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Gearing up for the long haul

Budget Commentary Singapore

An analysis of the main tax proposals presented in Budget 2012

17 February 2012

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A Budget for the future

If you were a corporate tax practitioner, you would have come out from watching the Minister for Finance's Budget speech this year in a state of mild shock. While we waited for the usual, "and now the tax changes," our wait was in vain. The changes, such as they were, were consigned to an appendix in written form that was dished out after the Minister had sat down.

Not that a lack of juicy tax changes means it was a bad Budget. On the contrary, there were significant and innovative measures proposed to build the fair and inclusive society that the Government is aiming for. These centred around reliefs and government spending on the elderly, healthcare, education, and narrowing the income gap. Perhaps the neatest of the proposals was the Goods and Services Tax (GST) Voucher scheme, aimed at reducing the burden of increasing costs of essential household goods and services for the lower income groups. Calls had been made in the past to address this through the zero-rating of these essentials. However the Government had always maintained its preference for keeping the GST simple and broad-based. The voucher scheme effectively has the same effect, but without disrupting the structure of the tax itself.

Another welcome proposal, and one that shows that the Government does act on feedback from the business community, involves the introduction of safe harbour rules in relation to disposal gains made when share investments are disposed of by Singapore holding companies. While the conditions were somewhat more timid than we would have liked – there needs to be at least a 20% ownership for 24 months – it was nonetheless a big step in the right direction. It will provide significant stability for international businesses that want to use Singapore as their regional headquarters. Other tax changes involved a bit of tinkering around the edges for the usual suspects, financial services, the maritime sector and innovation-based activities, but nothing worth writing home about.

The controversial area, however, remains the tightening of the Dependency Ratio Ceilings (DRC) for foreign workers. Feedback from business leaders in the run up to the Budget, particularly in the small and medium enterprise space, had clearly spelled out that the tightness of the labour market was hampering expansion, in some cases even survival of businesses who were desperate to hire, but who simply could not find what they were after. It probably goes without saying that Singapore businesses would rather employ Singaporeans, but those with the requisite skills are either not available, or reluctant to do the type of work involved. The difficulty really is one of timing. It is not a case of turning one tap off and opening up another. The DRC changes have an immediate effect. Replacing staff with innovatory machines, techniques or processes takes time and often significant capital outlay. Although the proposals that then encouraged the retention of the older workforce might compensate for this shortage, they would only do so to a degree. Some jobs, particularly those that require some manual input, can simply not be done by 65-year-olds. Nevertheless the proposed measures to extend working lives are still to be commended as they address another increasingly troubling social issue, which is the need for older workers to stay in jobs as a matter of financial survival. Ultimately however, it is strongly suspected that the feedback from businesses in the human capital space will not be much different in the run up to next year's Budget from what it was in this.

The interesting aspect of this year's Budget though was the fact that there was no obvious attempt to increase public revenues in order to meet the enhanced social spending programme (except perhaps the hike in duties on beedies and "ang hoon", whatever they are). This was something in fact that had been hinted at by the Prime Minister in earlier discussions as perhaps being necessary if the social funding policy was to be sustainable over the long term. There was also little mention of there being measures aimed at steadying the boat in the midst of what are still choppy waters in the global economy. But as the Minister said, "The principal focus of this year's Budget is therefore not on providing a countercyclical boost to the economy, but on addressing Singapore's longer-term challenges and building a better future for our people. It is a Budget for the future." It certainly was that.

17 February 2012

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Corporate tax changes

The corporate income tax rate remains at 17%, which was largely expected.

For Year of Assessment (YA) 2011, companies were given the higher of a one-off 20% corporate income tax rebate (capped at $10,000) or a small and medium enterprise (SME) cash grant of 5% of the company's revenue (capped at $5,000).

The cash grant has been extended to YA 2012, with the amount remaining at 5% of the company's revenue, and subject to a cap of $5,000. The company must have made Central Provident Fund (CPF) contributions for at least one employee (who would have to be a Singaporean or permanent resident) in the financial year ended 2011.

Sadly, the 20% corporate tax rebate has not been similarly extended, although the grant may be set off against tax payable.

Productivity and Innovation Credit

The Budget should be lauded for improving the Productivity and Innovation Credit (PIC) scheme in four key areas:

- Cash payout option;
- Training;
- Research and development (R&D); and
- Investments in automation equipment.

Cash payout option

With the Singapore economy showing signs of slowing down, cash is king, particularly for businesses that are making losses. The cash conversion or payout option, while not giving the same bang for its buck as taking advantage of the PIC itself against taxable income, nevertheless gives access to cash when cash may be in short supply. Three enhancements were proposed for the cash payout in the Budget announcement, namely (a) an increase in the cash payout rate from 30% to 60% from YA 2013, (b) an extension of the option to YA 2015 (previously it was meant to stop after YA 2013) and (c) increased frequency (quarterly instead of yearly) of claims.

It would be difficult to argue that the first of the changes is not an improvement. With this change, the difference in absolute amounts between the PIC and the cash payout becomes smaller and is likely to make the cash option more appealing for a cash-strapped business.

Using a simple example, if we assume $100,000 of qualifying PIC expenditure had been incurred by a normal taxpayer, the corresponding cash payout would be $60,000 compared with $68,000 of tax savings ($100,000 x 400% x 17%). Depending on the tax attributes of the taxpayer, the tax savings (albeit 13.3% higher than the cash payout in nominal monetary terms) may typically take more time to be realised and therefore opting to get the cash of $60,000 on hand would be a much more pragmatic outcome. Arithmetically the increase in the cash payout rate to 60% means that any corporate taxpayer who has a tax rate of 15% or below will never lose out in monetary terms by opting for the cash payout over the 400% tax deduction/allowance ($100,000 x 400% x 15% = $60,000 tax savings). Hence for incentivised or exempt corporate taxpayers, the choice becomes emphatically clearer.

On (b), one difficulty is that expenditure across some years of assessment cannot be combined for this purpose, as allowing a combination would clearly increase flexibility for taxpayers with regard to their spending pattern. The increased frequency of claims suggested in (c) may of course sound helpful for any cash-strapped business but a general downside of the broader PIC scheme starts to creep back in: increased compliance burden and tracking requirements for the taxpayer.

Training

Two changes were announced in the area of training in relation to the PIC:

- In-house training courses; and
- Training of agents.

In-house training courses

Qualifying in-house training expenditure incurred of up to $10,000 per year no longer needs to be certified for PIC purposes, as was the case before.

By partially relaxing the earlier requirement for all in-house training expenditure to be certified, the taxpayer's position may improve somewhat. However, tracking the amount of in-house training expenditure (whether certified or not) for PIC purposes is already rather complex. For example, it contemplates apportionment of salary paid to in-house trainers between their time spent conducting training and their time spent on other employee functions (which are not related to training).

Training of agents

It was announced that expenditure incurred by a principal on the training of its agents may qualify for PIC subject to certain conditions. The conditions include:

- Existence of a regular working/contractual relationship between the principal and the agent;
- Requirement for the principal to bear the training expenses and not charge or recover the training expenses from the agent;
- Requirement for the training expenses not to be claimed by the agent as expenses of his/her trade or as course fees relief; and
- Requirement for sharing of risks and rewards of the agent.

Conceptually this is an interesting pronouncement. An example of where this could apply is where an agent needs to obtain additional knowledge of the principal's products/services through training in order to fulfil the agency duties under their contractual relationship. While this is fine and there may be instances where a principal may be more than happy to facilitate and bear the cost of training the agent, we have two lingering questions at this stage:

- Whether the agent necessarily has to be an individual (as opposed to say, a company); and
- Whether the requirement for sharing of risks and rewards is superfluous.

To the first question, it can be inferred from the gender reference in the stated third condition and the examples of agents (insurance agents, financial advisers and real estate agents) listed, that the agent must be an individual. There is however no compelling reason from a theoretical standpoint why such an agent cannot be a corporate body (e.g. even an individual may choose to operate his business through an incorporated vehicle). A contract manufacturer may for example have a need for his principal to train his staff in the operation of the principal's machinery.

On the second question, the respective contractual risks and rewards accrue to both the principal and the agent in most forms of principal-agency relationship and are "shared" although the proportion may differ depending on the contractually agreed remuneration scheme. In the situation where the agent is remunerated on a cost-plus basis for most of its activities, it may well be the case that fairly limited risk/reward is borne by it, but would such an arrangement still qualify?

It would be interesting to get further clarification on the above, and it is also hoped that this pronouncement applies to training across all industries as opposed to those more focused on the financial sector (as the examples of agents seem to suggest).

R&D

R&D cost-sharing agreements

As economies around the world struggle to recover, many governments are taking steps to make their R&D regimes more attractive to multinational businesses and Singapore is no exception. The R&D tax regime has been significantly enhanced at the front end of the innovation cycle in this Budget.

Prior to the Budget, companies had to seek the Economic Development Board's (EDB's) approval to claim writing down allowances on expenditure incurred on R&D cost-sharing agreements. In addition, these expenses did not qualify for the PIC benefits. This created an anomaly as prior approval was not required to claim a tax deduction for other R&D expenses incurred under sections 14D and 14DA(1) of the Income Tax Act and the PIC benefits applied to other R&D expenses. With the announcement, expenditure incurred on R&D cost-sharing agreements will now qualify as expenditure on R&D. This effectively means that companies that collaborate on R&D projects can now claim:

- Enhanced deduction of 400% (subject to an expenditure cap of $400,000) under the PIC for qualifying expenditure (i.e. staff costs and consumables) on R&D activities carried out in Singapore or overseas (if the R&D done overseas relates to the company's Singapore trade or business);
- 150% deduction on the balance of qualifying expenditure exceeding the cap of $400,000 for R&D performed in Singapore; and
- 100% deduction on the balance of all other R&D expenses, including expenses for R&D done overseas (which is related to the company's Singapore trade or business).

The Minister clarified that the R&D cost-sharing expenditure claimed will count towards the expenditure cap for the R&D activity and the qualifying expenditure under R&D cost-sharing agreements will be deemed to be 60% of the shared costs, similar to outsourced R&D where a breakdown of the expenditure items is not available to the taxpayer. We believe that if R&D under a cost-sharing agreement is performed by a Singapore taxpayer, the shared costs incurred by the taxpayer, to the extent that they relate to qualifying expenditure, should be 100% deductible.

The Minister also clarified that transitional rules will be provided for existing claimants under approved cost-sharing agreements.

This announcement will be welcomed by many industry players as R&D efforts are becoming increasingly costly and international alliances to pool resources and share risks to develop advanced technologies on a cost-sharing basis, instead of absorbing hefty R&D bills individually, has become a viable option for many industry players.

One question that comes to mind would be whether a buy-in payment to an existing R&D cost-sharing agreement would qualify for deduction under sections 14D and 14DA(1). Our view is that it should not, as generally a buy-in payment compensates the transferor for costs/risks undertaken in developing or acquiring pre-existing intellectual property (IP) and is strictly not an R&D expense on IP development. We also believe that the claw-back provisions applicable to approved cost-sharing agreements in the event of sale, assignment or disposal of any IP developed or equipment acquired under the agreement, should no longer be applicable.

Software development

Prior to the Budget, expenditure incurred for the development of internal-use software did not qualify as R&D expenditure and software was presumed to be for internal use unless it was developed to be commercially sold, leased, licensed or otherwise marketed, for separately stated consideration, to third parties. This was referred to as the "multiple sales" requirement.

In the Budget, it was announced that the "multiple sales" requirement will now be removed to facilitate R&D in software development not intended for sale. However, the threshold of "novelty" or "technical risk" should still be met to qualify as R&D. Generally, if the software is innovative and differs in a significant and inventive way from prior versions or if the software development involves significant economic risk to the taxpayer due to substantial uncertainty arising from technical risk, the R&D expense should qualify. However, software R&D will still not be considered R&D if the software is developed to be used for internal business administration, which is in line with the approach in several developed countries around the world.

This announcement will be welcomed by many industries including the financial industry as the development of electronic platforms and service offerings is critical to competitiveness in the financial sector and should be recognised as a valid area for R&D. Examples of software development that should qualify would include the development of fast and efficient e-banking and e-finance applications for internet service delivery and the development of unique algorithms (and supporting software and systems) to take advantage of opportunities for arbitrage in global markets.

Investments in automation equipment

Currently, the cash conversion option is only available on a per-item basis, subject to the expenditure conversion cap of $100,000 for all six qualifying activities for each year of assessment. Businesses must convert the full amount of expenditure incurred on an item of qualifying equipment into cash, subject to the expenditure conversion cap for each year of assessment.

As expenditure incurred on the qualifying equipment cannot be partially converted into cash, the option is not available to any qualifying equipment acquired on hire purchase with a repayment schedule straddling two or more basis periods, i.e. financial years.

However, to support cash-constrained small and growing businesses in innovating and improving productivity, it was announced in the Budget that with effect from YA 2012, qualifying automation equipment acquired on hire purchase with a repayment schedule straddling two or more financial years will be eligible for the cash conversion option. All other existing terms and conditions of the scheme apply. This is good news, especially for SMEs.

Gains on disposal of equity investments

The Singapore tax legislation imposes tax only on items of income. Gains or profits that are on capital account are not taxed. Because of the stark difference between a taxable item of income (taxable at rates of up to 17% for companies and 20% for individuals) and a non-taxable item that is on capital account, the distinction between what is and what is not capital has been a significant bone of contention between the Inland Revenue Authority of Singapore (IRAS) and taxpayers, for many years.

In response to lobbying, this year's Budget introduced guidelines to determine when a company will not be taxed on gains from the disposal of equity investments. This should give international businesses more confidence in using Singapore as a holding company or headquarters location than before, when Singapore could not really be recommended because of this uncertainty.

For shares disposed of on or after 1 June 2012, gains derived by companies will not be taxed if:

- The divesting company holds a minimum shareholding of 20% in the company whose shares are being disposed of; and
- The divesting company has held the minimum 20% shareholding for a minimum period of 24 months immediately prior to the disposal.

For share disposals in other scenarios, the tax treatment of the gains or losses arising from share disposals should continue to be determined based on a consideration of the facts and circumstances of the case. At least that is what is hoped. The scheme will be reviewed after five years and the IRAS will release further details by 1 June 2012.

It is mentioned in the Budget that the new treatment is given in the context that the acquisition and sale of shares are often necessary as a company restructures for growth or consolidation. If one focuses on the word “restructure” it remains to be seen whether there would be other conditions when details are announced. Imposing additional conditions would undermine what looks to be a very robust and useful change.

This concession appears to be akin to the participation exemption regime that is operated by many European countries. It would certainly be welcomed by local and overseas investors. Companies that have used Singapore or planned to use Singapore as a location for holding investments can obtain solace that a future exit would not be taxable if the conditions can be met. The improvement will put Singapore ahead of Hong Kong, where taxpayers still need to contend that their gains are capital in nature or sourced offshore.

There are still several issues to consider however:

- For companies which hold investments for less than two years, would such gains then be automatically taxable? As noted above, we would hope that this question should still be considered based on the facts and circumstances of the case. When similar time frame conditions were proposed for the real estate industry in 2009 to exempt gains from the sale of property from tax where the property was held for four years or more, it was a concern that any gains from a shorter holding period would automatically be considered taxable.

- Given that the average minimum shareholding requirement in most European countries is about 5% to 10% to qualify for a similar tax exemption, the current minimum shareholding of 20% is a more stringent requirement. This seems to be benchmarked against the accounting treatment for investments in associated companies. If this is the reason for the benchmark, it appears that the concession is targeted to benefit genuine strategic investors who prefer to have some significant influence in determining the financial and operational strategies of their qualifying targets. This threshold should also cater for financial investors who in many cases acquire a minimum of a 20% stake. The incentive could therefore be of appeal to Singapore companies that are looking for alternative sources of funding.

- “Equity investments” would typically refer to ordinary shares with voting rights. However, it can also be interpreted more widely, depending on the features, to include instruments such as preference shares, rights or options or even convertible bonds. It is not uncommon for investors to invest through hybrid instruments to better manage their risks. Hopefully, the details can allow for such alternatives to be considered as equity investments and for the exemption to apply accordingly.

- Following the above discussion on how hybrid instruments may be used to invest, it would also be worthwhile to consider how the holding period can be defined. Where investors invest through a convertible bond initially to manage their risks and allow for easier redemption of the principal sum, they may convert the bond into shares, i.e. equity investments, at a much later stage, and just before a disposal. Where the holding period of the shares falls short of the two-year requirement, the investors may run the risk of being taxed on any gains.

- There is the question of whether the new provisions may renew concerns that Singapore may be viewed as a tax haven.

- Given the increased scrutiny of holding structures by other jurisdictions, it is noteworthy that this proposed scheme makes no reference to any need for substance (such as whether the holding company has business activities, employs individuals, has a minimum spend threshold, etc).

The table below outlines other schemes and their respective broad benefits and conditions.

Summary of participation exemptions

Country	Taxation of gains	Minimum shareholding	Minimum period	Comments
Netherlands	Ordinary income	5%	None	Not held as portfolio investment
France	Ordinary income	Subsidiary	2 years	95% exempt
Italy	Ordinary income	None	1 year	95% exempt Booked as financial fixed asset in accounts Carrying on commercial activities for specified period
Germany	Ordinary income	None	None	95% exempt
Sweden	Ordinary income	10% voting (listed) None (unlisted)	None	Excludes shell companies
Belgium	Ordinary income	None	1 year	Booked as financial fixed asset in accounts
Austria	Ordinary income	10% issued share capital	1 year	Must meet active business test and be subject to tax of 15% or more
Norway	Ordinary income	10% voting for shares outside European Economic Area (EEA) None if in EEA	2 years	97% exempt Excludes shareholdings in low tax jurisdictions (2/3 Norwegian rate) EEA investments not subject to shareholder or period requirements
Luxembourg	Ordinary income	10% share capital or euro 1.2m	1 year	Complex additional conditions
Australia	Capital gains tax	10% voting	“certain period”	Tied in with controlled foreign companies legislation

Mergers and Acquisitions scheme

The Mergers and Acquisitions (M&A) scheme was initially introduced in Budget 2010 to help Singapore-based enterprises defray a portion of their acquisition costs when seeking to expand their businesses inorganically.

The existing M&A scheme provides a tax deduction equal to 5% of the value of the acquisition, subject to a cap of $5 million for all qualifying deals executed in a year of assessment. This accommodates deals of up to $100 million in any one year. Under the existing scheme, the allowance will be written down equally over five years, and is deductible against the buyer's taxable income. At a 17% rate of corporate tax, this effectively gives a buyer up to $850,000 of tax benefit, or $170,000 a year. It would have been better though if the allowance could be written down in one year. This would help defray the transaction costs that need to be borne upfront.

Budget 2012 introduced the following changes:

- **200% tax allowance on transaction costs incurred**
  Generally, transaction costs incurred in a business acquisition are considered capital in nature and not tax-deductible. The M&A scheme now grants a 200% tax allowance for transaction costs incurred. Common transaction costs include professional fees on due diligence, legal and financial advisory fees. However, the expenditure qualifying for the 200% tax allowance is capped at $100,000 per year of assessment. This works out to a benefit of $34,000 based on a 17% tax rate. SMEs undertaking small deals to grow through acquisitions should welcome this effort to defray some of their costs. However, a deal size of say $50 million (used as an illustration in the 2010 Budget) could face costs of approximately $1.5 million given that a deal of this size would warrant the need for financial advisers, an army of lawyers and other professionals. In the face of such deals that SMEs may consider to reach the target of $100 million revenue (based on the Economic Strategies Committee target, below) it remains to be seen if a $34,000 carrot is big enough.

  The new allowance for transactions costs can be claimed in one year. An SME can claim relief against its current year income (where it has taxable income). It is hoped that details to be released by the IRAS by 30 June 2012 will allow a company to carry forward any unused allowance where its income is insufficient in the current year. This is based on the current treatment for the existing M&A allowance.

- **An enhancement of the M&A scheme to allow for more complex structures**
  The benefits of the M&A scheme should now apply to more complex structures where the target company need not be directly held by the acquiring company or its wholly-owned Singapore subsidiary incorporated specially for the acquisition as was the case under the original scheme. It is however unclear if all of the relevant holding companies need to also be incorporated, or tax resident in Singapore. If there is no such condition, this enhancement may appeal to sophisticated players in the market, who may have multi-tier holding structures, where some are incorporated outside Singapore. On the target side, the relevant conditions that the target company has to meet may now be satisfied by any of the multiple tiers of wholly-owned subsidiaries of the target company.

- **An extension of the M&A scheme to existing headquarters incentive schemes in Singapore**
  For companies that qualify for existing headquarters incentive schemes in Singapore, the condition that the acquiring company must be held by an ultimate holding company incorporated in Singapore may be waived, subject to meeting certain conditions set by the EDB. This extension of the M&A scheme should attract foreign investors with a holding structure in Singapore that meets existing commitments of the headquarters incentives. Such a company could make acquisitions. Previously the scheme was restricted to Singapore-based acquisition companies.

One of the primary difficulties with the scheme, even in its enhanced form, is that the acquiring entities have to already be carrying on a taxable activity in Singapore. This restriction certainly limits the appeal of the structure. More flexibility should be introduced to enable the allowances available to an otherwise empty acquisition company to be group-relieved within the target group.

The above changes will take effect for qualifying M&A completed from 17 February 2012 to 31 March 2015. All other existing terms and conditions of the scheme continue to apply. The IRAS and the EDB will release further details of the changes by 30 June 2012.

It is hoped that these measures will help meet the objective set by the Economic Strategies Committee to have 1,000 Singapore companies with a turnover of over $100 million each by 2020 (i.e. 530 in 2007 to 1,000 in 2020). While we would have preferred the Government to introduce outright measures such as giving interest expense deductions, we will add these to next year's wish list.

Renovation and refurbishment tax deduction scheme

In the 2008 Budget, the renovation and refurbishment (R&R) tax deduction scheme was introduced to allow a special allowance for expenditure incurred on fixtures, fittings and installations for renovations undertaken by companies. However, the special allowance was subject to a cap of $150,000 for every three-year period and was applicable for expenditure incurred up to 15 February 2013. The IRAS issued a circular on 18 June 2008 to explain the tax treatment and provided a list of qualifying expenditure which would be eligible for the special allowance.

To further enhance this scheme, the sunset deadline of 15 February 2013 has been abolished to make it a permanent feature of the tax regime and the expenditure cap has been doubled to $300,000 for each three-year period. It is proposed that all other terms and conditions of the scheme will continue to apply.

While the scheme is enhanced to help businesses renew and refresh their premises regularly, the following points are worth noting:

- With a cap of $300,000 for a period of three years, the scheme continues to remain attractive mainly for SMEs as it does not provide significant benefit to big enterprises which may incur significant R&R costs.

- The tax deduction continues to be available to the taxpayer on a straight-line basis over a period of three years. Hence, a taxpayer does not get the full tax benefit in the year in which he incurs the expenditure.

- R&R costs relating to structural changes and certain other costs (e.g. designer fees, etc) continue to be non-qualifying expenditure. Considering the cap on the expenditure, it would have been more effective to say that all R&R-related expenditure should be eligible for tax deduction.

The changes will take effect from YA 2013, and further details will be released by 30 June 2012.

Capital allowance claims for low value assets

Currently, companies can claim capital allowances over one year on assets which cost no more than $1,000. This is subject to a cap of $30,000 on the aggregate claim.

The cap on the costs has now been increased to $5,000 for each asset. This should certainly help taxpayers as the cost ceiling of $1,000 was becoming inappropriate with increasing costs, and not many assets could qualify for the one-year claim. The changes should result in reduced administrative effort in identifying and tracking the fate of low value items. The changes will take effect from YA 2013, and further details will be released by 30 June 2012.

Integrated Investment Allowance

The IRAS originally took the view that a company that places its plant and machinery with a sub-contractor (related or not) for the manufacturing of its products is not entitled to capital allowances on capital expenditure incurred for that machinery. It was presumably for this reason that in 2003 the Government introduced the Integrated Industrial Capital Allowance (IICA) scheme to cater for Singapore companies that outsourced their production activities to wholly-owned subsidiaries outside Singapore. Under the IICA scheme, Singapore companies could claim capital allowances on their plant and machinery (used by wholly-owned subsidiaries) for projects that were approved by the EDB.

However, in the recent case of *ATG v Comptroller of Income Tax*, the Board of Review decided that capital allowances should be available to companies under the normal provisions of the Income Tax Act for capital expenditure incurred on plant and machinery placed with a sub-contractor as long as it is clear that such plant and machinery is used for the purposes of the trade of the Singapore company. This decision raised questions about the relevance of the IICA scheme.

With the introduction of the Integrated Investment Allowance (IIA) scheme in this year's Budget, it has been acknowledged that the IICA scheme is no longer relevant.

Further, the new IIA scheme will provide an additional allowance on top of the capital allowances normally available for capital expenditure incurred for productive equipment placed overseas on projects approved by the EDB. Hence, this is not an automatic claim and companies will have to obtain approval from the EDB. Neither a percentage nor a range of the additional allowance has been specified and we believe that it may be subject to discussion and negotiation with the EDB by the companies involved.

In today's economy where outsourcing is becoming key to driving cost efficiency and many companies are increasingly looking at setting up an entrepreneurial hub in Singapore, the additional allowance will certainly give added appeal to the model. However, companies which are considering placing their plant or machinery with companies outside Singapore for the manufacturing of goods have to evaluate the overall tax benefit, as this model may create withholding tax and permanent establishment (PE) tax exposures in other countries for them.

Double Tax Deduction for Internationalisation

Currently, businesses may claim up to 200% tax deduction for qualifying expenditure incurred on qualifying market expansion and investment development activities. This is granted on an approval basis by International Enterprise (IE) Singapore or the Singapore Tourism Board (STB).

It was announced in the Budget that approval is no longer required, and a tax deduction of up to 200% will be allowed on qualifying expenditure, up to $100,000 per year of assessment. Expenditure has to be incurred on the following four specified activities:

- Overseas business development trips/missions;
- Overseas investment study trips/missions;
- Participation in overseas trade fairs; or
- Participation in approved local trade fairs.

With the level of the cap on the qualifying expenditure, this is clearly targeted at SMEs. However, it is a welcome move as it dispenses with the need for approval if the qualifying expenditure does not exceed $100,000 per year of assessment.

The enhancement is said to be aimed at encouraging our SMEs to venture abroad. The question of why there is a restriction on the spectrum of specified activities should be raised. It is notable that activities leading up to the actual venturing into overseas markets are omitted, for instance engaging external consultants for overseas feasibility or market studies.

From an administrative standpoint, over-zealous policing of the new enhancement may defeat its purpose which is to "reduce administrative burden on businesses".

The changes will take effect for expenditure incurred on or after 1 April 2012, and IE Singapore and the STB will release further details of the changes by 31 March 2012.

Filing and payment deadline for withholding tax

Currently, where withholding tax is applicable, the deadline for filing and paying the tax to the IRAS is the 15th of the month following the date of payment to the non-resident.

The extended deadline for the payment of withholding tax is now the 15th of the second month following the date of payment to the non-resident. This extension can ease administration and cash flow pressures, especially for recurring month-end payments where effectively the payers only have two weeks to complete the filing and payment of the withholding tax.

This change will take effect for payments made to non-residents on or after 1 July 2012. The only question here is whether the effective date could be moved earlier, e.g. 1 April 2012, rather than have taxpayers wait for another four months for the changes to kick in.

Illustration 1: Current deadline

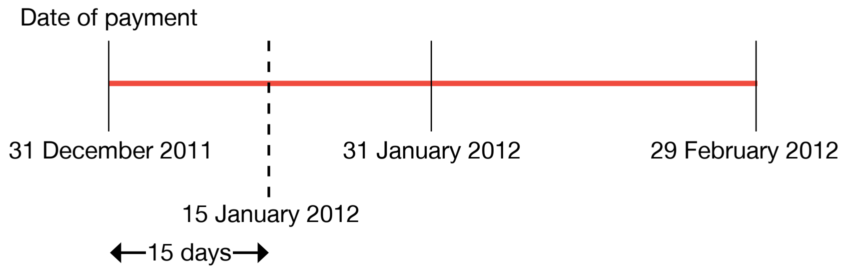
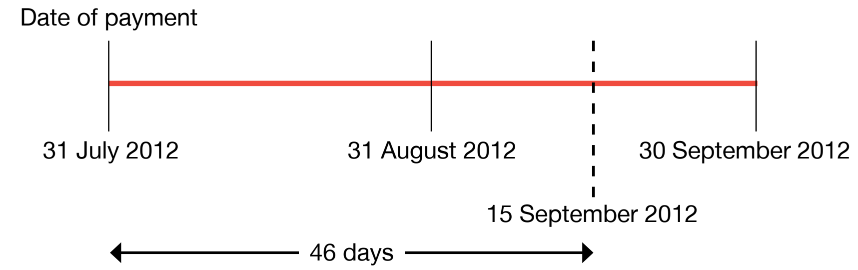


Illustration 2: New deadline



[1] *Date of payment is clarified by the IRAS to be the earliest of the following dates:*
a) when payment is due and payable based on agreement/contract. In the absence of contract/agreement, the date of invoice would be the deemed date of payment (credit terms should not be taken into consideration);
b) when payment is credited to the account of the non-resident (reinvested, accumulated, capitalised or carried to any reserve) or any other account however designated; and
c) date of actual payment.

The date of payment for director's fees is the date they are voted and approved (e.g. company's Annual General Meeting).

Maritime and aviation

Maritime sector

The maritime sector has always been one of the mainstays of the Singapore economy and is a frequent beneficiary of Budget proposals. This year has proven to be no exception, with one or two enhancements on offer.

Automatic tax exemption for gains on the disposal of vessels by qualifying ship operators and ship lessors

Since 2005 when this concession was first announced until now, shipowners have had to deal with extensive queries from the IRAS in order to justify capital gains treatment for the profits from the sale of their shipbuilding contracts, completed ships or shares in ship-owning companies. An attempt to relieve them of this effort was made in June 2011 through the offer of a section 92(2A) class remission. To benefit from this remission, the shipowner had to file a self-declaration form with the IRAS. However, this created more uncertainty, as by electing for remission of tax, it would appear that the shipowner is in agreement that the gains from the sale of their ships are in the first place taxable as revenue gains (as opposed to capital gains).

To provide certainty, from 1 June 2011, qualifying shipowners, operators and lessors under the Maritime Sector Incentive (MSI) will be granted automatic exemption from tax on profits from the sale of their vessels, without the need to opt for the tax remission. It was also made clear that in granting this automatic exemption to shipowners whose main business was that of ship operating, the distinction between revenue and capital gains from the sale of ships will no longer apply.

The automatic tax exemption has been expanded to cover gains from:

- Sales of vessels under construction and new building contracts; and
- Sales of foreign vessels by ship lessors awarded the MSI-Maritime Leasing (Ship) incentive.

The above exemption also covers gains from the sale of 100% of the shares in a ship-owning company. It is relevant to note that where less than 100% of the shares in a ship-owning company are sold, the gains will also not be taxed if they meet the conditions as mentioned in the section on “Gains on disposal of equity investments”.

Withholding tax exemption on charter fees paid to non-residents

With effect from 17 February 2012, all charter payments (i.e. bareboat, voyage and time charter) made to non-residents will be exempted from Singapore withholding tax. This enhancement certainly benefits ship charterers who do not qualify for the MSI-Approved International Shipping (MSI-AIS) scheme or the MSI-AIS (Entry Player) scheme, both of which provide for such exemptions.

It is likely that this would also benefit oil traders and commodity traders who charter ships to transport their products.

One point to note is that although tax need not be withheld on such charter payments to PEs in Singapore, the Singapore PEs will still be required to declare the charter fees received as taxable in their annual income tax return since they are not covered under the MSI scheme.

Automatic withholding tax exemption for interest and related payments arising from loans taken to finance qualifying containers

Under the MSI-Maritime Leasing (ML) (Container) scheme, qualifying income is subject to a concessionary tax rate of 5% or 10%. The Government has enhanced the MSI-ML (Container) scheme to further promote container leasing in Singapore.

Firstly, from YA 2013 the scope of qualifying income under the MSI-ML (Container) scheme is expanded to include income from the leasing of intermodal equipment (e.g. trailers) which is incidental to the leasing of the qualifying containers.

Secondly, to provide certainty, automatic withholding tax exemption is granted to interest and related payments made on or after 17 February 2012 for loans taken to finance qualifying containers and intermodal equipment (e.g. trailers). The payer would need to ensure that the loans meet the qualifying conditions and file a self-declaration form.

With effect from YA 2013, qualifying containers will refer to containers that adhere to the standards defined by the International Organization for Standardization or the Institute of International Container Lessors or any other relevant organisation.

Funding for R&D initiatives relating to deep water oil production

The $150 million from the National Research Fund to Agency for Science, Technology and Research (A*STAR) and the EDB to fund R&D initiatives to develop solutions for deep water oil production that was introduced in the Budget will benefit our local shipyards specialising in building oil rigs and top side modules for these rigs. This is a sizeable amount compared to what is currently provided. Singapore is the leading builder of oil rigs in the world and hence it is important to maintain this lead.

Although the enhanced deduction under the PIC only covers R&D expenditure incurred which is net of this grant, any additional funding would still be welcome.

Aircraft leasing

The Aircraft Leasing Scheme (ALS), which grants a concessionary tax rate of 5% or 10% on income derived from the leasing of aircraft or aircraft engines and other qualifying activities, was slated to expire on 29 February 2012. To continue to promote the aircraft leasing industry in Singapore, the ALS will be extended to 31 March 2017.

In addition, an automatic withholding tax exemption will be granted for qualifying interest and related payments made on foreign loans for financing aircraft or aircraft engines. The qualifying period for this concession will be from 1 May 2012 to 31 March 2017.

As usual, there are conditions that must be met. The EDB will release further details by 30 April 2012.

Financial services

The financial sector is a key component of Singapore's economy. Numerous tax incentives have been introduced over the years to promote the development of this sector. That being said, there are gaps in the provision of finance that are not currently filled by the private sector. Recognising the potential for infrastructure development and in the expansion of cross border trades for SMEs, the Minister announced the launch of a specialised project finance company, established by a consortium of financial institutions put together by Temasek Holdings, as well as enhancements to the current suite of trade financing schemes administered by IE Singapore. These measures are intended to act as catalysts for businesses to capture opportunities for expansion into the region and other emerging markets.

Given the raft of regulatory changes it is currently undergoing, the financial services industry should welcome this Budget, for it has introduced certain measures to simplify our tax incentives regime. The extension of the withholding tax exemption introduced in last year's Budget and the relaxation of the cash distribution rule for real estate investment trusts (REITs), as well as the adoption of an exclusion list approach to determine incentive income under the fund management and trust schemes, go to show that the Government has listened to the industry's calls for simplification. It is hoped that the exclusion approach to determining incentive income will be more widely adopted for the financial sector tax incentives, as given the pace of change and innovation in the industry it is not feasible to list down all items of income that would qualify for concessionary tax treatment.

Liberalised withholding tax exemption regime for banks

In last year's Budget, the withholding tax exemption regime was liberalised to allow banks, finance companies and entities licensed under the Securities and Futures Act involved in debt or equity underwriting and that are specifically approved by the Monetary Authority of Singapore (MAS) to enjoy a withholding tax exemption on interest and similar payments made to non-residents (except PEs in Singapore). This is provided that these payments were made for trade or business purposes. The exclusion of PEs in Singapore no longer applies for payments to be made from 17 February 2012 to 31 March 2021 (for contracts already in force before 17 February 2012), and all payments arising from contracts effective on or after 17 February 2012 to 31 March 2021. The rationale is that PEs in Singapore will be assessed to tax on these payments and will be required to declare the payments received in their income tax returns, unless the payments are specifically exempt from tax. This somewhat overdue enhancement will ease the compliance burden for financial institutions and is a particularly welcome measure for reinsurers and general insurers who typically operate as branches in Singapore and receive significant interest income from deposits with banks in Singapore.

Withholding tax exemption for over-the-counter financial derivative payments

As expected, the withholding tax exemption for financial institutions on all payments made on over-the-counter financial derivatives to non-residents (except PEs in Singapore) which is due to expire on 19 May 2012 has been extended to encourage the continued growth of the Singapore derivatives market.

This applies to payments to be made from 20 May 2012 to 31 March 2021 on contracts taking effect, or that are extended or renewed before 20 May 2012, and all payments to be made on contracts taking effect, or that are extended or renewed from 20 May 2012 to 31 March 2021. The MAS will release further details by 30 April 2012. It is not clear why the exclusion of PEs in Singapore was not also removed in line with the liberalised withholding tax exemption regime for banks above.

Tax deduction for collective impairment provisions

This is again an extension of an expiring tax concession. Banks may claim tax deductions for collective impairment provisions (in ordinary parlance, general provisions) for groups of similar loans made under MAS Notice 612 subject to the caps under section 14I of the Income Tax Act. Under section 14I, the deduction for general provisions by banks and qualifying finance companies for doubtful debts from their loans and diminution in the value of their investments in securities is limited to the lowest of (a) 25% of the qualifying profits for the basis period, (b) ½% of the prescribed value of the loans and investments in the basis period, or (c) 3% of the prescribed value of the loans and investments in the basis period, less the total deduction previously allowed after adjusting for write-backs. Finance companies and merchant banks may claim a similar deduction for collective impairment provisions under MAS Notices 811 and 1005 respectively. These tax concessions will expire after YA 2013 or YA 2014. The Budget states that in order to encourage "banks" to maintain adequate levels of impairment allowances, these tax concessions will be extended for a further three years to YA 2016 or YA 2017, depending on the financial year-end of the taxpayer. It is unclear at this stage whether the extension applies to finance companies and merchant banks as they are not specifically mentioned.

Designated investment and specified income lists for financial sector tax incentives

The last Budget when major new incentives or improvements were announced for the fund management industry was in 2009. Given the rapidly changing global fund management landscape, the Minister must have thought it timely this year to introduce new measures to strengthen Singapore's competitive position as a fund management hub. With proposals that are sure to bring excitement to fund managers and investors, the Minister has responded to lobbying efforts by the fund management industry and ourselves to enhance the different tax incentive schemes that are currently available to the industry.

The first is a move to simplify the criteria by which funds and other investment vehicles determine the kinds of income which can qualify for tax exemption in Singapore. Moving away boldly from its long-standing position of (painfully) listing all the types of income (e.g. dividends, interest or disposal gains, etc) which are incentivised, the Government has decided to change its approach by adopting an exclusion list. With effect from 17 February 2012, any income which is not specifically prohibited will qualify for tax exemption under the various fund management tax incentives. This also benefits the fund managers, trustee companies and other financial institutions involved in fund management activities by way of relaxing one of the conditions for them to qualify for the concessionary tax rate on their fee income.

The second measure involves a (gradual) expansion of the list of so-called "designated investments" which qualify for the tax concessions. This year, the Minister has proposed to add the following types of investments to the list:

- Private trusts that invest wholly in designated investments;
- Freight derivatives; and
- Publicly traded partnerships (PTPs) that do not carry on a trade, business, profession or vocation in Singapore.

The addition of private trusts as a designated investment should enable Singapore-based fund managers to better cater for wealthy clients who may prefer making investments through the privacy of a trust arrangement, thus bolstering Singapore's appeal as a wealth management hub. It could also attract more fund-of-funds managers to consider setting up shop in Singapore by removing an area of contention in the qualification of private trusts as designated investments.

The inclusion of freight derivatives as designated investments attempts to capitalise on the growing presence in the market for freight derivatives of a host of players (such as energy companies, trading houses, hedge funds and investment banks) as shippers, global traders and logistic companies increasingly look to use these financial instruments to hedge against greater volatility in freight rates.

The final addition to the list of designated investments recognises that many of the investments in the modern world may not always be structured in the form of corporations or trusts but may be in the form of unconventional vehicles such as partnerships. PTPs are common investment structures, especially in the US, for investments into the natural resources, oil and gas and real estate industries. Their inclusion as a designated investment is a timely move to attract more specialised fund managers to set up business in Singapore.

Besides adding new investment options, the Government will also streamline the current list of designated investments by consolidating the different types of qualifying investments into fewer categories. It is hoped that the wording of the final regulations carries through the objective of simplification of the rules and does not include complicated caveats or convoluted exceptions.

In the very competitive global investment management industry where fund managers continuously seek better returns for their investors by investing in complex financial instruments and developing innovative investment structures to cater for different investors, the expansion of the designated investment list will surely be welcomed by the industry. If there were to be any gripe to make about the proposals, it would be that the Minister could have taken a bolder step in adopting the exclusion list approach for both the specified income and designated investment definitions. This could have better served the Government's objective of simplifying the incentive conditions and keeping up with industry development.

Real estate investment trusts

In order to qualify for tax transparency treatment, a REIT must distribute 90% of its taxable income in the same financial year in which the income is earned. These distributions must be made in cash.

The Minister has proposed relaxing the cash distribution rule. Under the proposal, distributions can take the form of units in the REIT, provided the unit holders are given an option to choose between receiving cash and units in that REIT, and on the date of distribution, the trustee of the REIT has sufficient cash balances to fund the entire distribution in cash (clearly in case all unit holders opt for it).

Unit holders who elect to receive their share of the distributions in the form of units will be taxed in the same manner as if they had received the distribution in cash. This mirrors the tax treatment of scrip dividends, where shareholders of a company are considered to have received dividend income if a cash option is offered in a scrip dividend scheme. However, where no cash option is available, the scrip dividend is economically equivalent to a bonus share issue, which is not considered income under tax principles.

This proposed measure should help to strengthen the cash position of REITs, where certain unit holders (e.g. sponsors of the REIT or cornerstone investors) may be prepared to take their share of the distributions in the form of units to preserve available cash for expansion purposes. It would also allow REITs to meet their obligations with the banks in times of crisis and should therefore be welcomed by the industry, especially in this uncertain economic climate.

Generally, a withholding tax of 10% applies to distributions made to non-resident unit holders. Where a unit holder chooses to receive distributions in the form of units, withholding tax should similarly apply since such units would also constitute income.

PIC in financial services

As noted earlier, the cash payout rate will be increased from 30% to 60% for up to $100,000 of qualifying expenditure from YA 2013. This means the cash payout is up to $60,000 a year. If we assume a company incurs qualifying expenditure of $100,000 then if it pays tax at the normal tax rate of 17%, the tax savings are $68,000 ($100,000 x 400% x 17%). For a company that is taxed at a concessionary tax rate of 10%, the tax savings are only $40,000 ($100,000 x 400% x 10%). With the increase in the cash payout rate, businesses (especially those with income subject to concessionary tax rates of 10% or 12% in the financial services sector) may benefit more by taking up the cash payout option for the first $100,000 of qualifying spend, and then claim the remaining qualifying expenditure as a tax deduction.

Previously, only qualifying expenditure incurred on external and certified in-house courses for the training of employees will qualify for the PIC benefits. The certification requirement has been removed for in-house training expenditure of up to $10,000.

Interestingly, with effect from YA 2012, the PIC scheme has been extended (with qualifying conditions) to include the training of agents who are not strictly employees of the company. Previously, it was only available for training of employees. This is good news to principals (such as insurers, financial planners and real estate companies) who outsource the training of their agents. However, the benefit might be limited for principals who conduct agent training in-house as the benefit for uncertified in-house courses is limited to just $10,000 of qualifying expenditure.

For insurance companies, especially life insurers, that use an agency distribution model, the costs of training its agents is likely to far exceed its costs of training employees. While some agency training may be in-house, the level of costs spent on external agency training is also significant. The extension of the PIC scheme from the training of employees to include the training of agents is likely to significantly increase the ability of insurance companies to fully utilise their qualifying PIC expenditure on training.

Personal tax

For the vast majority of Singaporeans, there was nothing to celebrate or commiserate in the Budget from a personal tax perspective. There were no changes to the tax rates, and tax reliefs for most employees remained the same. With the competitive personal tax regime in Singapore, the Minister chose to target his support on the elderly, the disabled and the needy.

Benefits for the elderly

The elderly were the main beneficiaries in this year's Budget. There were two main changes introduced for them: an increase in CPF contributions and enhanced Earned Income Relief.

The CPF contribution rates for employees aged above 50 will continue to be banded according to age. However, the rates for the 50-55 year age group will gradually be aligned with workers below 50 at a total contribution rate of 36%. With effect from September 2012, the employer contribution rate will increase by 2% to 14% and the employee rate by 0.5% to 18.5% for a combined total of 32.5%. The employer and employee contribution rates for the 55-60 age group, and the employer contribution rate for the 60-65 age group will also be increased, though at a reduced rate.

Earned Income Relief for employees aged 55 and over will double from $3,000 to $6,000 and, for those aged 60 and over, from $4,000 to $8,000.

The increase in CPF contributions and the doubling of Earned Income Relief will be welcomed and are steps in the right direction to help these employees save and provide for their retirement. As illustrated below, an employee aged 56 earning an annual salary of $75,000 would realise tax savings of over 11%; however, given that in dollar terms, this translates into only a $252 per year saving, it may not be a sufficient incentive to coax such older workers out of retirement.

Table 1 Comparison of Singapore tax payable for a senior citizen employee Years of Assessment 2012 and 2013

Scenario: Taxpayer is 56 years old, with a dependent spouse and no dependent children.

Total Remuneration						
	YA 2012	**YA 2013**	**YA 2012**	**YA 2013**	**YA 2012**	**YA 2013**
	$	$	$	$	$	$
Gross Income	75,000	75,000	100,000	100,000	200,000	200,000
Less: Personal Reliefs						
Earned Income	(3,000)	(6,000)	(3,000)	(6,000)	(3,000)	(6,000)
Spouse	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)
CPF						
- 1 January to 31 August	(4,500)	(5,000)	(4,500)	(5,000)	(4,500)	(5,000)
- 1 September to 31 December	(2,500)	(2,600)	(2,500)	(2,600)	(2,500)	(2,600)
Chargeable Income	**63,000**	**59,400**	**88,000**	**84,400**	**188,000**	**184,400**
	2,160.00	1,908.00	4,270.00	3,856.00	18,710.00	18,098.00
Tax savings	252		414		612	
% tax savings	11.67%		9.70%		3.27%	

The increase in CPF rates shows the Government's concern that the elderly may not be able to provide for their own retirement out of CPF savings, and these concerns are well founded. Whilst there is a need to limit the increased cost for employers and the net income impact on employees, the questions remain - is this too little too late for this group of older workers, and what about the younger employees whose CPF funds are also going to be insufficient to sustain them through their retirement? The Minister could have considered additional measures to encourage regular savings to help grow the retirement nest for all Singaporeans. For example, encouraging additional tax deductible voluntary CPF contributions, and updating the Supplementary Retirement Scheme to enable greater tax deductible contributions and fully tax-free withdrawals could have been added. The Minister's focus was clearly on a "Budget for the Future" but to ignore this significant issue is to ensure that further government handouts will be needed for future generations rather than encouraging self-sufficiency.

Silver Housing Bonus and Lease Buyback Scheme

The Silver Housing Bonus and Lease Buyback Scheme will enable home-owning Singaporeans to release some of the equity of their Housing and Development Board (HDB) flats, and help fund their CPF, whilst enabling them to move into housing which may be more appropriate for their later years. These measures should result in an improvement in the financial and social well-being of the elderly.

Special Employment Credit

As a means to incentivise employers to recruit and retain lower-wage elderly workers, giving their employers a Special Employment Credit (SEC) is a clever move. The Jobs Credit Scheme of 2009 was very popular but, rather than repeating the credit for all workers, the Minister has chosen to target the credit for elderly (and handicapped) workers only.

Whilst this initiative should be applauded, the decision to reduce the SEC for those pentagenarians earning more than $3,000 per month and eliminating it completely at $4,000 per month will diminish its impact and may create something of a "glass ceiling" on wages at $3,000.

As an alternative, the Minister could have capped the credit available under SEC at $240 (8% of $3,000) in order to incentivise employers to retain and hire older workers of all income levels. Limiting the SEC to the relatively low-paid elderly and disabled means the segments of society which are retained or added to the labour market may not help move their employers up the value chain through enhanced productivity.

Other changes

Handicapped employees will benefit from the doubling of their Earned Income Relief and other income supplements and subsidies. The SEC will also apply to handicapped employees, with a 16% credit available subject to similar income limits for older workers. These changes will certainly benefit this group of employees, however the same glass ceiling effect could set in, due to the scale-down in credits for employees earning over $3,000 per month. One of the Government's long-standing aims has been to reduce the economy's dependence on foreign workers for lower-skilled, lower-paid positions. The DRC will thus be changed in a graduated manner to help businesses reduce reliance on foreign workers. While the fine print makes it clear that the reductions are for Work Permit and S-Pass holders, the broad reference to "foreign workers" could send a mixed signal to the foreign talent and multi-national companies that Singapore is seeking to attract. They may perceive from the headlines that they are no longer welcome in Singapore, and may look elsewhere.

Missed opportunities

The Budget needed to balance the desire to enhance Singapore's social capital without significantly increasing the cost to either businesses or to the Government. The outcome was a Budget with a clear focus on helping classes of the population considered most in need of support: the elderly and the handicapped. While this focus is right, there was perhaps an opportunity for the Minister to thank the low and middle income earners for their contribution to society by eliminating the current 2% income tax rate. This would have saved every taxpayer $900, but would have delivered a greater proportional benefit to the lower and middle income earners.

Although steps were taken to address the needs of the silver generation, there was no encouragement offered for the other half of the demographic equation – Singapore's worryingly low birth rate. Introducing paternity leave, adjusting CPF for mothers returning to work part-time, and increasing the corporate tax deduction for provision of childcare to employees could have helped grow the next generation of Singaporeans who in time would help replace foreign workers and support their older family members.

It is impossible to please all of the people all of the time and, overall, the Minister must be applauded for the thoughtful and targeted measures introduced. It is clear that many suggestions put forward by businesses, professionals and public forums have been listened to, and several have been adopted in one form or another. More can always be done but these are uncertain times for the global economic outlook. By targeting those most immediately in need, he leaves room to manoeuvre if there is a dip in Singapore's economic fortunes in the future.

Goods and Services Tax

A hike in the GST rate was not expected in this year's Budget following comments from the Prime Minister and Finance Minister last April and none was announced. Instead, the Finance Minister introduced a number of changes that tweaked the current system as described below.

Exemption on investment-grade gold and precious metals

Exemption from GST is currently applicable to certain prescribed financial services. The implication of the GST exemption is that the input GST on costs that are attributable to the making of the exempt transaction is not available as a credit to offset the output GST that applies to taxable supplies.

At present, transactions in investment-grade gold (e.g. a bar, ingot, coin or wafer) that has a purity of 99.5% and above and possesses certain characteristics, and in precious metals like silver and platinum, are treated as taxable supplies and subject to GST at 7% if they are sold in Singapore. They are zero-rated if they are exported overseas.

To develop a new refining and trading cluster in Singapore which draws on Singapore's strengths as an international financial hub, the import and supply of investment-grade gold and precious metals will be treated as exempt supplies, similar to a supply of financial services, with effect from 1 October 2012. The Minister also indicated that measures will be introduced to ease the cash flow and compliance costs of qualifying refiners and local consolidators of precious metals in the payment of input GST on the import and purchase of raw materials.

The IRAS will release further details of the changes by 1 September 2012 following consultation with the industry.

GST temporary import period

The temporary import scheme allows goods, except for liquor and tobacco, to be imported without payment of duty and/or GST if the goods are to be re-exported within three months from the date of importation. The goods must be imported for approved purposes, such as exhibitions, fairs, auctions, repairs, stage performances, testing, experiment and demonstration.

The temporary import relief period of three months will be extended to six months with effect from 1 April 2012.

GST Tourist Refund Scheme

Tourists departing Singapore by air from Changi International Airport and Seletar Airport may claim GST refunds on goods purchased in Singapore under the GST Tourist Refund Scheme (TRS). However, the TRS is not available to tourists leaving Singapore by land and sea in view of the additional customs resources required to deal with the high tourist traffic at these exits.

The TRS will be extended from January 2013, to international cruise tourists departing from the Singapore Cruise Centre at Harbourfront and the new upcoming International Cruise Terminal at Marina South. In addition to having to satisfy the existing eligibility and conditions of the TRS, the tourist must declare that Singapore is his final exit point using his cruise itinerary as proof of departure, and commit that he will not return to Singapore within 48 hours.

The proposed change is intended to capitalise on the growth of international cruise tourism, and is in line with the new electronic TRS that was introduced last year to enhance the tourist experience in Singapore.

GST import relief for incoming travellers

Depending on age and time spent outside Singapore, the amount of GST import relief for new non-commercial gifts or souvenirs brought in by a bona fide traveller varies between $0 and $300.

The import relief amounts will be raised and simplified from 1 April 2012 as follows:

Time spent abroad	GST import relief
48 hours or more	$600
Less than 48 hours	$150

GST Vouchers

The Government faces the challenge of having to balance the need to have the GST to provide revenues to finance future social spending and investments in infrastructure and capabilities. At the same time, it has to address the negative impact the GST has on rising prices particularly for the lower income group.

The introduction of the GST Voucher in the form of cash, Medisave top-ups and U-Save rebates to offset utilities bills, addresses the regressive nature of the GST especially where it affects the lower and middle income group. The Minister said that the GST Voucher will be a long-term feature of Singapore's fiscal system and not a scheme of temporary offsets which was used in the past to offset the costs of the GST. A GST Voucher Fund with an initial funding of $3.6 billion will be set up, from which payouts will be made in the coming years.

Rather than cut the GST rate or introduce GST exemptions for household essentials, the introduction of the GST Voucher confirms the Government's position that the GST will remain a core part of our taxation system to raise the revenue that is necessary for the Government to strengthen our social net and long term growth.

Others

Vehicle tax changes

Special tax for Euro V-compliant private diesel cars

With effect from 1 January 2013, the special tax for Euro V private diesel cars (excluding taxis) will be lowered by 70% from $1.25 per cc of engine capacity to $0.40 per cc, subject to a minimum annual payment of $400.

This is intended to encourage the adoption of new and cleaner diesel technologies.

Carbon Emissions-based Vehicle Scheme

The Green Vehicle Rebate Scheme (GVRS) which expires at the end of 2012 will be replaced by a new Carbon Emissions-based Vehicle Scheme (CEVS) with effect from 1 January 2013.

Under the CEVS which will be based on carbon efficiency, all new purchases of passenger car models with low carbon emissions will enjoy up to $20,000 in rebates on the Additional Registration Fee (ARF), while those with high carbon emissions will have to pay a registration surcharge of up to $20,000 (with effect from July 2013). For taxis which have a higher mileage than the average private car, the rebate and surcharge will be up to $30,000, or 50% higher than that for cars.

The GVRS for commercial vehicles, buses and motorcycles will be extended by another two years until the end of 2014.

Removal of Additional Transfer Fee

Vehicle buyers and sellers currently pay the following fees to transfer the registration of their vehicles:

	Transfer Fee	Additional Transfer Fee (2% of value of vehicle)
Motorcycles/scooters	$3	Subject to a minimum of $5
Other vehicles	$10	Subject to a minimum of $20

With effect from 18 February 2012, the Transfer Fee for all vehicles will be revised to $11; while the Additional Transfer Fee will be abolished.

Excise duties for tobacco products

As part of the Government's move to harmonise the excise duties on cigarette and non-cigarette tobacco products, the Minister announced that excise duties will be raised with immediate effect from 17 February 2012 on the following:

- Beedies, "ang hoon", and smokeless tobacco, from $199/kg to $239/kg (up 20%); and
- Unmanufactured tobacco, cut tobacco, and tobacco refuse from $315/kg to $347/kg (up 10%).

2011 in retrospect

The PIC, first introduced in Budget 2010 and generously enhanced in Budget 2011, remained one of the most talked about corporate tax topics in 2011. The year also saw the first anti-avoidance case before the Income Tax Board of Review since the introduction of the general anti-avoidance section in 1988.[1] While these are exciting to tax practitioners or in-house tax teams, they are hardly dinner-table topics. Something closer to most people's hearts has to be the additional buyer's stamp duty announced in December.

Productivity and innovation credit

Purportedly originating as a scheme targeting SMEs, the PIC has been attracting much attention from multinationals operating in Singapore. This is because of the significant enhancements announced in Budget 2011.

Among other things, an enhanced deduction of up to $400,000 is available for each category in a year of assessment. A tax deferral option is also available: a dollar of tax can be deferred for every dollar invested in PIC qualifying activities, up to a cap of $100,000. PIC benefits have also been extended to research and development (R&D) activities performed outside Singapore. During the year, some further tweaks were made so as to ease compliance; these relate mainly to the acquisition and disposal of automation equipment. One recent change relates to payments for cloud computing services. Based on the Income Tax (Amendment) Act 2011, these payments qualify for the PIC.

The swift response of the Ministry of Finance to the initial feedback given is commendable. From experience, PIC claims are most often made in the categories of training and automation equipment. The next most likely category would be R&D. This area has been the major focus of the Government in recent years. While many activities obviously qualify as R&D within the meaning of the Income Tax Act, it is not as clear-cut for many others and this is particularly so for work done on computer software. It was hoped that the Ministry would re-look into the definition of R&D so as to ensure that taxpayers are indeed able to reap the benefits of the PIC scheme. Interestingly, this has been addressed in Budget 2012.

Stamp duty

Despite the downturn in 2008 and 2009, the Singapore property market has held up remarkably well overall, and residential property prices continue to be a concern for many Singaporeans. The Government has implemented various cooling measures in recent years and these include the imposition of additional stamp duty.

Seller's stamp duty was first introduced in February 2010. The requisite holding period and rate was increased six months down the road, and revised upwards again in January 2011.

In December 2011, additional buyer's stamp duty was introduced which differentiates Singaporeans from permanent residents and foreigners.

[1] *AQQ v Comptroller of Income Tax* [2011] SGITBR 1

The additional duty applies to a Singaporean only on his third residential property purchase. An eye-popping 10% additional duty applies to foreigners and corporate entities on all purchases. (However, one would do well to be a national of the US, Switzerland, Liechtenstein, Norway or Iceland: citizens of these five countries enjoy similar privileges to those applicable to Singaporeans, if privilege is the right word.)

It is of course too early to tell if this additional duty will contain market heat, but already some analysts think that this additional levy could be a "permanent fixture".

Other changes

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

- To facilitate compliance and improve tax administration, companies with a turnover of less than $500,000 will complete a simplified income tax return from YA 2012.
- In August, the Inland Revenue Authority of Singapore (IRAS) issued a consultation paper on dispute resolution for corporate taxpayers. The key message is the need for taxpayers to have precise grounds of objection; frivolous claims will no longer be entertained (even though it is not obvious they were in the past).
- On the GST front, the IRAS launched the Assisted Compliance Assurance programme (ACAP) in May. This involves an independent verification of a GST-registered business's GST controls framework. Where certain benchmarks are met, the IRAS will confer that business ACAP status, which comes with certain benefits. The IRAS announced in December that a further $5 million will be invested in the scheme.

Tax cases

AQQ v Comptroller of Income Tax is reportedly the first case on the general anti-avoidance section (in its current form). The case revolved around a corporate restructuring where a holding company borrowed funds externally to acquire a number of subsidiaries from another group company. These subsidiaries later declared franked dividends – this happened when the imputation system was still in place – which, when set off against the interest costs incurred, resulted in the holding company having tax repayable. The Comptroller of Income Tax argued that the financing arrangement was artificial and contrived and that the interest deduction altered the incidence of tax payable. The Board of Review agreed with him. The taxpayer is understood to have lodged an appeal. It is hoped that the courts will grasp the opportunity to set down clear guidance on what is a rather vague area in Singapore tax law.

ATG v Comptroller of Income Tax[2] is another interesting case. The question for the Board of Review was whether plant and machinery placed by the taxpayer with sub-contractors (in and outside Singapore) to manufacture the taxpayer's products and components were in use by the taxpayer for the purpose of its trade or business, thus entitling the taxpayer to capital allowances under the Income Tax Act. The Board of Review found for the taxpayer. It was said that there was sufficient connection between the capital expenditure incurred on the provision of the plant and machinery and the taxpayer's trade or business; that the sub-contractors benefited from the arrangement neither precludes nor negates that finding.

[2] [2011] SGITBR 2

2011 in snapshot

This year was little different from previous years. 2011 saw various legislative changes introduced and circulars issued by the Inland Revenue Authority of Singapore (IRAS) and other agencies. Many of the reflected changes were introduced in the 2011 Budget. Some highlights of the year's tax changes are set out below.

General corporate tax changes		
Tax rebate or cash grant	February	The Minister for Finance introduces a one-off corporate income tax rebate of 20%, capped at $10,000 for Year of Assessment (YA) 2011. The alternative is a cash grant based on 5% of the company's revenue, capped at $5,000.
Voluntary contributions to Medisave	February	Eligible companies that voluntarily contribute to Medisave accounts of self-employed persons will enjoy a tax deduction.
Donations	February	The 250% deduction for donations to qualifying charities is extended for five years until 31 December 2015. This applies equally to donations made by individuals.
Productivity and Innovation Credit (PIC)	March	The Minister for Finance announces the PIC tax deferral option, which is available to all businesses that invest in PIC activities.
	July	The IRAS issues an updated circular, incorporating changes announced in Budget 2011.
	September October	The IRAS announces that it will be separating the list of automation equipment for the purposes of the PIC from the Income Tax (Automation Equipment) Rules 2004 and issues that separate list. In October, the IRAS releases details of the qualifying criteria and approval application process for automated equipment not specifically included in the September list and details of transitional claim rules for YA 2011.
	December	The Income Tax Act is amended to include payments to procure cloud computing services as qualifying automation equipment expenditure for PIC.
Capital allowances	April	The IRAS issues an updated circular on what constitutes plant and machinery after the Court of Appeal's December 2010 decision in *ZF v Comptroller of Income Tax.*
	December	Following the Board of Review's decision in *ATG v Comptroller of Income Tax*, the IRAS issues a consultation paper entitled *Capital Allowances for Assets Used by Persons Other than the Taxpayer in a Manufacturing Outsourcing Arrangement.*
Deduction for employee equity-based remuneration (EEBR)	April July	The IRAS issues a consultation paper in April seeking feedback on the employer's tax deduction for EEBR schemes administered through special purpose vehicles. The finalised circular was released in July.
Withholding tax	February	The IRAS removes the 3% withholding tax rate on charter fee payments to residents of tax haven countries.
	April	The Monetary Authority of Singapore (MAS) issues a circular detailing the withholding tax exemption for interest or related payments made by banks, finance companies and other specified entities to non-residents.
Tax treatment for operating lease income	May	The IRAS issues a letter to the Singapore Institute of Accredited Tax Professionals announcing that taxpayers deriving rental income under an operating lease [reported under Financial Reporting Standard 17 (Leases)] may opt for concessionary tax treatment.

Foreign tax credit pooling	June	The IRAS issues a circular detailing the foreign tax credit pooling system.
Pre-commencement expenses	June	The IRAS issues a circular on the deduction for expenses incurred before a business commences.
Pension and provident funds	July	The IRAS issues a circular setting out the qualifying conditions that a pension/provident fund must meet to obtain approval under section 5 of the Income Tax Act.
Pharmaceutical manufacturing industry	August	The IRAS publishes a circular on the tax treatment of research and development and intellectual property-related expenditure for the pharmaceutical manufacturing industry, stating certain concessions that can be adopted when these companies prepare their tax computations.
Incentives		
Mergers and acquisitions (M&A)	January June	Following the public consultation exercise in June 2010, the IRAS issues a finalised circular a year later, detailing the conditions as well as the administrative procedure to claim M&A allowance and stamp duty relief for a qualifying acquisition. In the interim, a summary of the feedback received and the IRAS's response were published.
Shipping	February December	Shipping incentives are consolidated under an umbrella scheme called the Maritime Sector Incentive. Consequential changes to the reclassification of freight income are made in the Income Tax Act.
	July August	The Maritime and Port Authority of Singapore releases details of the automatic withholding tax exemption for interest and related payments incurred on a loan obtained to acquire Singapore- or foreign-flagged vessels. A circular is also issued in August for owners of Singapore-flagged vessels.
	August	The IRAS announces that eligible entities must make an election to enjoy the concessionary tax exemption for gains from the disposal of qualifying vessels.
Structured products	February	The tax exemption scheme for income from structured products is extended.
Approved Trustee Companies	March	The MAS issues a circular detailing changes to the tax incentive scheme for Approved Trustee Companies.
Insurance	February	Withholding tax exemption for financial guaranty insurers is withdrawn.
	April	The MAS issues a circular detailing changes to the offshore specialised insurance business tax incentive schemes, which include tax exemption for specialised insurers, marine hull and liability insurers and captive insurers.
Global Trader Programme (GTP)	February	The GTP is expanded to include all derivative instruments.
	April	The IRAS and IE Singapore issue a circular clarifying the administration of the conditions for physical trading transactions under the GTP.
Overseas market development expenses	April	Originally administered as two schemes, the further deductions for approved trade fairs and overseas investment development expenditure are merged into one because of their common objective of assisting businesses to internationalise and expand overseas.
Financial Sector Incentive	April	The MAS issues a circular on the renewal of and enhancements to the project and infrastructure finance tax incentives.
Islamic finance	June	The MAS issues a circular detailing the tax treatment for more Islamic financing arrangement concepts: Diminishing Musharaka, Istisna and Wakalah.

Tax administration		
Taxpayer compliance	February	The Minister for Finance announces that from YA 2012, companies with a turnover of less than $500,000 will complete a simplified income tax return.
	July	The IRAS streamlines the filing procedure for Account of Receipts and Payments by liquidators for companies in liquidation.
	August	The IRAS issues a consultation paper on the dispute resolution process for corporate taxpayers.
Circulars re-issued	September	The IRAS reissues three circulars: • Ascertainment of income from the business of making investments; • Tax exemption for foreign-sourced income; and • Group relief system. The re-issued circulars mostly consolidate the various circulars issued over the years on the same topic.
	December	The updated circular on the IRAS's interpretation of section 10(25) (on constructive remittance) was issued.
Exchange of information	December	The Income Tax Act is amended to allow Singapore to enter into stand-alone exchange of information agreements.
Statutory appeal procedures	December	Changes are made to the Income Tax Act to, among other things, clarify that a taxpayer's right to object to a revised assessment is restricted to the items revised. The period for a taxpayer to appeal to the Income Tax Board of Review is extended to 30 days from the original seven.
Representative offices	December	International Enterprise Singapore revises its policy to allow representative offices to operate in this form for a maximum of three years.
Personal tax		
Tax rates and rebate	February	From YA 2012, there will be a reduction in marginal income tax rates for income up to $120,000 with new 15% and 18% tax brackets for earnings above $120,000. There is a one-off tax rebate for YA 2011, capped at $2,000.
Alimony and maintenance payments	February	From YA 2012, alimony and maintenance payments received under a court order or deed of separation will be tax exempt, and tax relief is removed for individuals supporting their former spouse.
Central Provident Fund (CPF) contribution rate	March	The employer's CPF contribution rate increases from 15% to 15.5%.
	September	The employer's CPF contribution rate increases from 15.5% to 16% in September. The CPF salary ceiling is revised from $4,500 to $5,000 per month. The Supplementary Retirement Scheme contribution cap is increased accordingly.
Angel Investors Tax Deduction scheme	December	The condition that an angel investor must be a director in the start-up company is removed.
Goods and Services Tax		
Goods and Services Tax (GST)	May December	The IRAS launches the Assisted Compliance Assurance programme (ACAP), a co-funding scheme that aims to help GST-registered businesses to better manage their GST risks. A circular is issued to explain how the programme works. Consequential revisions are made to the circular on voluntary disclosure. In December, the IRAS announces that the initial budget for the IRAS to co-fund the ACAP has been fully utilised. New funding of $5 million will be available from 1 April 2012.

	January to December	New circulars issued in the year include: • Specialised Warehouse scheme and zero-rating of supplies (September); • GST guide for the biomedical industry (September, and revised in November); and • the marine industry following announcements made in Budget 2011 (September). Revised circulars relate to the import GST deferment scheme (January), tourist refund scheme (May and August), the Approved Contract Manufacturer and Trader scheme (September and November), fringe benefits (September) and market participants in the national electricity market (November).
	October	The MAS issues a circular to prescribe the fixed recovery rate for the GST remission for prescribed funds managed by prescribed fund managers for 2012.
	November	The IRAS issues a draft circular regarding GST pre-registration claims on goods and services for feedback.
	December	The scope for local agents to recover GST on goods imported on behalf of overseas persons is expanded to include situations where there is a change in the form of the goods imported which are subsequently supplied on behalf of the overseas persons.
Other taxes		
Stamp duties	February	The IRAS issues four circulars providing details on stamp duty relief for the transfer of assets upon conversion of an existing company or firm to a limited liability partnership, remission for aborted leases, as well as the removal of fixed and nominal duties announced in Budget 2011.
	March	The IRAS issues a revised circular on stamp duties payable by limited liability partnerships and their partners where there is a significant change in partnership interests.
	January June September	The IRAS revises its circular entitled *Imposition of Stamp Duty on Sellers for Sale or Disposal of Residential Property* to clarify certain information contained in earlier editions.
	December	The Government introduces additional buyer's stamp duty and the IRAS issues a circular entitled *Stamp Duty: Additional Buyer's Stamp Duty on Purchase of Residential Properties* to explain the mechanics of the additional duty.
	December	Stamp duty relief rules for qualifying M&As are aligned to those governing the grant of income tax allowance for qualifying M&As.
	December	The Stamp Duties Act is amended to provide more flexibility for the remission of stamp duty.
Property tax	March	The IRAS issues a circular entitled *Treatment of fixed machinery under the Property Tax Act.*
	December	The IRAS issues a circular entitled *Revision of Annual Values for HDB Flats from 1 January 2012.*
Foreign worker levy	February	It is announced in Budget 2011 that the levy will be increased for the different sectors.
Agreements for the avoidance of double taxation		
Agreements for the avoidance of double taxation (DTAs)	January to December	Singapore signs a revised DTA with Switzerland in February that among other things, incorporates the Organisation for Economic Co-operation and Development's (OECD) standard for the effective exchange of information (EOI) in DTAs. New DTAs with Ireland, Saudi Arabia (ratified in May), Albania and Panama entered into force in April, July (Saudi Arabia and Albania) and December respectively. The new DTA with Spain was signed in April, ratified in November and entered into force on 2 February 2012.

		Protocols incorporating the OECD standard for the EOI in DTAs with Mexico and Qatar were ratified in December. Both took effect on 1 January 2012. In addition, protocols are signed to incorporate the OECD standard for the EOI in the DTAs with the following countries: • Estonia, protocol signed in February; • Italy, protocol signed in May; • Uzbekistan, protocol signed in June and took effect on 1 November; • India, protocol signed in June and took effect on 1 September; and • Canada, protocol signed in November.
Tax cases		
Income tax	May	The Board of Review decides that a financing arrangement involving the claiming of interest deductions and the ensuing tax repayable under the (old) imputation system was a tax avoidance scheme. The taxpayer has lodged an appeal.
	May October	In another case published in May, the Board of Review decided that a provision for doubtful debts arising as a result of a director's misappropriation of company funds was not tax deductible. The Board's decision was upheld in a High Court judgment released in October.
	July	The Board of Review decides that the taxpayer in question is entitled to claim capital allowances on its plant and machinery placed with sub-contractors (inside and outside Singapore) to manufacture the taxpayer's products.
	October	The Board of Review decides that the Comptroller had exercised his discretion improperly in disagreeing to waive the substantial shareholders' test in the corporate taxpayer's case so as to allow it to carry forward its unutilised losses.
Stamp duties	August	The High Court rules that the acquisition of 83 condominium units by one buyer is not a block transfer under one transfer instrument. Therefore, the 83 contracts should be stamped individually and stamp duty is to be accounted for accordingly.
Tax legislation		
	November December	The Income Tax (Amendment) Act 2011, Stamp Duties (Amendment) Act 2011 and Goods and Services Tax (Amendment) Act 2011 are published in December. The Economic Expansion Incentives (Relief from Income Tax) (Amendment) Bill 2011 is published in November. Consequential amendments to the tax legislation are made by a number of other amendment acts.

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

Ministry of Finance	www.mof.gov.sg
Inland Revenue Authority of Singapore	www.iras.gov.sg
Economic Development Board	www.edb.gov.sg
International Enterprise Singapore	www.iesingapore.com
Monetary Authority of Singapore	www.mas.gov.sg
The Maritime and Port Authority of Singapore	www.mpa.gov.sg
Ministry of Manpower	www.mom.gov.sg
Singapore Tourism Board	www.stb.gov.sg

PwC thought leadership

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

Authored by our partners and managers, these articles were published in the media as part of the lead-up to the 2012 Singapore Budget.

Singapore Inc in the war for talent

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Continued global volatility may appear to be the order of the day, but the bullish confidence of Asia Pacific companies in their own performances has manifested in a war for talent.

According to PricewaterhouseCoopers' Global CEO Survey 2012, around 55 per cent of APAC chief executives surveyed anticipated increasing company headcount over the next three years — even as 70 per cent admit that hiring has become more difficult in the past 12 months.

This war for talent is beginning to have a quantifiable impact on companies in the region.

Approximately 70 per cent of CEOs have had to cancel strategic initiatives in the last year due to talent shortage.

The same percentage of CEOs report that talent costs have risen beyond expectations.

These immediate pressures are worsened by a growing need for agile company leaders who can navigate a volatile environment and drive growth through a period of fast-paced change.

Having their skills in such high demand gives top performers greater mobility in an otherwise moribund employment market, causing companies to lose talent they can ill-afford to let go.

Given this unpromising scenario, Singapore — with its wide exposure to international markets and constant under-supply of human capital — is likely to be affected.

But while the situation certainly presents risks, it also holds opportunities that can unfold over the long-term, offering the country a way to upgrade itself into the truly innovative business environment it desires to be.

Bringing back job credits?

Driving talent to key sectors is one of the most important concerns, and the Singapore Government can take the lead by defining specific initiatives that target the 12 priority sectors identified in 2010.

These sectors, which include healthcare, construction, retail and electronics, are the main focus for the Ministry of Manpower's Productivity Taskforce, and it makes sense that any incentives announced in this year's Budget should be directed towards enhancing growth in these industries.

As an example, it was reported in The Business Times that small-to-medium enterprises are hoping for the return of the Jobs Credit Scheme (JCS) in this year's Budget.

Introduced in 2009 and withdrawn in 2010, the initiative offered cash grants to employers to help preserve jobs in the wake of the 2008 crisis.

If it returns, the JCS could be more tightly focused on the 12 priority sectors, and align itself closely with other government initiatives aimed at driving growth, such as tax subsidies for training or productivity measures.

A bolder combination of training and cash grants could be borrowed from European nations, where the government subsidises employees' salaries while the latter work fewer hours per week and undergo training to increase their employability.

Regional exposure for local talent

Broadening the definition of training and development could also address the productivity imperative and the search for leadership.

Without the necessary overseas experience, few Singaporeans are able to take on regional leadership roles.

At the same time, certain sectors of the economy like manufacturing are experiencing a slowdown, leading to lower productivity levels.

With financial support from the Government — such as lowered tax rates — companies can direct their local talent towards growing markets in the region.

The employees sent overseas benefit in terms of individual development, while the Singapore-based companies enjoy higher productivity and strengthen their regional outreach.

In addition, another's loss can be Singapore's gain.

Although companies' instinctive tendency in hard times is to cut costs by reducing investments in development and human capital, Singapore-based enterprises can get ahead by enticing under-utilised or under-rewarded talent to its shores, as the West continues to grapple with instability and high unemployment.

When the long-anticipated upturn arrives, it will do so quickly — and companies that have been proactive in talent investment will find themselves ready to take advantage of it, while their competitors scramble to locate new hires with the right skill-sets.

Getting innovative

Long-term growth for Singapore can only come from innovation, and the talent crisis presents a good opportunity to invest in the next generation of entrepreneurs.

In a volatile global environment, traditional industries such as financial services respond by scaling back their hiring of fresh graduates.

The 2008 downturn saw the Government offering incentives to companies to continue hiring young talent, in the form of training subsidies and matching programmes.

These incentives continue to be useful, but they should run alongside a gamut of initiatives aimed at developing local entrepreneurship.

One suggestion is that the Government offer some form of a safety net around failure by linking investors up with small companies, or providing partial investments and incentives that reduce the risk to entrepreneurs' pockets.

At the same time, the cultural conversation regarding risk needs to be shifted, possibly through a campaign profiling leaders or business people who have taken risks, failed and bounced back.

Building a similar resilience in budding entrepreneurs is essential.

If cultural perceptions regarding risk and failure do not evolve, cohort after cohort of Singaporean students will continue to opt for traditional career routes over more innovative paths.

The MIT Inspiration

On this note, coordination between the Government, industries and higher education institutions should be enhanced, particularly in fields belonging to the 12 priority sectors such as clean energy and nursing.

For inspiration, Singapore can look to colleges such as the Massachusetts Institute of Technology (MIT), one of the first American institutions to collaborate with companies and government departments in creating successful ideas and products.

Even after graduation, mentorship programmes like the Global Accelerator Network — a partner of The Startup America Initiative — have worked successfully to translate students' ideas into real-world start-ups.

Through such programmes, fresh graduates turned entrepreneurs gain valuable guidance in areas like marketing and investor communication.

While the Singapore Institute of Technology has taken the right step in bringing in partners like the Technological University of Munich, more can always be done to encourage the entrepreneurial spirit of younger generations.

If all these efforts are undertaken successfully, Singapore will make the next leap to become an innovative, entrepreneurial city — and a top draw for talent all over the world.

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Secrecy in private banking under Western siege

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Tax authorities in many developed countries have been concerned about the erosion of their tax base and have tackled the issue by attacking tax avoidance and evasion through cooperation among themselves.

The main tool for this is the exchange of information (EOI), through their tax treaties or by way of a separate tax information exchange agreement (TIEA). The way it works is to allow the tax authorities to override domestic secrecy or taxpayer confidentiality laws and share information that enables them to build a case against tax offenders.

In March 2009, Singapore announced its commitment to the Organisation for Economic Co-operation and Development standard for the international exchange of information in tax matters. Soon after, Parliament passed a bill to allow, among other things, the exchange of bank and trust information upon due process. This came into operation in February 2010.

So what exactly is an EOI? The OECD model treaty language envisages the sharing of information as is 'foreseeably relevant' to the administration and enforcement of a country's tax laws. Not so long ago, it used to be that tax authorities did not much care about the collection of revenue on behalf of a foreign counterpart.

The doctrine of national sovereignty dictated that a foreign taxman had no business enforcing his tax laws outside of his home turf. This could soon be a thing of the past as the hunt for tax revenue moves up the agenda of many governments. Singapore has always prided itself on the security and integrity of its banking information, and in the eyes of the wealth management industry, banking secrecy remains a top concern.

So will the embracing of the EOI concept detract from Singapore's jealously guarded reputation for banking secrecy? The good news is that there are safeguards to a taxpayer's rights enshrined within the EOI provisions. Treaty partners are not allowed to embark on 'fishing expeditions', i.e. speculative requests for information that have no apparent link to an investigation.

It also has to be shown that there is sufficient reason to believe that tax is being evaded, and that all other avenues of information retrieval have been exhausted. Nonetheless, the requested country is not allowed to use bank or trust confidentiality rules to hamper the enquiries of their treaty partners.

Singapore has a wide treaty network - there are 31 tax treaties that incorporate the EOI standard as at 30 November 2011 - but no comprehensive tax treaty with the US. So does that mean that American citizens intent on avoiding US taxes by parking funds in Singapore are safe from the US Internal Revenue Service?

The answer is a resounding No. The US can still negotiate a standalone TIEA with Singapore and the wording of a standard TIEA is similar to that found in tax treaties. But then, the US already has something more fearsome. US citizens (and in certain cases non-US citizens) should pay attention to the Foreign Account Tax Compliance Act, more commonly known as FATCA.

Essentially, FATCA requires all foreign financial institutions (FFIs) to report to the IRS details of any of their US clients with more than US$50,000 in an account. Disclosure is mandatory unless the FFI wants to suffer a 30 per cent US withholding tax on its and its clients' investment income and gains, and on what are known as 'passthru' (yes, that's how it's spelled) payments which can include income from non-US sources paid to non-US persons.

These withholding tax provisions will take effect from 1 January 2014. The alternative is to not hold any US investments and not have any US clients - something that most financial institutions will find commercially crippling, however tempting the thought. Not surprisingly, a number of banks have been lobbying for a change in the rules, while some organisations (e.g. pension funds, insurers) have been requesting exemption. Their cries have largely fallen on deaf ears. This is exchange of information on steroids. Well, actually, it's not an exchange. It's a one-way street.

Under the rules, FFIs are required to obtain from their US customers, not only their name, rank and inside leg measurement, but also a waiver of the local jurisdiction's banking secrecy laws. From that angle, FATCA appears to be more draconian than an EOI. At the very least, the courts are involved in an EOI request when deciding whether banking information should be given. By asking US customers to grant waivers, FATCA effectively sidesteps the courts and gives the IRS free rein, outside the US.

Terry Campbell, head of Canada's banking association, has reportedly commented that this law is akin to 'conscripting financial institutions around the world to be arms of US tax authorities'. And here is how well it has been received by Jacqueline Bugnion, a director of American Citizens Abroad, speaking to the New York Times: 'The FATCA legislation treats all Americans with overseas bank accounts as criminals, even though most of them are honest, hard-working individuals who happen to be living and working or retired abroad.'

Unfortunately, the story does not seem to end here. China is already licking its lips at the prospect of piggy-backing off the FATCA infrastructure. Even the Swiss attempt at preserving bank secrecy has FATCA overtones, although it has voluntary qualities that FATCA lacks. Its solution is to sign final withholding tax agreements with other countries under which it will levy a withholding tax on income earned on assets belonging to a customer who is a resident of the other country.

It has signed two such treaties so far, with the UK and Germany. Undoubtedly, others will follow. This arrangement allows Switzerland to preserve banking secrecy by forgoing the automatic exchange of information. However, if the withholding tax turns out to be penal, it is not clear whether the customer can volunteer his information as a means of getting off the hook.

Is Singapore likely to sign up to such treaties? Well, unlike most countries, Singapore does not tax income on a worldwide basis. It cares little therefore about what goes on, for instance, in the Swiss bank account of its residents. So the motivation is not there.

It is submitted that the EOI sign-ups were more in response to a stick than a carrot, waved around in the context of treaty benefits (or withdrawal thereof next time round). It is likely that the EOI is as far as it will go. But the reach of FATCA seems inescapable. So the question is whether Singapore is losing its edge in the private banking arena. The answer is that it is comparative. While undoubtedly the EOIs will give rise to some erosion of confidentiality, they certainly do not give carte blanche to other countries to demand random information.

FATCA, well that is something else, but it applies globally, so the erosion, through voluntary disclosure (with a bit of arm twisting), will affect all countries equally. But then, take a look at the alternative havens for your funds . . . What's your verdict?

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Helping firms continue to hire S'poreans

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Since the days of Sir Stamford Raffles, Singapore has attracted immigrants from China, the Malay Peninsula and India. Many of these foreigners, who came looking for a better life, worked hard and decided to settle down in Singapore.

The current generation of Singaporeans are, to a large extent, descendants of these migrants, whose efforts helped to build Singapore into what it is today.

Even today, Singapore continues to attract foreigners who can contribute towards the development of the city-state. Some of them eventually put down roots as Singaporeans or permanent residents (PRs) and make it their home.

To maintain the economic momentum in a globalised environment, this will be a never-ending cycle. However, in the recent past, the issue of employment, or perhaps more accurately, unemployment, has become a hot topic of debate here.

Declining salaries and ever-increasing competition from foreigners for fewer available jobs have made it difficult for certain segments of the Singaporean population to find jobs.

Furthermore, there are indications that the debt crisis in the West is likely to continue to affect the local job market in 2012 and beyond adversely.

While various measures were put in place to raise the bar in employing foreign workers, in the forthcoming Budget, the government should consider introducing the following fiscal measures to alleviate the concerns of citizens and encourage companies to recruit and retain more Singaporeans and PRs:

Create a level playing field for hiring Singaporeans and PRs

Currently, in order to employ Singaporeans and PRs, employers are required to bear an additional cost of 16 per cent in the form of the employer's contribution to CPF - for employees aged 50 years or less. Perhaps employers should be allowed to claim a double deduction for these costs, to help level the playing field for Singaporeans and PRs looking for work.

Double tax deduction for hiring and training local talent

Under an existing tax scheme, employers are entitled to claim a double tax deduction for qualifying recruitment and relocation costs incurred when hiring foreign talent and Singapore citizens/PRs returning from overseas. This scheme may be expanded to allow employers to claim a similar enhanced tax deduction for costs incurred in hiring local Singaporeans and PRs, as well as providing them with in-house training (such training programmes may not be certified by the Singapore Workforce Development Agency or the Institute of Technical Education).

Reintroduce the Jobs Credit Scheme

The dark clouds of a continuing global economic crisis are making employers nervous about their business prospects. Unfortunately, in their bid to cut costs and stay lean, they may be forced to consider the option of reducing their workforce to help them ride out the storm.

To encourage businesses to preserve the jobs of employees for whom CPF contributions are made, the Jobs Credit Scheme should be reintroduced. The earlier scheme provided cash grants to employers and played a significant role in retaining existing employees, and employing new ones where the opportunity presented itself.

Reduction in personal tax rates and relief for additional CPF contributions

To encourage savings for future years, the personal tax rates for residents should be calibrated downwards with the top marginal rate being reduced from 20 per cent to at least 17 per cent, which is where the corporate tax rate now rests.

In addition, Singaporeans and PRs should be allowed to claim tax relief in respect of any additional contributions (over and above statutory contribution rates) made by them to their CPF accounts, particularly to their Special and Medisave accounts. This would help address the next issue looming - an ageing population that is unable to support itself.

Encourage investments in life and medical insurance products

In view of Singapore's ageing population, increased life expectancy and, therefore, the need for more medical attention, Singaporeans and PRs should be encouraged to invest in approved life and medical insurance products. This can be achieved by delinking life assurance relief from the CPF relief and allowing them to claim tax deductions for expenses incurred by them to buy such policies.

Allow a tax deduction for medical expenses without caps

Currently, an employer is allowed to claim a tax deduction for his employees' medical expenses subject to a cap of 1 per cent of the total remuneration payable for the year. Where the Portable Medical Benefits Scheme (PMBS) or Transferable Medical Insurance Schemes (TMIS) are implemented and qualifying conditions under the schemes are met, the cap is enhanced to 2 per cent of the total remuneration.

In today's business world, employers offer attractive medical (and other) welfare facilities to retain talent and keep them motivated. Against this backdrop, it should be prudent to allow employers to claim, without any restriction, tax deductions for medical expenses incurred by them for their Singaporean and PR employees.

Allow double deductions for internship expenses

To gain commercial exposure and experience, many graduates these days are keen to take up internships with reputable business organisations during their term breaks or gap years. Such programmes offer an opportunity for the interns to gain valuable on-the-job experience, as well as present an opportunity for them to join the same organisation on a full-time basis after their graduation.

Businesses should be encouraged to develop and offer structured internship programmes to Singaporeans and PRs by allowing them to claim double tax deductions for the expenses incurred to run such internship programmes.

While the above fiscal measures will provide the necessary support to Singaporeans and PRs working here to ride out the future economic turbulence and build a better future for Singapore, they should on their part continue to retain a strong work ethic, uphold a positive attitude and learn to live and work with foreign talent.

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Get to the social root of the problem

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As he prepares to deliver the 2012 Budget on Feb 17, the Finance Minister is in an unenviable position. The global economy has not rebounded with the vigour hoped for 12 months ago. It appears the road to recovery may be longer, and perhaps steeper, than many had originally anticipated.

While the Finance Minister may take bold steps to protect the economy, there are some more basic issues to contend with at home — such as Singapore's low birth rate and ageing population.

It is well known that birth rates in developed countries tend to drop during times of economic strife. Putting the expected boom in this year's "dragon babies" to one side, there could be severe long-term consequences for Singapore's already low birth rate, if the financial recovery is as slow a process as it currently appears and if we follow this statistical trend. Quite simply, in order to become more self-sufficient and reduce the reliance on foreign workers, Singapore will need to grow a larger labour force.

The Government has already introduced a number of fiscal incentives. The Baby Bonus, Child Relief, Parenthood Tax Rebate and Extended Maternity Leave have all been in place for a number of years, but do not appear to have had a material effect on population growth.

Rather than providing greater monetary "carrots", it may be more effective to address some of the underlying social factors which influence a family's decision to have (or to have more) babies:

Mothers of Singaporean children are currently entitled to up to four months of fully-paid maternity leave. This compares favourably to most other countries in the region, yet relatively few mothers are taking breaks from their busy careers to have children.

It may be that women are unwilling to spend significant periods of time out of the office, fearful of the perceived impact on their long-term career prospects. The Government could allay these fears by encouraging employers to develop flexible working practices, enabling new mothers to work from home or return to work part-time after childbirth.

Of course, developing flexible working practices and hiring part-time workers would involve additional costs to the employer. To reduce this financial impact, the Government could fund the employer's Central Provident Fund (CPF) contributions for up to six months for individuals who return to work after childbirth on reduced hours or with flexible working arrangements. Employers would also be far more positive about releasing experienced staff for their full four months of maternity leave if they could claim a 150-per-cent tax deduction for the cost of hiring temporary workers to cover regular employees during maternity leave.

The father plays as much a part as the mother in the decision to have (or not have) babies. This decision may be influenced not only by financial considerations but also emotional considerations, such as lack of quality time to bond with the newborn.

Providing the father with mandatory paternity leave (say, two weeks) may enable a family to share the time out of the office between both parents, help create an everlasting family bond and generally lead to a happier parenting experience. In order to minimise the cost to the employer, the second week's pay could be reimbursed to the employer, to mirror the funding for maternity leave during the third and fourth months.

Flexible working patterns and mandatory paternity leave are still relatively uncommon in the region, so introducing these measures would have the added advantage of highlighting Singapore's progressiveness and modern approach.

After four months of maternity leave, mothers who return to work may need to use infant and childcare facilities to look after their babies. The expensive nature of such childcare may prevent some mothers from returning to work after birth and possibly even discourage childbirth in the first place.

Employers may already provide tax-free childcare subsidies to employees whose children are in licensed childcare centres. However, such subsidies are relatively uncommon in practice. Employers may be encouraged to provide such subsidies more regularly if they were given a 150 per cent (or more) tax deduction for the provision of infant/childcare benefits and subsidies to all employees.

As to the matter of Singapore's ageing population, the CPF can only provide limited support to the elderly. Tax relief is available to children who support their parents, grandparents or great-grandparents — but as there are fewer children being born than there are parents, a time may be reached when there are not enough children to look after older generations.

The Government should, therefore, introduce measures to encourage Singaporeans to provide for their own old age.

It has already taken initial steps to encourage employers to hire and retain older employees by introducing the Retirement Age Act. The Act enables employers to offer reduced wages to employees who have reached the statutory retirement age. While this encourages employers to employ and retain older workers, this may have a negative effect on the income of those workers.

Rather than reduce wages, the Government could help turn silver into gold for employers by providing a 150 per cent deduction for the salary costs of employees aged over 62. This would help stabilise incomes for the elderly, while still incentivising companies to employ more experienced workers.

Employer and employee CPF contribution rates decrease for employees after they reach their 50th year. While this reduces the business cost of employing older staff, it reduces the overall CPF contribution at exactly the time when older workers may become increasingly reliant on their CPF.

The Finance Ministry could allow increased voluntary CPF contributions for the elderly, to encourage them to save more for their post-employment years.

In addition to mandatory CPF contributions, individuals may top up their CPF funds with voluntary contributions, up to certain annual limits.

To encourage younger workers to provide for their own old age, the limit to voluntary tax deductible CPF contributions should be removed, to allow unlimited contributions with full tax relief for all voluntary contributions.

Limited tax relief is already available for children who support their dependent parents, grandparents or great-grandparents. But as this relief is only available if the parent earns less than S$4,000 a year, many carers fail to qualify for this well-intentioned tax relief.

As the above measures are all designed to encourage the elderly to continue earning their own income, it may be worth raising the income threshold, or abolishing the income threshold condition altogether.

Finding a “magic bullet” to address the challenges that Singapore businesses currently face must surely rank highly on the Finance Minister’s agenda, but using the forthcoming Budget as a means to enhance the social capital in the country will be a timely step.

These measures may well enable the Government to create a silver lining to the current cloud which continues to loom large over the global economy.

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Keeping the insurance hub edge

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Singapore has big ambitions to be an insurance hub in Asia, but so too do a number of our Asian neighbours. More needs to be done to ensure that Singapore remains agile, competitive and attractive as a hub for insurance businesses and for their regional and global headquarters.

We set out below some of the key improvements we'd like to see for the insurance industry.

Offshore Insurance Business

The Offshore Insurance Business (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 per cent on specified income earned through its offshore insurance and reinsurance business.

The OIB scheme tax rate has remained at 10 per cent over the last 30 years. Yet, over the same period, Singapore's corporate tax rate has more than halved from about 40 per cent to the current 17 per cent.

Particularly for the reinsurance industry, Singapore's OIB scheme tax rate is grossly uncompetitive. Hong Kong now levies an 8.25 per cent tax rate (being half of its corporate tax of 16.5 per cent) on offshore reinsurance business. Malaysia is also shaping up to be a serious competitor. Although its domestic corporate tax rate is 25 per cent, it offers a 5 per cent tax rate on offshore insurance and inward reinsurance business. Labuan is even more attractive, offering a near-zero per cent tax regime with flexibility to base various operations in Kuala Lumpur.

Singapore should consider reducing the OIB scheme tax rate to, say, 5 per cent or alternatively, to one third of the corporate tax rate. Pegging the OIB scheme tax rate to one third of the corporate tax rate would ensure that the incentive rate is continually adjusted in line with the corporate tax rate.

Offshore incentives

As an alternative to reducing the OIB scheme rate, we suggest a consolidation of all current offshore tax incentives at a blended rate of, say, 5 per cent or one third of the corporate tax rate.

Currently, besides the OIB scheme, there are targeted tax-exemption schemes for approved offshore specialised risks businesses (such as agriculture, 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 work is required to segregate its financial accounts accordingly, which often creates unnecessary administrative burden.

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 per cent or one third of the corporate tax rate. 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).

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

Investment activity is a big part of the insurance business. Funds received from writing policies are usually invested to support the insurance business.

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

Given the importance of investment activities to the industry, 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?

The tax concession applying to investment income needs to be expanded. 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, the list of investment income in the insurance regulations should be expanded to include items such as onshore and offshore income from rental, interest, dividends, unit trust distributions, income from derivative contracts, discounts from debt securities, and gains from disposals. Better still, perhaps the same income that is incentivised for the fund management industry (that is, the 'specified income' from 'designated investments' under the fund management regulation) could be similarly extended to the insurance industry.

Expanding the pool of incentivised investment income will increase the attractiveness of Singapore's incentive schemes. It would also promote the growth of the onshore investment management industry in Singapore.

TDSR scheme

Insurance is based on the principle of spreading risk over a large number of policyholders, and in relation to infrequent, catastrophic events, of spreading risk over time. Hence, it is not unusual for insurers and reinsurers with exposure to catastrophe risks to build up contingency reserves to help them cope with sudden and infrequent big losses. The establishment of such reserves can be either voluntary or compulsory by law.

In Singapore, insurers writing mortgage risks, financial guarantee risks and trade credit and political risks are required by insurance law to set up contingency reserves.

However, under Singapore's normal tax rules, such contingency reserves are not deductible on the premise that the loss event has not yet happened. There is however an existing Tax-Deductible Special Reserves (TDSR) incentive scheme under which a tax deduction can be achieved for certain approved offshore special reserves. The scheme was introduced in 2002 but the take up rate has been low.

As the window period to apply for the TDSR scheme is due to expire on July 1 this year, it is perhaps a good time to review the scheme to make it more attractive to insurers. Here are some suggestions:

- Currently, the TDSR scheme is crafted as an incentive scheme with qualifying criteria and annual reporting requirements. However, the benefit of a tax deduction for contingency reserves is one of timing only as the benefit is reversed when a disaster occurs and the reserves are utilised to meet claims. For these reasons, we suggest that the deduction should not be crafted as an incentive scheme. Rather, an amendment should be made to the Income Tax Act to introduce a special deduction provision for contingency reserves.

- The deduction allowed would be equal to the same amount that an insurer would be required to set aside for insurance regulatory purposes. This would replace the current complex rules under the TDSR scheme for quantifying and tracking the amounts which may be transferred into and out of the deductible special reserves pool.

- The current TDSR scheme is only available to specified approved offshore businesses. We propose that the deduction scheme be available to both onshore and offshore businesses.

Loss carry back system

A number of natural catastrophes in 2011 occurred close to home - the Thai floods, the Japan earthquake/tsunami, the Queensland floods, the New Zealand earthquake, to name a few. These disasters have affected the financial results of a significant number of Singapore based insurers and reinsurers writing offshore business, especially those with exposure to catastrophe risks.

Insurers with exposure to catastrophe risks typically find themselves in cycles of profitable years, and when a significant disaster hits, find themselves in significant loss positions.

The current carry-back loss relief system allows a taxpayer to only carry back for one year a maximum amount of S$100,000 of tax losses. This is grossly inadequate in view of the cyclical nature of general insurance business. We recommend the following:

- Allow the carry back of losses to at least three preceding years

- Allow unlimited carry back of losses, that is, no restriction on quantum. And if this is untenable, at least allow unlimited carry back to the year immediately before the year of loss. As for the earlier two years, a limit of say, S$1 million of tax losses, could be set.

Insurance is a very global and mobile business. If Singapore does not continually innovate and update its fiscal policies, it could see itself losing out to competitor locations such as Hong Kong, Kuala Lumpur and Labuan.

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A tale of two cities: great expectations in hard times

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Hong Kong unveiled its Budget last week, while Singapore will do the same this Friday. Did the proposals put forth by the Hong Kong financial secretary pose fresh challenges for Singapore in an increasingly competitive economic landscape, and are there lessons we can learn from our neighbours in the north?

It is trite today to suggest that Hong Kong is Singapore's closest rival. It may not even be true; given the mobility of capital and labour, competition comes from all corners of the world.

Nonetheless, in an integrated global economy that is facing some rather stiff headwinds, it would be remiss not to consider the moves by Hong Kong to boost its competitiveness.

This is particularly so given the fairly similar economic profiles of Singapore and Hong Kong, and the expectations of the role these two hubs play in powering the Asian growth engine in these turbulent times.

It is clear many of the measures proposed in Hong Kong are peculiar to addressing some of the territory-specific social and economic issues of the day. Perhaps what is most notable about the Budget for the international business community is not so much what has been suggested but rather what has not.

The cry from business for a comprehensive review of the tax system has not been heeded, nor have calls for measures to enhance research and development and for a more certain tax regime for the fund management and private equity industries.

It has been suggested that as this is the last Budget for the current government, it may not wish to tie down the next administration with long-term structural recommendations.

That said, Hong Kong already has one of the most competitive tax systems in the world, with low headline rates and simplicity in administration. It is also actively expanding its tax treaty network, fulfilling its role as gateway to the greater China market. That a territory with such a profile would want to improve its tax system, and in those areas that are also our priorities, speaks volumes of the challenges Singapore faces.

We have had a head start in certain quarters, and our tax incentives regime has, in no small part, succeeded in propelling us to the forefront of the world economy in selected areas - for instance, financial services.

However, there is no question the gap is closing, not just between Hong Kong and us, but also between Singapore and many other global cities that have stepped up their game in attracting talent and capital.

Therefore, it is timely to review and streamline our plethora of tax incentives, with a view to sharpening their focus in shaping the vision for the next phase of Singapore's development.

A starting point could be widening the tax rate differential between the incentive schemes and the corporate rate of 17 per cent (which, for certain schemes, could be as narrow as 2-5 per cent), to make them attractive and the incremental cost of compliance worthwhile.

One-off measures

The Hong Kong Budget is marked by a number of one-off measures introduced, ranging from a partial waiver of profits and salaries tax (subject to relatively low caps) to non-tax measures such as subsidies, waiver of business registration fees and financial guarantee schemes, targeted at alleviating the impact of the rising cost of living and the cost of doing business, particularly for small businesses.

This much was acknowledged, in jest, by the financial secretary, who noted that one-off measures 'receive greater attention perhaps because they are of greater news interest'.

On a serious note, there is a feature common to Singapore and Hong Kong, as both cities have had to cope with, among various things, increasing income inequality, ageing populations and a high cost of living.

Unlike Hong Kong, our government will be presenting the first Budget for its current term. It will be interesting to note what the mix will be between one-off measures and the longer-term structural changes that Singapore will introduce to address these larger social issues.

The measures contained in a Budget form the cornerstone of a government's economic policies for the fiscal year ahead. They serve as the platform for the government to articulate how it intends to fulfil the obligations under its social compact with the citizenry, and how it proposes to engage the business community to compete in the international arena. From this perspective, it appears that the Hong Kong Budget lacks a strategic vision for the territory's long-term development - for it has, to some extent, looked to one-off measures to address certain domestic problems with the intention of nipping them in the bud, and there aren't any major structural initiatives like tax reforms to enhance Hong Kong's competitiveness. That said, there is no room for complacency for Singapore.

We face many of the same challenges as Hong Kong, where the impetus for change is strong (even if it is not introduced through this Budget). Therefore, it is hoped that through a mix of short-term responses and long-term measures to strengthen our social infrastructure, the Singapore Budget will also contain strategic moves such as a review and revamp of our tax system and incentives regime, so that we can better position ourselves to seize opportunities in the global marketplace as they arise.

Much is expected of Singapore and Hong Kong as the centres of the Asian growth engine in these trying times. Hong Kong has shown its cards; now, all eyes are on Singapore.

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The taxing problem of capital gains

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It is a fact well publicised that Singapore does not have a capital gains tax regime. It helps attract investors to set up their regional hub on our sunny island. Singapore is home to many investment holding companies that are used to hold, manage and control investments in the region.

But when such holding companies realise a gain on the sale of their investments, they may not be ready for the wave of questions about the gain and that there is a risk of paying Singapore taxes on it. This can also apply to other investments such as property or other fixed assets. A taxpayer can also be an individual or any other legal person, and is not just a corporate entity.

It is true that gains of a capital nature are not taxable in Singapore, but gains that are characterised to be revenue or income in nature are taxable. A company making such gains could be taxed at the current corporate tax rate of 17 per cent. An individual can be taxed up to 20 per cent. The onus is on the taxpayer to demonstrate that his gains are capital in nature. It can suddenly dawn upon him that a 'no capital gains tax' attribute comes with a very big 'but'.

There are currently no comprehensive provisions to guide taxpayers. The closest that a taxpayer may have are the 'badges of trade', a concept developed under common law. These call for a review of various facts including:

- Dates on which the investments are acquired and sold to establish the length of period of ownership. Investments that are held for a shorter period will more likely be seen to be held on revenue account.
- Reasons for acquiring the shares in the first place. This is to establish motive. Taxpayers that invest in businesses of a similar or related trade to their existing ones will more likely be seen as holding the investment on capital account.
- Circumstances leading to the sale. This is to establish if there is any profit-making intent. A taxpayer who is forced to sell due to a distress situation will be looked upon more favourably than a taxpayer who acquires investments such as shares with an intent to sell to realise a profit.

The history of the taxpayer will also be under scrutiny to determine if there is a pattern of trade. A person who has a history of buying and selling shares will have an uphill battle to contend that any gain made from a sale is capital in nature.

The examination of the above can be a subjective exercise. The relative strength or persuasiveness of each badge requires an element of art rather than science. Take this as an example: A Singapore company that owns dealerships in the retailing of tyres acquires a tyre manufacturer in December 2008. There are troubles after the acquisition, and the company decides that it needs to sell the manufacturer. It is a good market, and the company realises a gain in January 2010 after holding the shares for about 13 months. Would the gain be capital in nature? The motive for the acquisition may point to capital but the length of ownership can be regarded as unfavourable.

The uncertainty surrounding this issue can be frustrating for a taxpayer which could drive an incorrect decision to hold an investment outside Singapore.

The indicators of capital or trade are merely that - indicators. These can be fraught with subjectivity. Uncertainty makes decision making more difficult. In the face of two options, one of which presents a certain position (locating the holding company in a tax haven) and one where no certainty can be given, a taxpayer could opt for certainty. However, even a 'certain' position can present other problems. If a taxpayer has to create a reserve to pay potential taxes, he unnecessarily diverts resources needed for business expansion.

There is also the potential for a dispute process. This can be lengthy and require significant resource commitments due to protracted queries from the tax authorities. These assessments can sometimes take years to be finalised. Taxpayers can quickly discover the process to be most daunting.

What are some possible solutions? For a start, an outright exemption on any sale of shares could be provided. This may sound like a good solution to investors but there may be ramifications in terms of how other countries then regard Singapore. It may also not be well received by the wider electorate.

Alternatively, rules similar to those that were introduced back in 1996 to curb the speculation in the real property market could help. You may recall that, at that time, the amount of taxable gains from the disposal of real property in Singapore will depend on the holding period of the property. 100 per cent of the gains were taxable if the holding period was one year or less. The percentage was reduced for properties held between one and three years, and there was no capital gains tax on properties held for more than three years. Unfortunately, that did not mean that you were not trading and so little certainty was introduced. The same flaw was inherent in the later attempts at taxing real estate gains.

A third option, and one that is perhaps more palatable to the authorities, is that Singapore operates what is commonly known as a 'participation exemption' regime which is predominant in Europe (for example in the Netherlands and Luxembourg). Singapore would not be alone. In essence, the regime provides for exemption on gains realised on the sale of shares, subject to a list of conditions. In most cases, the key conditions revolve around a minimum shareholding requirement and a minimum holding period requirement.

The global norm for the minimum shareholding is 5-10 per cent. This is so because the sums involved in such a stake would make it less likely that the investment was just a liquidity alternative or short-term profit-making venture. The holding period requirement can range from one to two years. If an investor is serious about the assertion that he is fostering a long-term relationship and the investment is an integral part of the business strategy, such a requirement would not be seen to be too unreasonable.

The negative impact on public revenue should be limited but the advantages could be significant:

- More certainty on the tax treatment in a share sale event;

- The freeing up of the resources of the tax authorities and the taxpayers otherwise expended in dealing with the dispute process; and

- Helping put Singapore ahead of the competition for the holding company location of choice, such as Hong Kong.

To help align policy with the goal of making Singapore a first choice to locate a regional hub, this could be a very telling first step.

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Staying ahead in tax competition

For the sixth year in a row, Singapore has maintained its No 1 position in the World Bank's Ease of Doing Business Rankings. This was in part made possible by Singapore's continued fourth-placed ranking in Paying Taxes, which is one of 10 indicators measuring the Ease of Doing Business in an economy.

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PwC released its joint flagship publication with the World Bank, Paying Taxes 2012, providing an in-depth analysis of these results in late 2011. The annual study is broadly modelled on a total tax contribution (TTC) framework developed by PwC, which looks at the overall tax burden of a business.

TTC is a comprehensive approach, taking into account:

- the total tax rate (the total tax cost borne by the company as a percentage of its commercial profits) (TTR);
- 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.

Results of the three sub-indicators on a case study company are then used to assess the cash tax burden on a small to medium enterprise locally and rank the economies' performances accordingly.

Standing

Comfortingly, Singapore's fourth-placed ranking continues to put it ahead of competitors such as Ireland (5th) and Switzerland (16th). However, observers may note with dismay that traditional rival Hong Kong beat us to third place. This is mainly due to Singapore having one more tax (Goods and Services Tax), correspondingly increasing our compliance burden for businesses.

By global standards, Singapore has a very efficient and competitive tax system. Its TTR stands at 27.1 per cent, significantly below the world average of 44.1 per cent. Our time to comply is 84 hours against the global average of 277 hours. The only indicator where Singapore performs marginally below the global average is our number of payments (31 against 28.5 payments), which is hardly consequential in the big picture. Electronic filing, which is considered a best practice, is also available.

Signposts

The race is, however, not restricted to our traditional rivals. Political pressures and the need to balance fiscal budgets have increased the spotlight on businesses' tax contributions. On the other hand, tax competition is intensifying at an accelerating pace. We are competing with the world.

In the past seven years, more than 60 per cent of the 163 economies covered by the Paying Taxes study implemented changes aimed at simplifying tax administration and reducing the tax burden. The most common types of reform were reducing tax rates, introducing electronic systems and simplifying tax compliance by reducing the frequency of filing or allowing joint filing of taxes.

Results from these reforms have been significant. Since the start of the Paying Taxes study, the average TTR across the globe has fallen by 8.5 per cent, time to comply by 54 hours, and number of payments by five. This shows that improving the tax system is high on government agendas, and rightly so.

According to PwC's 15th annual Global CEO Survey 2012, 44 per cent of CEOs surveyed say that tax policies are a significant factor in their decision-making regarding cross-border locations, 29 per cent are expecting to change growth strategies over evolving tax conditions, and 19 per cent said that they were extremely concerned over an increasing tax burden in their operating countries. Governments cannot afford to rest on their laurels.

Potholes

How then can Singapore stay ahead? To be honest, there is possibly not much more that can be done to improve our rankings in the study (well, apart from abolishing taxes that is!). Incremental improvements to tax administration, though welcome, may not have enough impact on sub-indicator results to propel the republic ahead of heavyweight contenders such as Maldives, who came first, and Qatar, who came second in the Paying Taxes study, which hardly have tax systems to speak of.

As the story of the tortoise and the hare goes, the winner is the first across the finish line and not off the starting point. The study only measures tax burdens up to the point of filing. However, in practice, it can take several years and extensive resources to finalise a taxpayer's filing position after the filing has been done. While the authorities have been proactive in improving the efficiency of tax administration, detailed questions are increasingly being raised by the Inland Revenue Authority of Singapore. Further study could thus be done to ascertain the impact and best practices of various tax administrations around the world to identify areas for improvement.

The hare should also not be so caught in a web of details that it cannot run. A case in point - the Productivity and Innovation Credit (PIC) scheme first introduced in Budget 2010 that now provides up to 400 per cent deductions/ claims for qualifying expenditure.

Claims for prescribed automation equipment require tracking on an asset-by-asset basis to ensure that no disposals are made within a year from purchase; detailed conditions for research and development expenditure apply before one ascertains whether expenses are qualifying. Simplification of these rules would enhance take-up and help achieve the true objective of the policy (i.e. productivity and not administrative drag).

PwC network firms which have conducted TTC studies on actual companies have also observed deviations and useful trends beyond the Paying Taxes results. For instance, the proportionate burden of non-profit-based taxes (e.g. property tax, GST etc) on businesses increase during years of declining revenues. Information on resources needed to manage each type of taxes is not captured. Furthermore, the case study company's simplistic parameters do not reflect Singapore's intricate and targeted incentives, which many businesses benefit from. An actual TTC study would hence have to be conducted to assess these issues in detail.

No doubt, Paying Taxes provides a unique and useful reference to tax stakeholders, facilitating our understanding and comparisons of tax systems worldwide. Nonetheless, flower pot companies (used as the case study) do not exactly reflect real life. Policymakers need to look beyond the limitations of the study to introduce reforms that would make a difference to real businesses. Only then can Singapore's tax system continue to lead the race.

The World Bank-PwC Paying Taxes 2012 report may be downloaded for free at *www.pwc.com/gx/en/paying-taxes*

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Growing private equity in Singapore

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The year 2011 was challenging with the eurozone economic crisis and significant natural disasters occurring worldwide. There is little doubt that the economic impact of these events will potentially be felt for years to come, including here in Asia.

Despite these challenges, growth in the region is expected to continue and Asia remains a key area of focus for the private equity industry. In particular, South-east Asia is expected to be one of the more interesting markets for private equity players this year.

Singapore, with its strategic geographic location in South-east Asia, established financial ecosystem and good infrastructure, is well placed to serve as a base for private equity houses looking to cover Asia.

These factors also mean that Singapore is a front-runner to act as a platform for private equity investments into the region. The city state has a number of tax incentives available to encourage such activities, including schemes aimed at making it tax neutral for investment funds to set up in Singapore.

To enhance its appeal even further, Singapore should ensure enhancements to the current tax incentive schemes. We discuss some of the key potential tax enhancements below.

Reduce tax rate for fund management companies

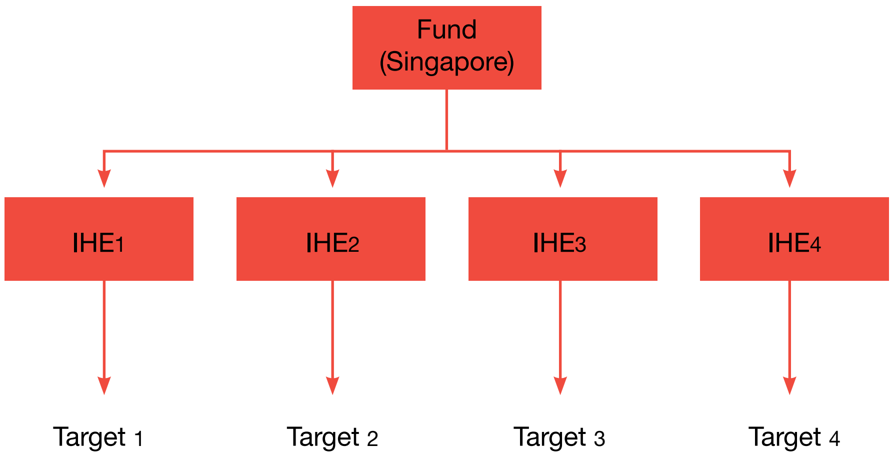
Fund management companies set up in Singapore currently pay corporate tax at the rate of 17 per cent. Companies that meet the conditions and have plans to expand operations in Singapore can apply to the Monetary Authority of Singapore (MAS) for a concessionary tax rate of 10 per cent. While the corporate tax rate has been more than halved in the last couple of decades, the 10 per cent concessionary tax rate has held steady. In relative terms, this makes the 10 per cent tax rate less attractive than it used to be. Given the level of resources and commitment required from taxpayers in order to receive tax incentives, one sometimes wonders if the tax rate differential is worth the effort.

It's time to re-evaluate what level of tax rate reduction will be substantial enough to make the incentive more appealing, and in turn attract private equity managers to Singapore. Relative to the existing rate of 17 per cent, a concessionary tax rate of 5 per cent would certainly be more attractive. Other approaches, such as tax exemption for applicants who commit to substantial growth in their operations and employment in Singapore could also be considered.

Enhance the tax exemption schemes for funds

Funds set up in Singapore are eligible for tax exemptions, subject to meeting certain conditions. In practice, this has worked quite well and we are seeing a significant shift in favour of Singapore when it comes to the location of investment funds and/or their investment platforms.

However, a key challenge for the industry is that such incentives grant an exemption to the Singapore-domiciled fund but do not automatically grant exemption to Singapore investment holding entities (IHEs) that sit below the fund and actually hold the final investment. The use of IHEs is commonplace which serves a number of purposes, including facilitating exit from the investments and segregating risks. To get tax exemption under the current regime, each IHE has to apply separately and demonstrate compliance with the relevant conditions. For example, if a Singapore fund has four IHEs for four investments (refer to accompanying chart), the current regime provides a tax exemption for the Singapore fund but taxes the four IHEs, thus negating the entire benefit of the fund exemption.



To avoid this situation, a taxpayer would have to make separate applications for each fund and IHE - which in this case would involve five separate applications and complying with five sets of conditions. There are a few concerns with this approach:

- Firstly, the tax exemption application process takes up valuable time and resources. Understandably, the authorities need to take some time to review the application before an approval is granted. As tax certainty is important to most private equity houses, applicants will need to wait for the approval before they use a Singapore IHE. However, this waiting time conflicts with the commercial need to seal the investment within a relatively short period of time.

- As each private equity fund is expected to have multiple investments, the current regime means that the process has to be repeated every time a new IHE is set up for a new investment.

- Perhaps the most compelling cause for concern is that certain conditions of the tax exemption schemes that are meant to be imposed on fund entities are currently applied on a wholesale basis to each IHE. Not all IHEs are able to meet these conditions, raising the question - why should each IHE be required to meet conditions which are intended for a fund entity?

- There are ways to work around these issues but they would inevitably make the private equity fund structure more complicated and more costly to maintain. In view of the above, we believe there is merit for the tax exemption schemes for funds to be enhanced to allow a fund structure as a whole (that is, the fund and its IHEs) to meet only one set of the conditions currently imposed on each fund, regardless of the number of IHEs.

Review and refresh Singapore's tax treaties

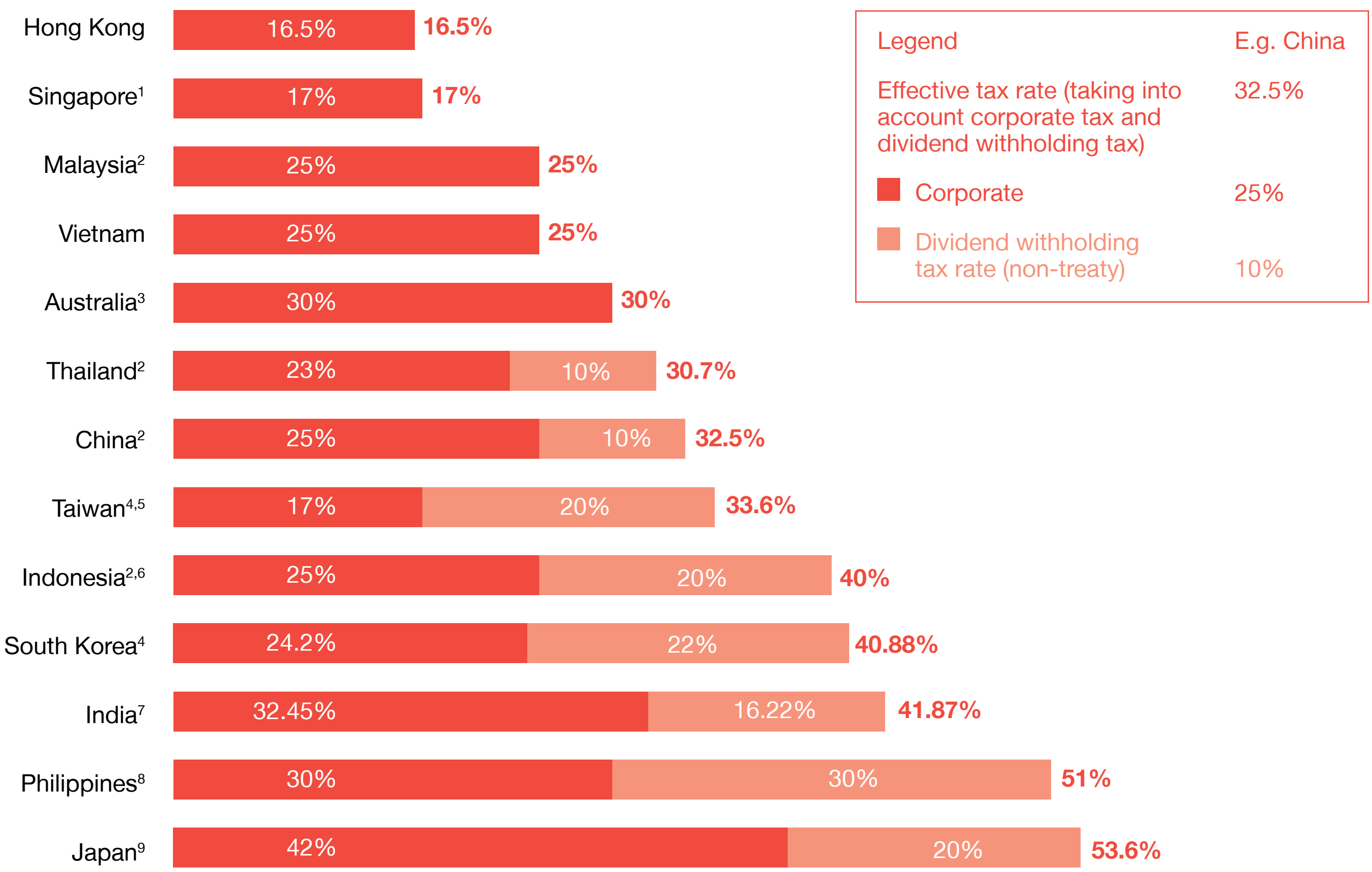
Where two countries are parties to a tax treaty, the treaty will generally provide lower withholding tax rates and capital gains tax exemptions on income received from one country which has been derived by a resident of the other. Singapore has a reasonably good tax treaty network, but a number of the treaties are quite dated (for example, the tax treaties with Indonesia, Taiwan and Vietnam) and potentially less beneficial than other countries' treaties in the region. Given the recent global trend towards decreasing tax rates, it is timely that Singapore's more dated tax treaties be re-negotiated. The availability of capital gains tax exemptions also tends to be a high priority item for private equity players, since this has a direct impact on the returns to funds. This key element is also missing from a few of the older treaties and is a further reason to support re-visiting them.

Although these suggestions involve simple additional steps, we believe their implementation would go a long way to developing the private equity sector in Singapore further. We hope the Singapore Budget that will soon be announced in the year of the dragon will bring some good news to the private equity industry here.

This article was contributed and first published in The Business Times on 26 January 2012.

Appendix A

Comparison of Asia Pacific effective tax rates on repatriated corporate profits (for income year 2012)



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 exemption of up to $152,500 applies to the first $300,000 of chargeable income.

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

3 Fully-franked dividends 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.

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

5 The dividend withholding tax rate is 20%. An additional 10% profit retention 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 Listed companies which satisfy certain requirements are subject to tax at 20%.

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 20% or greater credit for the underlying tax paid by the dividend-paying company. In addition, a 10% improperly accumulated earnings tax is imposed on the improperly 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 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 2011)

	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	2,234	3	4,844	5	20,729	10
Australia[1]	17,167	23	26,455	26	67,256	34
China[2]	14,725	20	22,225	22	60,967	30
Hong Kong	3,610	5	7,860	8	24,859	12
India	19,942	27	27,667	28	58,567	29
Indonesia	15,048	20	22,439	22	52,001	26
Japan	5,619	7	10,544	11	41,805	21
Malaysia	14,038	19	20,538	21	46,538	23
Philippines	22,148	30	30,148	30	62,148	31
South Korea	8,731	12	15,001	15	51,449	26
Taiwan	6,790	9	12,150	12	45,833	23
Thailand	15,549	21	23,049	23	57,549	29
Vietnam	19,107	25	27,857	28	62,857	31

Notes:
1 Based on new tax rates for year ending 30 June 2012. Includes a one-off flood levy imposed for the year ending 30 June 2012 payable by all taxpayers except those impacted by the flood.
2 Based on new tax rate bands effective 1 September 2011.
3 Deductions for Social Security are not taken into account unless the contributions are compulsory by law.
4 Standard deductions are taken into account.
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 Years of Assessment 2012 and 2013

Chargeable Income		Years of Assessment 2012 and 2013	
	$	Rate %	Tax $
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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