easier for private equity fund managers to navigate, making it a more attractive option for those looking for a base in Asia.

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"5 Rs" for the upcoming Budget

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With the Singapore economy registering an impressive performance last year, resulting in the build-up of a robust budgetary surplus, Singaporeans are eagerly anticipating carrots from the upcoming Budget as we enter the Year of the Rabbit.

Prime Minister Lee Hsien Loong has already suggested that the Budget this month should bring good news on the back of a higher-than-anticipated tax yield. Before we jump for joy, however, we need to recall Mr Lee's words in March 2008, when he cautioned against focusing on immediate handouts when discussing the Budget and instead stressed the need to take a longer-term view.

The PM's mindset is reflected in the recent decision of the Ministry of Finance to increase employers' contributions to the Central Provident Fund (CPF) by 1 percentage point, as well as the decision not to repeat the one-off personal income tax rebate of up to $2,000 that was given for the Year of Assessment 2009. Both decisions suggest a move away from short-term handouts and a focus on long-term investment in the country's future.

Senior Minister Goh Chok Tong's speech before last year's National Day, when he encouraged us to strive for the "5 Cs" of career, comfort, children, consideration and charity also places a strong emphasis on planning for the future. In keeping with the PM's and SM's theme, we have identified "5 Rs" for the upcoming Budget, which can help to build a stronger future for Singapore.

1. Remove the 3.5% and 5.5% bands for personal income tax

Currently, the two lowest tax bands of 3.5% and 5.5% yield a maximum tax intake of $900 per year per individual and are most proportionately felt by the lower earners in our society.

Removing these two tax bands would go a long way towards reducing the burden on the less well-off. It would also reduce employers' administrative burden in creating large numbers of IR8As for those who earn less than $40,000 a year, thereby cutting down on the cost of doing business in Singapore.

Finally, it would reduce the Inland Revenue Authority of Singapore's administration costs in processing large numbers of tax returns to collect only a few hundred dollars in tax from lower-paid employees each year.

2. Revisit tax-deductible voluntary CPF contributions

Currently, employees' mandatory CPF contributions decrease with age, starting at the age of 51. However, the closer we get to retirement, the more likely we are to want to plan for this period of our lives.

Allowing tax-deductible voluntary CPF contributions (subject to reasonable limits) for employees aged 51 and older would be a welcome move for those looking to plan for their silver years.

An increase in available tax deductions would also be more valuable for employees later in life as many enter higher tax brackets towards the end of their careers.

Such a move would also be in line with PM Lee's call at the recent ComCare appreciation lunch encouraging people to provide for their own future needs rather than relying on the Government's assistance.

3. Review tax reliefs and rebates

Certain tax reliefs and rebates are given in recognition of individuals' efforts and contributions in areas consistent with the Government's social policies. In view of the current healthy state of the country's exchequer, now may be a good time to build upon the available incentives for consistency with the Government's policies.

Retaining the current tax deduction of 250% for approved charity donations on a permanent basis would be a firm commitment to helping those who cannot help themselves, and in line with SM Goh's definition of the "5 Cs".

The percentage of 250% could also be applied to course-fee relief – this would make the relief more attractive to lower-income earners who may be most in need of upgrading their skills and qualifications to remain competitive in the labour market.

A review of the foreign maid levy relief, currently applicable only to female taxpayers, would also be welcome. Male taxpayers are increasingly employing foreign maids to take care of the elderly in their families, and recognition of this would be in keeping with the strong emphasis we place on the family unit. A similar review of the working mother's child relief to make it gender-neutral would also be a positive move.

Finally, it is generally acknowledged that the fact that the younger generation is typically marrying and starting families later in life, to pursue careers, is a contributing factor in the declining birth rate.

A balance between a healthy birth rate and maintaining a strong career focus could be helped by introducing an annual married couple's relief, which would encourage couples who are both already working (and therefore more likely to return to work after childbirth) to "tie the knot" and create their family units earlier.

4. Revamp the "Not Ordinarily Resident" (NOR) scheme

The requirement for three years of non-residency before qualifying for the NOR scheme effectively excludes most Singaporeans from enjoying the time apportionment concession available to many internationally mobile foreign nationals based in Singapore.

A removal of this condition is in order, considering that a number of home-grown talented Singaporeans are increasingly assuming regional positions but do not stand to benefit from the NOR scheme in its current format. At the same time, abolishing the five-year limit on NOR status would help Singapore to retain its existing pool of foreign talent, making it a more attractive base for medium- to long-term residency, and retaining our competitiveness as a leading business hub for the Asia region and beyond.

5. Readjust the Skills Development Levy (SDL), Angel Investor Scheme (AIS) and Green Vehicle Rebate (GVR) programme

Last year's strong economic performance has benefited employers as well as the exchequer. In view of this, it may be an opportune time to consider an increase to the SDL rate.

Currently, the SDL is capped at 0.25% of $4,500 per month. Increasing it to 0.5% should not result in a significant additional cost to the employer. However, it would represent a substantial increase in the funds available to the Workforce Development Agency to encourage employers to send their workers for training and skills enhancement.

Secondly, the AIS is a welcome scheme to encourage the investment of seed capital in Singapore start-up enterprises, but the conditions make it difficult to qualify and administratively burdensome to apply for.

A simplification of the application processes and an increase in the investment ceiling would make this a more valuable proposition to potential investors, as many may feel there is a disproportionate amount of work currently required to qualify for a tax saving of $20,000 in two years' time.

Finally, the GVR programme, aimed at promoting the purchase of green vehicles, which are more fuel-efficient and emit less air pollutants than their conventional petrol or diesel equivalents, is due to expire in December. The scheme should be extended further to narrow the cost differential between green vehicles and conventional vehicles. Ideally, the scheme should be maintained until such time as the cost of green vehicles is lower than that of conventional vehicles.

While the Budget has always strived to lead Singapore in the desired direction of long-term sustainable growth, last year's inspiring economic performance provides us with a unique opportunity to work collectively towards the "5 Cs" envisioned by SM Goh and to build for a stronger future.

By giving consideration to the "5 Rs", the Finance Minister could take steps to achieve this in a well-planned manner, resisting the temptation of short-term windfalls and ensuring we can continue to help ourselves as we move forward.

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Why paying taxes in Singapore is a breeze

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Tax policy plays an integral role in Singapore's strategy to become a major global business hub. And the republic ranks consistently as one of the world's top 10 competitive tax regimes, according to the World Bank-PwC Paying Taxes study, a study which evaluates the efficiency of tax systems around the globe and which was launched five years ago.

In the 2011 study, Singapore nudged up to fourth place in 2009 from fifth in 2008. The Paying Taxes study is broadly modelled on a total tax contribution (TTC) framework, which looks at more than just corporate tax – which in its own right tells little about how much a company's economic activity contributes to the fiscal coffers overall. TTC is thus a comprehensive approach which takes into account:

- the total tax rate (the total tax cost borne by the company as a percentage of its commercial profits)
- the number of tax payments it has to make each year; and
- the time it takes the company to comply with its filing and payment obligations.

These are then used to measure and compare the efficiency of tax systems in 183 economies, using as a benchmark a "model" small enterprise located in each country. The 2011 study analyses actual cash tax burdens for calendar year 2009.

Singapore beat notable competitors such as Ireland and Switzerland into seventh and 16th places respectively. However on closer examination, it actually did better than its fourth ranking. As will be noted from the table, it was beaten only by those well-known international business centres of… the Maldives, Qatar and (well, okay) Hong Kong. Without wishing to take anything away from the elegant simplicity of the Maldavian or Qatari tax systems, it has to be said that they don't really have one. So let's call Singapore second.

Singapore's total tax rate this year reduced from 27.8% to 25.4%, which may be due to reforms introduced in the 2009 Budget. While this rate may appear high in the context of a 17% corporate tax rate, it should be remembered that the study includes all taxes and not just corporate tax. Interestingly, nearly 60% of Singapore's total tax rate arises from the employer component of Central Provident Fund (CPF) contributions, captured under the methodology as Singapore's labour tax. Arguably it is not. Without it, the total tax rate drops to a very competitive 10.5%.

Compared to the global average of 30 payments, Singapore's five tax payments (corporate tax, Goods and Services Tax or GST, property tax, road tax and CPF) are regarded as best practice. While you might wonder about the accuracy of these numbers as you submit your fourth quarterly GST return and 12th CPF form, it should be mentioned that credit is given for the use of electronic filing, which is almost, if not completely, universal now in Singapore. As a result, the methodology lumps the annual filing obligation together as a single tax payment.

Nonetheless, Singapore's time to comply may still seem high at 84 hours per annum compared to that of Hong Kong, where only 80 hours are required.

"The pace of streamlining tax cost and administration here must not slow down while the world races to catch up."

What needs to be realised is that 40 hours of Singapore's compliance time is very kindly contributed by GST, a tax which Hong Kong has studiously avoided so far. It thus takes only a comparative 44 hours in Singapore to comply with our remaining tax obligations, propelling us ahead of all competition. While none of Singapore's total tax rate is contributed by GST, due to its flow-through nature, GST's administrative and cash-flow burdens cannot be overlooked.

Nevertheless, against a global average of 35 days to comply (or 282 hours), Singapore's performance looks decidedly healthy. It does bring a slightly smug smile to one's face to read that the time to comply in Brazil is 2,600 hours (that is, 325 out of 365 days in a year), and that five African countries have total tax rates of over 100% topped by the Congo Democratic Republic of 339.7%. It's not clear where they find the time, or will, to make money.

When governments consider tax reform therefore, it is crucial that they look beyond the obvious corporate income tax. The most popular measure of tax reform is to reduce profit tax rates (as it wins votes). However, tax authorities need to use creative ways to facilitate tax revenue collection and administration by considering businesses' total tax contributions as a whole, while promoting economic activity.

Worldwide, economies that make paying taxes easy typically offer electronic systems for tax filing and payment, and have one tax per tax base. They also focus on lower tax rates across a wider tax base. These strategies are generally consistent with Singapore's existing tax policy principles. So how then can Singapore possibly improve?

Well firstly, there is a bit of work that can still be done to facilitate return preparation. The claiming of capital allowances, for example, currently requires tracking asset by asset, which in large, capital-intensive businesses can require almost a full-time job. A pooling approach for categories of assets may thus save taxpayers both time and money, and end up costing the government little (capital allowances are, when you think about it, only timing differences). There are other areas where a little less detail would produce similar increases in efficiency.

Secondly, while the study shows the time taken to fulfil the initial filing obligations, it does not show how long it takes to get one's tax position agreed – a different matter entirely. In this context, revisions to tax legislation can perhaps better take into account commercial realities and be clearer, as tax disputes are time-consuming and create undue uncertainty to taxpayers. The biggest culprit in this area is the annual tennis match between taxpayer and tax officer with the "capital vs revenue" argument as the ball. (It's capital and tax free, no it's revenue and taxable. Oh no, it isn't, oh yes it is…). So it might only take 30 hours to prepare the computation, but it can take (no kidding) 10 years to get it agreed. Time for a break.

So even though we can celebrate Singapore's outstanding results in Paying Taxes 2011, we should not rest on our laurels. The pace of streamlining tax cost and administration in Singapore must not slow down while the world races to catch up. Change, after all, is the only constant in life – apart from death and taxes, that is (which in Brazil are more or less the same thing)!

Note: A copy of the World Bank-PwC Paying Taxes 2011 report may be downloaded for free at www.pwc.com/gx/en/paying-taxes

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Grow the productivity carrot, ditch the stick

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One of the principal thrusts of last year's Budget was aimed at increasing the productivity of Singapore businesses. And in this respect, a two-pronged approach was taken.

It was perceived that Singapore is over-dependent on foreign workers and an attempt was made to reduce dependency on this work force. This was done through the introduction of graduated increases in the Foreign Worker Levy (FWL) – effectively a tax on the use of foreign labour – in the hope that it would "encourage" businesses to turn to more labour efficient alternatives through enhanced productivity initiatives.

These initiatives would, in turn, be supported by "positive" incentives aimed at encouraging companies to spend on that productivity upgrade process. This incentive came in the guise of the Productivity and Innovation Credit (PIC).

It essentially works by giving enhanced tax deductions for approved spending on the following six activities: Research and development (R&D) done in Singapore; design work done in Singapore; acquisition of intellectual property (IP); registration of IP; automation through technology or software; and training of employees.

The spending limit cap is $300,000 per activity, with deductions of up to 250%. So assuming a tax rate of 17%, the cash benefit works out at $127,000. So if you are smart enough to maximise spending on all six categories, you will help yourself to tax benefits worth $762,000.

So is it working?

It all seems quite compelling. A stick to penalise you for inappropriate behaviour and a carrot to reward you for being good. But there are some fundamental issues with using a stick. The first is borne out of my experience when faced with the stick approach as a young miscreant. It might have worked eventually but, boy, did it annoy me in the meantime. The second is that, with the best will in the world, sometimes it is not possible or that easy just to change behaviours with a stick.

Productivity is most easily enhanced in the manufacturing industry where machines and clever systems can replace people. The service industries, which rely more on personal interaction and customer care, will struggle more to achieve noticeable productivity increases that do not also damage the customer relationship.

Two industries in particular will be starting to feel the impact of the Foreign Worker Levy hike: Construction, and food and beverage (F&B). Certainly, construction techniques are forever improving but there is no substitute for human intervention and control. Also, Singapore, unlike some European cities, is surrounded by a wealth of cheap labour that is not going away anytime soon.

On the F&B side, there is again no choice. This industry is already plagued by labour shortages. Foreigners must be brought in to fill the gap, as there are simply not enough Singaporeans to go around. So in the context of F&B, the only potentially appealing PIC choice is the training option and it is doubtful if a multi-national hotel operator is going to change the habits of a lifetime for the sake of $127,000.

Initial feedback on the FWL increases has, therefore, been unsurprisingly negative.

In many cases, all it does is represent an increased cost of doing business and even amongst those that have evidenced a desire to enhance productivity, there is a realisation that this process takes time, and that in the interim, profitability will just have to be hit. Some industries are simply shunned by the local population (construction, marine, etc.) and so there is no choice but to continue sourcing labour from overseas.

The alternative is to turn work away through lack of resources to service the contract. There is as usual no simple answer to this but, perhaps, here are some useful suggestions:

- Remove absolute value limits from the PIC and make it turnover or labour cost related. This will give it more personalised significance to each business by making the benefits more aligned with the size of the business and its contribution to the economy.

- Remove absolute limits for foreign worker quotas and link them to the training and upgrading of local labour. This will allow for a more dynamic employment policy in that it will enable businesses to recruit in a manner more tailored to their specific needs but in exchange for enhanced training for local employees.

- Provide further training based credits and subsidies for local workers to offset the increased levy.

- Simplify and streamline the various schemes. There is a bewildering array of options available but selection of the most appropriate scheme can be difficult and certain schemes are being heavily underutili-sed because of the complexity of the application process in the context of the value obtained.

In short, a simple, dynamic and tailored approach is needed if Singapore is to meet the aspirations it has set for itself in the longer term. There is no doubt that Singapore-based businesses are hungry enough for the carrot to drive them forward. They should not be made so lean in the meantime that they want to turn around and eat the stick.

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Clarity needed on capital gains tax

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The statement that Singapore does not have a capital gains tax is always followed by a string of caveats. Any taxpayer disposing a large asset that is assumed to be a capital asset may be in for a rude shock. The taxpayer will invariably be asked to demonstrate that the gain is not from a trade or business, or of an income nature. What follows can often be a host of correspondences with the Inland Revenue Authority of Singapore (IRAS), which can sometimes go on for years, with each side trading case law precedents and "badges and trade" features. For some, this can be a source of aggravation and uncertainty.

The situation is becoming less palatable to foreign businesses that simply want to know where they stand. The sale of assets (including shares) is often a commercial reality necessitated by restructuring, refinancing, fund-raising for ventures, or divestment of a non-core business or a stake in a failed venture.

While some effort has been made to specifically exempt gains from the sale of investments, they relate mainly to incentives to promote the fund management industry. There are various criteria to be met, but they can be meaningless for a manufacturing group for example.

The global financial crisis has added pressure on investors to seek greater certainty of tax treatment. A potential 17% tax on disposal by a Singapore holding company casts serious doubt on the choice of locating one's holding company in Singapore.

Changing "taxscape"

If uncertainty on the tax treatment of gains for holding companies persists, Singapore may lose its hub status for such companies. Competition from Hong Kong, which already has a good treaty with China, is ever present. The soon-to-be ratified tax treaty between Hong Kong and Indonesia may also offer an alternative investment platform for investors to set up shop in Indonesia. Hong Kong is in the process of concluding more tax treaties with Malaysia and Saudi Arabia, and in due course, may become the preferred destination for investors.

Despite mounting pressure for holding companies to prove economic and legal substance (ie to employ real people and have substantial economic activity) before they can enjoy lower withholding taxes on dividend or interest inflows, many still structure their investments through entities outside Singapore. These destinations include the British Virgin Islands, the Cayman Islands, Mauritius and Guernsey. This is because of the uncertainty over the tax treatment in Singapore of such gains.

Helping the investor

The 2011 Budget should provide clarity and certainty. Companies incorporated in Singapore to hold investments in and outside the Republic should not be taxed in Singapore on gains derived from any subsequent sale of investments, subject to certain criteria.

Such a measure will help maintain Singapore's attractiveness to investors. It can lead to spin-off benefits for other areas of the economy as well. Tax leakage, if any, will also be minimal. Similar measures in developed countries such as the Netherlands have been a major draw for investors.

Guidelines that provide certainty will encourage investors to establish an international or regional company in Singapore to oversee group investments. They will send a clear message that Singapore is serious about wooing holding companies, and can also augment other incentives given by the Economic Development Board to entice multinationals to locate certain corporate functions in Singapore.

The guidelines should ensure that investors incorporate in Singapore for reasons other than tax benefits. They should require substance that is demonstrable by certain measurable standards.

For example, the Netherlands has participation exemption rules that exempt gains on sale of investments and receipt of dividends, subject to prescribed conditions (although Singapore already has adequate rules in respect of foreign dividend exemptions). A Dutch entity must have a 5% or more shareholding and demonstrate that it conducts an active business. The investment must have sufficient business involvement with the Dutch holding entity. Certainty is provided through a ruling mechanism.

Singapore's guidelines could be similar to the Dutch rules and perhaps require additional profits to be recognised in Singapore.

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Budget wishes for risk business

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The insurance sector got hardly a mention in last year's Budget, except for some (largely) procedural changes to the offshore insurance business (OIB) incentive scheme. More can be done to the fiscal system to incentivise the insurance sector and attract global insurance players to base their operations in Singapore. We set out below some of the key improvement areas we'd like to see in Budget 2011 for the insurance industry.

Reduce the OIB scheme tax rate

The OIB scheme is the most widely used tax incentive by the insurance industry. An insurer or reinsurer approved under the OIB scheme is subject to tax at 10% on specified income earned through its offshore insurance/reinsurance business.

The OIB scheme tax rate has remained at 10% over the last 30 years. Yet, over the same period, Singapore's corporate tax rate has reduced from about 40% to the current 17%. Hong Kong now levies an 8.25% tax rate (being half of its corporate tax of 16.5%)on offshore reinsurance business. Malaysia, although having a corporate tax rate of 25%, offers a 5% tax rate on inward reinsurance and offshore insurance business.

Singapore should consider reducing the OIB scheme tax rate to, say, 5%. This would ensure that Singapore remains competitive and attractive compared to its usual competitor locations such as Hong Kong and Malaysia.

Consolidate the various offshore incentives

As an alternative to the above proposal of reducing the OIB scheme rate, we suggest a consolidation of all the current offshore tax incentives at a blended rate of, say, 5%.

Currently, besides the OIB scheme, there are targeted tax-exemption schemes for approved offshore specialised risks business (such as terrorism, political, energy and aviation, and aerospace) and for approved marine hull & liability (MHL) business. An insurer writing more than one line of specialised offshore business could potentially qualify for more than one incentive and, in doing so, average down his effective offshore business tax rate. However, there are practical issues to this targeted incentive approach.

For one thing, each of these incentive schemes has its own qualifying criteria and tenure, which can be a minefield to navigate. In addition, when a tax loss is made in a particular tax-exempted business, the loss in question is quarantined and can only be used to relieve future profits arising from the same tax-exempted business. It cannot be used to relieve profits made under the OIB scheme or under other lines of business. Further, the more tax incentive schemes an insurer subscribes to, the more segregation of accounts is required. This is often seen as an unnecessary administrative burden.

Blending schemes

To make our offshore incentives more attractive, the OIB scheme and the tax-exempt offshore schemes could be blended together and offered as a lower

overall offshore rate of 5%. This would simplify the tax incentive structure and would enable the use of tax losses against profits taxable even under the normal corporate tax rate (subject to the usual adjustment under section 37B of the Income Tax Act).

Further, it would ease the current administrative and accounting burden of keeping separate books for each incentivised business. Allocation of common expenses would also be easier.

Enhance existing schemes – expand the investment income that is taxable at incentive rate

Currently when a particular business is incentivised, the underwriting profits earned from accepting the particular incentivised business enjoys the incentive tax rate. However, in terms of investment income, only offshore dividends, offshore interest and interest from ACU (Asian Currency Unit) deposits supporting the incentivised business (for example, OIB scheme, offshore captive scheme, offshore specialist risks business scheme, MHL business scheme, etc) enjoy the same lower tax rate or exemption.

Investment activity is a big part of insurance business. Funds received from writing policies are usually invested to support the insurance business. Thus, it seems logical that all investment income (whether onshore or offshore) supporting the incentivised business should be allowed to enjoy the same incentivised tax rate. Why attract the underwriting of the incentivised (mainly offshore) businesses to Singapore, yet prompt these businesses to make their investments offshore?

"Singapore has big ambitions to be an insurance hub in Asia. The right fiscal policies will ensure that the country remains competitive and attractive as a place from which to carry out insurance business and from which to base regional operations."

The tax concession should be extended to a proportion of all investment income which supports the incentivised business. Rather than apply the tax concession to only selected types of investment income, one suggestion is to apply the ratio of incentive premiums as a proportion of total premiums to the total investment income arising. Alternatively, to level the playing field with the fund management industry, perhaps the same income that is incentivised for the fund management industry could be similarly extended to the insurance industry.

There is clearly a need to widen the pool of investment income that should be incentivised. Doing so would increase the attractiveness of Singapore's incentive schemes. It may also indirectly promote the growth of onshore investments within Singapore.

New framework for group reinsurance vehicles

Global insurance groups frequently set up a group reinsurance vehicle to pool risks together before on-reinsuring excess risks into the market. Such vehicles are now typically being set up in Labuan (Malaysia), Luxembourg and Ireland. Even Hong Kong, with its 8.25% tax rate, is considered a good location.

Singapore should consider setting up a framework to attract insurance groups to set up their global reinsurance vehicle in Singapore.

For example, the framework could provide for the following:

- allow such vehicles lower capital and regulatory requirements than that for a normal registered reinsurer.
- allow a 5% concessionary tax rate on offshore reinsurance business without imposing onerous qualifying criteria.

More tax friendly framework for insurance regional operations

In the aftermath of the global financial crisis, a number of global insurance groups are reorganising their operations and setting up Asian holding vehicles. This can be through a separate holding company or by holding investments in other insurance entities through an insurance company.

Despite having an Operational Headquarters (OHQ) incentive in Singapore, it is still the case that most insurers choose to locate their Asian regional offices in Hong Kong. Some of the matters impeding the use of Singapore as the location of the Asian holding entity are:

a. no clear exemption of foreign dividends or foreign-sourced income. In comparison, Hong Kong does not tax offshore profits/income.

b. no clear exemption of capital gains arising from disposal of core insurance investments, particularly when the investments (whether in the form of branch, associate investment or subsidiary) are held by an insurance entity. It cannot be assumed that all investments held by an insurance company are revenue in nature. The lack of tax certainty in this area is a major drawback when insurers plan their location.

c. management fees are always expected to be derived from management activity. In practice, a company holding the group's Asian investments would also be actively managing the investments and acting as a regional OHQ. The holding company OHQ may then seek to derive dividend income instead of management fee income from its investments. Under current practice, the dividends arising are typically treated as "passive sourced" with no allowable deductions. At the same time, there is an expectation that a management fee be earned on the management activity.

If none exists, it is not unusual for a deemed profit to be imputed on management expenses incurred in the OHQ. Such tax treatment is not consistent with reality. Pure investment holding companies or conduit holding companies hardly exist as many tax authorities now require a holding company to have substance and activity.

Some possible improvement suggestions would be:

- to introduce a new framework/tax scheme to address the first two situations (a) and (b) outlined above for insurance MNCs setting up a regional holding vehicle in Singapore.
- review our current tax law and practice to allow greater tax deductions for management expenses against dividend income rather than insisting that management fees should always be received for management activity.

Conclusion

Singapore has big ambitions to be an insurance hub in Asia. The right fiscal policies will ensure that Singapore remains competitive and attractive as a place from which to carry out insurance business and from which to base regional operations.Without the benefit of a hinterland, Singapore always has to try that much harder to succeed.

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Taxing cloud payments still a grey area

The issue hinges on distinguishing between cloud computing payments as being a "service fee" or a rental payment.

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Not a day goes by without some buzz and excitement about the potential for cloud computing to transform how IT is purchased, deployed, and managed for all enterprises. In Singapore, we see a concerted effort by the government to attract major IT players to develop their infrastructure here and establish Singapore as a cloud computing hub for the region.

Cloud computing provides an approach to consume IT through Internet-based technologies, often utilising a "pay-as-you-use" model for infrastructure and software applications. Singapore is ideally placed to take a lead in attracting globally and regionally based service providers to develop and deploy their cloud offerings for their markets in Asia. From a tax perspective also, there are opportunities for IT service providers to establish Singapore as a base for their regional cloud offerings.

Tax opportunities

Singapore's corporate tax system is already considered conducive for IT service providers and the rapid evolution of cloud technologies gives further incentive to establish their data centres or other IT infrastructures, as well as management talent and cloud professionals to serve customers on a regional basis. Here are some specific examples of opportunities to promote a tax efficient approach:

- A foreign multinational IT vendor can establish a Singapore sales agency entity to support its regional cloud computing business. In certain jurisdictions, such a sales agency entity could create a taxable presence, thus subjecting significant profits to tax. However, in Singapore, under certain situations, the sales agency entity can operate without the risk of the foreign profits being significantly attributed to tax in Singapore.

- IT service providers can centralise significant parts of their cloud operations as a Singapore entrepreneur. Depending on the extent of centralisation or expansion, the Singapore entrepreneur can seek certain incentives on its tax rates ranging from zero to 10% on incremental profits, seek tax amortisation for acquisition of intellectual property, and seek withholding tax exemptions for certain royalty or interest payments. Cash grants could also be available on related infrastructure investments such as data centres.

However, one area that could be considered for modification, is the taxation of income earned by a Singapore-based vendor from its foreign customers (e.g. from country "X").

Where the Singapore-based IT service provider does not have any business presence in country X but merely earns service revenue from a customer located there, IRAS is likely to tax the gross amount of the service revenue earned from that country without giving credit or deduction for any withholding tax imposed on the revenue by country X. This potentially gives rise to double taxation.

To support the development of cloud business offerings in Singapore, it is suggested that some amount of tax credit or deduction could be accorded to a Singapore-based vendor in respect of country X tax suffered, to improve their effective tax rate position.

Withholding tax

When a Singapore-based enterprise pays a foreign vendor for cloud computing services, the user needs to determine whether withholding tax is applicable on the payment. Whether withholding tax is applicable depends on whether the payment is considered as service fees or payment for the use of, or right to use, movable property ("rentals").

If payment is characterised as a "service fee", the payment for services performed outside Singapore would not be subject to withholding tax. The alternative view results in the payment being subject to withholding tax, without the privileges of any special domestic withholding tax exemptions or tax treaty protection. The issue hinges on distinguishing between cloud computing payments as being a "service fee" or a rental payment, which unfortunately is not always clear cut. For example, it can be difficult to differentiate when some vendors describe their offering as a Web service but specify that payments are for use of capacity ("rental"?).

"One possible way is for tax authorities to take a broad-brush approach by regarding cloud computing payments as rentals."

Uncertainty aside, if the foreign vendor has a strong bargaining power over the Singapore user, the withholding tax applicable could be "passed on" to the Singapore user, increasing the cost of doing business here. So, how does one differentiate and develop clarity around these interpretations?

One possible way is for the tax authorities to take a broad-brush approach by regarding cloud computing payments as rentals and prescribing tax exemptions to specified types of payments. Since the late nineties, this approach has been applied to certain payments such as software payments and those relating to satellite and international submarine cable capacity.

However, such an approach can be criticised as being incompatible with international best practices. The OECD has long established certain principles that could be used to distinguish between service fees and rentals. Such principles (some described below) suggest that payments should be characterised as rentals only if:

- the customer physically possesses the property
- the provider does not bear significant risk of losses if there is non-performance
- the provider does not use the property concurrently to provide significant services to other entities

The distinction can become unclear when the payments cover multiple IT service offerings. On balance, we believe that adopting a principled approach as described above is the preferred way forward. Cloud computing as an emerging technology impacts many sectors beyond the IT industry in Singapore. Whilst it has enormous potential as a game changer for the IT industry and the way that all enterprises consume IT, it does create certain tax complexities.

These issues are not necessarily new, although arguably a fresh approach may be necessary to address the pervasive impact that cloud computing is expected to have across all industries. This will also fit well with Singapore's grander ambitions of being a leading, trusted cloud hub for the region.

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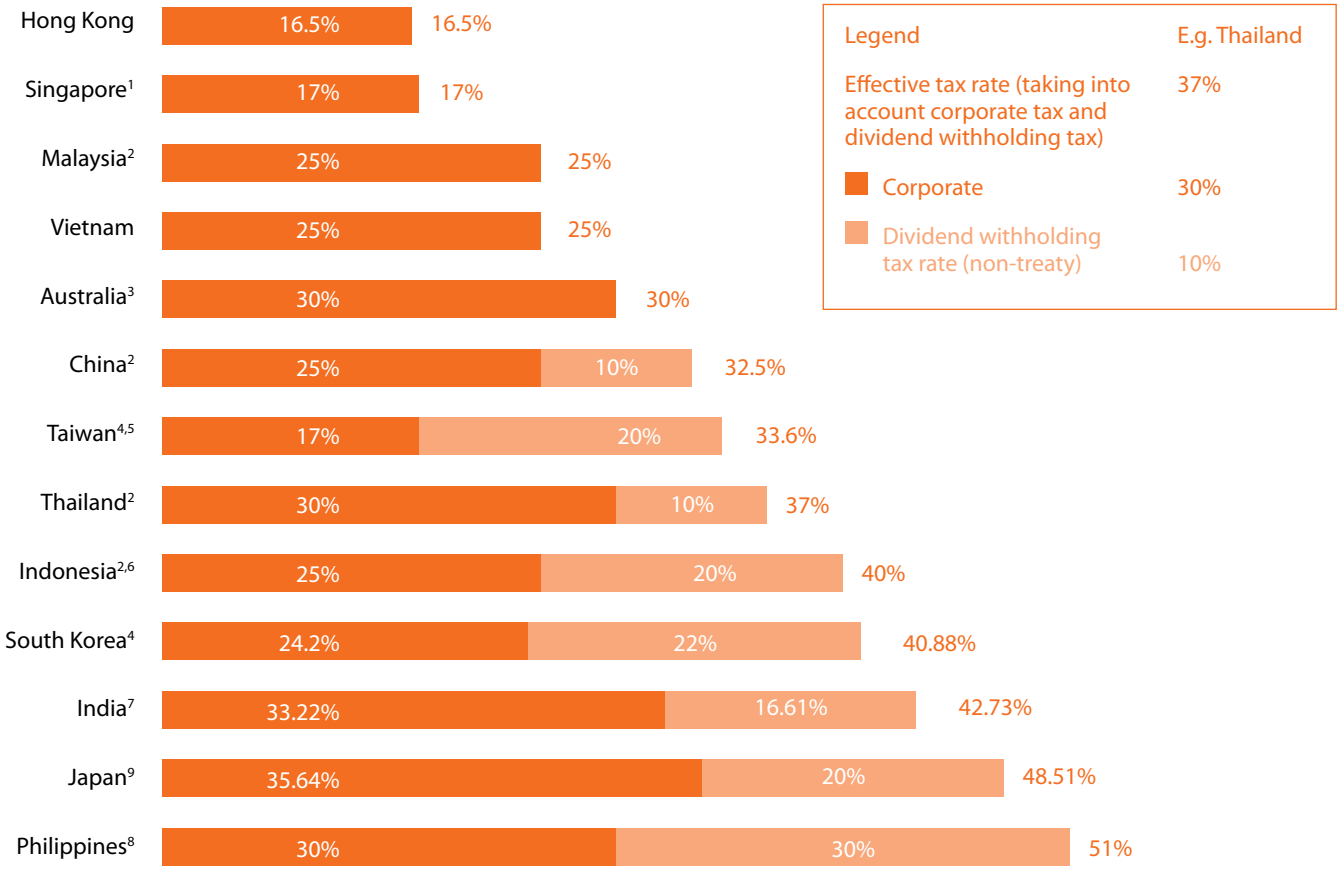
Appendix A

Comparison of Asia Pacific effective tax rates on repatriated corporate profits (for income year 2011)



Notes:
Certain rates above are approximate effective rates which include local/resident surtax or surcharge (e.g. China, India and South Korea), and additional income-related taxes such as provincial, inhabitants, enterprise or municipal tax and undistributed income tax (e.g. Japan).

1 Partial tax exemption of up to $152,500 applies to the first $300,000 of chargeable income. In addition, the higher of a 20% tax rebate (capped at $10,000) or a cash grant of 5% of revenue (capped at $5,000) is granted for Year of Assessment 2011.

2 Lower rates of tax apply to small- and medium-sized enterprises.

3 Fully-franked dividends (ie. dividends paid out of previously taxed profits) paid to non-residents are not subject to dividend withholding tax, but to the extent that a dividend paid to a non-resident is unfranked, withholding tax of 30% will generally apply. However, to the extent an unfranked dividend paid by an Australian resident company to a non-Australian resident company represents the on-payment of foreign income (ie. non-Australian sourced income) that has been exempted from Australian income tax, a nil Australian withholding tax can also apply in certain circumstances.

4 Lower rates of tax apply to income below certain levels.

5 The dividend withholding tax rate is 20%. An additional 10% tax will be imposed on any current earnings that remain undistributed by the end of the following year. However, the 10% surcharged amount may be used to offset the dividend withholding tax, subject to a certain tax limit.

6 Corporate tax rate is reduced by 5% for listed companies satisfying certain requirements.

7 India does not impose dividend withholding tax. This is a dividend distribution tax on the dividends declared, distributed or paid by the company. Such dividend is exempt from tax in the hands of the recipient shareholders.

8 Dividends paid to a non-resident corporation are subject to a lower rate of 15% if the country in which the recipient corporation is domiciled either does not tax such dividends, or allows a 15% or greater credit for the underlying tax paid by the dividend-paying company. In addition, a 10% improperly accumulated earnings tax is imposed on surplus or accumulated earnings of a corporation, which allows its earnings or profits to accumulate beyond its reasonable needs.

9 This is an approximate statutory effective rate of tax due to the varying influence of national and local taxes, which may vary depending on the capital base, size and nature of the company's business. The proposed 2011 tax reform reduces the effective corporate tax rate from 40.69% to 35.64% (for corporations with capital exceeding JPY 100 million in the Tokyo Metropolitan Area). The 20% withholding tax applies to private (unlisted) companies; a lower withholding tax rate applies on dividends from listed Japanese companies.

Appendix B

Comparison of Asia-Pacific individual tax liabilities
(a married man with two dependent children for income year 2010)

	Total Remuneration US$75,000		Total Remuneration US$100,000		Total Remuneration US$200,000	
	Tax Liability US$	Effective Tax Rate %	Tax Liability US$	Effective Tax Rate %	Tax Liability US$	Effective Tax Rate %
Singapore[1]	2,549	3	5,349	5	21,208	11
Australia[4]	17,240	23	26,571	27	66,815	33
China	14,192	19	21,476	21	58,959	29
Hong Kong	4,029	5	8,279	8	25,279	13
India	19,901	27	27,626	28	58,526	29
Indonesia	15,294	20	22,685	23	52,247	26
Japan	6,021	8	11,915	12	45,544	23
Malaysia	14,315	19	20,815	21	46,815	23
Philippines	22,187	30	30,187	30	62,187	31
South Korea	9,174	12	15,829	16	52,404	26
Taiwan	7,324	10	13,310	13	48,052	24
Thailand	15,805	21	23,305	23	58,184	29
Vietnam	18,572	25	27,322	27	62,322	31

Notes:
[1] Inclusive of one-off income tax rebate of 20% granted to all resident taxpayers, capped at S$2,000.
[2] Deductions for Social Security are not taken into account unless the contributions are compulsory by law.
[3] Standard deductions are taken into account.
[4] Based on new tax rates for year ending 30 June 2011.
[5] Tax liability figures may differ from prior year due to varying exchange rate of the local currency vis-à-vis US$.

Appendix C

Resident individual tax rates for Year of Assessment 2011

	Chargeable Income	Year of Assessment 2011	
	S$	Rate %	Tax S$
On the first	20,000	0	0.00
On the next	10,000	3.50	350.00
On the first	30,000		350.00
On the next	10,000	5.50	550.00
On the first	40,000		900.00
On the next	40,000	8.50	3,400.00
On the first	80,000		4,300.00
On the next	80,000	14.00	11,200.00
On the first	160,000		15,500.00
On the next	160,000	17.00	27,200.00
On the first	320,000		42,700.00
On income above	320,000	20.00	

Resident individual tax rates for Year of Assessment 2012

	Chargeable Income	Year of Assessment 2012	
	S$	Rate %	Tax S$
On the first	20,000	0	0.00
On the next	10,000	2.00	200.00
On the first	30,000		200.00
On the next	10,000	3.50	350.00
On the first	40,000		550.00
On the next	40,000	7.00	2,800.00
On the first	80,000		3,350.00
On the next	40,000	11.50	4,600.00
On the next	40,000	15.00	6,000.00
On the first	160,000		13,950.00
On the next	40,000	17.00	6,800.00
On the next	120,000	18.00	21,600.00
On the first	320,000		42,350.00
On income above	320,000	20.00	

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