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, some of these articles were published in the media as part of the lead-up to the 2013 Singapore Budget.

Contents

Fund managers' wishlist for Budget

Authored by

Anuj Kagalwala
Tax Partner
(65) 6236 3822
anuj.kagalwala@
sg.pwc.com

Tan Hui Cheng
Tax Director
(65) 6236 7557
hui.cheng.tan@
sg.pwc.com

It is that time of year again when the Singapore government prepares the Budget for the coming year, which includes reviewing its financial and tax policies. While the global economic outlook continues to be uncertain, many analysts agree that most of Asia should enjoy relatively higher growth in 2013. This should continue to spur investment interest and attract new funds to this part of the world. Given the strong investment interest, the asset management industry in the region is poised for further growth in the coming years.

The Singapore government has been sensitive to the needs of the industry and has quickly responded with fine-tuning measures to facilitate its growth. However, we believe a few key policy changes, if made in the upcoming Budget announcement, will allow Singapore to remain a relevant and attractive hub in Asia for fund managers and funds. Delay in bringing about these changes carry the risk of making Singapore less attractive than other competing jurisdictions.

Use of investment entities by funds

It is commonplace for fund managers to set up separate investment entities (IEs) to hold different investments. This is done for a number of reasons, including the availability of more exit options and segregation of risks.

While the fund entities set up in Singapore can apply for income tax exemption, the tax exemption status does not automatically extend to the IEs held by the fund entities. Separate tax exemption applications have to be made for each IE. This leads to additional conditions to be met and additional resources to be expended by fund managers to apply for and comply with the requirements of the tax exemption schemes.

One obvious way to address the above issue would be to tie the conditions for the tax exemption to the fund entity in Singapore, without the need for the individual IEs to apply for tax exemption. However, this may appear to go against the policy objective of using tax incentives to encourage fund managers to set up or expand their existing operations in Singapore.

In this case, the government could consider tweaking the conditions of the tax exemption schemes to provide more flexibility to meet the commercial needs of fund managers, while not losing sight of this objective. The schemes should nonetheless be administered such that the individual IEs do not have to make separate applications. The existing conditions for the tax exemption schemes for funds can be tweaked for funds that use IEs as follows:

- Minimum level of assets under management by the fund management group in Singapore or globally;
- Minimum number of investment professionals in Singapore;
- Minimum local spending requirement; and
- Minimum fund size.

Further, instead of imposing all requirements indicated on every application, our suggestion is to allow each applicant to choose to apply three out of the four stated conditions, for example.

Legal framework for fund companies

The other aspect of the Singapore framework which has been discussed at length is the lack of a tailored legal framework for funds set up as companies in Singapore. Singapore fund companies are set up as normal operating companies under the Singapore Companies Act. The Singapore legal framework for companies does not currently have provisions modified to cater for the needs of fund companies, and present a number of issues.

The key issues are:

(a) **Directors need to declare that the company is solvent before it redeems shares**
Each time the fund needs to redeem shares from its investors, the directors of the fund company have to sign a declaration that the company is solvent. For this purpose, the company must be able to repay debts as they fall due, and its assets must be greater than its liabilities. It is common for funds to issue preference shares to investors (in addition to other instruments) to facilitate a return of capital. However, for accounting purposes, preference shares may be classified as liabilities under certain circumstances. This may sometimes result in one leg of the solvency test mentioned earlier not being met. There is also administrative inconvenience involved if the fund companies expect to have to meet frequent redemption requests by investors.

(b) **Information on shareholders (i.e. investors) and investments can be accessed by the public**
Fund managers' primary concern with allowing public access to investor information relates to their ability to attract and retain quality investors. Allowing investor information to be confidential ensures that the fund and fund manager maintain their competitive advantage. Investors also do not want solicitation from third parties. This is a particularly important consideration for high net-worth individuals and families. Disclosure of investments similarly leads to concerns over their competitive advantage being made known to other fund managers.

The current legal framework thus creates a number of hurdles that fund managers using Singapore fund companies need to be aware of, and plan ahead lest they trip over them. One suggestion is to introduce a legal framework for funds that builds on the existing company law framework, with modifications that cater for companies that are funds. Additional attractive features that may be considered include allowing for open-ended investment companies, migration of domiciliation of funds from other countries, and segregated cell companies' concept.

Given Singapore's strategic location in Asia and its reputation as a financial centre, there has been increased interest in setting up fund companies in Singapore. If a legal framework for fund companies were to be introduced, it would certainly help to facilitate the fund managers' decision to set up more funds here and to boost their operations as a result.

Lower concessionary tax rates for fund management companies

Lastly, we believe the concessionary tax rate of 10% granted to fund managers needs to be reviewed. It is no longer attractive in the context of the current corporate tax rate of 17%, given the extent of compliance obligations and the conditions that the fund managers are expected to meet.

If the concessionary tax rate can be brought down to 5% or even 0% for income derived by fund managers, Singapore will present an even bigger draw for fund managers. However, this should be tied to reasonable conditions and business and employee growth targets, which should be set taking into account current market conditions and the different operating models of different classes of fund managers (e.g. private equity and hedge fund managers).

With fund inflows to Asia expected to remain high, this presents a golden opportunity for Singapore to fine-tune its value proposition to the asset management industry, to enable it to grow further as a hub for asset management activities in Asia.

This article was contributed and first published in The Business Times on 1 February 2013.

Managing immigration: What Singapore can learn from others

Authored by

Ling Tok Hong
Advisory Partner
(65) 6236 7228
tok.hong.ling@
sg.pwc.com

At the announcement of the White Paper on population, Singapore Deputy Prime Minister Teo Chee Hean said the government hopes to strike the "appropriate balance". This balance is key.

The Singapore government's marriage and parenthood package may set the brakes on the falling total fertility rate and help build the core of citizens, but there is a limit to how much impact it will have in the long run. This is because of changing social trends and norms which have had a negative impact on global fertility rates. A "closed-door" approach to immigrants in the long run will therefore not work. Immigrants are needed to complement the resident workforce by taking on lower-skilled jobs, as well as to provide access to highly-skilled workers who facilitate economic upgrading and productivity increases.
On the other hand, a fully "open-door" approach is also not the way to go, as it will put tremendous pressure on Singapore's scarce resources and on social integration issues.

Finding a balanced approach to immigrants – "smart and managed growth" – will be key to the success of the population strategy, and Singapore could look to the experience of other leading cities that have sought to increase immigration levels. Their experiences provide a useful reference, even if they may not be fully applicable to Singapore's unique context.

Social cohesion policy

What is particularly important is that Singapore actively manages the type of immigrants it brings in. A targeted policy to attract immigrants based on particular skill and resource needs, in areas where there is a shortage of locals, will have positive impact on growth; but these resource gaps must be carefully defined and continually updated as Singapore's economy develops over time, global demands change and demographics alter.

The social and political impacts should also be managed. Suitable immigrants should be willing to sink roots and grow their families here. It will be important to create a national consensus around the need for integration and to encourage greater acceptance of immigrants. While Singapore already works hard to ensure that ethnic diversity is valued and social cohesion encouraged, it should consider developing a multicultural social cohesion policy which is fully integrated with the city's strategic planning processes. There would be well-defined objectives and initiatives, with periodic monitoring of their implementation.

Toronto: Easing in newcomers

Toronto is a useful reference point. It has a very big immigrant population but has managed to build a strong sense of national identity based on civic commonalities and values. Every year, roughly half of Toronto's new residents are born outside Canada and many more immigrate from all areas of the country. Specifically, 60,000 or more newcomers settle in Toronto each year, adding to the number of languages spoken and cultures mixing in the city. Programmes introduced by the city of Toronto to help the integration process of newcomers include services like reception, orientation, translation and referral to community services – all of which can go a long way in helping them adjust. Language can also become a significant barrier to inclusion and participation for many new immigrants, which is why basic instruction in French and English is provided.

Another way Toronto addresses the needs of young immigrants is by providing settlement workers in schools to help their families adapt to a new country. Its main approach to addressing the needs of young newcomers is by working with the family as a whole.

South Korea: Tackling prejudice

Closer to home, South Korea is an interesting example of where the government has sought to ease the integration of immigrants through encouraging transition to a multicultural society and reducing race-based discrimination.

In April 2006, the government granted legal status to people having mixed-race backgrounds and their families, “as part of measures to eradicate prejudices and discrimination against them”. Universities were required to admit a certain number of “mixed-heritage” students; and special programmes were proposed to provide educational assistance, legal and financial aid and employment counselling to poor families. The law barring “mixed-race” Koreans from serving in the military was also revised in 2006.

In June 2009, the Korea Immigration Service released a report, The First Basic Plan for Immigration Policy, 2008 to 2012. This 120-page report provides a basic blueprint for a transition to a multicultural society in South Korea and acknowledges the inexorability of global immigration to South Korea (for non-skilled workers, high-skilled workers, foreign spouses, the Korean “Diaspora” and others). The report addresses key issues including social integration, citizenship and naturalisation laws or procedures, civic education on multiculturalism, educational policies and so on. The plan signified a dramatic, even fundamental, shift in South Korea’s official perspective on immigration: multiculturalism, inclusivity and integration are key themes.

Netherlands’ woes

On the other hand, the Netherlands is one country whose immigration integration policies did not succeed in the 1980s, resulting in negative impacts. Population measures had included capping the number of schooling years immigrants could have to ensure they would not compete with locals for higher-value jobs. That approach backfired. Immigrants struggled to learn the local language and integrate into Dutch society.

Last but not least, from our experience studying global cities and population issues, it is important to note that advances in technology mean that cities of the future can accommodate greater population numbers, and various strategic policies can be implemented to ease the infrastructural constraints. The government’s plan on land use, released on Thursday, is a key ingredient in the White Paper’s aim to strike the appropriate balance. An early positive sign are the plans to greatly expand the rail network.

Singapore's strong tradition in urban planning and its cutting-edge position in urban technology and solutions also put it in a good position to meet these challenges.

This article was contributed and first published in TODAY on 2 February 2013.

Consider tax relief for population woes

Authored by

Abhijit Ghosh
Tax Partner
(65) 6236 3888
abhijit.ghosh@
sg.pwc.com

Ajay K Sanganeria
Senior Tax Manager
(65) 6236 3703
ajay.k.sanganeria@
sg.pwc.com

With increasing life expectancy as well as low fertility rates, Singapore is faced with two key imbalances in its population: It is getting older and, due to low fertility rates, it will have fewer younger people to support this ageing population.

In the past fortnight, the Government has announced various schemes to encourage people to get married early and have children. While these are extremely calibrated measures, the Government may wish to consider these suggestions to supplement and make its policies more effective.

First, the saying "prevention is better than cure" needs to be applied effectively. The ageing population has to remain healthy, not only to reduce the Government's medical bills but also to provide support to our younger generation who are willing to get married and have children.

The Government could incentivise adopting a healthy lifestyle by, for example, granting tax reliefs or rebates to individuals for obtaining gym or other memberships for physical exercise and weight management programmes – which they would have to prove they have attended. Or they could provide enhanced tax deductions or rebates to companies for the expenses incurred in providing these benefits to employees. The mentality to stay healthy should be instilled from a young age.

Some countries, such as Canada, provide a tax credit to parents for registering a child in eligible physical activity programmes, including sports and dance. The policy is aimed especially at low-income families who may not otherwise be able to afford such programmes.

These children typically develop fewer medical complications later in life, thereby reducing the stress on the public health system. Singapore could consider similar schemes.

Ease medical cost burden

Even so, the reality is that senior citizens will inevitably require medication and/or hospitalisation support at some point in time.

Individuals could be encouraged to obtain additional private health insurance plans over and above MediShield and ElderShield protection. This is because Medisave and MediShield can be easily wiped out, while Eldershield payouts may not be sufficient when an individual is diagnosed with a critical illness requiring surgery or prolonged care.

The Government could encourage individuals to obtain additional private health insurance plans by granting tax deductions for the extra premiums paid.

Concurrently, medical and health insurance services, currently subject to 7% GST, should be zero-rated to make medical and health plans cheaper and to provide an incentive for individuals to invest and provide early for their healthcare.

Zero-rating life insurance policies would also allow life insurers to recover their input tax, the cost savings of which can be passed on to customers in the form of lower premiums.

Similarly, companies offering employee medical benefits should be allowed to claim a tax deduction for their employees' medical expenses in full, instead of the current cap of up to 2% of the total remuneration of employees. A spin-off benefit would be a reduction in the disproportionate tax compliance cost of calculating the deductible expenses.

Egg-freezing option

The measures in the enhanced marriage and parenthood package to provide partial funding for assisted reproduction treatment and allow Medisave withdrawals for assisted conception procedures are a step in the right direction. But this does not address the needs of women who, for various reasons, may desire to have children at a later stage in their life.

One measure that could be considered is to give women the option of freezing and storing their eggs, as some form of protection against the irreversible decline of egg quality that comes with advancing age and increased risk of miscarriage and abnormal births. This would be useful for women who, for various reasons, decide to defer their plans to have children till such time they are ready to take the plunge.

In this regard, the Government could conduct open fertility clinics to educate women on childbirth options, for example, egg freezing procedures. It could also consider co-funding the costs associated with these fertility treatments or grant tax relief for these costs.

This would encourage a certain segment of our women, who may not otherwise be able to conceive, to have babies at a later stage when they are ready. Ultimately, it is better late than never.

This article was contributed and first published in TODAY on 4 February 2013.

Iskandar for Singapore businesses – a nearshore advantage?

Authored by

Abhijit Ghosh
Tax Partner
(65) 6236 3888
abhijit.ghosh@
sg.pwc.com

The Iskandar Development Region (IDR) in Johor, Malaysia is three times the size of Singapore and can be considered an appropriate destination for Singapore companies which are seeking to expand their businesses in a location which offers lower land prices and a cheaper talent pool.

Faced with rising wage bills, rentals and other operating costs in Singapore, Singapore businesses, particularly small and medium sized enterprises (SMEs), may find it commercially feasible to move their low value added, labour-intensive businesses there. Its accessibility and close proximity to Singapore enhances its attractiveness for Singapore companies seeking to expand overseas.

The plans to connect Singapore and Johor Bahru via a rapid transit link by 2018 will not only facilitate greater cross border trade and investments but will also make it easier for Singapore businesses to manage their operations across the border. Recognising the potential of Iskandar, Singapore's Finance Minster, Mr Tharman Shanmugaratnam recently acknowledged that IDR could be "a nice complementary space" for Singapore businesses.

It is not surprising that Singapore is the single largest foreign investor in the IDR, with cumulative investments of $2 billion since its inception in 2006. According to the Malaysia Investment Development Authority, more than 300 Singapore companies have already set up a manufacturing presence in the IDR.

However, before making a beeline to set up shop in the IDR, Singapore investors should first validate their cost structure and the efficacy of their expansion plans carefully. Issues such as security, the availability of human capital and the presence of supporting services/infrastructure should be carefully evaluated. In addition, IDR business plans should also factor in the effect of the new minimum wage requirements for workers in Peninsular Malaysia which took effect from 1 January 2013.

Taking into consideration the advantages of Singapore vis-a-vis Iskandar, it is likely that businesses will set up or shift to the IDR manufacturing or service facilities which require more land and/or labour, but can continue to house high value-added business activities such as headquarter functions, supply chain control towers, intellectual property ownership and management, treasury functions, etc., in Singapore.

Interestingly, Singapore companies expanding to the IDR can even take advantage of assistance schemes offered by the Singapore Government and administered by IE Singapore. These include:

- the Internationalisation Finance Scheme, Loan Insurance Scheme and Trade Credit Insurance Scheme which are meant to provide financial and risk management support for foreign investments; and

- the Political Risk Insurance Scheme which helps to subsidise the premiums payable by companies to buy political risk insurance as they venture overseas.

IE Singapore also offers grants to help companies develop the talent (e.g. for training, overseas attachments and human resource strategy development) that they need to support their international business needs. In addition, Singapore businesses are automatically entitled to claim a 200% tax deduction for qualifying expenses incurred on overseas business development, investment study trips or participation in overseas trade fairs.

Further, the newly-introduced Integrated Investment Allowance (IIA) scheme now allows Singapore companies to claim enhanced writing down allowances (i.e. over and above the normal capital allowances) on equipment used for an approved project outside Singapore. For example, IIA may be granted for productive equipment purchased by a Singapore company but provided for use to its IDR subsidiary company to carry out a project in the IDR. This project should involve the manufacturing of products or provision of specialised engineering or technical services for the Singapore company (i.e. the IDR subsidiary operates as a contract manufacturer or contract service provider to the Singapore principal entity).

On the other side of the causeway, there are a host of attractive incentives and support packages available for qualifying companies undertaking qualifying activities in the IDR. These include tax exemption for certain income sources, investment tax allowance, exemption from withholding tax, exemption from real property gains tax for entities located within approved nodes (Medini is the first approved node), unrestricted employment of expatriate employees, reduced tax rate of 15% for workers residing and working on qualifying activities within the designated zones in IDR, etc.

Subject to appropriate structuring, Singapore investors should be able to earn dividends or branch profits from their Malaysian investments free of both Malaysian and Singapore tax.

Likewise, any gains earned from eventual disposal of the Malaysian investment should also not be taxable in Singapore or Malaysia provided they are regarded as capital gains. Investors can also take advantage of the Singapore-Malaysia tax treaty to enjoy reduced Malaysian withholding tax on other streams of income such as interest and royalties and subject to Singapore tax rules, can claim foreign tax credit for such Malaysian taxes against the Singapore tax payable on that income.

The network of Free Trade Agreements including either or both Singapore and Malaysia will facilitate goods moving across the border without undue delay and charges. It may also help exporters on either side of the border to qualify for preferential treatment in third country destination markets through either so-called origin cumulation rules or specific relaxations in the rules of some agreements allowing processing in neighbouring countries to count as domestic processing.

Although tax advantages should not be the reason for Singapore companies to expand their business footprint in the IDR (or, for that matter, anywhere else), a favourable tax system in Singapore, which helps to reduce tax costs, can go a long way in helping businesses to grow overseas and yet retain their control towers and value added functions/activities in Singapore.

In the context of encouraging Singapore businesses to expand into Iskandar, it may be worthwhile for the Singapore government to consider the following fiscal measures:

- Businesses should be allowed to deduct borrowing costs incurred to finance investments in designated territories (such as the IDR) against their Singapore trade income.

- The IIA can be made automatic instead of requiring companies to go through an approval process.

- Foreign tax credit that cannot be fully offset against Singapore taxes on foreign income should be allowed to be set off against Singapore taxes on Singapore-sourced income and/or carried forward for set off against future income of the Singapore company.

- Automatic suspension of import GST for goods imported from the IDR or other designated territories for further processing in Singapore before eventual export, without the need to apply for the Major Exporter Scheme nor the need to register the goods at the time of import and re-export.

Singapore is still an attractive place to do business. However, the high cost of doing business here is clearly posing an increasing challenge and the Government while still attempting to address these challenges, has recognised that certain types of business operations will need to relocate to lower cost locations such as the IDR. However, Singapore must continue to remain attractive for companies, particularly our home-grown ones, such that they do not move out completely as they seek greener pastures overseas.

This article was contributed and first published in The Business Times on 7 February 2013.

Need to tweak policies on productivity and workforce

Authored by

Abhijit Ghosh
Tax Partner
(65) 6236 3888
abhijit.ghosh@
sg.pwc.com

This refers to The Business Times editorial of 6 February 2013 on the White Paper on Population.

The article focused on the concerns of local businesses over proposals to cap workforce growth to 1% to 2% a year until 2020 and plans to lower the number further in the long run.

Painting a rather worrying future ahead, The Business Times indicated that companies which cannot quickly implement productivity raising measures, "will sooner close down or relocate than innovate or automate".

While quite certainly, most firms are finding it tough adjusting to the tighter foreign labour policies, it is too simplistic to tar all businesses with the same brush. There are different types of businesses and industries in Singapore. Some lend themselves to automation more readily than others. Some are able to cut costs by outsourcing or moving certain operations to cheaper locations. Then there are some – and these are the businesses which are bearing the brunt of the tighter foreign labour policies – which need more time to adjust as increasing productivity in these sectors may not be as straightforward as substituting a pair of hands with equipment.

Unfortunately, this last category, typically the retail, food and beverage, hospitality and construction companies, rely heavily on foreign workers.

First of all, if we are to introduce effective measures to help companies in Singapore adjust and adopt the push to reduce their reliance on foreign workers and increase productivity (and they will have to at some point), they will have to be targeted to the needs of the different industries. Representatives from government agencies, unions and the businesses themselves should come together to form work groups and develop productivity strategies uniquely tailored for each sector. Government policies and assistance schemes can then be crafted accordingly.

For example, the Productivity and Innovation Credit (PIC) scheme, which was introduced to help companies to innovate and raise productivity levels, could be tweaked to increase the level of support that companies, particularly SMEs are able to get. The scheme gives support for six different activities, with a cap on the amount of benefit a company can claim for each activity. From our experience, the two main activities that companies are able to access the PIC scheme relate to automation and training. The remaining four activities (acquisition and registration of intellectual property rights, research and development and approved design projects) are of relevance only to a limited group of companies. So industries that have a heavy reliance on overseas labour and yet are identified as having greater potential to automate and/or have the ability to reduce their reliance on foreign labour, should be allowed a higher cap for their PIC claims in relation to expenses incurred on automation or training to raise productivity of local employees for each relevant activity.

Incidentally, the government may also want to give some thought to extending the PIC scheme as it is slated to expire in the year of assessment 2015, as it is clear that Singapore's productivity efforts need more time to yield effective results.

The Business Times also quoted statistics from the latest manpower survey by the American Chamber of Commerce, which stated that 5% of respondent companies had already relocated out of Singapore and a further 15% are considering doing so.

These figures may be alarming on the surface, but may also be an arrangement that ultimately allows Singapore businesses to survive. Both international and local firms in certain sectors can easily redistribute some of the more costly aspects of their production activities to countries where labour and land is cheap. The issue that needs to be addressed for these sectors is how to persuade them to retain that part of their operations at the higher end of the value chain in Singapore. These would possibly include headquarter functions, supply chain control towers, intellectual property ownership and management, treasury functions, etc. This sort of "twinning" arrangement would allow businesses to remain competitive and become more profitable while at the same time tap on the skill sets of the relatively large pool of educated Singaporean professionals, managers, executives and technicians (PMETs).

To this end, the government may want to consider giving Singapore companies financial or other assistance to relocate certain parts of their production operations overseas, such as Malaysia's Iskandar Development Region (IDR), especially so if the companies pledge to maintain their other high end aspects of the business within the island here.

Finally, we must address the needs of businesses for which there is no substitute for human workers, but which offer jobs that Singaporeans are not keen to take up. In particular, quite a large number of local SMEs seem to fall into this category, and for them the future might seem bleak as they may not even have the option of relocating elsewhere.

In Professor Tommy Koh's article in the Straits Times ("What Singapore can learn from Europe" published on 19 May 2012), he observed while looking at the Nordic states, that the average monthly wage of a cleaner in Denmark is $5,502 while in Sweden it is $3,667. In Singapore, he had noted that it was $800.

He attributed this disparity to Denmark and Sweden having better productivity standards as well as having tighter foreign labour policies. The influx of foreign workers, he argued, can reduce wages.

In other words, Singapore businesses need to improve productivity so that they can make do with fewer workers and yet offer them better wages. Investments in employee training are therefore especially important for this group of businesses and where again, a targeted PIC enhancement for training activities would come in handy.

In the immediate future, the government could consider whether and how it can relax its stance on tightening the foreign labour supply a little to give these businesses more time to adapt.

It is indeed vital for Singapore to reduce reliance on cheap foreign labour and raise productivity. This mantra needs to be taken more seriously and more effort needs to be put in place, especially if we want to reduce the widening gap between top and low earners here.

However, the government should ideally give another five years before getting heavy with workforce growth. In the meantime, some fine-tuning of the foreign labour policies would allow companies highly reliant on foreign labour to achieve better productivity measures as well as be better prepared to absorb changes.

This article was contributed and first published in The Business Times on 8 February 2013.

No longer just a question of paying taxes

Authored by

Gavin Helmer
Tax Partner
(65) 6236 7208
gavin.rh.helmer@
sg.pwc.com

The recent Starbucks tax story in the UK has been interesting in so many ways. Who would have thought that so many people from different walks of life could become overnight experts in taxation, well-versed and skilled in the intricacies of cross border transfer pricing, issuing forth in their blogs or through their Twitter accounts to all that might read their sage words? And I had been under the misapprehension that transfer pricing was a specialist area in the world of tax, requiring some years of learning and experience to master.

I jest of course. The public's hostile reaction to the disclosure that Starbucks had paid very little tax in the UK for a number of years as a result of adopting aggressive transfer pricing was somewhat uninformed and borne of a sense of moral outrage. "It's not fair, we pay tax, so should companies" was the cry, regardless of whether Starbucks' transfer pricing was in accordance with the rules. And on balance, one would expect that it was, and that Starbucks acted within the law. Further, it is difficult to believe that the UK tax authorities would not have reviewed Starbucks transfer pricing over the years and challenged it where appropriate. One upshot of the whole saga was that various people made it known publicly, again through Facebook, Twitter or other such media, that they would henceforth be taking their coffee business elsewhere. In a number of cases, the sentiment was expressed in the following terms: "From now on, I will be buying my coffee at X, because at least they pay tax". Again, who would have thought? People determining their preferred barista on the basis of how much tax they pay; you could not make it up!

One irony in all of this is that should Starbucks lose any significant portion of its market share in the UK as a result of the public's anger, as some commentators are predicting, this could plunge it into losses for some years to come, in which case… it won't have any corporate tax to pay! Except that, in an attempt to appease the public and UK government, Starbucks has announced that it will voluntarily deny tax deductions to the extent necessary so that its tax bill will be GBP 10 million for each of the next two years.

There are some important messages and lessons coming out of this affair.

First, a recognition that tax may become, if it has not already become, part of the Corporate Social Responsibility (CSR) agenda. If you go into any Starbucks and read some of the literature on the walls or counters, you will see that they are very active and do a great deal of good work in their local communities, as well as regionally and globally. Like many leading organisations Starbucks, it seems to me, has a worthy CSR programme. It appears that paying enough tax (whatever that may mean) will now have to be part of that programme, but some potential pitfalls need to be borne in mind. Many organisations are now seeking to disclose voluntarily their total tax contribution as part of their efforts to demonstrate good corporate citizenship, and in defending itself against the recent public backlash in the UK Starbucks pointed to, among others, the amount of Value Added Tax (VAT) that it accounted for to the UK tax authorities each year. However people were quick to point out that it was they that were paying the VAT and that Starbucks was merely handing it over to Government. Some people went as far as to suggest that they would ask Starbucks to deduct the VAT from the price of their coffee purchases, and only then could the company claim to be contributing the tax on its own account. The total tax contribution debate could take up several pages, so I will leave it at this: organisations are going to have to be much more mindful of the tax that they pay, if and how they report this (recognising the possibility of mandatory country-by-country reporting of taxes in the future), and how this will be perceived by governments and the public.

Second, and this is nothing new, organisations have to be very careful about their PR. It is often the case that CEOs will be keen to highlight positive results in a particular area, be it product, business segment or geography related. Starbucks made claims that its UK business was profitable, and this is probably what antagonised people the most. "How can a company claim to be profitable and yet pay no tax?" was the basic question to which people wanted an answer.

The lesson here: make sure that any public statements that you make about your business activities take into account all relevant issues, including taxation. Tax authorities can and do read and listen to the news, and if they see a company's announcement that it is performing strongly in their jurisdiction, they will look to see how this compares with the tax that the company is paying. It's simple, really, but organisations can get it wrong and overlook the importance of tax, in its widest context, in PR.

Third, the pressure on tax havens will continue, if not increase, and in the wake of the Starbucks furore, the UK government has continued to re-affirm its commitment to the fight against tax evasion and aggressive avoidance, in which tax havens are invariably named as culprits. The US, the EU, the OECD and many other countries and organisations are stepping up their efforts to curb the use of tax havens by Multinational Corporations (MNCs). Measures like America's Foreign Accounting Tax Compliance Act (FATCA) are designed to tackle tax evasion by targeting the secrecy and opacity of some of these jurisdictions, but it is worth noting that although the Starbucks episode may have fanned the flames of the debate about the use of tax havens, in the Starbucks case, the jurisdictions in play were not the Cayman Islands or Bermuda, but Switzerland and the Netherlands (a member of the EU no less!). Basically, governments are tired of losing money through evasion or avoidance that involves the use of tax havens, and they believe that more has to be done. Expect more measures in the coming years.

Fourth, and as a related matter, the Starbucks case has cast the spotlight on the arm's length principle, the generally accepted standard governing pricing between related parties, and at the heart of why Starbucks paid so little UK tax for so many years. The case has reopened the debate as to whether the arm's length standard is the best way to achieve the "right" result in terms of revenues (and therefore tax liabilities) between related parties dealing with each other, or whether an alternative system is needed. The most commonly proposed alternative is formulary apportionment, a system under which the profits of an MNC are divided by entity (and so in effect geographically) according to pre-determined keys e.g. headcount, assets, etc. The theory is that under such a system, it should not be possible for the profits of MNCs to end up in low tax jurisdictions where little or no commercial activity is taking place. At the detailed level the debate is complex. The OECD continues to espouse the arm's length standard as the only reasonable basis for achieving the correct outcome, but this ignores the possibility that the will of people and governments to see a “fairer” outcome could point to a different result. The OECD continues to work on developing its transfer pricing framework to achieve rules which are acceptable to businesses and governments alike, but patience may be wearing thin and there may be more pressure on the arm’s length standard in the coming years; alternatively governments may adopt different rules on a unilateral basis, which would only be bad for business and potentially result in increasing amounts of double taxation for MNCs.

Some final observations. Popular activism will continue to play a role in how governments react to these sorts of incidents and in turn how they might come to shape tax (and other) policy; the power of Twitter and other social media in this context cannot now be ignored. Companies need to recognise that the press and social pressure groups are actively scouring their accounts and news to uncover anything that might be seen as less than impeccable behaviour – even if within the rules – and often how and when this is reported may come as a surprise and shock. The Starbucks case raises questions about the fundamentals of capitalism: Starbucks was – one has to assume – seeking to maximise shareholder return through legitimate tax planning and structuring, but increasingly it seems that people are not prepared to accept this, they want responsible capitalism, going beyond the requirement for organisations to act legally, and looking to the moral dimension and the concept of fairness, both of which can be very difficult to define, rationalise or reconcile in the context of taxation.

The debate about abolishing corporate taxes altogether one day may receive more air time, but in the current climate that is unlikely to be a realistic option. I could go on, but I have run out of space, and I’m in need of a coffee. As I say, so interesting in so many ways.

This article was contributed and first published in The Business Times on 8 February 2013.

Opportunities await savvy investors

Authored by

Teo Wee Hwee
Tax Partner
(65) 6236 7618
wee.hwee.teo@
sg.pwc.com

The latest round of property cooling measures announced on 11 January 2013 triggered a sell-off in the shares of developers as analysts predicted a drop in private housing prices, but opportunities await tax-savvy investors, who may find the post-curb market not as inhospitable as initially perceived.

There's no question that real estate has proven itself to be a sustainable asset class. Yet the additional buyer's stamp duty (ABSD) of 5% to 7% and the 25% minimum cash downpayment – among other new measures imposed last month – pose an obstacle to investors looking to purchase local property.

A different class

Investors can turn to the stock market as an alternative asset class to invest their funds even as some property counters have been directly hit by the new measures. Property-related stocks such as real estate investment trusts (REITs) could benefit from this new demand.

And while some investors may choose to head overseas, others will remain focused on Singapore and explore other options in the property market such as strata office space, which saw rising demand last year. While they may not offer the same level of capital appreciation in the short term compared to industrial properties, strata offices and retail space could become the next asset class to be chased after by investors.

Medical suites are another asset class not to be missed out on. Although this is a relatively new investment class, it is set to grow as more medical tourists arrive.

In addition, owners of office blocks who are anticipating downward rental trends and tighter bank loan policies could consider strata-titling their property. While they may have initially made their office property purchase with the goal of long-term capital appreciation, such a strategic readjustment could be beneficial. Holding on to several units, selling some others and renting out the rest will ensure greater stability in the event that the bank refuses to extend a loan.

From a tax perspective, the issue is whether the resultant gain from a sale qualifies as a capital gain, which is not taxable in Singapore, or is regarded as a change in intention from long-term investment to trading. If it is the latter, the gain may be taxed as trading income, leading to the inevitable question – whether it is possible to step up the cost base, based on the market value of the property at the point of change in intentions? This can be tricky, given that the market is so volatile now that determining the exact date on which investment intentions have changed can make a huge difference in the step-up cost base.

To illustrate, let's assume an office block was acquired in 2008 for long-term investment purposes. Two years down the road, the owner decides to strata-title the property and sell the units, and let's assume that this constitutes a change of intention from long-term investment to trading. Typically, the point in time at which the decision to strata-title the building is made would be taken as the date of the change in the intention, and the market value as at that date should form the base at which the subsequent gain is to be computed.

Unexpected consequences

While many analysts expect private home prices to take a hit from the new curbs, the measures could have effects that go beyond their original intent.

There will be some Permanent Residents (PRs) who are priced out of the private property market due to the 5% ABSD levied on their first residential purchase, which forms an additional and irrecoverable cash outlay. Their only options would be to turn to the rental market or to purchase a resale Housing and Development Board (HDB) flat. With the resale flat supply being limited, this increased demand may result in higher HDB resale prices in the long run, despite predictions that the Cash-Over-Valuation component will fall in response to the lower mortgage servicing ratio (MSR) for loans.

Another consequence is that the average Singaporean will find it more difficult to invest in real estate for retirement, particularly if he or she is not cash-rich. The wealthy will be able to continue investing for the long term, even with the ABSD and reduced MSR.

Furthermore, tax-savvy investors would know that when it comes to acquiring property in Singapore, whether it is booked as an asset deal or a share deal can make a great deal of difference in acquisition costs and exit tax consequences.

In the case of residential properties, particularly with the imposition of seller's stamp duties and the substantial increase in ABSD, a share deal has never looked so attractive. But this is likely to be more appealing to institutional investors such as real estate funds, who are looking to buy a huge portfolio of residential apartments already owned by special-purpose vehicles.

Moving towards share deals

At the moment, there are no look-through provisions relating to ABSD or seller's stamp duties, meaning that if an investor buys shares in a company that owns underlying residential properties, ABSD should not apply. Instead, a stamp duty would be imposed at a rate of only 0.2%. Investors may also go through a "back-door" purchase of any future residential development projects by buying into the shares of the project company, hopefully at an attractive pricing point made even more attractive without the ABSD.

As for the seller's stamp duties, the applicable rate is determined from the perspective of the company that first purchases the residential property. Hence, by buying the shares of the property holding company instead, the seller's stamp duties can certainly be managed, given that they only apply on a prospective basis.

For instance, let's say a property holding company acquired residential property on 1 February 2010. Seller's stamp duties for the divestment of residential property came into effect for such properties acquired on or after 20 February 2010. The shares in the property holding company are then sold to another company on 31 January 2013. When the property holding company later sells the property on 31 December 2014, seller's stamp duty should not be applicable.

The same probably applies to industrial properties to which seller's stamp duties have just been introduced. This may lead to share deals involving industrial properties becoming more common, given that most investors are likely to have incorporated an entity to hold industrial properties in order to claim back the Goods and Services Tax paid on the purchase consideration.

It is important that a share deal should be taken where there are commercial advantages too. Otherwise, there is a risk that the Commissioner of Stamp Duties may disregard or vary any arrangement to counteract any reduction in or avoidance of stamp duty liabilities.

Although the latest round of cooling measures has been called the most severe to date, there is only so much that can be done to curb speculation without causing damage to the investment climate. Singapore's property market will continue to be attractive to global investors and real estate investments will continue to constitute a retirement nest egg for Singaporeans who can afford it.

This article was contributed and first published in TODAY on 15 February 2013.

Off the cuff

Authored by

David Sandison
Tax Partner
(65) 6236 3675
david.sandison@
sg.pwc.com

About five weeks ago, I was asked to write an article that might be relevant to the upcoming Singapore Budget. "I know", I thought, "I'll write an article about Singapore's population dilemma". After all, I had been banging on about it for years, so maybe something on the topic was worth at least one last shot. As history will tell, I was lost in the stampede of articles, opinions and feedback in the wake of the White Paper issued at the end of January on the topic. Rather than throw petrol on an already suitable blaze, I realised it was clear another topic would need to be chosen. But after a period of scratching the wooden stuff, (and getting only painful splinters), I was fortunate enough to have lunch with Vikram Khanna, of this august publication, who kindly informed me that what the reader really wants is something "off-the-cuff".

So here goes. But not without warning the reader that what I am about to pour forth is completely un-researched idle speculation. Off the top of the head, off the cuff, or off any other part of the anatomy which, a posteriori, might seem most appropriate. But hopefully, food for thought.

OK, something needs to be said about the population

I do not believe there is anything more need be said about whether and to what extent foreign labour, talent or just plain foreign bodies need to be brought in to Singapore. What I will say though is that, if every male Singaporean (of requisite age and marital status, of course), went home this evening and did his national service, it would still be a good 18 to 20 years before the ensuing offspring began to be economically viable units (around 2031 to 2034). A bit of a time lag in anybody's book, during which time the happy bunnies need to be fed, watered and educated at somebody's expense. (This reminds me of Cyril Fletcher's joke about the cost of education. He said, "My friend wrote to me and said that he paid school fees of ten thousand quid per anum. I asked why he didn't just pay through the nose like the rest of us").

But let's do a back-of-the-envelope calculation. It assumes that 30% of the female citizen population (about 500,000) is of child bearing age, that 20% of males of that general age are unmarried and a fertility success rate for those in the zone of 80% (and ignoring infant mortality). This would produce 320,000 new Singaporeans by the end of the year (which is to be contrasted with the current annual rate of 36,000). Assuming national service was delivered a second time, same time next year (perhaps Valentine's Day should be made a national holiday), we would have 640,000 new national babies. Obviously this pro-generation cannot go on annually, as penguins seem to manage. So the new baby population would remain static until, as suggested above, they could start to produce their own. In the meantime, mortality (currently at a rate of 18,000 per annum) would erode that base by 360,000, leaving 280,000 (a few short of the projected increase of 400,000 by 2030). But is this realistically going to happen? Draw your own conclusions.

The other point I would make is that, just possibly, at a macro level, converting a birth-rate of 1.12 (births per female head of the population) into 2.1 (the replacement rate) just simply cannot be done, however much money or how many tax breaks are thrown at the concept(ion). The more affluent a nation becomes, the lower its birth-rate (proven supposition – see above). Applying simple mathematics then (F = Gm1m2/r2 – familiar to most as Newton's formula for acceleration due to gravity), it should be clear that, organically speaking, the citizen population of Singapore is in a downward spiral. Foreigners are here to stay. It's how you integrate them. Enough said.

Bi-polar disorder

For no other reason than pure interest, I was recently reading about trading routes, and was intrigued to see that Singapore was applying to become a member of the Arctic Council, "as an observer". The Arctic Council is, not surprisingly, a body that brings together the Arctic nations, i.e. America, Canada, Denmark, Finland, Iceland, Norway and Russia plus representatives from indigenous Arctic people (basically Eskimos). So why is a country on the equator wanting to observe the goings-on above the Arctic Circle? It seems about as logical as Iceland applying to become a member of ASEAN. Valid points.
But while I cannot comment on the reticence on the part of Iceland to be a member of ASEAN, I can certainly take a stab at Singapore's interest in the Arctic. It is, quite simply, that the polar ice cap is melting - and at an alarming rate. What this means of course is that, should the "Northern route" (the route between Europe and Japan around the top of Russia) become navigable for extended periods, this would cut in half the shipping time from East to West compared with the traditional route (through Singapore) that is now the only option. Admittedly, the availability of a consistently safe and predictable shipping route is many years off. But it is possibly only years, and who knows how quickly the ice will melt?

This led to me thinking about other threats to one of Singapore's best competitive advantages – its geographic location on the shipping routes between East and West. So along comes Myanmar, almost out of nowhere. Not an obvious threat you would think, with all the political turmoil surrounding it, until you read about the 800km gas pipeline which will connect Kunming, capital of Yunnan province in China, to the Bay of Bengal. This will apparently reduce China's dependency on the Malacca straits (read Singapore?) by a third, for oil from the Middle East (Financial Times, 31 January 2013). With this will come road and rail links and, undoubtedly also, a route for Mongolia's mineral exports and capital imports.

Finally, although Thailand and Malaysia do not always seem to see eye-to-eye, they have already forged an alliance with a land bridge between KL and Bangkok. Potentially it is only a hop and a skip to realising that the isthmus at their border is only some 100 kilometres wide, and ripe for a similar coast-to-coast transport arrangement.

Black swans, possibly, but hopefully not so black that they will be allowed to glide in under cover of darkness. Though little seems to be happening on the surface with swans, there is a shed-load of paddling down below. So watch this space.

At the bottom of a cliff, by Eileen Dover

Finally, and at a more international level, it has always struck me that quantitative easing, or printing money as it is more accurately known, lacked a certain logic. Akin, it seems, to holding yourself up with your own bootstraps. We have also heard much of the fiscal cliff that faced the US earlier in the year when the Bush tax reforms came up for renewal, and of the debt ceiling, both of which seem to have been swept conveniently under the carpet (relevant as the US is Singapore's largest trading partner). So far so good though, as the can has again been kicked down the road and everything moves swiftly on without apparent ruction; but when you try to kick a can down a road while suspended on your own bootstraps at the top of a cliff, something suggests it is all going to end in tears, unless of course, Newton's theory of gravity turns out to be total bunkum. As second office Scott in Star Trek said, "Aye captain, ye cannae change the laws o' physics".

Difficulties ahead? Of course there are, which is why there is a need for Singapore to remain flexible and light on its feet; and while the Budget this year will inevitably focus on local and perhaps micro issues that keep the population happy, we cannot ever lose sight of the very things that provide the country's prosperity in the first place. So there we are. Some off the cuff remarks for what they are worth, which hopefully do not earn the writer a good cuff round the ears.

This article was contributed and first published in The Business Times on 16 February 2013.

What Singapore must do to be a premier investment fund centre

Authored by

Justin Ong
Financial Services
Industry Practice
Partner
(65) 6236 3708
justin.ong@
sg.pwc.com

Armin Choksey
Financial Services
Industry Practice
Senior Manager
(65) 6236 3359
armin.p.choksey@
sg.pwc.com

Over the past decade, Southeast Asia has become an area of interest for many investment houses. The widening of the middle income class, outstanding talent and abundant natural resources have contributed to this growth. What is of striking importance is that the region is not only being eyed as an investee destination but countries like Singapore, Hong Kong, Taiwan, and Japan have also firmed up their infrastructure to cater to this upswing. The question now is, what should Singapore do, to be considered a premier investment-fund centre destination, comparing to the likes of Luxembourg and Dublin, among others?

In recent years, there has been an increasing trend towards setting up Singapore-domiciled investment vehicles. This is primarily driven by the fact that Singapore offers a place where substantive fund management activities and investment vehicles can co-exist. Singapore also boasts of having a large network of tax treaties that provides an additional sweetener. It has treaties with China, Australia, Indonesia and India, all of which are popular investment destinations. These treaties have favourable provisions that help in reducing withholding and capital gains tax.

In a recent Fund Domicile Matrix report issued by PwC, Singapore was rated very highly together with the other established investment fund jurisdictions in many aspects. In addition to the tax treaty benefits, Singapore also offers an unparalleled location where fund managers, investment banks and capital introducers can mingle in a business friendly environment, a highly respected regulator who is pragmatic, world-class infrastructure for travel and internet coupled with a large selection of securities services providers and professional services firms. Nevertheless, Singapore lacks a fundamental feature which prevents it from being called an "investment fund centre" in comparison to the likes of Luxembourg and Dublin. Today, Singapore does not have an investment fund platform which caters to the specific needs of hedge funds, private equity, securitisation or cross border investment funds. One of the primary criteria to access the double tax treaties is that the investment vehicle needs to be set up as a body corporate. The current regulatory framework in Singapore caters mainly to investment funds set up as a unit trust only, which cannot access the privileges offered in the double tax treaties.

Due to the existing lack of investment fund platforms, the current fund structures are set up in Singapore as trading subsidiaries with pooling outside of Singapore. This will also in the medium term have limited potential for growth, primarily because the days of having anti avoidance provisions in tax treaties are not far and the only way to ensure compliance with the substance of the rules would be to have management of assets and pooling of investors in the same jurisdiction coupled with physical substance or presence.

Currently, the trading subsidiaries are typically set up as private limited companies which would have fixed capital. Typically, an investment fund should offer the ability to invest in and out of the structure by way of subscriptions and redemptions, thereby calling for the need to have an open-ended nature. The Companies Act in Singapore at present requires that any redemption out of such companies would need a solvency test to be performed by the directors of the Company which if were to be performed frequently i.e. daily or even weekly, would prove to be an administrative burden on the management. The Companies Act in Singapore also requires a company to declare dividends from profits and not capital. This again is not conducive, as in a typical investment fund structure, redemptions would be funded at the net asset value which incorporates accumulated profits and capital. As a result, there is limited or rather no other option available in Singapore at present for frequent subscribing-redeeming structures i.e. an open ended investment company, apart from the collective investment scheme which again is set up for primarily trust purposes. This is one of the reasons why most of the alternative investment funds today are set up as private limited companies in Singapore, with feeder funds in Cayman Islands.

There are several other downsides to setting up an investment vehicle in corporate form, e.g. the financial reporting framework in Singapore which is convergent to the International Financial Reporting Standards, is not most conducive to the investment fund industry as it could lead to financial instruments being classified as debt instead of equity which creates serious implications on the solvency test. Another anomaly of such a reporting framework would be to consolidate the underlying portfolios if certain thresholds are met. Most investment centres that have specific investment fund laws have a financial reporting framework tailored for the investment fund industry which rids itself of the anomalies of the international framework which is not built to be industry specific. In reality, Singapore currently has an investment fund reporting framework known as the Recommended Accounting Practice 7 “Reporting Framework for Unit Trusts” (RAP 7) which has been revised in 2012 to eliminate some of these inconsistencies with the global investment fund reporting frameworks. However, the RAP 7 is only applicable to unit trusts and any investment vehicle incorporated under the Companies Act would need to comply with Singapore Financial Reporting Standards.

Last but not the least, and what could be viewed as a deal breaker for most investment houses and investors would be that shareholder’s register and financial statements have to be filed with the Accounting Authority of Singapore (ACRA), which is available to the public through paid searches. In the alternative investments world, privacy remains a key currency especially with regards to investor and investment portfolio information, and access to the fund financial statements and shareholders’ registers would be unacceptable. International investors into alternative fund vehicles are also more familiar with corporate entity structures where a board of directors is present, rather than unit trust structures which requires a manager and a trustee, thus adding to more costs.

To come to par or even compete with investment centres like Luxembourg and Dublin, Singapore must be able to offer a variety of investment fund platforms beyond the current structures, such as open-ended companies, segregated portfolio companies and even segregated sub-funds. To manage funds in Singapore, the Monetary Authority of Singapore (MAS) requires that the investment managers have physical substance in Singapore, and can avail themselves to the tax incentive schemes for investment funds. This means the investment managers must be physically present in Singapore with the talent and infrastructure to manage the assets, which prevents Singapore from being labelled as a post-box investment subsidiary centre.

As discussions around an Asian cross-border investment fund recognition regime start to take pace, Singapore should ensure that it has the bandwidth to allow alternative investment structures to fit both regulator and investor preferences, so that it stands a good chance of becoming the preferred centre to domicile and launch funds for Asian distribution.

So in a nutshell, what should Singapore do? The creation and introduction of a new investment fund law separate from the existing Companies Act or common law trust environment would be ideal. This could be wrapped around either a trust or a company granting it variable capital structure, along with tax exemptions and free from all the above drawbacks emanating from existing trading subsidiary structures among other criteria and features. If the above can be achieved, there is no reason that Singapore cannot be the Luxembourg or Dublin of Asia, with the added bonus of having substance of managers and other capital market players within its jurisdiction.

This article was contributed and first published in Singapore Public Review on 20 February 2013.

Singapore thrives as a major trading post

Authored by

Chen Voon Hoe
Assurance Partner
(65) 6236 7488
voon.hoe.chen@
sg.pwc.com

Jasmine Tan
Assurance Senior
Manager
(65) 6236 3237
jasmine.ch.tan@
sg.pwc.com

Singapore has been a major trading nation despite having no significant natural resources of its own. From its early days as an outpost of the Sumatran Srivijaya Empire ("Temasek" or "seatown") to becoming a major port of call between Europe and East and Southeast Asia for ships plying their trade in the 1800s, it was the development of and demand for rubber planting as a commodity that set the course for Singapore to become a major export-import centre.

Fast-forward 200 years, Singapore is now arguably one of the world's busiest ports. The World Trade Organisation (WTO) report showed Singapore's total merchandise export and import by Asia stood at $5.53 trillion and $5.56 trillion respectively in 2011, comprising 30% of the world's export-import volume. The same report ranked Singapore as the ninth largest exporter and importer in the world.

Singapore is emerging as a major commodities trading hub

The trading business traditionally involves a relatively straightforward process of buying a product and selling it at a higher price for a profit. Today, trading has become more sophisticated with technological advancement, the outsourcing phenomena, complex supply chains around the globe, and one characteristic aspect of trading today – the ability to extract value from various parts of the supply chain. For example, as more and more businesses centralise their trading or commercial activities, the flexibility to mix and match various sources of supply with customer orders from around the globe for the highest profit margin or to ensure supply stability, has become important. Added to the complexity are the various trading strategies adopted – arbitraging between different grades of particular products, asset optimisation, derivatives trading and hedging and structured financing transactions. Freight is often treated as a separate commodity where ships can be rerouted to different locations to optimise costs and returns.

Hence, while location has always been an important competitive advantage for the business, the ability to extract value from various parts of the supply chain has made this success factor even more critical.

Singapore has continued to evolve as a popular choice for companies as they seek the advantage of a centralised trading hub experience, including a whole array of infrastructure and incentives: political stability, robust legal system, easy access to financial markets, attractive tax incentives, available talent and high quality business infrastructure, as well as proximity to key Asian markets like China, Japan, Korea and Australia.

For years, Singapore has been a major location for oil trading. Now, this has extended to other commodities like metals, minerals and agricultural products. But over the one year, Singapore made headlines in the industry with news of commodity trading houses like Trafigura, and mining giants like Anglo American and BHP Billiton either relocating or establishing their sales and marketing hubs in Singapore. It is attracting not just major trading and commodity players from Geneva, The Hague and London, but also global consumer goods companies that procure significant amount of commodities.

Opportunities and challenges ahead

However, Singapore needs to continue to evolve to stay in pole position as competition is intensifying from Hong Kong, Shanghai and emerging locations like Malaysia, Dubai and Brazil.

Here are some opportunities and challenges for Singapore to help it to retain its position in trading, taking commodities trading as an example:

- **Provide incentives for companies to build capabilities to enhance value in the supply chain:** While there are many different business models, many commodities trading companies are horizontally expanding and vertically integrating to entrench themselves within the supply chain. Even producers – mining and plantation companies – are setting up their own trading arms. For these companies, centralisation is important for more dynamic supply chain management, as are the ability to achieve synergies across business units and extract efficiencies across each activity e.g. the ability to manage or hedge the cost of procurement on top of the usual approaches to reduce cost, utilise asset optimisation or charter efficiencies. While integrating along the physical commodity value chain can be financially rewarding, it brings with it unique and often, little understood complexities.

- **Greater volatility and the trend towards 'enterprise' risk management approach**
  Activities of commodity companies straddle both physical trades and paper (derivatives). With volatility becoming the new normal in the world of commodity price and foreign exchange, more companies are seeking to manage risks actively. More companies are establishing commodity trading and risk management functions to take pro-active risk management stance to optimise rather than simply "hedge" underlying exposures. Companies typically start their risk management journey with a 'federated' risk management structure (where commodity risks are managed locally by different businesses), then progress to an 'enterprise' risk management approach (which covers the entire supply chain spectrum to enable cost savings, synergies and certain optimisation). Challenges in moving to an 'enterprise' risk approach include agreeing on a common risk management strategy, an appropriate governance and control framework, a clear performance management framework including transfer pricing mechanism, and a robust, information, data and systems architecture, all of which arise because there is typically a lot of autonomy across different functions and product types within the supply chain.

- **Derivative trading regulation**
  Derivatives trading are often an intrinsic component of a commodity trading company – whether as a risk management or proprietary trading tool. However, post the Global Financial Crisis, the G20 pledged to improve market transparency and avoid risk concentration by introducing central clearing and reporting of the much-criticised "opaque" over-the-counter

(OTC) derivatives. New regulations such as the Dodd-Frank Act in the United States, and the European Market Infrastructure Regulation (EMIR) in the European Union, and closer to home, the proposed amendments to the Securities and Futures Act by the Monetary Authority of Singapore would have wide ranging impact to commodity traders, especially the smaller players. The impact includes the readiness of in-house infrastructure, increased cost of trading and hedging, to squeeze cash and liquidity position. While Singapore strives to harmonise with international regulations, market participants hope that the local regulators will provide options and clarity on certain rules like licensing and exemptions which will continue to promote liquidity and the attractiveness of Singapore as a commodities trading hub.

- **More sophisticated financial offerings**
  Access to financing is of utmost importance to trading companies. A super tanker oil shipment for instance could require financing of up to hundreds of millions of dollars. With European financiers reining in some of their lending due to the Eurozone crisis, Singapore with its strength as a financing hub can fill the gap through improving capital markets liquidity, a more diversified investor base and well-developed banking system. Singapore is also the fastest growing bond market in Asia where the financial systems are still very dependent on banks. Singapore needs to continue to broaden and deepen its financial offerings as commodities trading players continue to desire more sophisticated tools like niche insurance underwriters, funding from alternatives sources like commodity funds, private equity, trust structures, joint funding between commodity players and the financial sector and structured trade financing. Further flexibility around withholding tax on interest expense under the Global Trader Programme would also help the larger players sourcing billions of financing globally.

- **Productivity and sustainability of the talent pool**
  No business can thrive without talent. The points raised above show that for every trade executed by the trader, there needs to be an army of support staff to complete the transaction – production, logistics, marketing, settlement, ocean freight management, risk management, treasury, governance, legal, underwriting, accounting and finance just

to name a few. This resource pool needs to comprise of highly skilled and talented people to optimise every activity in the supply chain to produce value and superior return. While Singapore has a ready talent pool for some of the skillsets e.g. ocean freight management (Singapore being one of the world's busiest ports), financial sector talent which can interchangeably work on foreign exchange risk management and treasury, it still needs to continue to grow the talent pool in others areas within the supply chain like asset optimisation, trading, commodity risk management and operations.

Trading, in particular commodities trading, has grown to become an important capability for many global companies. For Singapore to thrive as a leading trading hub, it should continue to take a proactive stance to ensure that a conducive eco-system exists to support businesses and trade flows. Above all, it needs to continue to attract the best talent who understand business complexities in a changing landscape to compete with other emerging hubs.

This article was contributed and first published in The Business Times on 26 Feburary 2013.

Walking on the high wire

Authored by

David Sandison
Tax Partner
(65) 6236 3675
david.sandison@
sg.pwc.com

Great Expectations

It was clear early on that this year's Budget was not going to be of significant interest from a tax technical perspective (unfortunately, as Tom Jones would have said, that's not unusual). On the other hand, it was probably the most anticipated in a general sense, against a backdrop as it was, of a government white paper on population in January, which sparked off the largest public demonstration in the country's modern history, and the announcement of closer economic and infrastructural ties with Malaysia, aimed at, among other things, a high-speed rail link to Kuala Lumpur, the Malaysian capital.

The Budget had to do a balancing act, (and an aerial one at that, given how high the stakes are), between political and economic expediency. On the one side sits a population that is becoming increasingly concerned about immigration, not only from the perspective of "Singapore our Home", but from the fear of an overcrowded Singapore buckling under the weight of sheer numbers. On the other side sit the small to medium enterprises (SME's) who are concerned that turning off the foreign worker tap, too quickly, will damage or even destroy their businesses.

So how did the Budget fare on the population front?

The population issue has of course been the topic of hot debate. So how did the Budget do in this context? In the run up to the Budget, a report suggested "Coming in the wake of the Population White Paper, Mr Tharman's Budget speech at 3.30pm will be closely watched to see how it addresses the issues raised by the White Paper."

Well, anybody who was watching the speech with this in mind will have been somewhat disappointed. Notably, it was almost silent on the issues raised in the paper. In particular, there was no reference to the need to increase the patter of tiny Singaporean feet, apart from some collateral impact there may be from the reduction in the foreign maid's levy from $170 to $120 month (although this is also aimed at the elderly); and the $3 billion projected spending on the pre-school sector (which is aimed more at increasing capacity and quality rather than lowering the costs per se).

However, one area that will of course have an impact on the population – not necessarily the size, but the ethnic mix – is the relentless pursuit by the government (reinforced in this Budget) of enhanced productivity through strict controls on the number of foreign workers allowed into the country. With no apologies to the hardship that certain businesses may experience as a result of these controls, the Minister for Finance gave the thumb screws a further twist this year. Not only is he proposing an increase in, but a sharpening of, the focus of the dependency ratio caps – the ratio of foreign workers to Singaporeans that a company can employ.

Leaving aside the impact on the SME's who may feel the heat, the other side of this of course is to force businesses to increase the use of Singaporeans, if of course they can find one who is not already gainfully and quite happily employed, to do the job required of him or her.

Ultimately, the government is quite right to try to cap the increase in the workforce, as even with this capping, the population will drift inexorably towards the more than six million projected by 2030. Some demographers may say that even this cap is not enough; but the uncontested message is that if labour force growth is allowed to stay at current levels (about 3.9% per annum), the outcome could be significantly more alarming; not only that, the proportion of Singaporeans to foreigners in such a scenario would be quite insignificant.

The other uncontested message is that the population of Singaporean citizens is dwindling, rapidly. Accordingly, continued immigration is a sine qua non for the survival of the country as a multi-cultural cosmopolitan state, or indeed as a state at all.

The last Mohican

In this context, I was fortunate enough to attend a lecture by a world renowned demographer last week, who suggested that Singaporeans should be less concerned than they are about the future of their indigenous population. While a 2.1 birth rate is the target replacement ratio, a country that is increasing the productivity of its population, can continue to grow its economy with a lower fertility rate (1.7 was suggested) through increased educational standards, both within formal education and in the workplace. This is something that Singapore is actively pursuing.

That is fine and dandy, but there are limitations to productivity per head; and if the Singaporean headcount is still falling (albeit more slowly than with the current rate of 1.2), then you end up one day with only one lonely, but admittedly very productive Singaporean. Mathematics at its finest.

Integrate or disintegrate

So controlled immigration is undoubtedly the best and only way forward. As that is a given, the next question that needs to be asked is how to integrate new immigrants, to make them “Singaporean”. Clearly this is a social question and there is really little than can be done in terms of fiscal measures, at least any that have a short term impact. Rather, it is the integration of foreigners’ children into schools and the local environment, that “reverse engineers” itself back to the parents through enhanced contact between parents of different backgrounds. How this process can be enhanced with the help of fiscal measures, is an area to which thought should now be given. No choice, lah.

This article was contributed and first published in The Business Times on 26 February 2013.

The message for businesses

Authored by

David Sandison
Tax Partner
(65) 6236 3675
david.sandison@
sg.pwc.com

Loh Eng Kiat
Tax Senior Manager
(65) 6236 3820
eng.kiat.loh@
sg.pwc.com

More increments in foreign worker levies across the board and a complementary cut in foreign worker quotas for the services and marine sectors will, no doubt, further raise the level of anxiety for affected businesses. We suspect it won't be long before we hear from another restaurant pointing out how no Singaporeans turned up for job interviews for waiters.

Although the tightening of foreign worker supply has stoked a buzz in recent weeks, one should not read these measures as being xenophobic. Rather, as the Finance Minister put it, the key emphasis is on reducing reliance on manpower – as opposed to merely replacing foreign workers with locals – in order to "catch up from a decade of slow productivity growth".

Probably the thought on the minds of many, is whether the underlying message to businesses is to "shape up or ship out". Or perhaps move offshore while retaining some core functions in Singapore (indeed, help is pledged to small and medium enterprises [SMEs] expanding their overseas footprints).

While this could well be the case (indeed, another Minister's recent written reply to a parliamentary question states that "businesses that cannot restructure and adapt... may eventually close down"), one wonders whether some sectors in fact deserve a greater helping hand.

Take the services industry, like F&B for example. Any further weakening could have a knock-on effect on travel and tourism statistics, a not-insignificant part of our Gross Domestic Product (GDP). Despite the recent announcements of infrastructural link-ups, it will take a while to persuade people to have their next fancy meal in Iskandar.

Pain alleviation

There are, of course, many aspects of the Budget aimed at countering the painful effects in this phase of restructuring the economy.
Some, such as the new Wage Credit Scheme, will clearly be of help to many businesses. Other than subsidising the future wage increases of Singaporean employees, it has the benefit of supporting both the SME employer as well as the larger mutinational corporation (MNC) player.

And not surprisingly, given its prominence in the last few Budgets, the Productivity and Innovation Credit (PIC) scheme continues to be given tweaks. The current variant is a PIC bonus, where a dollar-for-dollar matching cash bonus (capped at a certain level) will be given to the extent that PIC qualifying expenditure exceeds $5,000 per year of assessment.

More changes to the PIC scheme are reflected in the annexes to the Budget statement, and it is heartening that some of these changes reflect business practicalities – such as an indication that equipment that is a "basic tool" can qualify for PIC as long as it increases productivity.

In addition, the tried and tested corporate tax rebate will find its way back (as it has done a few times over the last decade or so) to help businesses again. This time, a corporate income tax rebate of 30%, subject to a cap, has been announced for three years of assessment rather than for just one year.

It may be sending a telling sign to the rest of the world that this rebate, coupled with other tax features, means that a small profitable company with $300, 000 of taxable income will, in fact, have an effective tax rate of no more than 5.9%, despite a headline rate of 17%.

This article was contributed and first published in TODAY on 26 February 2013.

Striking the right balance

Authored by

Sunil Agarwal
Tax Partner
(65) 6236 3798
sunil.agarwal@
sg.pwc.com

Charles Collett
Tax Senior Manager
(65) 6236 7224
charles.a.collett@
sg.pwc.com

THIS year's Singapore Budget was labelled a Budget for "quality growth" by the Minister for Finance, Mr Tharman Shanmugaratnam, in Parliament on Monday. In order to achieve that quality growth, the minister's announcements sought to continue a course of economic restructuring by increasing productivity and innovation while improving social inclusion.

For big businesses, some may argue a lack of headline-grabbing announcements, though the key concern for many MNCs could be the continued focus on reducing Singapore's reliance on foreign workers in an already tight labour market. The minister outlined further increases in foreign worker levies, particularly on those less skilled, and reductions in dependency ratio ceilings (which stipulate the maximum percentage for non-Singaporean workers). These measures are aimed at compelling companies and industries to innovate by slowing the growth of the foreign workforce.

Other announcements of interest to big businesses included enhancements to the existing Productivity and Innovation Credit scheme, a corporate tax rebate capped at $30,000 and a Wage Credit Scheme which will subsidise the future wage increases of Singaporean employees.

There was also some tinkering with Singapore's tax incentive regime, mainly to withdraw some outdated incentives and provide enhancements and extensions to incentives in the maritime and financial services industries.

However, many of the changes impacting corporates appeared targeted at small and medium enterprises. A corporate tax rebate of $30,000, for example, may not raise too many eyebrows in the MNC boardrooms. Indeed it seems most of the corporate measures seek to provide generous support to SMEs throughout the government's enforced drive for productivity.

To underline this, the minister's speech highlighted that Singapore's overall productivity is currently only 70 per cent of that of global productivity leaders such as the US and Japan and that this must change with increasing global competition.

However, it was not all good news for SMEs. Mr Tharman bravely admitted that this evolution in Singapore's economy may force some companies to downsize, change industries, or even move abroad. Ultimately, he said, this is how productivity and profitability improves and how the country will achieve a dynamic and revitalised SME scene.

This honest recognition of the potential impact of the government's vision on SMEs may be worrying some business leaders reading their papers today, but the message was clear; shape up or ship out. Singapore does not need inefficient business.

The Budget was also not all good news for the wealthy individual, with enhanced measures aimed at taxing high-end residential properties and expensive cars. Property tax rates for high-end residential properties will increase where their Annual Value exceeds $30,000 and owners of landed property in the centre of Singapore with an Annual Value of $150,000 or more will see an increase in property tax of at least $9,000 per year.

Additional Registration Fees for cars will be tiered so that luxury cars with an open market value of $74,000 will see a 42 per cent increase in the ARF (to a whopping $105,200).

The minister described these measures as progressive, but there may be some individuals who view this as personal taxation by stealth, or potentially even the start of a trend towards a higher personal income tax burden.

Of course, there were other winners in this Budget. The minister's commendable focus on the elderly, ill and low income is targeted at ensuring those in the worst positions to take advantage of "quality growth" will not be left behind. Measures designed to reinforce social safety nets included a review of healthcare financing and improvements to social service delivery.

There were also direct measures to assist with the increasing cost of living such as a personal income tax rebate for all (increased for those aged over 60) and a one off GST Voucher special payment to add to last year's permanent GST Voucher scheme for lower- and middle-income households.

So, while this Singapore Budget was perhaps short on headline-grabbing announcements for the large corporate and the squeeze on labour may continue to be of concern, many MNCs may be thinking it could have been a lot worse considering the tough message handed out to the SME market.

This article was contributed and first published in The Business Times on 27 Feburary 2013.

Another step towards a better IP tax regime

Authored by

Abhijit Ghosh
Tax Partner
(65) 6236 3888
abhijit.ghosh@
sg.pwc.com

Florence Loh
Tax Senior Manager
(65) 6236 3709
florence.ch.loh@
sg.pwc.com

The concepts of innovation, research and development, breakthrough, patent, copyright, trade secret and other intangibles (Intellectual Property [IP]) are lifelines of today's businesses. In an era of accelerating innovation and discovery, businesses recognise that they must maximise the value of their portfolio of IP and strategically manage its usage. Trite but true, and it is therefore not surprising that IP management has become, ever more so than before, a hot topic of discussion for businesses and policy makers around the world, including Singapore. The Singapore Government continues to be committed to this aspect. In 2012, the Ministry of Law set up an IP Steering Committee to evaluate and recommend on the future strategies which will help to enhance Singapore as an Asian IP hub.

Singapore's tax framework has been instrumental in encouraging the creation and ownership of IP up to now. On the Reserch and Development (R&D) front, taxpayers undertaking qualifying R&D activities in Singapore can enjoy 400% tax deductions on their qualifying R&D expenditure (up to $400,000) and under certain conditions, they may even elect to convert some of these costs into a cash pay-out (worth up to $60,000). In addition, writing down allowances over five years is also available for the acquisition of qualifying IP. However, there is currently no specific tax incentive to support corporates which are engaged in exploitation or commercialisation of IP.

Of course, Singapore offers myriad of other tax incentives (requiring negotiation between the interested applicant and the relevant authorities) that could benefit businesses operating in Singapore. However, the need to negotiate for such limited tenure incentives may discourage an IP owner to commercially exploit IP from Singapore. IP management requires up-front investment and one need to appreciate the fact that it involves a lengthy payback period. Returns to IP exploitation are uncertain and typically realised over the medium to long term. For businesses in certain industries (e.g. pharmaceutical, etc.), the lifecycle of their IP from creation through to commercialisation and exploitation can be more than eight to ten years, if not more. By the time it reaches the exploitation stage, the incentive could well be at a point of renewal (where further commitments are required) or expiring. Perhaps a permanent and targeted IP tax regime encouraging exploitation should be introduced to allow the benefits of the incentive to be enjoyed from day one of its exploitation.

A targeted and yet an automatic incentive regime which essentially mirrors the life cycle of IP will facilitate businesses to enjoy full benefits of the incentive when exploitation begins. This can be very appealing to businesses apart from also reducing the uncertainty currently faced by them from an incentive negotiation perspective.

Interestingly, there is an incentive programme under our current tax legislation which is applicable for individuals (or companies owned wholly by these individuals) who are authors, creators, etc., deriving royalties for the use of prescribed IP (e.g. literary, musical or dramatic works). The scheme is available for five years but requires approval from the concerned authorities. Under this incentive program, the chargeable income is deemed to be lower of the net royalties (i.e. after allowable deductions) or an amount equal to 10% of gross royalties. In effect, only 10% of the income from exploitation of the prescribed IP rights is subject to applicable tax.

We believe that with Singapore's continued efforts to be an Asian IP hub, the Government could consider extending the incentive regime for individuals to all Singapore based businesses on a broader scale and hopefully, without a sunset clause. The regime can be extended on a reduced corporate tax rate basis (similar to our tax incentives) or a notional deduction basis (where only a proportion of the qualifying income is deemed as taxable). Globally a number of countries have designed and introduced various fiscal policies to attract, encourage and retain the innovation and commercialisation of intangibles. Countries such as U.K., the Netherlands, Belgium, Spain, Luxembourg, Cyprus and China have in place IP "box" regimes that effectively provide a low tax rate (5% to 15%) for profits derived from IP ownership and management. Whilst some of these countries' strategies could come from a defensive front to encourage retention of locally created IP, introducing a similar IP box tax regime is definitely a measure that Singapore can seriously consider. Given that Singapore has already invested billions of dollars in the R&D space, we believe that it has now reached a stage of maturity that allows it to harness the IP developed or brought in from overseas, and to further encourage exploitation activities in and from Singapore. In UK, the introduction of their patent box regime was cited explicitly as the key reason for GSK to invest £500 million in their first UK factory for almost 40 years, creating up to 1,000 jobs.

Coming back to the IP incentive regime in place for individuals, the programme should also be expanded to make it automatic and the five years restriction should be removed.

Of course, it is expected that in coming up with any new tax rules pertaining to IP-related activities, the Singapore Government will need to constantly review the corresponding efficacy of those rules and make modifications where required, especially in light of the recent tax developments on the need for substance. The incentives should be enjoyed by businesses with bona fide activities in them.

In the challenging global business environment, Singapore must continue to invest in and nurture businesses which commit possibly the most important aspect(s) of their value chain in Singapore. It is an opportune time to consider introducing an IP incentive as discussed above to encourage and support IP exploitation activities in and out of Singapore. This will encourage multinational companies to house, manage and exploit their IP portfolio from Singapore but more importantly, it will also help our small and medium enterprises nurture and develop IP exploitation capabilities and leverage off their IP assets to expand regionally or globally.

Continuing tax challenges in the R&D sphere

Authored by

Elaine Ng
Tax Partner
(65) 6236 3627
elaine.ng@
sg.pwc.com

Shantini Ramachandra
Tax Director
(65) 6236 3823
shantini.
ramachandra@
sg.pwc.com

Another year, another Budget – an opportune time, then, to take stock and reflect upon the issues faced by taxpayers as a result of the key Research and Development (R&D) measures introduced in last year's Budget, as well as other issues that the Government might like to address in this year's.

For taxpayers undertaking R&D activities, last year's Budget tackled two particular areas of concern: the tax treatment of R&D cost sharing agreements and the availability of R&D deductions for expenditure incurred on the development of internal-use software. Whilst the measures were welcomed, there are still concerns with regard to expenditure incurred in both these areas.

R&D cost sharing agreements

With the increasing cost of conducting R&D, many businesses are pooling resources and sharing risks in order to develop advanced technologies through R&D cost-sharing agreements. These R&D cost-sharing agreements more commonly involve cross-border parties.

Certain changes were announced in the 2012 Budget with regard to such agreements and, simply put, these mean that expenditure incurred on R&D cost-sharing agreements may now qualify as expenditure on R&D without the need for prior approval from the Economic Development Board. Indeed, taxpayers that collaborate on R&D projects can now claim:

- Enhanced tax deductions of 400% for qualifying expenditure on R&D activities (subject to an expenditure cap of $400,000) or convert R&D qualifying expenditure (up to a cap) into a cash payout under the Productivity and Innovation Credit (PIC) scheme;

- 150% deduction for the balance of qualifying expenditure exceeding the cap of $400,000 for R&D performed in Singapore; and

- 100% deduction for the balance of all other R&D expenses, including expenses for R&D done overseas.

Whilst these changes are to be lauded, taxpayers face significant administrative hurdles, and therefore cost, in order to take full advantage of them, or risk forfeiting the benefit altogether.

This is because taxpayers who have incurred expenditure under an R&D cost-sharing agreement are now required to submit detailed documentation to IRAS for all R&D projects covered under the agreement, if they incur R&D expenditure of at least $150,000. In multinational organisations, R&D projects are normally numerous, complex and multi-jurisdictional undertakings. Consequently significant resources are required both in terms of money and administrative effort in order to fully collate all the necessary data for all their worldwide projects for submission to IRAS.

We would suggest that where these details are to be provided, a pragmatic option would be for taxpayers to only have to provide details for a representative or statistical sample of the projects in question.

Software development

Prior to the announcement of the 2012 Budget, expenditure incurred on 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 in order 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 announcement of the 2012 Budget, this “multiple sales” requirement was removed.

Whilst the removal of the requirement is a sensible development, there still remains a difficulty in assessing the eligibility of the software development projects for enhanced deductions. The IRAS has published a list of exclusions - however, arguably, these have muddied the waters and made it even more difficult to assess what software development qualifies and what does not.

One option to resolve this may be to provide illustrations of how the exclusions would apply, or (radically) not to have any exclusions at all, and simply rely on the definition of R&D as provided in the Income Tax Act.

Despite the action that has been taken on the above issues, there still remain other concerns that the Government might like to address in the Budget:

R&D partly undertaken in Singapore and partly outside of Singapore

Under the PIC scheme, an enhanced tax deduction of 400% for up to $400,000 of R&D qualifying expenditure is available to companies who perform R&D activities. However, once that limit is reached, an enhanced deduction of 150% of the balance of the qualifying R&D expenditure is only available if the R&D activities are carried out in Singapore.

Some R&D activities must by their very nature, be undertaken partly outside of Singapore. An example of this would be in the pharmaceutical industry where R&D conducted in connection with clinical testing of a new drug often needs to be conducted outside of Singapore, simply because of the required population size for conducting a statistically significant clinical trial. Another example would be oil and gas companies that develop specialised drilling and exploration machinery. Whilst some of the R&D activities can be conducted in Singapore fairly easily, R&D activities in connection with the field testing of prototypes cannot (this would need to be done in, say, the Middle East).

For such R&D expenditure incurred overseas, the taxpayer would be able to claim an enhanced tax deduction of 400% for up to $400,000 of R&D expenditure. But any R&D expenditure incurred overseas beyond that, is only eligible for a 100% deduction, and not a 150% deduction.

In contrast, a company operating in a different industry but with R&D that can be conducted wholly in Singapore would not face any such restriction on the tax deductions available to it.

In both cases the intellectual property is likely to be retained in Singapore. However, when it comes to the question of the amount of tax relief received by each company, there is an obvious disadvantage for the company that, simply by virtue of its industry or the products it deals in, has to conduct part of the R&D activities outside of Singapore.

Our recommendation would be for this anomaly to be addressed. Otherwise, we face a real threat of innovative companies moving out to neighbouring countries which have steadily introduced their own R&D incentive packages. These can be as competitive and in some cases more attractive than what Singapore has to offer. They also enjoy more appropriate larger demographics and geography.

Double deductions for approved projects

In certain situations, the Income Tax Act does provide for a double tax deduction to be claimed in respect of expenditure incurred on R&D projects in Singapore. The projects do, however, need to be approved by the Singapore Economic Development Board (EDB) before the deduction can be claimed.

In practice, few companies make use of this provision in the legislation; whilst it cannot be said for certain why this is so, it is likely that many companies that could benefit from this provision are also likely to qualify for government grants in respect of their activities. As the grants are likely to be more attractive to the companies, these are opted for instead of the double tax deduction.

Given the low take-up rate of this incentive, some consideration should be given to whether the incentive could be differentiated and made more "taxpayer friendly" so as to increase its take-up rate.

The Government has maintained its focus on R&D as a driver for economic growth and the creation of jobs – and clearly this is bearing fruit. Steps have been taken to provide tax incentives to all companies to encourage them to invest in R&D activities. Nevertheless, there are still areas that need to be addressed.

The Government should implement measures that reduce the costs for business of taking full advantage of the incentives, reduce uncertainty, promote clarity in what can be claimed, and remove any anomalies referred to above in the tax incentives system.

Encouraging growth through Mergers and Acquisitions with More & Attractive (M&A) incentives

Authored by

Chris Woo
Tax Partner
(65) 6236 3688
chris.woo@
sg.pwc.com

Jennifer Lee
Tax Manager
(65) 6236 7492
jennifer.cy.lee@
sg.pwc.com

Recent changes to the tax rules that affect mergers and acquisitions (M&A) are positioning Singapore as a more attractive destination for acquisition and holding companies. The M&A scheme is there to help Singapore-based enterprises defray a portion of their acquisition costs. Following that, the introduction of rules to provide definitive guidelines that outline relief from the taxation of gains from the disposal of equity investments seeks to position Singapore ahead of competing locations (such as Hong Kong) for the set-up of holding companies. Such changes have been well received by the M&A market. But the overall tax environment can allow for more fine-tuning so that Singapore becomes even more attractive.

The M&A Scheme

The M&A scheme was first introduced in Budget 2010 and effectively gives a buyer up to $850,000 of tax benefit over five years. It also includes a stamp duty relief for share acquisitions, subject to a cap of $200,000 a year.
Budget 2012 then liberalised the parameters of the scheme and introduced further enhancements such as the double tax deduction on transaction costs incurred, an extension of the scheme to more complex structures and the headquarters (HQ) incentive schemes.

The liberalisation and enhancements to the parameters of the M&A tax rules have certainly helped but are far from a situation worth rejoicing over. The various restrictions however limit the overall appeal of the scheme.

A deal size of $50 million could face costs of approximately $1.5 million given that a deal of this size would warrant the need for financial advisers, lawyers and other professionals. Therefore, while small and medium sized enterprises (SMEs) undertaking smaller value deals through acquisitions may welcome this effort to defray some of their costs, the expenditure cap of $100,000 appears to be unrealistic when considering the larger deals. Also, a company which borrows to fund share acquisition(s) currently cannot get a tax deduction for the interest costs incurred.

To make the scheme more attractive and applicable to the major M&A market players, the scope of coverage on the qualifying transaction costs should be expanded to the full range of pre-M&A activity costs. This should also include interest and borrowing costs which are often significant but continue to remain non-deductible for tax under existing rules. More flexibility could also be introduced to reflect the reality of M&A and provide for more scenarios to promote this as a means to grow and expand.

Taxation of gains from the disposals of equity investments

The introduction of the safe-harbour rule for gains from disposals of equity investments creates confidence to businesses on the use of Singapore as a holding and headquarters location. It has been an issue that has long vexed many investors holding equity through a company in Singapore. This change is a well received movement in response to heavy lobbying to allow for a better business environment.

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 ordinary shares of the company whose shares are being disposed of; and

- the divesting company has held this 20% for a minimum period of 24 months immediately prior to the disposal.

The tax treatment of the gains or losses arising from share disposals in other circumstances should continue to be determined based on a consideration of the facts and circumstances of the case.

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

But there still remain several options that should be considered to enhance the current rules and make Singapore an even more attractive holding location:

- The minimum 20% shareholding threshold is a more stringent requirement than that imposed by the participation exemption schemes in other jurisdictions, e.g. 5% in the Netherlands and 10% in Luxembourg. The same can be said of the 24-month holding period. The Netherlands does not impose any minimum holding period while Luxembourg requires only one year.

- The rule is only applicable to a disposal of ordinary shares. Other types of instrument (e.g. preference shares, rights, options or convertible bonds) do not qualify. This might be a disincentive for certain investors to use Singapore as a holding company location if hybrid instruments are used to better manage their risks or to address certain ownership requirements relating to ordinary shares.

Singapore has certainly taken the right step in introducing this safe-harbour rule. Overall, the scheme appears to be refreshingly straightforward without many complex conditions, but it is hoped that the conditions will be liberalised if it were to be extended after the initial five-year period.

Interest deductions

The interest expense deduction rules continue to remain a significant cost factor to M&A players.

Under the current tax legislation in Singapore, interest costs on debt taken by a Singapore acquirer to finance the acquisition of business assets that generate taxable income is tax deductible. The same interest costs however are not tax deductible if the debt is taken to finance the acquisition of shares in a company that owns the same business assets. This is because dividend income from the shares of a Singapore company is tax exempt in the hands of the acquirer despite the fact that the profit of the investment would have been subjected to underlying corporate tax. In the past under the old “Section 44” franking credit rules, this would not have been the case.

Holding companies should be allowed to deduct their interest costs incurred on the investment in shares against such business income. In order to promote growth, certain rules could be introduced. For example, the deduction of interest costs should be allowed where a holding company meets certain conditions such as additional and substantive new business activities, additional business spending and/or a minimum number of management employees based in Singapore to be placed in the holding or acquiring company.

The deduction of interest costs should not be strictly limited to the nature of income received. Such conditions should also not be as demanding as those relating to current tax incentives that offer reduced corporate tax rates. In a situation where a group of companies are acquired with foreign subsidiaries or affiliates, it may be possible to restructure operations that would allow the Singapore company to derive more profits. This could serve to provide greater value-added activities and employment in Singapore, and help promote additional revenue streams in Singapore.

Given the potential benefits outlined, it is timely for Singapore to undertake a reform on the interest deduction rules to create a more encouraging environment for M&A activity to thrive in. This will greatly facilitate more growth, and position Singapore as an even more attractive destination for acquisition and holding companies.

It is predicted the 2013 Budget will not be about short term measures but to change Singapore for the better and for the longer term. Such measures are not hand-out, but structural in nature. With the right “out-of-bounds” markers the necessary checks and balance can be achieved. It is time to think out of the box and to view such suggestions as a way to sustain growth for Singapore while giving benefits. The end game will result in more tax revenue.

You need to spend money to make money!

Going beyond Singapore for growth

More can be done to help Singaporean SMEs venture overseas

Authored by

Darryl Wee
Executive Director,
Private Client
Services
(65) 6236 7023
darryl.el.wee@
sg.pwc.com

This year's Budget announcement will be watched closely by small and medium enterprise (SME) owners, who have been cheered by Minster of State for Trade and Industry Teo Ser Luck's comments at the recent 26th Singapore 1000 Awards. Mr Teo said that the government would help SMEs maximise productivity, leverage on growth opportunities and create a conducive business environment.

This is welcome news to Singaporean SMEs, which make up 99% of local enterprises, employ 70% of the workforce, contribute over half of the Gross Domestic Product (GDP) – and according to the PwCs' Family Business Survey 2012, conduct 60% of their sales internationally, primarily in the Asia Pacific Region. This figure is set to increase to 69% in five years' time.

For most Singaporean SMEs, the relatively small domestic market means that business growth is necessarily synonymous with expanding overseas. Yet going abroad has its risks for SMEs, which possess fewer resources and even smaller margins of error. With the following initiatives in place, SME owner-managers can more confidently make their first moves abroad.

Leveraging on local knowledge and expertise

One challenge facing SMEs looking to expand overseas is the difficulty in understanding the market they plan to enter. While government agencies regularly facilitate overseas business missions to help SMEs understand local markets better, the end result may lack on-the-ground experience. Personal visits to the country offer a welcome high level perspective of the market, but bestow little awareness of ground level reality.

This issue can be addressed by engaging an experienced local partner which can reliably represent the SME abroad, and working with an established consultant to gain a much-needed ground-level perspective. So far, the grants are already available for SMEs wishing to hire consultancy services to aid in their international expansion, but SMEs could get more value out of the consultants by requesting not just a market assessment, but also insight into the long-term market scenario, including the process of locating and linking up with a strong channel partner.

For SMEs who have little or no experience with third-party consultants, the experience of selecting one to suit their needs can be a daunting one. In a government agency's website, there were up to almost 20 consultants listed as resources, with limited objective information available on each provider's track records, particular areas of expertise, or experience. This squarely places the onus on SMEs to conduct their own research before selecting a consultancy to work with – not an easy task, on top of running their daily business operations. One suggestion is for government agencies to offer a form of grading or criteria list for consultants to meet, in order to help SME business owner-managers make informed decisions. This grading could be supplemented by consolidated feedback and ratings from previous clients who have benefited from the consultants' services.

While government agencies must naturally maintain their objectivity towards third-party entities, providing a recommended shortlist would go far in helping SMEs select the right consultancy to suit their individual needs.

Streamlining the grant process

Mr Teo stated the government's intention was to make its grant and funding schemes "simpler and more accessible to all groups of SMEs, whether big or small", will include trimming application forms and possibly expanding grant eligibility.

This is certainly a welcome move for SMEs, constrained as they are by the manpower crunch. Time and effort formerly spent on filling in paperwork and filing claims can be put to more productive business use.

Yet another idea for streamlining the process would be to further improve the speed at which grant-related claims are processed, as SMEs are particularly vulnerable to cash flow issues. With employee salaries and supplier invoices to pay on a monthly basis, the average SME might balk at having twenty or thirty thousand dollars tied up in claims that take several weeks or months to be released. Expediting the process would allow more SMEs to feel confident that taking up a grant is a strong value proposition – one that won't end up costing them in terms of lost productivity and a choked cash flow.

Beyond traditional sources of capital

Mr Teo also offered some ideas on ways to smoothen the internationalisation path of SMEs. Among other suggestions, he said that inter-company partnerships could be facilitated, or companies encouraged to band together to tap on a network or fund for overseas expansion.

Financing, typically a concern for Singaporean SMEs looking abroad, need not be limited to debt or Initial Public Offerings (IPOs). SMEs can explore other options such as corporate financing or private investor platforms. Government agencies could potentially play a key role in connecting SMEs with companies or consultancies willing to accept a stake instead of receiving cash.

When it comes to heading abroad, investors can contribute essential input on running the business efficiently in an unfamiliar and shifting environment. As professional investment firms are typically helmed by experts who have had extensive experience in guiding business owners and managers, they will be able to help SMEs venturing abroad to grow in a sustainable manner.

At the same time, there is a need for a balance of control between investors and the business owner-managers. Both parties must respect each other's skills and contributions, and work to build a synergistic partnership. In this area, government agencies can play a key role by emphasising more on facilitating these tie-ups, building awareness and educating Singaporean SMEs about the options available to them. Getting financing from private investment has become more acceptable to local companies who are keen to explore ways to fund their long-term development.

With the strengthened support of government agencies via the new initiatives in the Budget, more SMEs can focus on growing their businesses beyond Singapore's shores.

How much social spending?

or Scottish proverb – ask thy purse what thou should spend

Authored by

Koh Soo How
Tax Partner
(65) 6236 3600
soo.how.koh@
sg.pwc.com

A slew of pre-Budget 2013 measures to help improve citizens' lives was introduced by the Government recently.

They ranged from additional public housing units to doubling the rail network lines, enhancements to the Marriage and Parenthood Package as well as beefing up the number of bus services over time. These are on top of the various existing projects that the Government has been rolling out since the last general election in 2011.

In addition, the White Paper on population projected a worst case scenario of a population of 6.9 million in 2030 as a planning parameter to sustain positive and sustainable economic growth. This means that more spending will be needed on infrastructure over the next two decades to help support the weight of the increase in the number of new Singapore citizens and residents on the back of an ageing population.

Although the outlook for the global economic climate remains uncertain and gloomy on the horizon, the Government is unlikely to discontinue its increasing level of social spending, especially when it comes to helping the lower income bracket.

But the long term sources of revenue to finance such spending might be rather limited. One area the Government has to manoeuver in for a bigger revenue stream is Goods and Services Tax (GST).

Prime Minister Lee Hsien Loong has said more than once that the country will have to raise taxes eventually to meet the demands of increased social spending.

When Budget 2013 is presented by Deputy Prime Minister and Finance Minister Tharman Shanmugaratnam on 25 Feburary 2013, analysts will be watching closely for hints as to how exactly the Government will be financing its plethora of public projects and policies.

However, it's unlikely that the Government will readily dip into our reserves, considering the safeguards around them and the sentiment that touching them should only be a last resort.

GST to the rescue?

The GST rate was increased from 5% to 7% in 2007, while the rate of corporate income tax was brought down to 17%. The top rate of individual income tax has remained stable for many years at 20%.

In the long term, it will be unsafe for the government to rely on individual income tax as a source of steady revenue in the light of an ageing population. Neither does it bode well to raise the corporate income tax, especially since the region is getting more competitive when it comes to attracting foreign direct investment.

As it is, some multinational companies have said they are considering moving out of Singapore, according to a recent news report.

The report said a manpower survey by the American Chamber of Commerce showed that 5% of its member companies have shifted out of Singapore and an additional fifteen per cent are looking at exiting the island.

The reason? A lack of manpower since the Government started tightening the noose around foreign labour policies.

So it will not make much sense to raise corporate income tax while the country is losing some of its shine when it comes to foreign investments. Neighbouring countries are fast copying the tax incentive regimes in Singapore and making them slightly more attractive, but nonetheless attractive enough, for a foreign company to be swayed to move to their land.

The taxman cometh

In July 2007, when the GST rate was raised by two percentage points, it was reported that the extra revenue collected would be $1.5 billion each year due to the increase. What the taxman collected for the financial year ended 31 March 2008 was an additional $2.2 billion from GST. For the last financial year, the GST collections amounted to $8.7 billion.

From the total taxes collected in 2000, the proportion of GST receipts was 12.3%.

This figure almost doubled to 23.6% last year, reflecting the rising importance of the GST for social spending by the Government.

No one likes to see taxes go up. But in this economy, it is already a surprise that the GST has been maintained at such a low figure for so many years.

The GST remains an effective and flexible vehicle for the government to drive towards increasing revenue. The various offset measures, some of which have become a permanent feature of the system, such as the GST vouchers, indicate that it is likely that the GST will play an important role in financing many national initiatives and programmes in the long run.

The $3.6 billion being set aside for five years to finance the GST Voucher scheme is also a better and more targeted way to help low-income families, rather than for instance, reducing the GST on essential items. Different people have different notions of what is essential. Besides, there's nothing stopping those in the high income bracket group from benefitting from what is meant to help low income Singaporeans.

Where is the money coming from?

But the Government has said it will not raise the GST. Not before 2016, at least. Unless there are extraordinary circumstances, it is very unlikely that the Government will not stick to this assertion.

Prime Minister Lee said during a speech to the Economic Society of Singapore last year that new streams of revenue will be needed by the country, "not in this term of government, but surely within the next 20 years."

While recent reports have forecast a higher than expected FY12 budget surplus from strong corporate earnings, motor vehicle taxes and stamp duty, the issue is whether these sources of revenue are stable and sustainable over the long term.

Dipping into past reserves is a possibility. However, the first and only time that past reserves have been drawn on was in January 2009 to fund the Jobs Credit Scheme and the Special Risk-Taking Initiative in light of Singapore's worst recession since independence. Will we have to draw on our reserves again? Possibly, but not likely in the near future in the writer's opinion.

So the question that remains right now is whether the government can indeed finance social spending effectively for the next five years without raising taxes?

If not, where will the money come from?

Quality growth, for all?

Authored by

David Sandison
Tax Partner
(65) 6236 3675
david.sandison@
sg.pwc.com

This year's Budget was labelled a Budget for "quality growth" by the Minister for Finance, Mr Tharman Shanmugaratnam, but in a brave step, it also recognised that quality growth may come at the expense of some.

Whilst many may have expected the foreign workforce to be impacted again this year as Singapore seeks to reduce its reliance on them, few may have predicted the Minister would also have a tough message for some Singaporeans. When outlining his measures to press on with the continued drive for productivity and innovation, the Minister stated the government does so in full knowledge of the difficulties this will cause for some companies and industries.

By increasing levies on foreign workers, particularly on those less skilled, and also by reducing dependency ratio ceilings, the Minister hopes to slow the growth of the foreign workforce and compel companies and industries to innovate. To support this, his speech highlighted that Singapore's overall productivity is only 70% of that of global productivity leaders like the USA and Japan, and that this must change with increased global competition in a number of sectors.

He claimed this evolution may ultimately force some companies to downsize, change industries, or even move abroad but this, he said, is how productivity and profitability improves. There was particular recognition of the impact this would have on small and medium Singapore enterprises, with the Minister for Finance saying he wanted a dynamic and revitalised small and medium enterprises (SME) scene. The message was clear; shape up or ship out, Singapore does not need inefficient business.

The message was also clear that the government does not simply wish to replace foreign workers with local ones in its drive to move Singapore's economy forwards. However, some commentators were left questioning how all this reduction in workforce growth reconciles with the recent White Paper on population, and the 6.9 million people projected by 2030 to achieve Singapore's economic growth targets. There were noticeably few mentions of the Paper and how the government intends to balance the social impacts of its contents with its economic goals. Perhaps this was a wise move given the public attention the Paper received.

Some may argue that quality growth may also come at the expense of the wealthy, as a result of measures aimed at taxing high-end residential properties and expensive cars. Property tax rates for high-end residential properties are now set to increase where their Annual Value exceeds $30,000. As a result, high-end property such as a landed property in the central area with an Annual Value of $150,000 or more will see an increase in property tax of at least $9,000 per year. Additional Registration Fees (ARF) for cars will be tiered so that luxury cars with an open market value of $74,000 will see a 42% increase in the ARF.

To call these "Robin Hood" measures may be overstating their effect, but compared to the alternative of increasing mainstream personal income tax rates, these may indeed prove to be more popular with some sectors of Singapore. Other sectors however, may simply view this as taxation by stealth, or even the start of a trend towards a higher personal income tax burden. For now, the Minister's description of "progressive" measures may appear adequate.

Of course there were still some winners in this Budget. The Minister's commendable focus on the elderly, ill and low income is targeted at ensuring those worst positioned to take advantage of "quality growth" will not be left behind. Measures designed to reinforce social safety nets included a review of healthcare financing and improvements to social service delivery. There were also direct measures to assist with the increasing cost of living such as a personal income tax rebate for all (increased for those aged over 60) and a one off Goods and Services Tax (GST) Voucher special payment to add to last year's permanent GST Voucher scheme for lower and middle-income households.

Whilst perhaps short on headline grabbing announcements, few would argue that this Budget did not contain brave and honest recognition of at least some of the challenges Singapore faces if it is to meet the social demands of the population and its economic growth targets. In particular the tough message for SME's may prove difficult for some businesses to swallow.

As such, many may be watching cautiously to see whether or not this actually proves to be a brave step in the right direction.

Positioning Singapore as the region's "digital" hub

Authored by

Greg Unsworth
Assurance Partner
(65) 6236 3738
greg.unsworth@
sg.pwc.com

Sunil Agarwal
Tax Partner
(65) 6236 3798
sunil.agarwal@
sg.pwc.com

As we all experience in our daily lives, the impact of digital technology can be seen everywhere. Whilst advancing technology is impacting organisations as well as individuals, for those companies that can embrace the benefits of new digital technologies and capitalise on the related new evolving digital business models, there are significant opportunities for growth and to expand their reach to new markets and customers. As identified in PwC's most recent Entertainment and Media Outlook, "digital is becoming the new normal" and becoming embedded as "business as usual" for consumers and enterprises alike. Organisations are adapting to evolving expectations of customers, employees and business partners.

Clearly, organisations from the Technology, Media and Telecommunications sectors find themselves at the centre of these changes. Enterprises are gradually embracing the use of cloud based technologies, whilst the dramatic proliferation of smart devices and extensive usage of social media is resulting in the generation of new business models and new ways of engaging with "digital" customers. Traditional media companies and telco service providers alike are rapidly transforming their own organisations whilst at the same time looking to expand their digital and cloud-based offerings. As an example, interactive advertising is growing at a rapid pace in most markets in the world. 42% growth was recorded for Singapore in the most recent Interactive Advertising Bureau (IAB) revenue report which measures the online advertising market in Singapore. This growth in digitally driven business is also bringing in new entrants to the market to compete with established players. This results in more choice for "digital" consumers and increases competition for their "digital" spending capacity. For the media industry, content production is increasingly being developed to cater for multiple distribution platforms and new ways of engaging with their audiences. Licensing and Intellectual Property (IP) rights requirements are restricting the roll out of some content offerings, although the expectations of "anywhere, anytime" on-demand content continue to shape the future direction of the industry.

We also see technology companies at the forefront as the enabler of these changes. Software and solutions companies are moving to service based models enabling more flexibility and agility for organisations in their IT purchasing decisions. Analytics and business intelligence software is being touted as the solution to manage the "big data" challenge allowing huge amounts of data to be converted into meaningful business insight.

What is Singapore's role in the development of these new "digital" business models?

Given these rapid changes with Singapore's excellent infrastructure, pro-business environment and technology-savvy consumer base, Singapore is already currently recognised as an ideal location for Technology, Media and Telecommunications companies to base themselves to address the fast growing markets in Asia. The Government is already focused on these sectors and is doing a lot through funding initiatives, entrepreneur development schemes and incentives for new entrants as well as providing broad based support for technology development and research. The Singapore Economic Development Board (EDB) in particular, plays a key role in attracting overseas investment and helping to promote a vibrant ecosystem for these digitally driven sectors.

Given the expectation of continued rapid change and future technology evolution, what more should the Singapore Government do to promote sustained growth and to position Singapore at the centre of the evolution of digital technologies in Asia?

The upcoming 2013 Singapore Budget provides one avenue for the Government to revisit existing policies and develop new ones to promote growth in these industry sectors. The Productivity Incentive Credit (PIC) scheme is an example of an area which has attracted a lot of attention in Singapore, given its potential benefits to business and its objectives to encourage greater productivity through innovation and use of technology.

However, to really harness growth opportunities and to help Singapore develop a vibrant ecosystem which allows the Technology, Media and Telecommunications sectors to grow sustainably will take a concerted, broad-based, multi-year approach. The following are areas which we believe are of strategic importance that would need to be addressed with a long term view for industry development:

1. **Address regional and global market opportunities**
   Given Singapore's relatively small size, there should be continued focus to encourage Singapore companies to expand their offerings and seek growth beyond our shores. To achieve this, there needs to be effective cross-border collaboration at both a government and enterprise level. This should focus on areas where Singapore has a comparative advantage and can add real value to international markets. There are a number of platforms already established to support this collaboration, although more can be done to help build sustainable regional business ventures and position Singapore at the centre of digital growth in Asia. Increasingly, incentives should be geared to encourage outbound expansion and investment by Singapore companies and there needs to be more platforms developed for cross-border collaboration for Singapore enterprises. For instance, the Government could consider providing deduction of impairment losses from overseas investments and exempt all foreign sourced income from Singapore tax.

2. **Capitalise on Singapore's competitive advantages**
   Singapore is ideally located in a dynamic region with direct access to fast growth markets in China, India and South East Asia. The multi-cultural and linguistic capabilities of Singapore's workforce as well as our world class infrastructure means that Singapore is both an ideal test bed for new technology development and as a hub to promote regional business ventures. The need to capitalise on and promote these strengths should not be underrated in their importance for Singapore to compete effectively in markets that will increasingly need to appeal to "global digital" consumers.

3. **Incentivise innovation and collaboration**
   Given the complexities of new emerging business models, no one company should "go it alone". The Government should continue to develop an ecosystem that supports innovation and business partnering to maximise economic value add for Singapore. Encouraging collaboration between industry associations, government bodies and cross-border business partnering will continue to drive progress, although a multi-faceted approach is required including developing new education programs, expanding creative talent development initiatives and providing business incentives for technology research that supports emerging new digital business platforms. Allowing a deduction for R&D expenditure outsourced overseas for a new business if the resulting intellectual property rights will be owned and exploited from Singapore would attract new research capabilities to Singapore.

Whilst the Government has an important role to play, it is important however, to appreciate that there is only so much that the Government can and should do. The greatest challenge may be in developing the necessary strategic focus required to promote those programs of greatest benefit. The objective should be to develop sustainable growth in these industries and ensure that no sector is overly dependent on Government support. There will also be the need for policies to evolve given the pace of change and the current global economic uncertainties. Technology, Media and Telecommunications companies will also need to embrace these changes and play their part to help achieve strategic objectives and to secure their own future success. In the meantime, the Government will necessarily continue to evaluate the following:

- Funding and incentive plans to encourage growth in key industry sectors and for those areas of greatest potential for digitally driven business
- Policies and incentives to encourage research and development and technology commercialisation through relevant Government agencies
- Encourage cross border business ventures - Government led initiatives such as the Iskandar development in Malaysia is a good example of what can be achieved through cross border collaboration
- Encouragement of international investment in Singapore's Technology, Media and Telecommunications sectors
- Programs to encourage and support mobility of Singaporean talent and development of global business executive talent
- Continued development of creative education programs and workforce development programs

The good news is that digital change presents opportunities for business growth and Singapore is well positioned to be the region's "digital" hub. The Technology, Media and Telecommunications sectors will be at the forefront of these rapid changes and this augurs well for Singaporean companies that seize emerging digital business opportunities in Asia.

Tax accounting – its basics, challenges and the need to get it right

Authored by

Mahip Gupta
Tax Director
(65) 6236 3642
mahip.gupta@
sg.pwc.com

Joan Neely
Tax Manager
(65) 6236 3707
joan.s.neely@
sg.pwc.com

Income tax accounting provides vital information to investors in respect of a company's income tax related cash flows as well as future expectations. Where management fails to adequately deal with the tax accounting, it often results in material weaknesses and restatements. Conscious of this, certain regulators such as the U.S. Securities and Exchange Commission (SEC) have increased their scrutiny of tax accounts, which often involves targeted questioning to various prominent multinational corporations (MNCs).

Financial restatements coupled with increased regulatory scrutiny of tax accounts and related tax disclosures have elevated the focus on tax accounting.

Given above trends, it is not surprising that tax accounting is rated as one of the most important drivers of tax expenditure for buyers of tax services – according to the Global Tax Monitor (an independent global study conducted by TNS – Taylor Nelson Sofres).

Against this backdrop, let us touch upon the basics of tax accounting before turning to its relevance to companies.

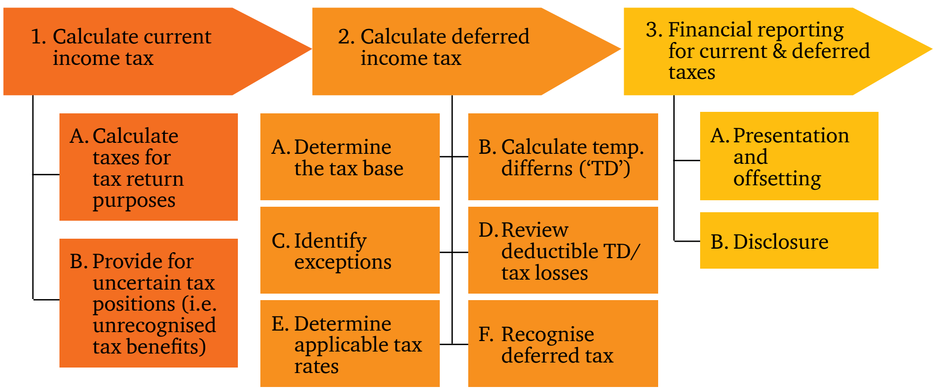
Tax accounting goes beyond mere accounting for the current taxes payable on tax returns, calculated by adjusting book profits with various book to tax differences in accordance with a tax law. Tax accounting basically starts from dissecting these differences into temporary and permanent ones. A temporary difference (TD) has a temporary impact i.e. while it does impact the current tax liability of a given year, such impact reverses in an opposite direction in future periods. A permanent difference (PD) has a permanent impact on a tax liability and causes the effective tax rate to differ from the statutory rate.

The temporary differences could be either deductible (reduces taxable income in the future) or taxable (increases taxable income in the future).

An example of a deductible TD could be a general warranty provision expensed in Year 1 accounts but tax deductible only in Year 2. The future (or deferred) tax benefit from this future tax deduction represents a deferred tax benefit in year one, and offsets the higher Year 1 current tax provision due to the disallowance of the general provision. This benefit is carried on the balance sheet as a deferred tax asset (DTA) and reversed in Year 2, on actual settlement of warranty claims.

Similarly, an example of a taxable TD would be a $100 computer that is depreciated fully for tax but only partly in the books in the first year. This leads to future book depreciation without a corresponding tax deduction (i.e. higher tax profits vs. book profits). This future ("deferred") tax liability is accounted as deferred tax expense in Year 1 and offsets the lower Year 1 current tax provision due to accelerated tax depreciation. The liability is recorded in the balance sheet as deferred tax liability (DTL) and reversed in future.

Besides the above, deferred tax assets/ benefits may also arise from tax carry forwards (such as unutilised tax losses) and accounted for based on their realisability. The chart below depicts a very basic tax accounting framework.



The above mentioned basic concepts apply equally to a simple as well as a relatively complex situation (with some very specific exceptions). Beyond the basics, there are definitely areas that companies may find challenging when accounting for their income taxes. For example, undistributed earnings of a subsidiary create a 'taxable' timing difference in the consolidated accounts of a multinational parent. A DTL would need to be recorded, except where such earnings are indefinitely invested overseas. Quite a few US Multinational Corporations (MNCs) rely on this exception to consolidate foreign earnings without corresponding DTLs. Most Singapore headquartered groups also need to consider this tax accounting aspect in their consolidation.

Another complex yet common area is the recognition of uncertain tax position (UTP). Usually, a company's tax affairs include numerous positions that are subject to varied interpretation. This leads to uncertainty about whether a particular position will ultimately withstand the scrutiny of the relevant taxing authority. Recognition and measurement of tax benefits from UTP is a formidable process requiring in-depth tax analysis and judgment. A Singapore based MNC needs to consider UTP in its Singapore as well as foreign operations to avoid any surprises that may affect credibility of its financial statements.

Recognition of deferred tax assets for tax losses requires weighing positive and negative evidence concerning various future sources of tax profits for the realisability of losses. Besides commercial projections, tax accounting standards allows companies to take into consideration future tax planning strategies such as merger, sale and leaseback, etc. for loss offsets.

Business combinations affects tax and book bases of assets in different ways depending on the transaction structure as well as jurisdictions involved. Addressing this from a tax accounting perspective could be quite complex yet very important to avoid material misstatements of financial statements post restructuring.

Tax accounting also deals with differences in two sets of accounts that large corporate groups prepare – the statutory set filed with local authorities and the Generally accecpted Accounting Principles (GAAP) accounts for group reporting (per International Financial Reposrting Standards [IFRS] or US GAAP). While the tax accounting conceptual framework is generally similar across different countries and accounting standards, there are certain key differences amongst local, IFRS (IAS 12) and US GAAP (ASC 740). As countries around the world continue to adopt IFRS, due analysis is required to assess the potential accounting and tax implications and plan accordingly.

At the end of the day, after addressing the numerous issues that may arise, the standards surrounding presentation and disclosure of the tax accounts is crucial as investors and regulators alike will be keen to analyse and scrutinise. For example, entities preparing their financial results for the interim periods will need to follow the respective tax accounting guidance which deals with determination of annual effective tax rate and separation of discrete items.

Lastly, with the announcement of a number of budgets looming, Singapore MNCs should take care to be updated on budget tax rates and other law changes as these may have an impact on both the current tax and deferred tax balances.

Intimidating on the surface, the above is only a sneak peek at the long list of issues (some basic, some complex) that a company may encounter when accounting for their income tax. Given the spotlight that tax accounting has gotten in the last decade coupled with today's regulatory landscape and constantly evolving accounting and tax standards, many companies may discover that they do not have the controls, processes, technology or resources to cope with the increasing demands. Rather than taking a reactive approach, companies should see all this as a compelling catalyst for action – proactive planning and optimisation of resources are key to overcoming these challenges.

Tax challenges and opportunities for foreign law firms in Singapore

Authored by

Shantini Ramachandra
Tax Director
(65) 6236 3823
shantini.
ramachandra@
sg.pwc.com

Leng Harn Szuan
Tax Manager
(65) 6236 3711
harn.szuan.leng@
sg.pwc.com

For a number of years now, Singapore has been trying to position itself as the Asian legal hub. To achieve that aim, it has been necessary to open up the local legal market to a certain level of international competition. To ensure that the local legal industry is not "cannibalised" by incoming foreign law firms, the government opted to introduce competition in a slower and steadier manner. Other than the regulatory changes, tax incentives have been introduced with the hope of attracting certain international legal activities to Singapore. This article looks at how the current provisions measure up and whether more can be done.

Key developments in 2012

A number of things happened in 2012. It was a rather eventful year for Singapore's legal sector, with many existing schemes enhanced. In June, it was announced that there would be greater flexibility for foreign law firms working with Singapore law firms. With these policy changes, there is now increased scope for collaboration between foreign law firms and Singapore law practices, and the path has been eased for foreign law firms that wish to take a greater profit and equity share in a Singapore law practice. In July and August, the second round of the Qualifying Foreign Law Practice licence was opened for application and the results were just announced – four global law firms have been awarded the licence. On the tax front, in December, the Income Tax (Amendment) Act 2012 was passed, with enhancements made to the International Arbitration tax incentive.

Tax challenges

On a day-to-day basis, foreign law firms in Singapore, whose clients are generally offshore, do face a common tax issue – foreign withholding tax, or rather, the rate that should be applied. It is not unusual for clients in certain foreign jurisdictions to withhold tax on legal fees even if the tax treaty between Singapore and that jurisdiction provides for certain treaty benefits requiring no withholding. Even where the foreign law firm is set up as a tax resident company, claiming the foreign tax as a credit against Singapore tax payable can be challenging as typically such legal fees are considered to be locally sourced income.

For foreign law firms constituted as a limited liability partnership, the problem is compounded. It is doubtful whether a partnership has access to Singapore's wide network of tax treaties (although the individual partners should be able to rely on the treaties signed by their country of residence). This is because partnerships are see-through entities for Singapore tax purposes and they are therefore not considered to be persons for tax treaty purposes. A partnership therefore generally faces the prospect of cash-flow issues and double taxation.

It is for this reason that some partnerships have been toying with the idea of converting into a company. Unfortunately, there seems to be no easy fix to this problem.

This is not the only worry for a foreign law practice constituted as a limited liability partnership. One other notable area of concern is the administrative tax filing aspect. As a partnership is tax transparent, it has to file a tax return (Form P) with the Inland Revenue Authority of Singapore (IRAS). This allows the profit or loss of the partnership to be allocated to the partners accordingly. To illustrate the concern, let us assume that a foreign law firm sets up a limited liability partnership in Singapore and registers all its individual partners, local and foreign, as partners of that partnership. The Singapore partnership would have to file Form P, and strictly, each partner would have to file their own tax return to declare their share of the tax-adjusted profits or losses. You can imagine the chaos created for a partnership with 200 partners scattered globally. Fortunately, and as an administrative concession, it is possible to request the IRAS to waive the tax return filing requirement for all non-resident partners. In return, the Singapore income tax liability of the non-resident partners will be paid by the nominated "precedent" partner of the Singapore partnership at that level.

In reality, it is more common to see a Singapore partnership being set up with the foreign law firm, and an individual nominee partner, as partners of that Singapore partnership. The IRAS has been known to require the foreign law firm (where set up as a foreign partnership) to file a partnership tax return in Singapore. From a tax collection angle, income tax would have been paid by the precedent partner of the Singapore partnership on all taxable income allocable to the non-resident individual partners. It seems unduly cumbersome if the foreign partnership also has to file a partnership return when in essence, the effect is much the same. It is hoped that the tax filing procedures can be streamlined further. This would be another step towards making paying taxes an easier task in Singapore.

Impact of current incentives for law firms

The other aspect where a partnership is disadvantaged is when it comes to the International Legal Services incentive, a tax incentive targeted at foreign law firms. This incentive is available only to corporate entities. A limited liability partnership may still apply for the incentive but it means incorporating a separate entity. The Ministry of Finance explained that this scheme is a concession for corporate income tax and is not meant to result in concessions for individuals. However, it is not entirely clear why there should be a distinction drawn based on the legal form of the foreign law practice. Most of the foreign law firms in Singapore are headquartered in the UK or US, and the majority of US and UK law firms are structured as global partnerships. Therefore, for various regulatory and tax reasons, a limited liability partnership is usually the preferred structure of choice for these global partnerships looking to expand overseas. A limited liability partnership is also a structure that the global partners know, understand and are generally most comfortable with. It is hoped that some thought can be given to extending this incentive to limited liability partnership structures as otherwise a significant number of foreign law firms in Singapore would be disadvantaged.

With the global trend leaning towards arbitration, the government has been promoting Singapore as an international arbitration seat. A tax incentive, the International Arbitration incentive, was first introduced in 2008 with the objective of encouraging law practices, local and foreign, to increase the service offerings for international arbitration with substantive hearings held in Singapore. The incentive allowed a 50% tax exemption for qualifying income exceeding a base amount, derived from international arbitration cases which culminate in substantive hearings in Singapore. The definition of qualifying income was rather restrictive initially – it covered only income derived from the provision of legal services in connection with international arbitration where the seat of arbitration was in Singapore. This was the general feedback from the legal fraternity.

Under the Income Tax (Amendment) Act 2012, this definition has been widened to include income from international arbitration cases, which but for a settlement, would have been heard in Singapore. Some might say that the amendment has not gone far enough. The reception might still be lukewarm as, for the incentive to apply, the arbitration must be heard in Singapore or would have been heard in Singapore but for a settlement. That limitation aside, some in the industry note that there could potentially be a conflict of interest if a law firm enjoying this incentive were to recommend to their clients that the arbitration seat be in Singapore. While it could well be that Singapore is indeed the more suitable arbitration seat for a particular matter, there is a risk that the law firm could be perceived as being biased. One way to allay that concern would be for the incentive to cover income from all international arbitration so long as the preparatory work is substantially done in Singapore. The downside is that this runs counter to the government's express wish of promoting Singapore as the chosen arbitration seat.

While steps taken to draw international law firms to Singapore have met with significant success, more can be done to address some of the local tax concerns of these foreign law firms. In addition, there should be more focus on tailoring the tax incentives to take into consideration the requirements and concerns of the foreign law firms in Singapore.

Tax changes to encourage self-provision through insurance

Authored by

Yip Yoke Har
Tax Partner
(65) 6236 3938
yoke.har.yip@
sg.pwc.com

Singapore is not a welfare state. In fact, it is quite the opposite. The Singapore government believes in encouraging individuals to make provision for themselves and their families and, wherever possible, not to rely on social welfare. That means individuals need to set aside money and save for old age, for retirement, for possible loss of a job and for unexpected events that can bring financial hardship like major illnesses, hospitalisation or death of a breadwinner in a family.

Saving for that rainy day requires discipline and few individuals have the ability to consistently set aside funds and not be tempted to touch them. Buying insurance however, is one means of encouraging such “enforced savings”. And this is where life insurance and health insurance policies have an important role to play. If individuals could be encouraged to take up cover against unexpected events like major illnesses, hospitalisation or unexpected death or disability of a breadwinner in the family, it could go a long way to reduce the reliance and burden on the community and the government, as ultimately, if individuals and their families cannot provide for themselves, the burden will fall on the community at large and the government.

The following ideas are some suggested changes that can be made to the tax rules to encourage higher take up of insurance policies:

1. **Zero-rate medical and health policies**
   Medical and health policies are currently subject to goods and services tax (GST) of 7%. We suggest that they should all be zero-rated (i.e., 0% GST). The consequent 7% reduction in costs would make the cost of purchasing medical and health plans cheaper, thereby providing an incentive for individuals to invest and provide early for their own healthcare.

2. **Zero-rate life insurance policies**
   Life insurance policies are currently exempt from GST. While exemption and zero-rating may seem the same at the policyholder level (no GST is charged on premiums in either circumstance), the practical reality is that exemption (as opposed to zero-rating) could result in a higher cost structure for insurance companies, which could in turn affect the level of premiums charged to policyholders.

   In the course of its business, the insurer incurs GST input tax when it makes purchases from GST-registered persons. Other than employee salaries and commissions paid to non-GST registered agents/brokers, most expenses and purchases of a life insurer could be subject to GST, including, say, office rental, utility bills, advertising, printing, etc. From the insurer's perspective, he would be able to recover all the GST suffered if the particular insurance business is either standard rated (7% GST) or zero-rated (0% GST). However, if the business is exempt, as life insurance is, the insurer would be unable to recover the input tax suffered on purchases made in connection with his life business. Effectively, the inability to recover GST suffered on purchases would mean a higher cost structure for insurers, which is inevitably passed on to the consumer.

   Our recommendation is that all life insurance policies should be zero-rated. Doing so would mean corresponding cost savings to life insurers that can hopefully be passed on to policyholders in the form of lower premiums.

3. **Overhaul the deduction provision for life insurance premiums**
   Currently, a deduction for life insurance premiums under Sec 39(2)(g) of the Income Tax Act is, amongst other limitations, subject to the following conditions:

- The deduction is available to a taxpayer who has made insurance on his life or the life of his wife; (note that this is rather discriminatory as a wife would not be entitled to a tax deduction on a policy taken out on the life of her husband).

- For a policy securing a capital sum on death, the deductible amount cannot exceed 7% of that capital sum. "Capital sum on death" in this instance generally refers to the lump sum payable by an insurer under a policy upon the death of the insured.

- The maximum deductible amount annually is $5,000. However if CPF contributions (plus other approved pension payments) are made by the taxpayer, the deduction available for life insurance premiums will be reduced by the CPF contributions concerned. Effectively, any taxpayer making CPF contributions in excess of $5,000 a year will not be able to enjoy a deduction for life insurance premiums.

To encourage individuals to make provision for themselves and their families, I suggest that the deduction provision for life insurance premiums be overhauled in the following manner:

(i) Delink deductions for insurance premiums from contributions to CPF pension funds. Allow a deduction of $5,000 per year for insurance premiums irrespective of whether the taxpayer has made a contribution to the CPF or another pension fund;

(ii) Expand the deduction beyond life insurance to include other policies such as accident policies, medical policies and health policies to the extent that the relevant premiums are not paid from Medisave;

(iii) Remove any restriction pertaining to capital sums; and

(iv) Allow the annual deduction to a taxpayer paying premiums on a policy on his or her life, on the lives of his or her spouse and on the lives of his or her children or parents. The same deductions should be available irrespective of whether the taxpayer is a man or woman.

4. **Exempt all life insurance payments**
   All payments and proceeds made on life insurance policies should be tax exempt. The tax law should be clear on this and ensure that there are no taxes at the life insurance company level that can indirectly tax these pay-outs to policyholders.

   Singapore is ageing, and the issue of the provision of long term care for its citizens is of utmost importance. Life insurance and health insurance has an important role to play in encouraging individuals to provide for themselves and their families. While there are currently schemes to encourage such self-provision, we are of the view that more can be done. Although tax incentives are not the only answer, the right fiscal policies can influence behaviour in the right direction.

Tax management in the dark: How do you see the light?

Authored by

Koh Soo How
Tax Partner
(65) 6236 3600
soo.how.koh@
sg.pwc.com

Lim Kexin
Tax Manager
(65) 6236 3665
kexin.lim@
sg.pwc.com

Once again, the Budget season casts tax in its annual limelight. In the excitement of possible new incentives, schemes and reliefs, one should not forget the risks that could be associated with managing your company's tax affairs. Are you in the dark about tax? If your tax footprint is a black box to you, how can you manage your tax risks?

The question may not be whether you want to comply with your tax obligations (we assume you do), but whether you know how to. In order to properly address compliance issues and develop the appropriate tax strategy, management needs access to information on all the taxes the business bears and collects. It only seems logical that management should not be left groping in the dark. Yet, observers may be surprised at how few taxpayers have clarity over their overall tax position when it can be such a significant line item.

For many Singapore-based businesses, the tax risks go beyond local shores. Many manage regional operations from here and Singapore is far from being the only jurisdiction with a changing tax environment. Complex and often unclear tax rules, aggressive tax authorities and significant tax rates in Asia add to a regional controller's headaches. Businesses are often overwhelmed by the rapid pace of change, lack of in-house tax resources, and handicapped by limited experience in tax disputes. If you think your Singapore tax matters are a grey area, then your Asian tax matters could be a complex web of dark matter.

Measurement also goes beyond the obvious corporate tax bill. The World Bank-PwC Paying Taxes study 2013 found that on average, corporate income tax is only 36% of a business' overall tax cost globally. Other tax costs may consist of indirect, property and labour taxes. The proportion of each tax type varies with the operating environment and varies with each taxpayer's profile. It will be difficult to gauge your actual overall tax footprint without a proper measurement framework.

What's more, the devil is in the detail. Even if you get your territorial and type of taxes right, you may still get, for instance, the classification of income and direct expenses to different tax rates wrong. In a tax incentive-filled world like Singapore, businesses have always been expected to meet and maintain compliance requirements before qualifying for tax incentives. Obtaining a tax incentive goes beyond the (sometimes) attractive concessionary tax rates available. With great incentives, come great responsibilities. Tax incentives require compliance with detailed conditions applied to complex practical situations, the process of which management may not be familiar with. As they say, there is no such thing as a free lunch.

What happens if you get tax wrong?

These are but some ways to trip up if businesses do not have clarity over their own tax matters. Tax authorities expect taxpayers to get their house in order. Implications of non-compliance could be severe and costly.

Take Singapore as an example. The Inland Revenue Authority of Singapore (IRAS) is revising its focus on tax management and compliance, and linking it to certain tax reliefs or incentives. On the Goods and Services Tax (GST) front, GST-registered businesses who wish to apply or renew this Major Exporter Scheme status (MES) to enjoy relief from import GST have to undergo an Assisted Self-Help Kit (ASK) review from 1 January 2013. Businesses who fail the ASK review may not be granted or extended MES status.

For income tax, IRAS is stepping up review of key risk areas. It is scrutinising the classification of income and direct expenses for incentivised businesses, issuing health-check questionnaires and more in-depth queries. Hefty penalties of up to 200% (or more) of tax underpaid and/or disciplinary action can be imposed when errors are discovered.

Conversely, carrots are dangled to encourage taxpayers to self-assess and self-correct their tax ”oversights”. The Assisted Compliance Assurance Programme for GST is partially subsidised to encourage businesses to self-assess their controls and enjoy auto-renewal of certain relief schemes. Another initiative - IRAS’ multi-tax Voluntary Disclosure Programme, offers reduced penalties of 0% or 5% (a good deal compared to 200%) of tax underpaid and was enhanced as of 1 January 2013 to encourage taxpayers to step forward with self-initiated correction of errors.

How then, do you see the light?

Much as businesses may wish to manage their tax affairs, the task may prove challenging until they have clarity over their tax liabilities and risks.

As awareness grows, more businesses are seeking ways to provide management with regular and comprehensive updates on their tax footprints. Some have relied on tried and tested frameworks such as PwC’s Total Tax Contribution (TTC)[1] methodology to measure and analyse all the taxes and contributions borne and collected locally, regionally or globally.

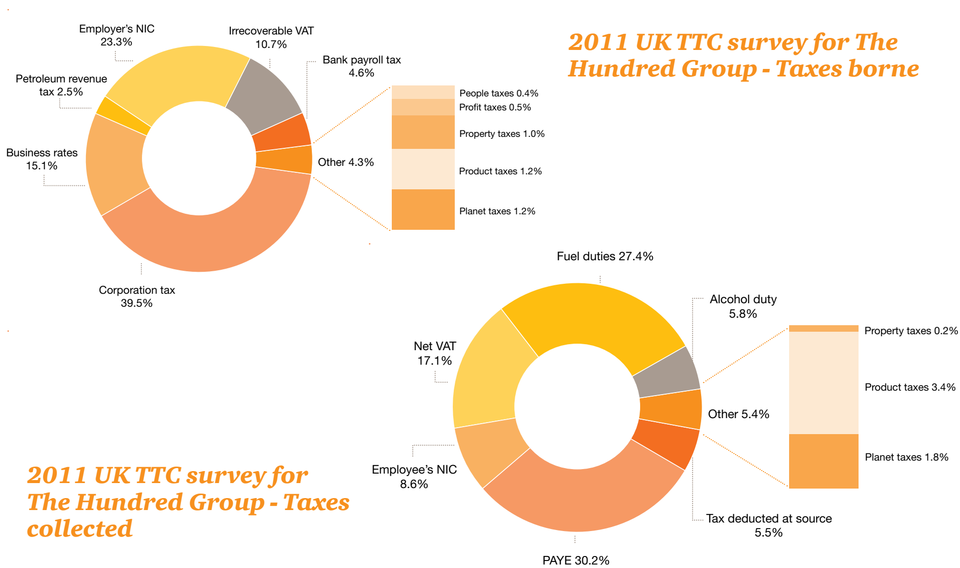


Figure 1: Example of an overview of the taxes borne and collected from PwC’s 2011 Hundred Group survey (an annual study of the TTC for UK’s hundred largest corporations).

[1] TTC is an economic study of a business’ overall cash-tax footprint borne and collected as well as the associated resources spent on corresponding tax management.

Whichever method used, a robust methodology provides visibility of potential tax planning areas and expected tax costs (i.e. light!). It allows businesses to anticipate, analyse and plan for timely action to correct errors. It facilitates dialogue about whether each tax type is managed and adequately resourced with the right expertise in each jurisdiction. It allows benchmarking to peers where data is available. TTC users also often leverage on findings to provide regular updates to their directors (and in some instances, the public) on their comprehensive tax positions.

At the end of the day, managing your taxes is simply a matter of good corporate governance. If not done, or done poorly, the implications can be costly. Measurement is the first step to illuminating the way forward in a complex tax terrain. So, if you have not yet started measuring your tax footprint (and if you do not want to trip over in the dark), it is timely to have that discussion sooner rather than later.

Winds of change in the new (tax) world order

Authored by

Tan Tay Lek
Tax Partner
(65) 6236 3768
tay.lek.tan@
sg.pwc.com

Loh Eng Kiat
Tax Senior Manager
(65) 6236 3820
eng.kiat.loh@
sg.pwc.com

It seems almost a Mayan apocalypse for the (professional) world of tax advisors, given the heavy siege the profession finds itself under. The Western press has been prolific in reporting criticisms of corporate tax planning. To those following the news of the likes of Amazon, Google and Starbucks being called on by British lawmakers to explain their "immoral" tax planning practices and for not paying their "fair" share of tax in the country, it would be of no surprise that the UK tax chiefs from the Big Four accounting firms were not spared, having been called to attend similar hearings in January.

British Prime Minister David Cameron has indicated that stopping "unfair tax farming practices" is right at the top of (his) agenda for the G8 this year and recently, US President Barrack Obama delivered his annual State of the Union address with a heavy emphasis on reforming the US tax code – "...The American people deserve...a tax code that lowers incentives to move jobs overseas...". The Organisation for Economic Development and Cooperation, with the support of the G20 and various other governments, has just released a report on "Addressing Base Erosion and Profit Shifting" and committed to the development of a comprehensive action plan to address the issue.

In Asia, the fear of losing tax revenues is increasingly pervasive in some emerging economies (although manifesting itself in different ways from those in the West/developed economies). An example would be China's (infamous) Circular 698, which seeks to impose extraterritorial taxation for indirect transfers of shares in Chinese resident enterprises. The Indian authorities also upped the ante by proposing to change tax laws retrospectively (by more than 50 years!) in an attempt to undo a significant revenue loss in the courts. And so it would appear that the tax world needs to gear itself up for major reform.

With the Singapore Budget 2013 set to be announced very soon, we are tempted to indulge in a bit of crystal-ball gazing and predict how these international developments could influence Singapore's tax policies in the years to come.

Tax competition amongst countries will intensify

Probably still insidious in the minds of many is the concept of "harmful tax competition" by some countries. With our relatively low headline tax rates and a plethora of tax incentives, Singapore is on the radar screen of politicians looking for a culprit to pin responsibility for job losses at home (see Senator Bernie Sanders' report on corporate tax dodgers at http://www.sanders.senate.gov/imo/media/doc/Tax-Dodge-Report-3.pdf). It is a continuous struggle to ward off such characterisation and retain legitimacy – while we can extol enthusiastically the merits and fairness of our tax incentive regime (e.g. stringent screening of substance-based criteria for applicants, forfeiture of benefits for failure to meet the relevant business commitments, etc.), it will be hard to change these perceptions.

However, while the race to the bottom for the lowest headline tax rate may possibly be over, countries do and will continue to engage in tax competition. This may now evolve through the introduction of specific and targeted tax regimes (e.g. the "IP box regime" which seeks to provide an effective lowered rate of tax on income specifically associated with intellectual property). In the same way commercial businesses compete with one another, so Singapore has to be creative in setting its tax policies to attract investments. For reasons already stated, offering a reduced rate of tax looks to be an increasingly untenable proposition. Novel tax measures such as the Productivity and Innovation Credit scheme can be enhanced and extended to cover other business costs that can bring strategic benefits to the economy, such as key talent acquisition, sending employees for higher education or allowing tax deferrals for profits reinvested into the country.

To continue attracting investments into Singapore, we have to develop a more holistic approach to attracting businesses using non-tax measures which complement our already attractive tax regime, for example, developing our corporate legislation to create new legal entities that can answer modern business needs, and easing conditions for extending government financing to start ups.

While Singapore's tax reforms are unlikely to be as controversial or draconian as those in other countries, knowledge of these regional developments (and any associated backlash) should certainly help benchmark our own competitive tax reform initiatives.

Tougher tax treaty terms

We also think that Singapore could find itself in tough negotiations on the formulation of tax treaties. To-date, Singapore has close to 70 comprehensive treaties (with a few more pending ratification), each of which is meant to prevent double taxation of the income of taxpayers in the two (treaty partner) locations. Inherent in many tax treaties are features which can prevent a taxpayer from enjoying those very benefits accorded under the treaties unless certain conditions are fulfilled. These are commonly referred to as "limitation of benefits (LOB)" clauses. While these can take various forms (e.g. the existence of some prescribed level of in-country substance for an income recipient), the LOB clauses contained in Singapore's tax treaties are relatively more benign compared to those more commonly seen in the West. For example, dividends earned from a foreign subsidiary by a Singapore taxpayer could be exempt from tax in Singapore, but where the counterparty country (in which such subsidiary is based) imposes tax on such dividends, a relevant tax treaty could potentially reduce the (foreign) tax to be imposed. A critical way of looking at this is that there is no "double taxation" to speak of. Instead the treaty partner has now become obliged to reduce its tax collection as a result of the treaty.

To be clear, many commentators have in fact expressed the view that Singapore ought to initiate renegotiations for some of its existing tax treaties and seek to improve some of the terms. However this could clearly become a double-edged sword if stricter LOB clauses are introduced into existing tax treaties (with many of the counterparty countries becoming more competitive and aggressive) while not providing any enhanced treaty benefits. More complicated rules for entitlement to treaty benefits could be progressively introduced into Singapore's tax treaties. The Inland Revenue Authority of Singapore would also be pressured to closely scrutinise an application for a certificate of Singapore tax residency, to avoid accusation of being lax in enforcing treaty requirements.

Tax reform – a key political agenda

In many developed economies in the West, the tax reform agenda is already taking on keynote significance and is not merely consigned to footnotes to an aspiring politician's pledge.

"An end to tax loopholes for multinational companies" slogan could well fortify German Chancellor Angela Merkel's election-year themes, while French President Francois Hollande has been branded an "amateur" and compared to the emperor with no clothes, after his flagship 75% tax rate for France's richest was ruled unconstitutional.

In the context of Singapore, the key premise of our tax policy has been low direct tax rates and simplicity of rules to attract foreign businesses/multinationals. Going forward however, any tax measures seen as being too "pro-big businesses" would need to be carefully considered and well communicated. To do otherwise would risk incurring public or even international displeasure and possibly lead to a furore like that seen in the recent debate on the Population White Paper.

Conclusion

So we were wrong about the Mayan calendar and the world has not quite ended, yet. And while we are neither clairvoyant nor have 20/20 foresight, we do believe that the tax world surrounding our professional lives will continue to evolve at a relentless pace and the stakes will just get higher!

Wiring ahead

A look at how some tax rules can be tweaked to support the Infocomm industry

Authored by

Sunil Agarwal
Tax Partner
(65) 6236 3798
sunil.agarwal@
sg.pwc.com

Loh Eng Kiat
Tax Senior Manager
(65) 6236 3820
eng.kiat.loh@
sg.pwc.com

It is no big secret that telecommunication companies ("telcos") worldwide are heavily regulated. Operating in their inherently complex business habitat, there is an unending quest by them to achieve certainty and sustainability in their business models. As the players evolve their offerings beyond traditional telephony, the complexities could of course well be exacerbated. In Asia Pacific markets, new technologies and rapid adoption of broadband are necessitating "technology-neutral" regulation (a theme not lost on the rule-makers).

Clearly, the tax framework in which telcos operate in, forms another regulatory aspect which cannot be ignored. A benign set of tax rules according long-term certainty and reduced tax costs, will undeniably be supported by the industry players. We look at some of the possible areas in which the Singapore tax rules referable to telcos can be refined in support of their business.

Withholding tax

Many telcos use submarine cable capacity due to its continued reliability. However, modern cables using fibre optic technology cost hundreds of millions of dollars to construct and lay. With the significant cost involved, there will be numerous telcos (e.g. some facilities-based operators ["FBOs"]) which do not build/own their international telecommunications submarine cable system, but instead purchase bandwidth capacity through an Indefeasible Right of Use ("IRU") arrangement.

Just a few days ago, we were staring at the possibility of a Singapore-based telco having to factor in a 15% withholding tax for its future IRU payments to a foreign (non-resident) vendor. This is because the Singapore tax authorities (IRAS) appear to regard such payments to be “rental for the use of movable property” (“rentals” in short) but for the last ten years (specifically from 28 February 2003 to 27 February 2013) they have granted a withholding tax exemption for such payments. Today, thankfully the understanding is that the above-mentioned possibility of 15% withholding tax on IRU payments would not materialise just yet as according to the IRAS (via an update in their website posted on 21 February 2013), the relevant exemption has just been extended for another five years till 27 February 2018.

Good news for many but a couple of points may still be worthy of critique here, particularly if one is keen to look beyond the next five years (and why not, especially when it is not uncommon for IRU contracts to be for 20 years or possibly even longer).

Firstly, is it so glaringly obvious that IRU payments (without doubt) constitute “rentals”? The IRAS seem to believe so (for the next five years at least) and in the context of taxing the vendor, their distinct reticence in treating such IRU payments as being for “services” will thus remain for now. The relevance from a Singapore corporate tax perspective is that the tax referable to “services” could either be (i) NIL (e.g. if the underlying activities are not even performed in Singapore) or (ii) taxed on a “net” basis (i.e. tax deduction will be allowed for the vendor’s expenses referable to its income taxable in Singapore). On the other hand, having the IRU payments treated as “rentals” would mean that a foreign vendor does not get a tax deduction (in most cases) for its expenses and the taxability of their receipts will be heavily contingent on whether (and to what extent) the IRAS continues to grant the above-mentioned withholding tax exemption. There is no guarantee that this exemption will be renewed again and again. Of course, while the foreign vendor now knows what to expect for the next five years, this timeframe may be seen as relatively short-term in the context of the typical length of IRU contracts. So while the short-term reprieve accorded by the extended exemption is definitely not to be scoffed at, a longer-term certainty continues to be clamoured for. And possibly, this can be attained via a permanent (as opposed to time-based) withholding tax exemption for IRU payments or alternatively through adoption of a more nuanced approach in characterising the payments rather than a perfunctory leaning towards calling these “rentals”. On the latter point of the characterisation issue, we note that this remains a complex issue for accounting purposes (i.e. distinction between IRU contracts as being for “lease/rentals” or for “services” remain a key foundational question to be addressed based on each contract’s underlying facts and circumstances). If the accountant is not immediately convinced one way or the other, why should the Singapore tax treatment be so decisive as to categorically dismiss that IRU payments are definitely not wholly for “services” (leaving aside the argument that tax treatment need not always follow accounting treatment).

To end this first point and without going into too much technical debate on whether/how to properly characterise IRU payments, we would just briefly point out that IRU payments could well fall into other categories not earlier described above. For example, there is no clear reason why part of the payments cannot be regarded as being in the nature of “interest” (rather than “rentals” for instance), if the IRU arrangement is in fact structured more like a finance lease (as opposed to operating lease) type of arrangement. This may be academic in light of the ongoing exemption but the practical effect could be very significant if the exemption expires one day.

Secondly, if one were to concede in some years’ time that Singapore withholding tax should indeed be suffered by the foreign vendor, a potential 15% tax bill (which would be the case if today’s withholding tax rates were to be applied) on the gross receipts does seem very high, considering that this will be the final Singapore tax for the vendor. Our corporate tax rate for Singapore-based businesses is currently 17%, and the effective tax rate can be very much reduced after factoring in deductible expenses, exemptions, etc for these businesses. With such a headline corporate tax rate of 17% (as compared to years gone by when say a 40% headline rate for corporates was in place), a final 15% withholding tax rate is no longer representative of the effective tax rates on (deemed) net income of non-resident persons. In fact, with the lacklustre economic situation showing no immediate/sustained signs of moving towards an upturn, the foreign vendor/cable-owner could well be unprofitable in its home base for a while (and possibly overall within their organisation) and thus any future Singapore withholding tax imposed will be a strain to their financial results. Therefore, the Government should seriously consider reducing the withholding tax rates on rentals (and one could also put forward a similar case for payments in the nature of royalties and interest).

Thirdly (and perhaps most importantly), as end-consumers of telco services, we could of course well be affected. To the extent the telcos bear some (or all) of the burden of increased withholding tax cost a few years down the road, these could well be passed on to us as they seek to maintain their margins.

To briefly conclude on the withholding tax point, it is thankfully not a dire situation right now, with the extension of the withholding tax exemption for IRU payments. In February 2013, the IRAS released a circular with the proposed adoption of a "rights-based approach" to characterise inter alia, software payments. Prior to this circular, the treatment pertaining to software payments to foreign vendors had been remarkably similar to that for IRU payments (i.e. for software it will firstly be treated as royalty but with tax exemption currently prescribed). With the "rights-based approach", it will no longer be a foregone conclusion that software payments are subject to royalty withholding tax (and one would naturally hope that similar outcomes can be extrapolated to IRU or other similar payments).

Tax deduction for IRUs on domestic cable systems

Currently, expenditure incurred for the purchase of an IRU over an "international telecommunications submarine cable system" can be written down for tax purposes (i.e. effectively a tax deduction can be available) in Singapore However, there is no equivalent rule to allow expenditure for IRUs on domestic cable systems (since these would not be "international") to be written down or tax deducted. This practically means that additional spending on local infrastructure by, say, FBOs may not be tax effective.

There is arguably no compelling reason from a tax deductibility perspective to differentiate between IRUs of an international nature or of a domestic nature. Countries like Australia have subscribed to this and harmonised the relevant rules in 2004 such that the term "international" in the present context has been binned. It may be worthwhile for Singapore to consider adopting a similar approach to help telcos reduce business costs (through tax savings).

Conclusion

The regulators have long expressed commitment to growing Singapore into a dynamic global infocomm hub. In nurturing a competitive telecoms market as well as a conducive business environment with programmes and schemes for both local and international companies, it is hoped that the government will consider and implement suitable tax changes at the opportune time to promote long-term certainty and competitiveness.