

Budget Commentary

Singapore • 22 January 2009



Braving the storm

Last year's Budget, delivered admittedly in comparatively good times, could be said to have met expectations at the time. There was no need to bring down corporate taxes as a general proposition, and in the face of a potential pick up in inflation, personal tax reductions would only have added to the risk of unwelcome retail liquidity. So tax rates stayed where they were.

Twelve months down the road, the world finds itself in a state of extreme economic distress with credit all but dried up and asset values crashing all around us. Businesses that were household names have gone down with all hands. Singapore, as a small economy almost entirely dependent on external trade, finds itself tossed around at the mercy of an economic storm that, for the time being at least, appears out of control and possibly could get worse.

In his Budget Speech of 2003, the then Minister for Finance, Lee Hsien Loong (now Prime Minister) was well aware of Singapore's vulnerability when he observed that "there is no safe harbour where our ship can shelter to rebuild and refit". Clearly the economy is on the high seas and emergency action was required from this Budget to allow the ship to shelter from the worst and enable it to find a place to drop anchor and hunker down until the storm blows over.

Many of the targeted handouts that were announced in the speech had already been hinted at in the press, thus there were few surprises on the day. The only uncertainty was how much the rescue package might be. The principal aim of course, was to help tide Singapore over the worst recession in its history; but the record S\$20.5 billion package also kept a firm eye on the need to emerge better, fitter and faster when the world economy turns around, as inevitably it will.

As expected, the rate of Goods and Services Tax (GST) remained untouched (although some had a tingling feeling it might be raised). However, against expectations (but not against hope) the corporate tax rate was lowered for income earned in 2009 to 17 percent from an already competitive 18 percent. This of course is of use to those that survive the downturn, and remain profitable. It also raises the question of a possible increase in GST next year when the current measures have to be paid for, thus allowing a continuation in the transition from direct to indirect taxes.

Against the expectations of many, personal tax rates remained unchanged and what was a little surprising was that the 'one-off' rebate, which was a feature of the 1990s and that many expected to be increased, was held at 20 percent with a cap of S\$2,000 as last year. This will all be seen by many as disappointing, as the tradition, and thus expectation, has been for the top marginal rate of personal tax (currently 20 percent) to chase down to the corporate rate of 18 percent. Those who had called for a tax holiday will be stunned, although it is not clear how serious their request could have been.

The Government again though, demonstrated its ability to listen to industry feedback. For those in losses, some additional relief was given under the loss carryback provisions which was something that was called for, although the measures announced really only scratch the surface of what was possibly needed. The effective removal of the GST issue that was plaguing Singapore funds was also something that had long been asked for. This, coupled with relaxations in the fund management incentive regime that now allow funds to flow in freely from even Singapore-based investors, will put Singapore head and shoulders above any other city in Asia and possibly the world, as a place to pool and manage funds.

Unusually, the financial services sector (outside of funds) got hardly a mention, although most incentives are already well embedded and were extended last year. There was therefore little call for major movements here, although they may benefit from the funds that could flow into Singapore under the one-year amnesty for remitted foreign income.

In all, it was a generous Budget which will have the Government dipping into its reserves in a meaningful way. The Resilience Package as it is called, is targeted and well thought out and while it seeks to provide stability in the storm, does not ignore the prospect of a rosier future. Hopefully, it will allow the ship to weigh anchor after the storm and get underway again in good shape.

22 January 2009

Contents

Change in corporate tax rate	4
Downturn measures for incentive companies	4
Accelerated writing-down allowance for the acquisition of intellectual property rights for media and digital entertainment content	4
Enhancement to foreign-sourced income exemption scheme	5
New tax framework for qualifying amalgamations	6
Financial services	7
• Fund management	7
• Specified income and designated investments lists	9
• Financial Sector Incentive – Headquarter Services	10
• Commodity Derivatives Traders incentive	10
• Tax deduction on loss provisions	11
Enhancing the maritime sector	11
• Special Risk-Sharing Initiatives	11
• Extension and enhancement of the Block Transfer Scheme	11
• Reduction in Singapore port charges	12
• Increased funding to the Maritime Cluster Fund	12
Enhancing the tax depreciation regime	12
• Loss carryback relief	12
• Accelerated tax depreciation	14
• Tax deductions for renovation and refurbishment expenses	14
Enhancing start-up tax exemption scheme	14
Personal tax rebate	15
Tax deduction on donations	15
Goods and Services Tax	15
• Recovery of input GST on expenses for qualifying local funds	16
• Zero-rating for the aerospace industry	16
• Suspension of GST and duty on goods temporarily removed from zero-GST or licensed warehouses for auctions and exhibitions	16
• Exemption of GST and duty for wines used at wine exhibitions and conference events	17
2008 in retrospect	18
2008 in snapshot	20
PricewaterhouseCoopers thought leadership articles	24
Appendices	41
A. Comparison of Asia Pacific effective tax rates on repatriated corporate profits	41
B. Comparison of Asia Pacific individual tax liabilities	42
C. Resident individual tax rates	43

Change in corporate tax rate

The one percent reduction in the corporate income tax rate from 18 percent to 17 percent with effect from the year of assessment (YA) 2010 (financial year 2009) was unanticipated but welcome news for companies across-the-board. Singapore is already an attractive and competitive location tax-wise, both regionally and globally. At 17 percent, it has narrowed the gap with its regional competitor, Hong Kong, which has a headline tax rate of 16.5 percent. Coupled with the availability of tax incentives and a wide network of tax treaties and free trade agreements, Singapore is in a comfortable position to rebound quickly from the current economic downturn.

It would have been good however, if the corporate income tax rate reduction had been aligned comparatively with a reduction in tax incentive rates. The regional headquarters (RHQ) incentive, for instance, which accords a 15 percent concessionary tax rate on qualifying income, will no longer be an attractive incentive proposition as it only provides a two percentage-point reduction from the new headline tax rate.

This rate reduction will deplete the Government revenue by S\$400 million to S\$500 million a year, which seems to set the scene for an impending increase in GST when the Singapore economy recovers later. That said, this one percent cut in the corporate income tax rate should serve well as a signalling effect for longer term economic growth for Singapore.

Downturn measures for incentive companies

To ease the pressure on businesses during the current economic downturn, the Economic Development Board (EDB) announced on 19 January 2009 that they would be adopting the following measures to assist incentive companies to tide over the current downturn:

(a) The EDB will be prepared to grant a grace period until 31 March 2010 for companies facing difficulties in achieving incentive milestones due in 2009.

(b) For companies whose Pioneer Status or Development and Expansion Incentives (DEI) are expiring in 2009, the EDB will be prepared to extend the tenure until 31 March 2010, provided there is no cutback in their present level of operations in Singapore.

For example, if an incentive company is required to employ at least 50 professionals by 30 June 2009 and is facing difficulties in achieving this milestone, the EDB is prepared to grant a longer time, up to 31 March 2010, for the company to meet this condition. On the other hand, if a company's Pioneer/DEI Status is due to expire anytime during 2009, the EDB is prepared to extend the incentive period up to 31 March 2010, provided the company is able to maintain its present level of operations. While there is no clarity as to what is meant by 'present level of operations', one can assume it refers to the level of local business spending, headcount, fixed asset investments, etc. These measures are not automatic and require companies to present their business case to the EDB for obtaining specific approval.

Accelerated writing-down allowance for the acquisition of intellectual property rights for media and digital entertainment content

While one would have expected this year's Budget to introduce more tax measures to support research and development and intellectual property (IP) exploitation activities in Singapore, the Finance Minister chose to encourage only the media and digital entertainment (MDE) industry players by allowing them to claim accelerated writing-down allowances (WDA) for acquired IP rights relating to MDE content.

Presently, under section 19B of the Income Tax Act, a company or partnership is able to automatically claim a five-year WDA on a straight-line basis on capital expenditure incurred in acquiring any IP rights for use in its business, provided both the legal and economic ownership of the IP rights are acquired. In cases where only the economic ownership of the IP rights is acquired, but not the legal ownership, the company or

partnership has to obtain specific approval from the EDB in order to claim the five-year WDA. IP rights are defined to include rights related to patent, copyright, trademark, registered design, geographical indication, lay-out design of integrated circuit, trade secret or information that has commercial value.

According to the proposal unveiled by the Finance Minister, the writing-down period for claiming WDA in respect of capital expenditure incurred by a company or partnership for acquiring qualifying IP rights for MDE content will be reduced from five years to two, subject to obtaining approval from the EDB. What is interesting is that the EDB's approval is required even if both the legal and economic ownership of the IP rights for MDE content are acquired. This benefit is available for qualifying IP rights for MDE content acquired by 31 October 2013. The expiry date of 31 October 2013 for the accelerated WDA is aligned with the current expiry date as provided under section 19B.

Presumably, the EDB will impose certain conditions before granting the accelerated WDA incentive. However, this does not preclude any MDE company or partnership from claiming an automatic five-year WDA if it has acquired both the legal and economic ownership of the IP rights for MDE content.

Further, to support the MDE industry, the Finance Minister proposed to set up a S\$230 million Singapore Media Fusion fund to provide grants to help local enterprises export content, applications and services to the world, as well as to build up a world-class media talent base. This will complement the Government's plans to develop Mediapolis at One-North. The tax measures, coupled with the proposed grants, will encourage the MDE businesses to actively exploit their IP rights from Singapore and help position Singapore as a leading MDE hub in Asia.

Enhancement to foreign-sourced income exemption scheme

Singapore adopts a territorial and remittance basis of taxation, whereby tax is imposed on all income derived from sources in Singapore, together with

income from sources outside Singapore if received in Singapore. Hence, foreign-sourced income is generally taxable only when remitted to Singapore. Since 1 June 2003, the following categories of income remitted to Singapore by resident non-individuals are exempted from income tax, subject to conditions:

- Foreign-sourced dividends
- Foreign-sourced branch profits
- Foreign-sourced service income

Specifically, the conditions for exemption are as follows:

- The foreign-sourced income must have been subjected to tax in the foreign jurisdiction from which the income was received; and
- At the time the foreign-sourced income is received in Singapore, the headline tax rate of the foreign jurisdiction from which the income was received is at least 15 percent.

To help businesses tap on financing from their overseas investments and operations to meet their business financing needs in Singapore, the Finance Minister decided to grant a one-year moratorium to allow all foreign-sourced income to be repatriated tax-free, without the need to satisfy the above conditions. The current scope of the foreign-sourced income exemption scheme will thus be expanded to include foreign-sourced income such as interest income, royalties and rental income.

This benefit is a temporary measure for one year, with effect from 22 January 2009. Hence, resident non-individuals and resident partners of partnerships in Singapore will be exempted from income tax on their remittance of all foreign-sourced income earned or accrued outside Singapore prior to 22 January 2009, if they remit that income to Singapore by 21 January 2010. In other words, any income that is currently being generated offshore will not get to enjoy this blanket exemption when remitted to Singapore, and one may thus wish to consider whether to retain this portion of income abroad.

Obviously, taxpayers should consider appropriate measures, like segregated accounts, to identify and track their offshore income that accrues from 22 January 2009. However it is likely that the Inland Revenue Authority of Singapore (IRAS) will allow a first-in first-out (FIFO) basis of remittance such that income earned prior to 22 January 2009 will be regarded as remitted first if separate identification is not possible. The IRAS will be releasing more details by April 2009.

It remains to be seen whether this temporary measure will be a prelude to the adoption of a full territorial basis of taxation as with the likes of Hong Kong and Malaysia. In the meantime, taxpayers should seize this golden opportunity to plan for the repatriation of their overseas income – but of course, they should not take too much time to do this!

New tax framework for qualifying amalgamations

Under corporate law, two or more Singapore companies (amalgamating companies) may amalgamate and continue as one company (the amalgamated company) which may be one of the amalgamating companies or a new company.

The general rule under the Singapore Companies Act enumerates specific effects arising from an amalgamation. This includes the following:

- All the property, rights and privileges of each of the amalgamating companies will be transferred to, and vest in, the amalgamated company.
- All the liabilities and obligations of each of the amalgamating companies will be transferred to, and become the liabilities and obligations of, the amalgamated company.

The amalgamated company should be treated as standing in the shoes of the amalgamating companies and treated as if there was no transfer or assignment of rights and obligations.

Under the existing tax framework however, certain rules can increase the tax burden for companies undergoing an amalgamation, as this is still seen as a transfer of business from one company to another followed by a liquidation of the transferor, as follows:

- The amalgamated company will not be able to utilise the unabsorbed tax losses and capital allowances of the amalgamating company.
- The specific bad and doubtful debts, and any other qualifying expense provisions taken over by the amalgamated company are not tax deductible when such debts are subsequently written off.
- The amalgamated company will not automatically take over the tax benefits or incentives enjoyed by the amalgamating company.
- A transfer of shares or immovable property under an amalgamation is still subject to stamp duty unless the amalgamation qualifies under a relief application which can be time consuming and expensive to pursue.
- The amalgamating company will need to apply for tax clearance which can take a number of months.
- There is a risk of GST applying at 7 percent on the asset transfer, although this can generally be reclaimed later.

A new framework for amalgamations was announced in the Budget which aims to provide greater clarity and minimise tax consequences arising from an amalgamation. However, details of what the framework would entail are yet to be available.

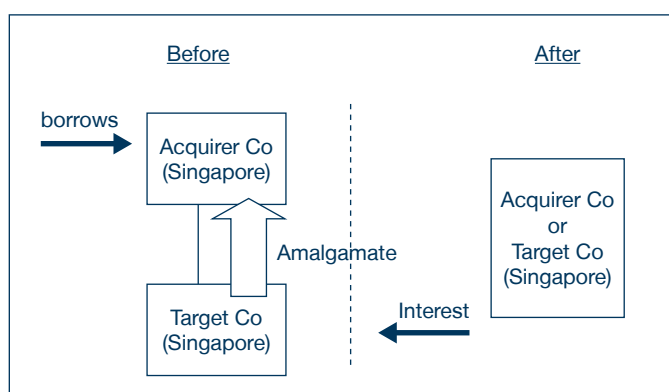
It makes sense that the tax rules should follow the spirit of the Companies Act, thus the framework should be expected to include the following:

- The amalgamated company should be able to utilise the unabsorbed tax losses and capital allowances of the amalgamating company.
- The specific bad and doubtful debts, and any other qualifying expense provisions taken over by the amalgamated company should be tax deductible.
- The amalgamated company should assume the tax benefits or incentives enjoyed by the amalgamating company.
- Transfers of shares or immovable property under an amalgamation should not be subject to stamp duty.
- The amalgamating company need not apply for tax clearance.
- GST would not apply in an amalgamation.

In addition, the amalgamation framework to be released should take into account an acquisition situation where the acquirer and target are then amalgamated. In that situation, the interest costs on

the acquisition loan taken out by the acquirer should be deductible to the amalgamated company as it had effectively borrowed to take over the assets and liabilities of the target. Currently, because the funds are borrowed to acquire shares (which produce exempt income), the funding costs are not deductible.

To illustrate, where a company (Acquirer Co) borrows to acquire another (Target Co) and both amalgamate, such an amalgamation would allow the debts and the business of Target Co to be in the same company post-acquisition.



We hope to see the new framework allow such borrowing expenses incurred by Acquirer Co to purchase shares to be treated as qualifying expenses to reduce the taxable operating profits of the amalgamated company. A direct purchase of the business/asset of Target Co and redress the rather unsatisfactory situation which makes financing the purchase of companies expensive.

Where such an incentive is covered under the new framework to apply to qualifying corporate amalgamations, the objectives outlined by the Minister should be fully met.

Incidentally, the Banking Act has had provisions that govern the merger of Singapore incorporated banks that pre-date the introduction of the amalgamation scheme under the Companies Act in 2005. Pursuant to these provisions, the undertaking of the transferor bank will, by the operation of law, be transferred to and vest in the transferee bank. This is as if in all respects the transferee bank were the same person in law as the transferor bank. There have also been a number of Singapore branches of foreign banks which have, under their home country laws, merged their operations under the doctrine of universal succession.

It is hoped that a new framework that would provide for tax neutrality upon mergers, and preserve the tax attributes of the assets and liabilities transferred to the transferee, would similarly apply to these bank mergers that have taken place.

Financial services

As in past years, the Government has continued to fine-tune the taxation framework for financial services in response to changing market conditions. The changes proposed by the Finance Minister are set out below.

Fund management

Currently, foreign funds managed by fund managers in Singapore are exempted from tax on specified income from designated investments if certain conditions can be met. The main conditions, which were introduced in 2007, are as follows:

- The funds have to be 'qualifying funds'. The definition of qualifying funds has been provided in the context of a company, a trust and an individual. No definition is available in the context of a Limited Partnership (LP). To be a qualifying fund, the company or trust must not be 100 percent beneficially owned by Singapore investors, and the company and the trustee must not be resident in Singapore. In the case of an individual, the individual must not be a Singapore citizen or a resident of Singapore.
- The investors in the funds are to be segregated into 'qualifying investors' and 'non-qualifying investors'. Non-qualifying investors will be subject to a 'tax' referred to as a 'financial amount'. The investors that are likely to fall within the category of non-qualifying investors seem to be Singapore investors (other than individuals) who own substantial stakes in the funds (generally more than 30 or 50 percent).

Fund companies incorporated and resident in Singapore, subject to conditions being met, may also be approved by the Monetary Authority of Singapore (MAS) as approved Singapore-resident fund companies. These companies also enjoy tax exemption for specified income from designated investments.

This year's Budget proposes to liberalise the tax incentive schemes for both foreign funds as well as

approved Singapore-resident funds. The areas where changes have been announced are not altogether a surprise, since in the past we have raised these with the authorities as potential areas for improvement.

Introduction of an Enhanced Tier

The 2009 Budget proposes to introduce an Enhanced Tier to the existing fund management incentives. The Enhanced Tier will entitle funds to certain additional concessions (discussed below). The Enhanced Tier status will require an application to be made to the MAS. It has been announced that a prerequisite will be that funds will have to be of a minimum size of S\$50 million at the point of application. Other conditions will also be imposed. The Enhanced Tier scheme will be effective from 1 April 2009 to 31 March 2014, although once a fund has been granted Enhanced Tier status, the relevant benefits will apply for the life of the fund.

The introduction of the Enhanced Tier could be a good way to improve the existing tax exemption rules for funds, as opposed to amending the existing rules and introducing complications. Whether this is in fact going to be the case depends on the details of the Enhanced Tier that will only be released by the MAS in April 2009.

One issue that comes to mind is the condition that the fund should have a minimum size of S\$50 million at the point of application. Does this require the fund manager making the application to have at least S\$50 million committed by investors at the point of application? This may not be practical in the case of fund managers looking to set up new funds, since they need the certainty of tax exemption before investors will agree to invest. This condition should hopefully be set such that, at the point of application, the fund manager only has to confirm that the minimum fund size will be S\$50 million at the date of closing or other applicable dates.

It was also stated that other conditions will be imposed. It is hoped that those conditions are reasonable and do not in any way create significant hurdles for funds to be granted Enhanced Tier status. The additional benefits for funds with Enhanced Tier status are discussed below.

No restrictions on residency status of the fund and investors

It has been announced that under the Enhanced Tier, there will be no restrictions imposed on the residency status of the fund vehicles or on the investors. It has been further clarified that the investment limits of 30 percent or 50 percent imposed on Singapore non-individual investors (see above) investing in qualifying funds will be removed.

This is a significant development and suggests that essentially the fund vehicle will not be subject to tax, and the investors not subject to the financial amount even if the fund vehicle and all its investors are resident in Singapore. Those who still remember the infamous “80-20” rule will appreciate that Singapore has come a long way with this announcement.

The proposed enhancement will allow Singapore companies to invest in funds managed by Singapore-based fund managers without being penalised. Currently, Singapore-based investors cannot own 100 percent of a fund and still get the incentive; and if they own less than 100 percent but more than 30 percent (50 percent in some cases), they would have to pay a financial amount to the IRAS, which is the equivalent of 18 percent of their share of the accounting profits of the fund. In addition, the enhancement will benefit Singapore-based fund managers by allowing them to tap an additional pool of investors.

It is likely that conditions will be imposed to prevent abuse of this enhancement, including possibly limiting the use of fund managers who are related to the investors.

What is interesting to note is that the Budget used the term ‘fund vehicles’ rather than ‘qualifying funds’. It is not clear whether this is an intentional deviation from the concept of qualifying funds for those with Enhanced Tier status. If it is intentional, it seems to be that the Government is open to tax exemption being granted to any form of vehicle (whether it be companies, trusts, LPs or other forms of pooling arrangements) and without regard to its location. Generally, such an open approach is a welcome move; but it does raise the question of whether the tax exemption scheme currently available to Singapore-resident fund companies will become redundant, or

whether it will be subsumed under the Enhanced Tier.

It is also interesting to speculate what opportunities this might present for local banks which could outsource their trading book to their in-house fund manager.

The conditions for approval remain to be seen.

Limited Partnerships

It has been announced that the Enhanced Tier will also apply to funds that are constituted in the form of LPs. In our view, this announcement is more of a tweaking of the rules to address commercial realities.

LPs are commonly used as fund vehicles, as investors from various countries (including the United States, United Kingdom and Japan) are more familiar with them than they are with other structures. However, the Singapore fund management incentives currently do not recognise them. After much engagement with the authorities, this issue has now been addressed. Funds formed as LPs will be entitled to the fund management incentives including tax exemption as long as the relevant conditions are satisfied.

This improvement is likely to save time and money for many foreign fund management groups that want to set up operations in Singapore. They will now not need to restructure their funds to merely convert their LP model to a corporate or trust model. The announcement will also encourage more foreign fund management groups with offices here to relocate senior personnel to Singapore. Previously, the Singapore offices of these fund managers had to limit the role of the Singapore office so that they did not create a Singapore taxable presence which would have in turn required them to rely on the fund management tax incentive schemes. All in all, the inclusion of LPs in the fund management scheme is a welcome move and will go a long way to increasing Singapore's competitiveness with other fund management centres around the world.

Specified income and designated investment lists

Not all income derived by qualifying funds and approved Singapore-resident funds is tax exempt.

Only 'specified income' derived from 'designated investments' enjoys this status. Both terms have been defined. Each year, the Government takes feedback from the industry and expands the list. The Government has done the same this year. The expanded list applies to all funds and not just those holding Enhanced Tier status.

The list of 'specified income' has been expanded to include:

- (a) Income realised (other than through sale) on or after 22 January 2009 from designated investments in other forms (held to maturity, redemption, or where the realisation leads to a transfer of both economic and legal ownership).
- (b) Certain income derived from debt securities under the Qualifying Debt Securities (QDS) scheme.

The list of 'designated investments' has now been expanded to cover the following:

- (a) Investments in structured products
- (b) Units in business trusts
- (c) Qualifying Islamic investments involving the *Murabaha, Mudaraba, Ijara wa Igtina, Musharaka, Istisna* and *Salam* concepts
- (d) Emissions derivatives
- (e) Stocks and shares of unlisted companies (whether resident in Singapore or not) denominated in any currency
- (f) Adjudicated and non-adjudicated liquidation claims

The MAS will release details by April 2009.

The expansion of the list is a welcome move and should help Singapore leverage on the growth in the areas covered including environment related products and Islamic investment products in Asia, both of which hold promise in this otherwise bleak investment climate.

What is disappointing, however, is that the Government has not conceded to the suggestion of coming up with an exclusion list for specified income and designated investments. This suggestion was made by us on the basis that an inclusion list runs the risks of inadvertent omission in an ever increasing and developing products market.

The changes announced will certainly be welcomed by the fund management industry in Singapore. This once again demonstrates the Government's willingness to listen to feedback from the industry, and to make adjustments to facilitate the conducting of business here.

Financial Sector Incentive – Headquarter Services

The Financial Sector Incentive – Headquarter Services (FSI-HQ) scheme is meant to encourage financial institutions to use Singapore as a base from which to manage their groups' regional or global operations. At present, a company cannot be approved as an FSI company if it:

- (a) Is not licensed or approved by the MAS, or is exempted from such licensing or approval under Singapore law; and
- (b) Provides treasury, investment or financial services in Singapore for its offices and associated companies.

The Finance Minister has proposed to expand the scheme to include a company that is wholly-owned by, or which wholly owns, another company that is regulated by the MAS or its home country financial supervisory authority, and which provides treasury, investment or financial services in Singapore to its related parties.

In addition, a FSI-HQ company will enjoy withholding tax exemption for interest on qualifying loans that is paid to non-resident qualifying persons. Local network companies, subject to their meeting the prescribed conditions, can also be approved as qualifying network companies. This should mean that income derived from the provision of qualifying services to these local companies may qualify for 10 percent tax. When the finance and treasury incentive was liberalised in 2005 to include local companies as approved network companies, a revenue threshold was introduced specifying that the local company should not account for more than 10 percent of the group's annual revenue. Similar conditions may be imposed for the FSI-HQ scheme. Details of these qualifying conditions are expected by April 2009.

The stated objective of the enhancement to the FSI-HQ scheme is to encourage financial institutions to

manage and control their regional or global operations from Singapore. Further, the qualifying criteria will be broadened to include a non-regulated applicant that is part of a regulated group. However, it would appear that the need for the applicant to provide 'treasury, investment or financial services in Singapore', coupled with the interest withholding tax exemption noted above, would refer more to finance and treasury type activities, as opposed to pure management support functions typically performed by regional headquarters. It is hoped that more clarity about the scope of the incentive will be available from the MAS when the details of the scheme are released.

Finally, the Qualifying Processing Services Company (QPC) incentive, which provides for a five percent tax on income derived from the provision of high value-added processing services, will be folded under the FSI-HQ incentive for which a 10 percent (rather than five percent) tax rate is prescribed. Effectively this incentive, which is due to lapse on 26 February 2009, will be renewed as it is now part of the FSI-HQ incentive. This realignment will only affect new applicants. Companies that have been (or will be) granted the QPC incentive prior to 27 February 2009 will continue to enjoy the concessionary tax rate of five percent until the expiry of their respective awards.

Consistent with the Government's policy of setting a sunset clause for tax incentives, the above enhancements will apply from 22 January 2009 to 31 December 2013.

Commodity Derivatives Traders incentive

The Commodity Derivatives Traders (CDT) scheme was introduced in 2004 to complement the Government's initiative to develop Singapore as a major hub for commodity trading. Among other things, it provides for a five percent tax on income from qualifying trades as well as services as an intermediary in connection with qualifying transactions. The scheme is due to expire on 26 February 2009.

The Finance Minister has proposed to fold the CDT scheme into a new sub-category within the FSI-Derivatives Market (FSI-DM) scheme, and to extend it to 31 December 2013. As part of this change, the definition of commodity derivatives will be expanded to include emission derivatives. It appears that an

applicant for the new sub-category will only enjoy the tax concession for income from transactions in, or services related to, commodity derivatives (as defined under the current CDT scheme as well as emission derivatives), but not necessarily from other types of derivatives. Otherwise, there is no need to create a new sub-category for this activity. If this is the case, the change is largely of an administrative nature.

On a more helpful note, the counterparty requirement that CDTs have to observe for income from exchange-traded commodity derivatives to be taxed at five percent has been removed. This will no doubt be very well received by the industry. Besides greatly easing the administrative burden in tax compliance, the scope of the five percent tax concession is effectively widened as it is no longer confined to trades done with a defined group of persons. The counterparty relaxation for qualifying trades will also be accorded to companies under the Global Trader Programme, given that such traders would be engaged in similar trades.

Tax deduction on loss provisions

As part of the package to promote bank lending under the current difficult economic times, the Finance Minister will extend the tax deduction for loss provisions made pursuant to MAS Notice 612 for banks, as well as other equivalent MAS notices for finance companies and merchant banks, for three years of assessment.

At present, banks, merchant banks and finance companies which are unable to provide for collective impairment in accordance with the *Financial Reporting Standards 39: Financial Instruments: Recognition and Measurement* (FRS 39), but are required by the MAS to maintain a certain level of collective impairment, are allowed a deduction for such impairment losses. This is provided that the claim falls within the limits prescribed under section 14I of the Income Tax Act. This was intended to serve as a transitional measure, as it is expected that these financial institutions will be able to comply with the requirements of FRS 39 within five years from the time they are required to adopt FRS 39 accounting. For a company that first adopted FRS 39 for the financial year that began on 1 January 2005, the expiry of the five-year term is fast approaching. Given the uncertain economic outlook, the proposed extension will provide some measure of

certainty for financial institutions to obtain tax relief (at least in part) for loan loss provisions raised pursuant to a regulatory requirement.

Enhancing the maritime sector

Most shipowners/operators are not tax paying because of the Singapore shipping tax incentives which they enjoy. Due to the severe credit crunch which may affect their viability, the following measures introduced in this Budget will help to improve their business environment and ease their cash flows:

Special Risk-Sharing Initiatives

The Special Risk-Sharing Initiatives (SRI) scheme for trade financing is meant for Singapore exporters (who mainly export by sea) and will improve shipping rates for Singapore-based shipping companies. The collapse of shipping rates has been partly blamed on the freeze in trade financing.

Under this initiative, the Government will take a significant share of the risk for trade financing. The SRI comprises two components:

- The New Bridging Loan Programme.
- Trade Finance Schemes, comprising the Loan Insurance Scheme and the Trade Credit Insurance Programme.

Extension and enhancement of the Block Transfer Scheme

To ensure Singapore maintains its competitiveness in the maritime sector and to promote the attractiveness of the Singapore registry, the Block Transfer Scheme (BTS) has been extended for another five years until 31 December 2013.

Under the BTS, a shipping enterprise can enjoy automatic exemption from withholding tax on interest (including front-end fees and commitment fees) paid on overseas loans to finance the acquisition of a Singapore-flagged vessel, subject to meeting relevant terms and conditions.

The BTS is further enhanced from 1 January 2009 to allow a waiver of withholding tax on interest payable on a loan obtained from an overseas lender to acquire

100 percent of the shares in a Special Purpose Vehicle (SPV) with a wholly-owned Singapore-flagged vessel registered between 1 January 2009 and 31 December 2013.

By way of background, the BTS is a volume discount scheme for ship registration fees, which is applicable on the registration of a new Singapore-flagged vessel. The BTS also allows foreign-flagged vessels to be registered in Singapore provided their primary registry elsewhere is suspended.

Reduction in Singapore port charges

To assist harbour craft companies involved in commercial activities in managing their Singapore port charges, there will be a 20 percent concession in port dues for one year from 1 April 2009 to 31 March 2010. Harbour craft for personal use do not qualify for this special concession.

This concession is meant to benefit the local small- and medium-sized shipping companies involved in bunkering, towing, dredging, and carriage of cargo and passengers.

Increased funding to the Maritime Cluster Fund

To upgrade the expertise and skills of staff in the maritime sector, the Finance Minister announced an additional S\$45 million (on top of S\$50 million which was originally set aside) to be contributed to the Maritime Cluster Fund (MCF). The MCF was set up in 2002 to promote training for the players in the maritime sector and to help maritime companies defray their staff training costs (including scholarships and tertiary programmes).

Enhancing the tax depreciation regime

Loss carryback relief

In the run-up to the Budget Speech, we had called on the Minister to enhance the loss carryback relief scheme to allow businesses to monetise current year tax losses and get back some of the tax paid in earlier (profitable) years. The current scheme allowing

carryback of S\$100,000 of qualifying deductions which translated (at most) to S\$18,000 in tax terms would hardly be sufficient to sustain ailing businesses. The following enhancements have been proposed:

- Allowing carryback to three years of assessment immediately preceding the year of assessment in which the capital allowances or trade losses were incurred.
- The losses carried back are to be set off firstly against the third year of assessment, followed by the second year of assessment, and then the year of assessment immediately preceding the year of assessment in which the capital allowances were granted or the trade losses were incurred.
- Increasing the limit of aggregate qualifying deductions carried back from S\$100,000 to S\$200,000 (effectively giving a maximum refund of S\$40,000 when applying the YA 2006 corporate tax rate of 20 percent).

While businesses will be glad that the losses can be carried back for a longer period, one wonders if the limit should not have been increased further. More details will be released by the IRAS shortly and we hope they will bring clarity to a few other interesting questions.

For a few years now, a certain amount of a company's chargeable income is exempted from tax. Under the current scheme, the loss carryback would have to be set off before the exemption amount. As illustrated on the next page, if the enhancement of the loss carryback is to help businesses which are making losses in this recession with their cash flow, the set off should be after the exemption amount.

Illustrations on carryback losses

Loss carryback set off after exempt income				
	31.12.07	31.12.08	31.12.09	
	S\$	S\$	S\$	
Net profit/(loss)	100,000	100,000	(30,000)	
Less: Capital allowance	(20,000)	(20,000)	(20,000)	
	80,000	80,000	(50,000)	
Less: Exempt income	(42,500)	(42,500)	0	Note
Chargeable income/(loss)	37,500	37,500	(50,000)	
Less: Loss carryback	(37,500)	(12,500)	50,000	
Adjusted chargeable income	0	25,000	0	
				Tax liability/ (refund)
Tax payable after loss carryback	0	4,500	0	4,500
Tax payable before loss carryback	6,750	6,750	0	
Tax liability/(refund)	(6,750)	(2,250)	0	(9,000)
				<u>(4,500)</u>
Loss carryback set off before exempt income				
	31.12.07	31.12.08	31.12.09	
	S\$	S\$	S\$	
Net profit/(loss)	100,000	100,000	(30,000)	
Less: Capital allowance	(20,000)	(20,000)	(20,000)	
	80,000	80,000	(50,000)	
Less: Loss carryback	(50,000)	0	50,000	
Chargeable income/(loss)	30,000	80,000	0	
Less: Exempt income	(17,500)	(42,500)	0	Note
Adjusted chargeable income	12,500	37,500	0	
Tax payable after loss carryback	2,250	6,750	0	9,000
Tax payable before loss carryback	6,750	6,750	0	
Tax liability/(refund)	(4,500)	0	0	(4,500)
				<u>4,500</u>

Pay more tax if loss carried back is set off before exempt income!

Note: For the first S\$10,000 of chargeable income, 25 percent is taxable. For the next S\$290,000 of chargeable income, 50 percent is taxable.

Could the tax be refunded more quickly?

It is all very well to increase the cap and the number of years that losses can be carried back, but the crux of the matter is how quickly the IRAS will refund the tax. For many December year-end companies which have estimated losses and are in the midst of filing their estimated chargeable income, it is welcome news that the IRAS will allow provisional claims for the tax refund to be based on estimated losses (instead of waiting for the finalisation of their chargeable income and tax assessments). We hope that the refunds could be expedited if not automatic upon submission and will not take the six to 18 months as initially indicated by the Minister (indeed the IRAS have clarified in their own note that they will try to make refunds within two months of the claim). Survival of some of the small businesses and entrepreneurs could well depend on it.

Accelerated tax depreciation

To stimulate spending during the current crisis and help businesses sharpen their competitiveness in preparation for the eventual economic recovery, businesses which invest in plant and machinery will be allowed accelerated capital allowances on capital expenditure incurred on plant and machinery in the basis periods for YA 2010 and YA 2011.

Businesses can claim the entire cost of the newly acquired assets over two years with 75 percent of the costs claimed in the first year. Without this proposed change, capital allowances on capital expenditure incurred on acquiring plant and machinery would generally only be allowed over three years on a straight-line basis.

This enhancement may not seem to provide immediate tax savings to businesses which do not expect to make a profit in the basis period for YA 2010. Even for profitable businesses, the cash flow effect will not come in until 2010. However if loss-making businesses are allowed to carryback the unutilised capital allowances arising from these accelerated claims, they may be able to obtain some prior year tax refunds within a few months.

Tax deductions for renovation and refurbishment expenses

In last year's Budget, the Minister announced a special allowance for fixtures, fittings and installations. This allowance takes the form of a special deduction under a new section 14Q of the Income Tax Act. The special allowance is subject to a cap of S\$150,000 every three years, and must be incurred between 16 February 2008 and 15 February 2013.

To encourage businesses to refit their business premises in 2009 and 2010, they will be allowed to deduct expenses incurred in these two years in one year instead of over three. The cap of S\$150,000 for every three years though will remain.

Many concerns were raised during the 2008 IRAS Budget Seminar and the feedback sessions organised by the Ministry of Finance (MOF), although these were largely addressed in the IRAS circular issued on 18 June 2008. The troublesome question of what constitutes 'structural works' and 'expansion of space' was clarified, and the solution given appears to be neat and straightforward – these will be determined by reference to structural changes that require prior approval from the Commissioner of Building Control. There is still scope for controversy however.

In addition, some small specific niggling areas still remain. Ornamental features or decorations are deductible, provided they are not fine art, which raises the question of when art is 'fine' since there does appear to be some overlap in the examples that were given, not to mention the question of personal taste.

Enhancing start-up tax exemption scheme

Social entrepreneurship is on the rise in Singapore. Social enterprises use business principles and methods to create social change, focusing on serving the needy and disadvantaged in Singapore. Although revenue-generating, they have a non-profit making purpose and are set up as companies limited by guarantee. In recognition of their contribution to

society and to encourage their growth, the Minister has proposed that the start-up exemption scheme currently only allowed to newly incorporated companies be extended to companies limited by guarantee with effect from YA 2010.

This means that social enterprises can claim full tax exemption on their first S\$100,000 of chargeable income and a 50 percent exemption for the next S\$200,000 of their chargeable income for their first three years of assessment upon incorporation. The maximum exempt income is S\$200,000 per annum.

Personal tax rebate

Against the expectations of many, personal tax rates were effectively left where they were from last year, with a similar 20 percent tax rebate capped at S\$2,000. It had been thought (at least hoped) that, if nothing else, the top marginal rate would come down from 20 percent to align itself with the corporate rate of 18 percent, with the usual cascading downwards of the lower rate bands. This is something that has always happened in the past, either in the same year or with a one year lag. It is now a two-year gap since the last alignment.

One might have taken the view that, in the context of an economy that is in need of some domestic stimulus, freeing up personal take-home could have had some beneficial effect. On the other hand, cutting the top rate of tax may have been seen as politically sensitive and pandering to the desires of the rich who are better equipped to ride out the storm; and there is no guarantee that the additional funds thus made available would have found their way into Singapore shops rather than cheap real estate assets in the United Kingdom.

For those that had been advocating a tax holiday (whether seriously or not it is hard to tell) this inertia on the personal tax rates must have come as a bit of an additional blow. We can only hope that there will be a reversion to tradition next year with a three percent drop in the top rate to 17 percent in conjunction with the new corporate rate.

Tax deduction on donations

Over the years, we have seen a slew of measures to make Singapore a philanthropy hub. To encourage charitable giving during these tough times, tax deductions for donations to Institutions of a Public Character (IPC) and other approved recipients made between 1 January 2009 and 31 December 2009 are proposed to be increased from 200 percent to 250 percent.

Assuming a taxpayer in the top tax bracket of 20 percent was to make a donation of S\$1,000, he or she would have a tax break of S\$500 ($S\$1,000 \times 2.5 \times 20$ percent). This might encourage higher income earners, who were not given any personal tax goodies, to increase their donations to a good cause.

Goods and Services Tax

In his Budget speech, the Finance Minister said that Singapore is able to respond to the immediate needs of businesses and households through prudent fiscal policies by maintaining a stable base of revenues. The Finance Minister further explained that the Net Investment Returns (NIR) and GST have given Singapore the stable revenue base that allows the Government to reduce taxes and invest in Singapore's future.

While the current economic crisis has given rise to an unprecedented move to dip into past reserves to fund the Budget measures, the cut in the corporate tax rate has long-term ramifications for the Government's fiscal position. So while on the one hand, the cut in the corporate tax rate to 17 percent from YA 2010 promotes Singapore's competitiveness and encourages investments, the question does arise as to whether the cut in the corporate tax rate and possibly future personal income tax rates set the scene for an increased focus on the certainty of revenues from indirect taxes such as the GST.

After all, the current rate of GST at 7 percent is still considered low by international standards and in Asia Pacific where the average rate is between 10 to 11 percent. Also, the reason for introducing GST in

the first place was to enable Singapore corporate and personal income tax rates to be lowered to enhance Singapore's competitiveness. This is the very reason the Government is offering in the Budget to explain the cut in the corporate tax rate to 17 percent. So do we expect to see an increase in the GST rate in future? It would be no surprise.

Moving to the Budget Speech, there was no cut in the GST rate, which was much as expected. Instead, there are some initiatives on GST which are aimed at certain business sectors as explained below.

Recovery of input GST on expenses for qualifying local funds

The exempt nature and character of fund income (e.g. dividends and interest income) is such that Singapore funds generally have a problem in registering for GST, and thus recovering the input GST on expenses that they incur in Singapore. As a result, there is a disincentive for funds to locate in Singapore if they have to bear the additional 7 percent on expenses such as fund management fees, legal and professional fees.

As part of the initiatives to promote fund administration and the asset management industry in Singapore, the Government will allow qualifying funds that are managed by a prescribed fund manager in Singapore to recover a 'substantial portion' of the GST incurred on prescribed expenses between 22 January 2009 and 31 March 2014.

While the measure is welcomed and is an issue that we have been championing for a while, the Budget alludes to a number of qualifications before the fund can recover the input GST. For example, the fund has to be a 'qualifying' fund managed by a 'prescribed fund manager' and the expenses have to be 'prescribed' expenses.

Pending further details to be released by the MAS by April 2009, it is hoped that the 'substantial portion' of input GST to be recovered will be sufficiently attractive

for a fund to set up shop in Singapore and pave the way for the country's pre-eminence in the regional fund management space.

Zero-rating for the aerospace industry

At present, zero-rating treatment is applicable to the sale or lease of aircraft as well as the sale of aircraft components and Maintenance, Repair and Overhaul (MRO) work performed on the aircraft. For zero-rating to apply, the aircraft must not be one that is used for recreational or pleasure purposes.

From 1 April 2009, the scope of qualifying aircraft will be expanded to include all aircraft, including private aircraft, which are wholly used or intended to be wholly used for international transportation of passengers or goods. Zero-rating is also extended to the sale, maintenance or repair services of aircraft components or systems. The IRAS will release details on a new scheme to facilitate the importation of aircraft components or systems without the payment of import GST.

The measures are clearly aimed at boosting the aerospace industry which is regarded as an important growth sector for Singapore.

Suspension of GST and duty on goods temporarily removed from zero-GST or licensed warehouses for auctions and exhibitions

In a step to encourage the growth of the auction and exhibition industry, as well as specialised storage facilities, GST and duty will be suspended on goods (including wine) that are temporarily removed from a zero-GST or licensed warehouse for auctions or exhibitions.

The initiative only takes effect from 1 April 2009, and further details will be released by Singapore Customs.

Exemption of GST and duty for wines used at wine exhibitions and conference events

From 1 April 2009, a specified quantity of wine for use at approved wine exhibitions and conference events will be exempted from GST and duty. However, the GST and duty exemption is restricted to three bottles of wine per label per day for each exhibitor and the main conference organiser at approved wine exhibitions and conference events.

If the Budget measure is to promote wine trading activities in Singapore, one does wonder why the Government does not just exempt all wine, beer and alcoholic products (except spirits) from duty as they do in Hong Kong. This would also have a beneficial effect on the tourism industry.

The monitoring costs of this initiative are likely to outweigh the savings and we sympathise with the Customs officer who has to audit the exhibitor and conference organiser to check that the GST and duty exemption is applied to only three bottles of wine per label per day.

2008 in retrospect

2008 was another busy year for tax, with some ‘beefing up’ for the transfer pricing landscape and an attempt at revamping the core concept of research and development (R&D) taking centre stage.

Transfer pricing

The IRAS demonstrated it is keen to engage with taxpayers with respect to their related party transactions. This was evident from a *Transfer Pricing Consultation* circular, issued by them in July 2008 which picked up where their earlier circular called *Transfer Pricing Guidelines*, issued in February 2006 that provided guidance on applying the arm’s length principle, had left off. On the back of these two publications, and in an attempt to help taxpayers comply with the arm’s length principle in their transactions with related parties, the IRAS will assess the level of compliance by taxpayers with the 2006 *Transfer Pricing Guidelines* through a consultative process. This involves written requests from the IRAS Transfer Pricing team, requiring taxpayers to provide various details in respect of all their intercompany transactions, as well as at least one meeting with the taxpayer.

Another circular, *Supplementary Administrative Guidance on Advance Pricing Arrangements (APA)* was subsequently issued in October 2008. An APA is a mechanism which allows taxpayers to obtain clearance for their transfer pricing methodology before they implement it, so as to obtain certainty of treatment, from the Singapore side at least. This circular provided additional clarification on the timelines, procedures, considerations and requirements that the taxpayers need to adhere to, prior to filing an APA application. One of the requirements stipulated in the circular was that taxpayers keen to apply for an APA should submit their application no later than six months before the first day of the proposed implementation. Furthermore, clear guidance, in terms of deadlines and minimum information required, has been provided with respect to the pre-filing meeting for the APA.

Another key point highlighted in the circular was that the IRAS will consider a ‘roll-back’ (which allows the agreed methodology to apply for prior years) only in respect of bilateral or multilateral APAs. Roll-back will not be allowed in the case of unilateral APAs. Finally, guidance was also provided on the circumstances under which an APA may be discontinued. The overall message of this circular was to ensure that taxpayers keen to enter into an APA with the IRAS were committed to the APA process.

Finally, in October 2008, a public consultation paper (currently still in draft stage) on *Transfer Pricing Guidelines for Related Party Loans and Services* was issued. With respect to related party loans, the IRAS clarified that all cross-border related party loans should adhere to the arm’s length principle, and provided guidance on how to determine the arm’s length interest rate.

Nonetheless, for domestic loan transactions, the IRAS appears willing to adopt its current practice of not insisting on interest being charged, being content to fall back on the old chestnut of restricting interest expense on financing costs supporting the interest-free lending. This of course misses the point that not all businesses are debt funded, and seems to ignore differentials in tax rates. Few, it seems, will argue though. Paradoxically, they require all cross-border loan arrangements (i.e. loans by Singapore entities to their foreign associates) to reflect arm’s length conditions. This makes little sense given that in most cases, the interest generated will be foreign-sourced and only taxable when remitted. A somewhat difficult task when there is no interest in the first place!

With respect to intercompany service transactions, the IRAS has clarified that it is prepared to accept a five percent mark-up for routine support service activities, specifically provided for in the draft paper, as a reasonable arm’s length charge for such services, which really means no change to current practice. The circular also provides guidance on ‘cost-pooling’ arrangements, whereby the IRAS is willing to accept no mark-up, provided various conditions, aimed at

preventing anti-avoidance, are met. Finally, the IRAS has also addressed the treatment of pass-through costs. In particular, they also seem to be willing to accept no mark-up, provided that these third party costs are identified as the legal or contractual liabilities of the related party itself, and the group service provider is merely the paying agent and does not itself act to enhance the value of the services that are passed on.

Although these guidelines are still in draft, they broadly set out the IRAS view on how these intercompany transactions should be treated.

In conclusion, the release of these circulars indicates that the IRAS has become increasingly vigilant on transfer pricing. It is, therefore, particularly important that taxpayers with significant related party transactions ensure that their house is in order with a sound transfer pricing methodology in place, supported by adequate documentation to mitigate the risk of any transfer pricing adjustments.

Research and Development tax measures

As part of the Government's initiative to make Singapore an attractive location for R&D and IP management activities, several tax reform measures were legislated after they were announced in the 2008 Budget.

Central to the R&D tax changes aimed at making innovation 'second nature' in Singapore was a modified definition of what 'R&D' actually means. This new definition now includes investigative and experimental study that involves novelty or technical risk with the objective of acquiring new knowledge. There are also exclusions for routine modifications or changes, cosmetic modifications or stylistic changes, and development of in-house computer software.

In addition, a slew of other measures were introduced to improve the tax landscape for R&D activities in Singapore. The key enhanced tax deduction and incentive measures were as follows:

- Up to 150 percent tax deduction for qualifying expenditure on R&D activities performed in Singapore, whether conducted in-house or outsourced. Importantly, the R&D does not need to be related to a company's existing trade or business. This is a departure from the previous situation. Disappointingly however, R&D outsourced overseas gets nothing at all.
- A new scheme, known as the R&D Tax Allowance (RDA) scheme, designed to encourage profitable small and medium-sized enterprises (SMEs) to engage in R&D activities in Singapore. Broadly, under the RDA scheme, a company may be entitled to RDA of up to S\$150,000.
- A new scheme, known as the Research Incentive Scheme for Start-up Enterprises (RISE), designed to encourage start-ups to engage in R&D activities in Singapore. Broadly, the RISE facilitates cash flow by allowing qualifying start-up companies to encash tax losses into cash grants of up to S\$20,250 per year.

This was all laid out fairly comprehensively in a circular on the subject that was issued in October 2008. In the light of the current global economic crisis, these R&D tax reform measures have created a timely opportunity to improve the bottom line, and enhance cash flow to allow spending for the future.

2008 in snapshot

As usual, 2008 saw various legislative changes introduced and circulars issued by the Inland Revenue Authority of Singapore (IRAS) and other agencies. Primarily, these reflected changes introduced in the 2008 Budget. Some highlights of the year's tax changes are set out below.

General corporate tax changes		
Tax exemption scheme for start-up companies	February	The tax exemption scheme for start-up companies is extended to start-ups that have corporate shareholders during the 2008 Budget Speech.
Unilateral tax credit	February	Unilateral tax credit is extended to all foreign-sourced income from non-treaty countries during the 2008 Budget Speech.
Withholding tax	February	The withholding tax exemption for payments for the indefeasible right to use international telecommunication submarine cable systems is extended by five years and expanded to include payments for the entire duration of contracts entered into or renewed during that period.
Foreign-sourced income exemption	April June	The IRAS revises its circular on foreign-sourced income exemption in April to provide clarification on the use of the prescribed tracing methods. The circular is revised again in June when the IRAS introduces a concession for foreign-sourced dividends received by nominee companies.
Renovation or refurbishment	June	The IRAS issues a circular on the special deduction for renovation or refurbishment expenditure.
Transfer pricing	July October	The IRAS issues a circular on transfer pricing consultations in July, and administrative guidance on advance pricing arrangements and draft transfer pricing guidelines for related party loans and services in October.
Research & development (R&D)	October	The IRAS issues a circular on the liberalised R&D tax deductions, the R&D tax allowance scheme and R&D incentive scheme for start-up companies (RISE). The circular also includes the Ministry of Finance's (MOF) guidelines on the interpretation of the new definition of R&D under the Income Tax Act.
Commencement of business	December	The IRAS issues a circular on the determination of the date of commencement of business.
Donations	December	The effective date for double tax deduction for donations to grant-making organisations is brought forward to 15 February 2007.
Tax cases	January November December	<p>In a decision published in January, the Income Tax Board of Review rules that a serviced apartment operator's rental income should be treated as normal recurrent business income and should not be subject to the restrictions applicable to property investment businesses. Unfortunately, the High Court overturns the Board's decision in December, ruling that the operator is in the business of making investments and that the relevant restrictions should apply.</p> <p>In an Income Tax Board of Review case published in November, the Board decides that an ex-gratia payment, made in relation to the surrender of a lease and the relocation of a factory, was not a compensation payment in respect of which a balancing charge need be computed.</p>

Tax administration	February March June August October November December	<p>The IRAS clarifies the YA 2008 tax filing requirements for charities in February and issues a basic record-keeping guide for small businesses in March.</p> <p>In June, the IRAS removes the requirement for companies applying for strike-off to first obtain a letter of tax clearance from it.</p> <p>The IRAS announces in August that it will continue to absorb the two percent increase in Goods and Services Tax (GST) on fees for advance rulings until 31 December 2008.</p> <p>The IRAS announces in October that with effect from 1 January 2009, revenue disclosure is required during Estimated Chargeable Income (ECI) filings and the Unique Entity Number (UEN) will replace existing registration numbers.</p> <p>In November, the IRAS revises the corporate tax filing deadline from YA 2009.</p> <p>In December, amendments to the Income Tax Act are published which allow the Government to set off the amount of outstanding tax against what is due to the taxpayer from the Government.</p>
Incentives for the financial sector		
Maritime finance	February	The Maritime Finance Incentive is extended to partnerships and container leasing, and the exemption for gains on the sale of vessels is renewed and enhanced.
Fund management	February	Investors in resident and non-resident funds managed by fund managers in Singapore are allowed more time to reduce their investment ownership to the qualifying threshold for tax exemption.
Insurance	April	The Monetary Authority of Singapore (MAS) issues a circular on the tax incentive scheme for the offshore insurance broking business.
Islamic finance and insurance	May	The MAS issues a circular on tax concessions to promote Islamic financial services and Islamic insurance activities.
Financial Sector Incentive (FSI)	May	The MAS issues a circular on the renewal of and enhancements to the FSI scheme.
Debt securities	May	The MAS issues a circular on the renewal of and enhancements to the qualifying debt securities (QDS) scheme and extension of the tax exemption for primary dealers trading in Singapore Government Securities.
Asset securitisation	May	The MAS issues a circular on the extension of and enhancements to the tax incentive scheme for approved special purpose vehicles (ASPVs) engaged in asset securitisation transactions.
Real estate	May	The IRAS issues a circular on the income tax treatment of an approved sub-trust of a real estate investment trust (REIT).
Family-owned investment holding companies (FIHCs)	June	The MAS issues a circular on the tax exemption scheme for qualifying FIHCs.
Other tax incentives		
International arbitration	April	The Economic Development Board (EDB) and Ministry of Law issue circulars on the tax incentive for international arbitration.

Partnerships	December	Certain tax incentives are made available to partnerships.
Tax changes for employers and individuals		
Tax rebates and reliefs	February August	<p>A one-off personal income tax rebate of 20 percent (capped at S\$2,000) for resident individuals for YA 2008 is announced during the 2008 Budget Speech.</p> <p>In addition, the tax reliefs for course fees, voluntary contributions to Medisave accounts and cash top-ups to the Central Provident Fund (CPF) Minimum Sum are enhanced.</p> <p>In August, Prime Minister Lee Hsien Loong announces enhancements to the tax measures to encourage marriage and parenthood.</p>
Supplementary Retirement Scheme (SRS)	March	The MOF issues a press statement on changes to the SRS, the tax relief for SRS contributions, and on the transitional concession.
Not Ordinarily Resident (NOR) scheme	July	The IRAS issues a revised circular which provides details of enhancements to the NOR scheme.
Employee equity-based remuneration	August December	In August, the IRAS issues circulars on the Equity Remuneration Incentive Scheme (ERIS). This includes a new circular on ERIS (Start-ups) and revised circulars on ERIS (All Corporations) and ERIS (SMEs). The IRAS also revises its circular on the tax treatment of employee stock options and other employee share ownership plans for employers. In addition, the Income Tax Act is amended in December to allow employers to use the last-in first-out (LIFO) method to determine the cost of treasury shares.
Employers' deductions for medical expenses	August	The Ministry of Manpower (MOM) issues a circular on the enhanced tax deductions for medical expenses for employers who provide employees with portable medical shield plans or who make ad-hoc contributions to employees' Medisave accounts.
Tax administration	March June December	<p>In March, the IRAS introduces the No-Filing Service (NFS) for individual taxpayers with straightforward returns and "Filetax", an SMS service that allows taxpayers to check if they need to file a return.</p> <p>In June, the IRAS announces the phasing-in of compulsory participation in the Auto-Inclusion Scheme for employers.</p> <p>In December, the Income Tax Act is amended to allow the Government to set off the amount of outstanding tax against what is due to the taxpayer from the Government.</p>
Goods and Services Tax		
	January	The IRAS issues a circular on the gold jewellery industry.
	February	The IRAS issues a new circular on the GST concession for REITs and qualifying registered business trusts listed in Singapore, and revises the circular on the transfer of a business as a going concern.
	May	The IRAS announces a change to the renewal process for the Major Exporter Scheme (MES) and revises the GST guide accordingly. A number of other GST guides are also revised to reflect legislative changes that took effect from 1 May 2008.

	August	The IRAS informs GST-registered traders that they will be required to report their revenue in their GST returns from February 2009. The IRAS also issues a draft circular detailing a new Hand-carried Exports Scheme for public consultation.
	September	The IRAS revises the circulars for property owners and property holding companies and for the Approved Contract Manufacturer & Trader (ACMT) Scheme.
	November	The IRAS issues a guide for market participants in the New Electricity Market of Singapore.
	December	The IRAS issues a guide on accounting software for software developers.
Other taxes		
Stamp duties	March	The IRAS issues a circular explaining the stamp duty treatment of properties acquired on an en bloc basis.
	November	A High Court ruling that the applicant was not entitled to stamp duty relief as the instrument was not in respect of a scheme of reconstruction was published.
	December	The IRAS issues a circular on the stamp duty treatment and stamping procedure for gifts.
Estate duty	February	Estate duty is abolished for deaths occurring on or after 15 February 2008.
Double taxation agreements		
	February July November	The double taxation agreements (DTAs) with Malta and Belgium are ratified in February and November respectively. Singapore also signs a DTA with Uzbekistan in July, which is ratified in November.
Tax legislation		
	September	The Estate Duty (Abolition) Act 2008 is published.
	December	The Income Tax (Amendment) Act 2008, Goods and Services Tax (Amendment) Act 2008 and Stamp Duties (Amendment) Act 2008 are published.

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

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



PricewaterhouseCoopers thought leadership

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

Authored by our tax partners and managers, these articles were published in the media as part of the lead-up to the 2009 Singapore Budget.

Looking back to turn the corner

Authored by



David Sandison

Tax Partner

(65) 6236 3675

david.sandison@sg.pwc.com

This article was contributed and first published in The Business Times on 23 December 2008.

The one good thing about the current financial crisis is that it relieves me from my annual head-scratching session, which involves looking back at all the Budget wishes we had last year that did not materialise, determining which are still desirable or practical; and finally coming up with ideas that are new, fresh and meaningful in a fairly straightforward, well-run and generally business-friendly tax regime.

This time round, I can dispense with calls for clarity on capital gains, interest expense and borrowing cost deductions, group relief enhancements and all those 'till I'm blue in the face' suggestions. All still relevant, but probably more structural and long-term in nature than what is needed at the moment – a quick-fix rescue package.

The problem we face is short-term. Quite how long 'short' is, nobody can tell; but in due course some modicum of sanity and stability will return. Construction companies may put projects on hold, banks are reluctant to lend; but ultimately they will have to or they too will go to the wall. Activity will be sparked either by one player spotting an opportunity, forcing others to follow suit or die, or there will be a wholesale sell-down of distressed assets whose buyers will break them up and get them back to work.

Where we find ourselves at the moment is in the eye of a Mexican storm, where everyone is simply standing off. And this period of inactivity is proving to be the tipping point for many businesses. They cannot get funding; their customers are cutting costs. Otherwise well-run, healthy businesses just cannot survive. On the retail side of the coin, people are losing their jobs, and the end of the property price bubble, as well as the 'rabbit in headlights' behaviour of the banks, has meant that it is no longer possible to remortgage your house to pay for a Maserati Quattro Porto or a holiday in Alaska.

So what can be done in terms of fiscal measures to help get us out of the bit? There is nothing, clearly, that is going to fix everything. And tax never has been able to do things

on its own, in a vacuum. But when timing is so critical and businesses can disappear off a cliff in a matter of minutes, every little bit can help.

Businesses need cash more now than ever before. Tax cuts have been suggested as offering some help, but this misses the point. When your business is about to go belly up, it is probably not because you are making record profits, and a tax rate of two percent is about as useful as a chocolate teapot. What you need is something to turn your losses to use, and quickly. So what can we do with losses?

Currently of course, they can be carried forward, but as there may be nothing that survives to carry them forward in or to, and of course they are of no use until after you have made your next profit, let us waste no more time with that. However if we can carry them back, we can perhaps access some of the tax we paid earlier, when our well-run healthy business was doing what it was meant to do – make profits, employ people and pay taxes.

At present, this can be done, but only up to S\$100,000 or S\$18,000 in tax terms, and only against the profits of the immediately preceding year (if you had any). This is hardly going to save a business. What is needed is for the limit to be taken off and carry-back to even earlier years allowed. This will then be a more potent and equitable way of getting relief to otherwise sound but currently ailing businesses.

Even with this though, timing may be an issue. If you have a December year end, then you will not know right now what your actual losses for the year will be, although you may be able to make a good guess. So when can you make the claim? And when will you get the tax back?

The first question here centres around the timing of the Budget speech itself. This is set for 22 January, a welcome decision in the circumstances. This could allow companies to submit provisional tax computations based on management accounts as soon as practicable after that date, and claim a refund. Given the potential for abuse however, some safeguards would need to be built in, and so the Inland Revenue Authority of Singapore (IRAS) could perhaps agree to refund up to, say, 70 percent of the provisional claim. The balance would be repayable on the final agreement of the losses for that year.

The second question is how long it would be before the refund is processed and handed over. The answer to this is that the process has to be automatic. It should not involve any of the traditional questioning techniques used on taxpayers trying to get their money back. Otherwise the whole purpose of the exercise is defeated. The only final question is whether this should only be a temporary solution for the crisis at hand, or whether it should not be permanently embedded in the system.

I would have thought that the other angle of attack would have been Goods and Services Tax (GST), given the need to stimulate consumer demand. In the context of the rate hike last year, the government should be in a position to ease the sting

for consumers by reducing it. Some in the past have called for reductions to be targeted at the lower income earners by zero rating essentials, but this option has already been ruled out by the government, and so the only option would have been for an across-the-board rate reduction. However, notions of such a reduction have been similarly quashed by recent ministerial statements in favour of more targeted, non-fiscal handouts.

So on the basis that there is a need for some cash stimulus in the economy, we will have to look elsewhere. As readers may know, Singapore's tax system is what is known as semi-territorial. What this means is that income derived from Singapore is taxed here as it arises; but income generated overseas is only taxable upon remittance, at least if you are a company. Individuals are of course already exempt from tax on income from overseas. It is likely though that a number of Singapore companies are sitting with significant amounts of cash and investments overseas which represent foreign income. The problem is that if this cash is brought into Singapore there is a tax cost attached.

A neat way of unlocking this cash potential and getting it back into circulation in Singapore would be to allow some form of 'tax amnesty' window period, much as the United States did a few years back, which would enable tax-free repatriation of those cash balances. A window period, rather than a fundamental change in the law (although some would also find favour with this), as it then allows a reversion to the status quo after the worst is over.

This last measure will not necessarily assist companies that find themselves staring insolvency in the face, but it will help from an overall perspective. Clearly the emphasis needs to be on businesses that are on the edge of the cliff and to this extent, the loss carry-back proposal is likely to be most effective, in conjunction, as mentioned above, with other non-fiscal measures. Paradoxically, it seems we may need to look backwards in order to turn the corner.

Easing the financial burden on individuals – What can we hope from the Budget?

Authored by



James Clemence

Partner

PwC International Assignment Services

(65) 6236 3948

james.clemence@sg.pwc.com



James Coleman

Senior Manager

PwC International Assignment Services

(65) 6236 3892

james.r.coleman@sg.pwc.com

This article was contributed and first published in The Business Times on 7 January 2009.

The perennial dilemma is with us again – what would you like to see included in the Finance Minister’s Budget speech this year? This is not quite as simple a question as it may have been in the previous years. The current economic conditions present the Finance Minister with a difficult dilemma – whether to give away generously to individuals via the personal tax system as a means to stimulating the stuttering economy; or to play things more cautiously keeping the purse strings tight on the tax system and use the money on more targeted economic stimulation projects such as infrastructure.

Whether you are in favour of a giveaway Budget or a more prudent approach, most would agree that it would be helpful to ensure at least two goals are achieved with any reforms that are made to the personal tax regime:

1. The working population should be recognised for the contribution they make to the successful and diverse economy of Singapore. Any measures introduced should continue to encourage more of the same commitment to push on through this difficult period; and

2. The working population of Singapore needs jobs. Therefore existing employers need to be encouraged to maximise employment opportunities and new employers, whether foreign or local, need to be encouraged to set up or relocate their businesses here.

If both goals are simultaneously achieved in the Budget reforms, Singapore should be well-placed to emerge stronger from the crisis than other less agile competitors. The Budget therefore represents an excellent opportunity to do this.

Personal tax rates and reliefs

If we start with the basics, there are some obvious measures that may be universally popular and may meet both of the goals set out above.

1. **Top marginal personal tax rate** – Bringing down the top rate of income tax (currently 20 percent) to at least match the corporate rate (18 percent) would put more money in the hands of the higher earners to enable them to invest more money back into the economy. It would also help to make Singapore more competitive than other regional locations, in terms of headline tax rates.
2. **Starting rates of taxation** – At present, annual income of S\$20,000 or below attracts zero percent taxation with the next S\$10,000 of income attracting tax at only 3.5 percent. By increasing the zero rate tax band from S\$20,000 to S\$30,000, a sizeable proportion of employees would be removed from the tax net completely. The administrative cost for employers to comply with tax filing requirements for these employees would be removed as would the cost of the tax authority collecting the tax of less than S\$350. It would also put a bit of extra money in the hands of all taxpayers.
3. **Income tax rebate** – This was used last year (albeit for very different reasons) and is an excellent way to inject good news and extra cash into the system without being committed in the longer term to repeat the measures year after year. Whilst this is not a ‘means tested’ or focused measure, it is a welcome ‘windfall’ that may boost morale in addition to short-term spending power.
4. **Family-friendly policies** – Earlier in the year a number of family-friendly measures were announced which helped new and existing parents by reducing their income tax bill. Is there scope to further enhance this by increasing the ‘spousal’ relief for married couples?

There are pros and cons to each of the above proposals, but at least they have one thing in common – they are simple to understand and to administer. It is important to keep this in mind, especially when we are all suffering from overload of financial news – sometimes ‘simple is best’.

Pensions

The idea that we should save enough for the future and be encouraged to 'look after ourselves' during retirement is also a 'sensible' message. This has been a recurrent theme in recent Budgets – last year saw the reform of the Supplementary Retirement Scheme (SRS), for example.

This idea has been brought into even sharper focus in recent months as those nearing retirement are finding that their net worth is considerably lower than they had expected due to the volatile markets. So can any more be done which may help the dual policy objectives of encouraging hard work and attracting foreign talent? Yes, maybe.

Singapore employers are increasingly using a 'pension' as a means of attracting and retaining staff. Section 5 of the Singapore Income Tax Act allows for tax-free contributions to be made to an approved scheme and in turn employers have the freedom to set their own terms around minimum service periods before contributions vest and contribution rates. The only catch is that these contributions must be 'employer' contributions and so employees are not permitted to vary the contribution rate or to make additional contributions.

A simple tweak to the existing law here, to allow employee contributions with a corresponding tax deduction over and above the current CPF cap, may allow 'thrifty' employees to save in a tax-efficient manner as well as to remove some of the perceived 'barriers' for foreign employees who may compare the Singapore system with that from their home country. For example, Employment Pass holders cannot make CPF contributions and so a Section 5 scheme may help to bridge the gap.

In addition, to further enhance the attractiveness of a Section 5 scheme, the 50 percent tax exemption of distributions from an SRS could also be mirrored in the rules that apply to Section 5 plans. This may also be an opportunity to improve flows of capital within Singapore and to stimulate investment in Singapore-listed companies as a new home is sought for the new flows of cash.

Retrenchment & retraining

In the recently released *Tripartite Guidelines on Managing Excess Manpower*, employers are strongly encouraged to consider retrenchment only as a 'last resort' and instead to consider sending their employees for skills training and upgrading under the Skills Programme for Upgrading and Resilience (SPUR). However, there will inevitably be some retrenchments in the sharp downturn and so what more could be done to help?

Firstly, there is already a tax concession called 'course fees relief' and, with a similar intention as SPUR, the aim here is to encourage retraining and help with employability. The current

limit to the relief is S\$3,500 which was set under 'normal' economic conditions. Perhaps there may be room to increase this in the Budget speech?

At the more 'radical' end of the scale, perhaps a scheme to defer income tax payments for those who have been retrenched and who are actively seeking work would help alleviate some more short-term financial worries? For example, monthly GIRO payment plans could be spread over a longer period until new employment is secured.

Focus on Costs

Cost control is the 'order of the day' among many businesses. A package of measures at the personal tax level which helps, in a sustainable and targeted way, to remove any remaining cost barriers for employers whilst also stimulating 'sensible' behaviours (e.g. saving for one's retirement) may reward past hard work and, at the corporate level, to encourage new lines of business to relocate to Singapore.

Conclusion

Whatever the outcome of this year's Budget, the Finance Minister is going to be hard pushed to please all of the people with all of the measures introduced. As always, there will be winners and losers.

About PwC International Assignment Services

The PwC International Assignment Services (IAS) practice provides a complete range of services for organisations deploying staff across international boundaries. This includes strategic consulting advice, planning and compliance services, as well as programme administration. With a global network of more than 4,000 professionals in more than 100 countries, we have the depth of expertise to maximise the business value from international assignments. Please visit our website at www.pwcias.com

To GST or Not to GST – so ask the SME

Authored by



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



Eudora Lee
Senior Tax Consultant
(65) 6236 3734
eudora.py.lee@sg.pwc.com

This article was contributed and first published in The Business Times on 16 December 2008.

Finance Minister Tharman Shanmugaratnam said earlier that companies can expect to get help with their costs and cashflow in next year's Budget to help them cope with the current economic downturn. While no details have been announced on the types of measures to help businesses get through these tough times, there is no reason why businesses cannot start to look at how they can cope with current cashflow costs. One such area where cashflow planning and savings can be achieved and often overlooked is that relating to the Goods and Services Tax (GST).

The purpose of this article is to highlight some of the opportunities for small and medium businesses (SMEs) seeking to reduce the cashflow costs of the GST.

Registering for GST

An SME that is not currently registered for GST can register for GST voluntarily even though its annual taxable turnover may not exceed the registration threshold of S\$1 million. This registration requirement was intentionally set high to exclude small traders (including SMEs) from the GST net. However, SMEs often opt to register in favour of claiming GST paid on purchases. While the rationale is sound, the decision to register for GST is however often not considered fully.

For a start, registering for GST would require adequate systems to monitor GST collected and paid. This is important as the Inland Revenue Authority of Singapore (IRAS) has noted that an SME, especially one that is family-owned and managed, may not necessarily have the resources and attention to maintain proper accounting records to meet their tax obligations. Such proper record-keeping is a critical aspect for GST-registered businesses as documentation is the cornerstone of the GST system. Failure to meet the record-keeping requirements can result in penalties for any incorrect accounting of the tax.

While the government introduced a two-year assistance scheme from 1 March 2007 to assist SME voluntary registrants cope with the associated GST compliance costs, the assistance scheme is capped at S\$5,000 per company. While this may cover the initial start up costs (such as training of staff and accounting software costs, etc.) to some extent, the SME needs to consider the long term costs of complying with the tax obligations including the submission of periodic GST returns, and the keeping of the records to support the zero-treatment of export transactions and GST input tax claims.

Other factors to consider include the SME's competitiveness and the nature of supplies made. If an SME's client base predominantly consists of non-registered customers, the GST component of the registered SME's sale to the customers will become a real cost (i.e. the customer is not able to claim a credit for the GST paid). The SME will therefore be in a less competitive position compared to a competitor that is not registered for GST. However, one must note that the GST could be a hidden cost in the competitor's pricing.

The practical issues of registering for GST are often overlooked by the SME due to its eagerness in receiving a potential refund of GST paid, especially when large capital purchases are made. If that is the sole objective of registering for GST, the SME must also be aware that the IRAS is able to recover GST claimed previously, on goods on hand with a value of S\$10,000 or more from taxable persons that subsequently decide to deregister for GST.

Filing of GST returns

Once registered for GST, the SME has the option to file its GST returns on a monthly or a quarterly basis. If the SME expects to receive refunds on a regular basis, it may decide to opt for a monthly filing cycle to reduce its cashflow costs. While this will improve cashflow, the SME must also consider the additional work that is required to file the monthly returns compared to filing the returns on a quarterly basis. The higher frequency of filing the GST returns can also result in a higher possibility of making mistakes in the accounting of the tax.

How errors can cost the SME more money

Businesses that are registered for GST often view GST with lesser concern in light of higher corporate tax rates (currently at 18 percent as compared to a GST rate of 7 percent). However, the risks associated with making GST mistakes can

be detrimental to SMEs given their relative size. Ask the 3,097 businesses which paid S\$87 million in tax and penalties after they were audited for GST in the last financial year¹.

Common mistakes that occur include the claiming of GST paid on purchases that are disallowed and insufficient supporting documentation.

Disallowed input tax includes GST paid on expenses relating to motor cars, club subscription fees, medical and accident insurance premiums, medical benefits, family benefits and any transactions involving games of chance. SMEs that do not have proper accounting systems tend to incorrectly claim the GST paid on such expenses. While one may claim ignorance, the onus is always on the taxpayer to be compliant.

To be entitled to make a claim of GST paid on purchases relating to business expenses, valid tax invoices must be readily available to support the SME's claim of credit. If the IRAS requests for supporting documentation and the tax invoices are not provided within a reasonable time frame, the IRAS can start a full scale audit. This often results in more costs for the business as it needs to spend administrative time and resources to deal with the audit.

The Major Exporter Scheme

Another reason why an SME may register for GST is to be eligible for the favourable import relief schemes. In essence, these schemes offer GST relief at the point of importing goods, hence alleviating cash flow issues for traders who primarily export goods that are imported.

The Major Exporter Scheme (MES) for example, allows traders to suspend GST at the point of importation of the goods. GST will only be charged if the goods are subsequently supplied locally. To be eligible for the MES, traders must satisfy certain conditions including exporting more than 50 percent of its total supplies made.

Previously, approved MES traders were required to renew their MES status every three years and to submit an auditor's positive assurance report that the numbers reported for GST are fair and correct. These renewal procedures were seen to add to the compliance costs of MES traders.

However, the IRAS has announced on 30 May 2008, that this requirement will be replaced by a simpler procedure commencing from 1 January 2009. The new procedure requires MES traders whose status expires post this date to complete a declaration form. The IRAS has therefore effectively shifted the onus to the MES trader to be MES compliant without the need for the auditor's positive assurance report.

While one may view this change to the MES renewal procedure a relief, MES traders still need to remain compliant and vigilant of their processes, as they are required to make a formal declaration of their compliance without any third party assurance. Any non-compliance can therefore potentially result in revocation of the MES status and penalties.

As you can see, there are a number of issues for an SME to consider whether to register or not for GST. SMEs therefore have to make the right choice from the word go on. If they opt to register, there are ways in which they can manage the cashflow costs, a number of which is outlined in this article. However, there are also administrative costs that need to be consistently evaluated to ensure that GST exposure is reduced to a minimum. The message here is that GST is no longer a small administrative issue and SMEs need to be GST vigilant at all times to avoid the negative consequences of any failure to properly account for the tax.

¹IRAS Annual Report 2007/08

Investing in R&D to tackle crisis

Authored by



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



Ho Kah Chuan
Tax Manager
(65) 6236 3813
kah.chuan.ho@sg.pwc.com

This article was contributed and first published in The Business Times on 30 December 2008.

The current global credit crunch could adversely affect investment in research and development (R&D), and seriously delay the discovery of new products, processes or solutions. In fact, if the global financial crisis drags on, businesses may consider investing in R&D activity to be a risky proposition.

To continue investing in R&D

While the R&D investment rate of Singapore-based businesses has grown over the years, it could be seriously affected by the current economic downturn. It would be unfortunate if the focus shifts towards layoffs and closing down research units.

Even though the global credit crunch has clouded Singapore's economic outlook, investment in R&D and innovation is more important now than ever. Continued investment in innovation will not only help businesses to emerge stronger and faster from the recession, but can also help to jumpstart the overall economy. Research dollars should not be curtailed because major challenges of the modern society, such as security of energy supply, food safety and climate change, will remain long after the resolution of this current crisis.

Over the past few years, government's efforts to spur R&D and intellectual property (IP) management activities in Singapore have resulted in the development of a supportive fiscal and legal regime, building world-class infrastructure capabilities, attracting scientists and engineers from across the globe and nurturing highly scalable IP business models like franchising and merchandising. Instead of slowing down, the pace of R&D and IP developmental efforts in the public and private sectors in Singapore should be continued or even stepped up during the current economic crisis. In fact, to encourage more R&D investment, the Singapore government introduced a slew of R&D tax measures in the 2008 Budget. Prime Minister Lee Hsien Loong has also recently reiterated the government's full commitment to investing in R&D to develop a key capability to keep the economy competitive. The government has taken the lead and it is up to businesses to react.

With 2009 Budget round the corner, what more can the Singapore government do to boost innovation amid the current economic gloom?

Liberalisation of tax deductions for R&D outsourced overseas

Under the current tax regime, new businesses can now get tax deductions for expenditure on R&D performed in-house and outsourced to an R&D organisation, with the possibility of qualifying for further deductions (ranging between 130 percent and 150 percent), if the R&D is carried out in Singapore. However, no tax deductions are available at all for expenditure incurred for R&D outsourced overseas in relation to a new business. This seems to go against the grain of the government's efforts to promote entrepreneurship and pervasive R&D. With Singapore's R&D and IP industry still in its infancy, it is difficult to understand why the government should penalise Singapore enterprises if they outsource their R&D overseas, especially when the IP rights are owned and exploited from Singapore. Perhaps there is a need to level the playing field and allow taxpayers to claim tax deductions for at least 100 percent of these expenses if Singapore is to continue to grow its entrepreneurship R&D development in Singapore.

Introduction of additional tax concessions to encourage IP exploitation

The government's vision is to build Singapore as a compelling hub for businesses to create, protect and commercialise their IP assets. Over the past few years, it has focused very much on creating a conducive tax environment for IP creation and protection. For example, tax concessions were introduced to encourage IP creation, IP acquisition and patent registration. However, there are limited tax concessions to specifically encourage IP exploitation, which involves harnessing IP rights to develop and market goods or services, or earn royalties and franchise fees. In this regard, the following two suggestions may be worth exploring.

First, a specific tax incentive programme should be introduced that offers a concessionary tax rate for income arising from specified IP management activities. Due to the inherent portability of IP, it is important to have a more competitive tax regime to attract and retain IP rights and related business activities in Singapore. Otherwise, the government's R&D and IP developmental efforts may go to waste if IP assets created here are ultimately shifted out of Singapore and exploited from elsewhere.

Second, to complement the proposed IP tax incentive, the current foreign tax credit regime could be liberalised to introduce the concept of pooling and carry forward of foreign tax credits, which arise on account of foreign withholding tax suffered on royalties received from overseas. Currently, claims for foreign tax credits are restricted to the lower of the foreign tax paid or Singapore tax payable on the net foreign-sourced royalty income. This significant disadvantage could be alleviated by pooling these foreign tax credits and offsetting them against tax payable on other sources of income, as well as allowing the excess foreign tax credits to be carried forward.

Conclusion

Singapore could differentiate itself by introducing further innovative measures to nurture an innovative economy. This will help the country to emerge as a stronger nation at the end of the present financial turmoil. Budget 2009 will hopefully provide an opportunity to introduce additional fiscal policies to encourage IP exploitation and bolster the government's vision and long-term commitment to support R&D and IP management activities in Singapore.

M&A activities may need a Budget boost

Authored by



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



Lim Chin Chin
Senior Tax Consultant
(65) 6236 3827
chin.chin.lim@sg.pwc.com

This article was contributed and first published in The Business Times on 1 January 2009.

Mergers and acquisitions (M&A) activities have overall ebbed in 2008 with credit constraints, volatile equity markets and weak confidence. Against this negative backdrop, there are still some positive sentiments that will limit the fall in M&A activities in the coming year. Valuations are going down by the day. Strategic buyers and cash-rich companies have the opportunities to cherry pick quality assets which are at distressed levels and shall emerge from this crisis with stronger balance sheets.

In times like these, Singapore will need more creative reform that will foster new growth areas to maintain its competitiveness as an international financial hub in Asia. Based on the 2008 Index of Economic Freedom by the US-based Heritage Foundation, Singapore was ranked second after Hong Kong in terms of economic freedom. Today, Singapore is already a preferred country to set up regional operations due to its low tax rates, wide tax treaty network and tax incentives.

However, a particular point for M&A players intending to acquire a Singapore target or use Singapore to host an acquisition vehicle is the tax impact relating to any interest cost. Currently, interest costs on borrowings used to acquire shares

are not tax-deductible. This is so given that dividend income is exempt from tax and therefore, interest costs attributable to the exempt dividend income shall have no tax benefit.

It is not uncommon for investments to be financed at least in part through borrowings and therefore, impact on funding costs is a major factor to be considered in any investment plan. The tax impact from the non-deductibility of interest costs can be hefty and may kill the appetite for a deal.

Perhaps it is an opportune time to introduce reform to this rule. To illustrate the point, tax regimes in countries such as the United Kingdom (UK), the United States (US), the Netherlands and Australia allow some tax deduction for interest costs on borrowings used in a shares acquisition of an entity. The allowance for interest deduction, however, may be subject to certain restrictions, which may include, but may not be limited to, thin capitalisation rules and limitations on the deductibility of interest costs on related-party loans.

Countries with favourable tax treatment for interest costs

Listed below are the general deduction rules for interest costs in the UK, US, Netherlands and Australia. The general rules set out below assume the acquirer and target are tax residents of the same country.

UK

Interest costs are generally given tax relief when they are taken to the income statements pursuant to generally accepted accounting principles in the UK. Interest costs are deductible against three forms of income (a) deductible on accrual basis against income in the same year; (b) against income of the company in the previous 12 months; or (c) against current year profits of the other company within the same group. Any surplus of interest costs after these options have been exhausted may be carried forward to offset against future non-trading profits derived by that company.

US

Subject to limitations, interest costs generally are deductible when paid or accrued on valid business indebtedness of the taxpayer claiming the deduction. After an acquisition in which certain ownership thresholds are met, the acquirer and the target may elect to file a consolidated US federal income tax return. A consolidated return generally results in the affiliated group of corporations being treated as a single corporation for US federal income tax purposes. Thus, subject to applicable limitations, an acquirer's interest costs on acquisition debt may be deductible against the target's profits.

The Netherlands

Subject to limitations, interest costs incurred on genuine third party debt are generally deductible, whereas interest paid to related parties could be restricted under certain circumstance.

Under the tax consolidation rules for Dutch subsidiaries, the Dutch tax resident companies can be treated as a single taxpayer and file one tax return. Essentially, in a simple acquisition structure involving a Dutch parent company acquiring a Dutch target, the fiscal unity concept is relied on by the parent company to offset the acquisition interest costs against the Dutch target's profits. In addition, the Dutch companies should be effectively managed and controlled in the Netherlands, i.e. have sufficient substance, to form a fiscal unity.

Australia

Interest costs are generally deductible in Australia, including situations in which entities are part of a tax consolidated group. Similar to the Dutch and US rules, resident group companies within a consolidated group are treated as a single entity for tax purposes. In this respect, the acquirer and the target can form a tax consolidated group and offset the acquisition interest costs against the target's profits.

Allow deduction for interest costs

Singapore should look to reform existing rules and allow tax deduction for interest costs to attract more M&A activities in Singapore. Rules as suggested below could be introduced:

- Concession to allow outright deduction of acquisition interest costs against target's business profits; or
- Make current group relief system more user-friendly – Taking the UK model as an example, the existing tax group relief provision could be widened to allow interest costs to be treated as normal business expense and be used to offset taxable income within a group; or
- Where the acquiring company has other sources of taxable income, to allow interest costs to be treated as a business expense and offset against the other operating profits of the company.

To avoid companies taking advantage of the tax benefit certain rules may be imposed. For example, thin capitalisation rules could be applied where there are related party loans.

Pros to support change

Reform to the existing rule may not necessarily result in loss of tax revenue to Singapore. There are greater benefits to be derived from the change.

- The valuation for Singapore companies could be enhanced and therefore increase stamp duty collections given the higher transaction values.
- The lending business in Singapore should be enhanced. A condition may be imposed on an acquiring company such that the financing must be obtained from Singapore-based banks in order to qualify for deduction of interest costs.

- Singapore could be a more attractive location for setting up a holding company or regional headquarters.

Conclusion

In Asia, tax rules in Hong Kong, China, India and Malaysia are facing the same issue as Singapore whereby deduction for interest costs are also not available under the respective countries' tax regime. Therefore, the reform does not only make Singapore more appealing to M&A players in Asia but could also be a step further in building Singapore into an international financial and business hub.

When transparency is not such a good thing – funds and the limited partnership issue

Authored by



Anuj Kagalwala
Tax Partner
(65) 6236 3696
anuj.kagalwala@sg.pwc.com



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

This article was contributed and first published in The Business Times on 13 January 2009.

2008 proved to be a tumultuous year for the fund management industry. While this may have taken some of the attention away from the tax incentives that Singapore has to offer for the time being, this should not stop the Singapore government from continuing to improve the tax incentive schemes to ensure that Singapore continues to be an attractive location in Asia for fund managers. The upcoming Budget will be a timely opportunity for the government to consider fine-tuning the current rules to make Singapore stand out against its competitors, as we ride out the global recession.

Revisiting the new rules

In 2007, the Singapore government announced the replacement of the infamous '80:20 rule' after receiving feedback from the fund management industry. The Monetary Authority of Singapore released details of the much awaited new rules replacing the 80:20 rule on 31 August 2007. The main features of the new rules are as follows:

- Foreign funds will now have to be 'qualifying funds' to come within the tax exemption scheme. To be a qualifying fund, one of the conditions is that it must be a company or a trust that is not 100 percent beneficially owned by Singapore investors.

- A second level test in respect of the investors in the funds was introduced – investors are to be segregated into 'qualifying investors' and 'non-qualifying investors'. Non-qualifying investors will be subject to a 'tax' referred to as a 'financial amount'. Stripping the definition down to its basic elements, the investors that are likely to fall within the non-qualifying investors category seem to be Singapore investors (other than individuals) who own substantial stakes in the funds (generally more than 30 percent).

What the rules mean basically is that only non-qualifying investors pay tax, rather than, under the old 80:20 rule, the whole fund. On the whole, the new rules should also help alleviate some of the compliance issues and uncertainties previously faced by fund managers in applying the 80:20 rule. Nonetheless, as with all new tax rules, there are teething problems that have to be sorted out for smoother implementation. To their credit, the authorities have clarified various aspects of the new rules. However, some problems have yet to be addressed satisfactorily.

Catering to funds in the form of limited partnerships

One major issue with the new rules, as was the case with the old 80:20 rule, is that they do not cater for funds set up in the form of limited partnerships (LPs). Such vehicles are commonly used for funds targeted at investors from the United States, the United Kingdom and Japan, amongst others. Very often, fund management groups from overseas already have fund structures involving the use of an LP. It is difficult to restructure these existing funds into a corporate or a trust structure just so that they can set up a Singapore office. This is for many reasons including investor preference to invest into funds set up as an LP and costs associated with restructuring. Often, after conducting a cost-benefit analysis, these fund management groups decide to either set up an office elsewhere in Asia or limit their level of activities in Singapore to avoid triggering Singapore tax issues for their funds. While the former is clearly not good for Singapore, the latter is not good either since it means fewer senior personnel in Singapore. It is surprising that the tax exemption rules for foreign funds have not been amended for LP vehicles given their widespread use in the fund management industry, and the recent introduction of LP legislation in Singapore.

Concern with look through of LP funds

What then is the problem of using an LP as a fund vehicle from a Singapore tax perspective? LPs, like general partnerships, are treated as transparent for Singapore tax purposes. While not explicitly stated in the new rules, the same treatment will apply for the purpose of determining whether a fund is a qualifying fund or whether the investors are non-qualifying investors. This may not sound like an insurmountable problem at first, but once you attempt to apply the new rules to an LP fund, the practical difficulties become quickly apparent.

To illustrate the complexities, we will briefly take you through the steps of applying the new rules to an LP fund. The first step is to apply the qualifying fund test. Because an LP is treated as transparent for Singapore tax purposes, the qualifying fund test is to be applied at the level of the partners in the LP fund. In other words, the fund does not exist, and each investor thus becomes a fund in his right. This brings about a number of issues, including the following:

- Some of the limited partners may not meet the definition of a qualifying fund, for example, companies resident in Singapore that own a small percentage of the LP fund and non-Singapore companies with Singapore operations. Had the qualifying fund definition been applied at the LP fund level, these investors may not have been exposed to Singapore tax on their investment in the foreign fund. It also does not appear to be the policy intention to impose Singapore tax on these investors.
- Assuming the fund manager has gone through the trouble of filtering out those limited partners who are not qualifying funds, the fund manager would have to then attribute a portion of the net income of the LP fund to each limited partner that is not a qualifying fund. This can be cumbersome administratively and again takes resources away from the core functions of the fund manager.

Assuming that the fund manager is able to overcome these difficulties, the next step is for the fund manager to apply the qualifying investor test. However, this test is to be applied to the shareholders of the investors in the LP fund. Will the fund manager be brave enough to ask for information on the investor's shareholding to the extent required under the qualifying investor definition? It may be unrealistic to expect investors to divulge this information readily. Furthermore, the qualifying investor test was never designed to be applied to persons other than the actual investors in funds. This look through treatment for LPs only moves all tests a layer up causing some needless complications.

You do not have to change the old with the new

The next question to ask is why the authorities have not looked into amending the rules? Perhaps the concern is that such a change will erode the existing government policy of treating all forms of partnerships as tax-transparent in Singapore.

This does not have to be the case. The over-arching tax policy of treating partnerships as tax transparent can remain, even if the rules are changed for foreign funds to cater for LP funds. All this requires is a tweaking of the rules for the qualifying fund definition to be applied at the LP fund level and the qualifying investor definition to the limited partners. This does not mean levying tax on the LP fund as a taxable entity. If an LP fund cannot meet the definition of a qualifying fund, the normal Singapore tax treatment of partnerships will apply, i.e. tax will be levied on all the partners accordingly.

In fact, with many countries introducing different forms of entities, the authorities should perhaps also consider amending the rules to cater for legal forms other than companies, trusts and partnerships (and variations of it).

Conclusion

The new rules certainly signal the Singapore government's readiness to respond to the needs of the fund management industry in providing a flexible and conducive environment for fund managers to operate in. One further aspect that the Singapore government can look into enhancing is fine-tuning the rules to cater for different legal entity forms, including limited partnerships.

This move will help Singapore to continue to position itself as a location of choice for fund managers looking to set up or to expand operations in Asia, and provide the impetus for growth of Singapore as a fund management centre as the Asian region rides out the recession.

Untrapping cash from imports and exports to boost your company

Authored by



Frank Debets

Partner

PwC Worldtrade Management Services

(65) 6236 7302

frank.debets@sg.pwc.com

This article was contributed and first published in The Business Times on 16 January 2009.

Most if not all importers and exporters are well aware that Singapore is like a 'freeport' for them, with few import or export related duties and taxes. Various facilities exist to even delay those duties that are payable, or prevent them from becoming a cost at all for transshipments, such as the Major Exporter and various Licensed Warehouse Schemes.

Therefore, it is not surprising that looking for available cash hidden in import and export activities does not appear to come natural to many Singapore companies, even when they are hit by a stuttering economy. However, rather than expecting some miraculous new advantages from the upcoming Budget, those importers and exporters would do well to re-examine their trade flows in the light of existing opportunities that may have become more attractive in these changed economic times.

Consider the following example: a company (let us call it Tradeco Pte Ltd) buys products made by a supplier in Thailand and stores them in a commercial warehouse in Singapore. No import or excise duty is due but import GST is duly paid. Three months later the products are sold at a 30 percent markup to two customers, one in the United States (US) and the other in Indonesia. The agreed terms of trade are Delivered Duty Paid (DDP), which basically means all costs and risks are Tradeco's responsibility until the products are delivered to the premises of the customers in the respective countries. Tradeco appoints a low-cost third party provider (3PL) to take the products from the warehouse in Singapore and deliver them to the doorsteps of the customers. The 3PL is paid for all its costs, GST is reclaimed after export and the customers pay the invoice for the goods a few months later.

Not a very exciting example and a pretty standard way of doing business, you may think. Given the current hard times, Tradeco has turned the products around pretty quickly and made a decent profit in the process. But let us examine the example in a little more detail to see whether we can find some hidden cash in the import and export operations.

Free Trade Agreements (FTAs)

Singapore has FTAs with both Indonesia and the United States (US), hence products could be entitled to lower rates of import duty in these countries. As the terms of trade are DDP, these would have meant savings for Tradeco, who have already secured a final sales price.

For the exports to Indonesia, if the relevant certificate of origin can be obtained from the Thai supplier, Singapore Customs can issue a so-called 'Back-to-Back' certificate which can be used to pay the lower rates of duty upon importation into Indonesia. For exports to the US, things are not so straightforward. Tradeco may need to perform some processing on the products in Singapore for them to be deemed 'Singapore origin' for the purposes of using the US-Singapore FTAs lower duty rates. The duty benefit obtained in the US may well outweigh the extra cost of performing some operations in Singapore.

If Tradeco already looked at the potential use of FTAs and discarded them, they should look again. Most FTAs offer a phased duty reduction for eligible products, and what was not worth the effort two years ago may be worth the effort now. This is particularly true as many countries are looking to increase their standard duty rates, usually known as most-favoured-nation (MFN) rates. These increases can go up to as high as the 'bound rates' agreed at the World Trade Organisation. Such increases in MFN rates may make the preferential rate that an FTA offers much more attractive.

If Tradeco's product is not covered by an FTA, it could be worthwhile to try and have it added. Most FTAs are reviewed regularly, and "he who shouts loudest usually gets heard".

Customs valuation

As duties are often payable as a percentage of value, DDP is often not an efficient trade term for customs valuation. Although the customer may be happy to receive the product at no effort, Tradeco may be paying duties on a value that includes post-importation costs that need not be subject to duty. Options do exist to separate such costs from the dutiable value. Tradeco may already have a subsidiary in Indonesia and/or the US, or even its own presence. Using such intermediaries often allows a lower import value to be declared, thus reducing all ad-valorem import taxes. As Table 1 shows, any duty savings will offset a corresponding corporate tax increase, usually quite handsomely.

Duty exemptions

Reducing an import related duty bill is desirable as such duties are treated by most companies as costs rather than taxes, hence impacting the bottom line. But should Tradeco be paying duties in the first place? Many countries offer facilities for duty exemption if the importer can demonstrate that a particular product is not available and cannot be produced in the local market. Building a case may not be straightforward, but the potential prize may justify some effort.

Managing a third party provider

And how about Tradeco's management of the 3PL? Most 3PLs are selected based on speed and cost, both measured directly. This is often not in the best interest of the importer or exporter. For example, the 3PL would usually regard import duties as pass-through costs and trying to use FTAs may involve more time and work, so it has no interest in using them.

Also, a customs officer at the port of import may insist on the use of a customs classification code which attracts a higher rate of duty. The 3PL, with little knowledge of the product and a vested interest in quick clearance, is unlikely to put up much of a fight. No decisions regarding the declaration of customs valuation, classification and origin should be taken by the 3PL without Tradeco's knowledge and approval. Changing the classification of a product may have an immediate impact on duty rates payable, as well as bring on a host of other problems, such as quota restrictions, licence requirements, anti-dumping duties, etc. It is also surprising how many companies do not know how much import and export duties they may be paying, such is the level of uncontrolled outsourcing of this function to third parties. Experience teaches that it is unlikely that the upside to such uncontrolled outsourcing outweighs the potential downside.

Customs classification

On the topic of customs classification, all the dangers of uncontrolled classification can also be viewed as opportunities for controlled classification, or 'tariff engineering'. Minor changes to product or supply chain often allow changes in product classification that significantly reduce a duty bill, or eliminate quota or licence restrictions or anti-dumping duties. Sometimes a review of existing classification codes uncovers opportunities to argue that a different code is more appropriate for a product, leading to similar benefits. Remember that product engineers have little or no knowledge of the impact of their actions on the customs classification of a product. In the food industry, a slight change in recipe could double the amount of import taxes that apply. Tradeco could improve its position by sitting down with the supplier to ensure the most advantageous appropriate customs classification is used.

Conclusion

The example in this article is necessarily simplified, for illustration purposes. At the same time, it has only discussed some of the most obvious opportunities for finding cash. Using an appropriate warehouse to suspend payment of GST in Singapore, for example, would provide a cash flow benefit. Subscribing to the various secure trade schemes may involve some upfront investment, but could be a good tradeoff for shorter clearance times and lower inspection rates.

The Singapore government, as others, has provided many of such facilities in the past, and may very well enhance some of them in the coming Budget. It is up to the importers and exporters like Tradeco to take full advantage. After all, you can take the horse to the water, but you cannot make it drink.

Table 1: Simplified duty savings calculation

	Current	Lower customs value	Savings	
Sales	2,000	2,000		
Customs value	2,000	1,800		
Purchases	-1,000	-1,000		
Customs Duty @ 10%	-200	-180		
Gross Profit	800	820	20	(Before Tax)
General Expenses	-600	-600		
Net Profit Before Tax	200	220		
Corporate Income Tax @ 25%	-50	-55	-5	
Net Profit After Tax	150	165	15	(After Tax)

About PwC Worldtrade Management Services (WMS) Pte Ltd

Worldtrade Management Services (WMS) is the global customs and international trade consulting practice of PricewaterhouseCoopers. WMS has been in Asia since 1992 and is a regionally integrated team of full-time specialists operating in every location. Our team is a blend of Asian nationals and expatriates with a variety of backgrounds, including ex-senior government officials, customs officers, international trade lawyers, accountants, and specialists from the private sector who have experience in logistics, customs and international trade.

Liberalising bilateral relations between Singapore and India

Authored by



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



Aparna Agrawal
Tax Manager
(65) 6236 3630
aparna.agrawal@sg.pwc.com

On 29 June 2005, Singapore concluded a Comprehensive Economic Cooperation Agreement (CECA) with India. This landmark agreement is India's first-ever CECA and Singapore's first-ever comprehensive bilateral economic agreement with any South Asian economy.

After the CECA was implemented, bilateral trade and investment between the two nations increased significantly. According to the Department of Industrial Policy & Promotion, Ministry of Commerce & Industry in India, the cumulative total foreign direct investment (FDI) from Singapore to India between April 2005 and August 2008 was approximately US\$5.5 billion. In comparison, the FDI from Singapore to India between April 2000 and March 2005 was only US\$0.43 billion. In July 2007, Singapore was ranked as the sixth largest investing country into India. Notably, Singapore became the second largest investor into India by August 2008, after Mauritius and ahead of Japan, the United Kingdom and the United States.

Following the first review of the CECA in 2007, Singapore and India signed a Protocol amending the agreement (dated 20 December 2007) to further liberalise the tariff concessions for Singapore's exports to India. The revised tariff concessions took effect from 15 January 2008.

The second review of the CECA is expected to begin during the first half of 2009. Both governments are aiming to expand bilateral trade to US\$50 billion by 2012, support international expansion for Indian businesses, and increase cross-border

tourism. Quite likely, special attention will be given to encourage Singapore's investment into India's infrastructure sector, with more opportunities for Singapore-based companies to participate in public-private partnership projects.

As part of the second review process and to promote greater business-to-business cooperation and cross-border investment, we hope to see both nations carefully re-examine and liberalise some of the existing tax reliefs provided under Singapore-India tax treaty. Furthermore, where necessary, they could clarify, by way of illustration, some of the doubts that currently exist with regard to the application of the Articles under the Protocol signed on 29 June 2005 relating to the tax treaty. This article aims to highlight some of the issues that should be considered in this second review process.

Tax exemption subject to India-Mauritius tax treaty

Pursuant to the 29 June 2005 Protocol to the tax treaty, Singapore investors investing into India will not be subject to Indian capital gains tax upon divestment of their stake in any Indian company, provided certain conditions are satisfied.

Unfortunately, under Article 6 of the Protocol, Singapore investors can only access this benefit as long as a similar capital gains tax exemption continues to be provided under the India-Mauritius tax treaty. If for any reason, the India-Mauritius tax treaty is renegotiated to dispense with the exemption, Singapore investors will suffer the same consequences.

Since Singapore-based investors will not be enjoying any additional benefits vis-à-vis a Mauritian investor, the authorities may like to consider omitting Article 6 of the Protocol to provide more certainty for Singapore investors who have long-term plans for investing into India.

Qualifying for exemption from Indian capital gains tax

The Protocol has laid down certain conditions to be fulfilled by Singapore investors in order to qualify for the exemption from Indian capital gains tax upon divestment of their stakes in Indian companies. Specifically, a Singapore resident investment vehicle will not be entitled to claim this exemption if, inter alia, it is a shell/conduit company. A company is deemed to be a shell/conduit company if its total annual expenditure on operations is less than S\$200,000 in the immediate preceding period of 24 months from the date the gains arise. A company listed on a recognised stock exchange will not be deemed to be a shell/conduit company.

While the above conditions were effective from 1 August 2005, a degree of ambiguity still clouds the application of the above conditions. Investors are keen to seek clarifications on some of these issues:

- Can a Singapore investor qualify for the exemption if it meets the expenditure criteria of S\$200,000 before expiry of the 24 months preceding the date when gains arise?

- Will capital expenditure (or depreciation) be considered for the purpose of calculating S\$200,000 threshold?
- What is the compliance process for satisfying the Indian tax authorities that the tax exemption is available? Will it be sufficient to file copies of management accounts, when divestments are made before close of the seller's accounting year?

In addition, there is a need to review the 24-month rule. This is because a company for example that has US\$5 million of local spending (which is not a shell/conduit company) will not qualify for the exemption, if it sells an Indian investment within, say, 23 months of incorporation. We hope the second review of CECA will provide the much needed clarity on these issues.

Withholding tax (WHT) on royalty and fees for technical services

Under the Protocol, effective 1 August 2005, the WHT rate on payments for royalty or technical service fees was reduced from 15 percent to 10 percent. This was meant to encourage cross-border transfer of knowledge and know-how between the two nations. However, effective 1 April 2006, under the Indian domestic law, the WHT applicable on these payments was also reduced to 10 percent (for agreements made on or after 1 June 2005).

The tax payer has a right to apply the WHT rate as per the tax treaty or the domestic tax laws, whichever is lower. Given that the WHT rate under the tax treaty and the domestic tax laws were brought to par, the preferential benefit under the Protocol was short-lived with a validity of only eight months! Perhaps, a further reduction of the WHT rate to, say, 5 percent, may help to achieve the desired objective.

Withholding tax on interest on borrowings

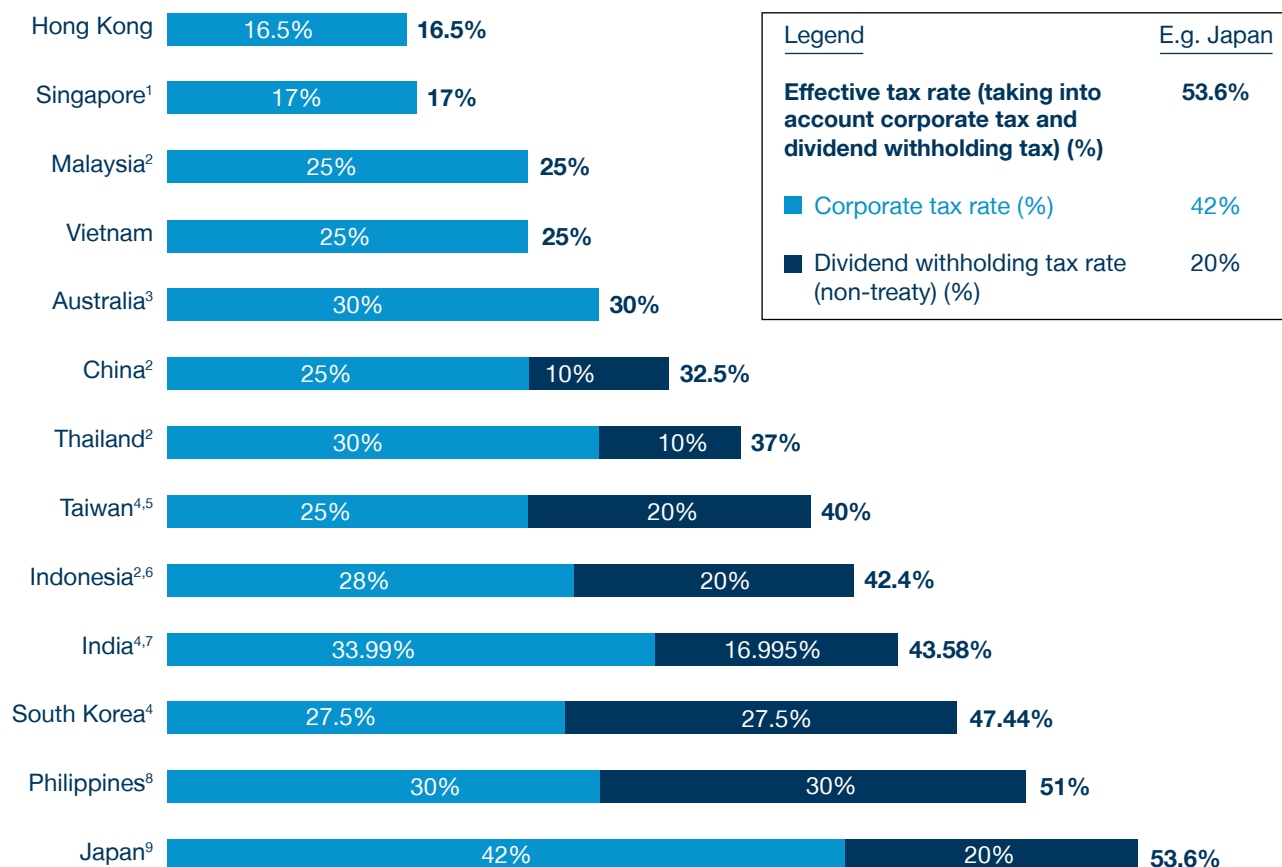
Over the last couple of months, India has liberalised its External Commercial Borrowing (ECB) policy to attract inflows of foreign capital and help Indian companies raise funds for financing specified projects. As a measure to entice Singapore-based investors to extend loans to fund Indian projects, India may consider the possibility of reducing the existing interest WHT rate of 15 percent to, say 10 percent (similar to the WHT rate as provided under the India-Cyprus tax treaty).

Conclusion

As India and Singapore continue to expand their bilateral economic relations for mutual benefit, one can hope that the authorities of both countries will consider liberalising their policies to develop a strong platform for expansion of cross-border trade and investments.

Appendix A

Comparison of Asia Pacific effective tax rates on repatriated corporate profits (for income year 2009)



Notes:

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

¹ Partial exemption of up to S\$152,500 applies to the first S\$300,000 of chargeable income.

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

³ Fully-franked dividends paid to non-residents are not subject to dividend withholding tax, but to the extent that a dividend paid to a non-resident is unfranked, withholding tax of 30 percent will generally apply.

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

⁵ The dividend withholding tax rate is 20 percent, but in some cases, it would be 25 percent if the corporate taxpayer did not obtain approval from the authority. An additional 10 percent tax will be imposed on any current earnings that remain undistributed by the end of the following year. However, the 10 percent surcharged amount may be used to offset the dividend withholding tax, subject to a certain tax limit.

⁶ Listed companies which satisfy certain requirements are subject to tax at 23 percent.

⁷ India does not impose dividend withholding tax. This is a dividend distribution tax on the dividends declared, distributed or paid by the company.

Such dividend is exempt from tax in the hands of the recipient shareholders.

⁸ Dividends paid to a non-resident corporation are subject to a lower rate of 15 percent if the country in which the corporation is domiciled either does not impose income tax on such dividends, or allows tax deemed paid credit of 15 percent. In addition, a 10 percent improperly accumulated earnings tax is imposed on the improperly accumulated earnings of a corporation which allows its earnings or profits to accumulate beyond its reasonable needs.

⁹ This is an approximate statutory effective rate of tax due to the varying influence of national and local taxes, which may vary depending on the capital base, size and nature of the company's business. The 20 percent withholding tax applies to private (unlisted) companies; a lower rate applies for withholding tax on dividends from listed Japanese companies.

Appendix B

Comparison of Asia Pacific individual tax liabilities (a married man with two dependent children for income year 2008)

	Total Remuneration US\$75,000		Total Remuneration US\$100,000		Total Remuneration US\$200,000	
	Tax Liability US\$	Effective Tax Rate %	Tax Liability US\$	Effective Tax Rate %	Tax Liability US\$	Effective Tax Rate %
Singapore ¹	2,754	4	5,554	6	21,657	11
Australia ³	21,325	28	31,700	32	76,900	38
China	14,229	19	21,547	22	59,213	30
Hong Kong	4,050	5	8,301	8	25,301	13
India ⁴	23,009	31	31,507	32	65,497	33
Indonesia ⁵	16,331	22	23,721	24	53,283	27
Japan	4,756	6	10,096	10	43,381	22
Malaysia ⁶	14,908	20	21,658	22	48,658	24
Philippines	22,305	30	30,305	30	62,305	31
South Korea	10,311	14	17,126	17	53,701	27
Taiwan	8,334	11	14,728	15	49,899	25
Thailand	16,562	22	24,062	24	59,973	30
Vietnam ⁷	17,350	23	26,100	26	61,100	31

Notes:

¹ Inclusive of one-off income tax rebate of 20% granted to all resident taxpayers, capped at S\$2000.

² Standard deductions are taken into account.

³ Based on new tax rates for year ending 30 June 2009.

⁴ Based on new tax rates for year ending 31 March 2009.

⁵ Based on new tax rates and income tax bands effective from 1 January 2009.

⁶ Based on new tax rates and income tax bands effective from calendar year 2009.

⁷ Based on new tax rates effective 1 January 2009.

⁸ Deductions for Social Security are not taken into account unless the contributions are compulsory by law.

Appendix C

Resident individual tax rates for years of assessment 2008 and 2009

	Chargeable Income	Years of Assessment 2008 and 2009	
		Rate %	Tax \$
	\$		
On the first	20,000	0.00	0.00
On the next	10,000	3.50	350.00
On the first	30,000		350.00
On the next	10,000	5.50	550.00
On the first	40,000		900.00
On the next	40,000	8.50	3,400.00
On the first	80,000		4,300.00
On the next	80,000	14.00	11,200.00
On the first	160,000		15,500.00
On the next	160,000	17.00	27,200.00
On the first	320,000		42,700.00
On income above	320,000	20.00	

PricewaterhouseCoopers Services LLP

Corporate Tax

Paula Eastwood	paula.eastwood@sg.pwc.com	65 6236 3648
Sunil Agarwal	sunil.agarwal@sg.pwc.com	65 6236 3798
Paul Cornelius	paul.cornelius@sg.pwc.com	65 6236 3718
Abhijit Ghosh	abhijit.ghosh@sg.pwc.com	65 6236 3888
Ho Mui Peng	mui.peng.ho@sg.pwc.com	65 6236 3838
Anuj Kagalwala	anuj.kagalwala@sg.pwc.com	65 6236 3822
Lennon Lee	lennon.kl.lee@sg.pwc.com	65 6236 3728
Paul Lau	paul.st.lau@sg.pwc.com	65 6236 3733
Elaine Ng	elaine.ng@sg.pwc.com	65 6236 3627
David Sandison	david.sandison@sg.pwc.com	65 6236 3675
Peter Tan	peter.tan@sg.pwc.com	65 6236 3668
Yip Yoke Har	yoke.har.yip@sg.pwc.com	65 6236 3938

Corporate Tax Compliance Services

Chan-Cheng Wei	cheng.wei.chan@sg.pwc.com	65 6236 3808
Jenny Goh	jenny.goh@sg.pwc.com	65 6236 3638

Indirect Tax

Koh Soo How	soo.how.koh@sg.pwc.com	65 6236 3600
-------------	------------------------	--------------

Transfer Pricing

Nicole Fung	nicole.fung@sg.pwc.com	65 6236 3618
Paul Lau	paul.st.lau@sg.pwc.com	65 6236 3733

Mergers and Acquisitions

Chris Woo	chris.woo@sg.pwc.com	65 6236 3688
-----------	----------------------	--------------

PwC International Assignment Services (Singapore) Pte Ltd

Personal Tax

James Clemence	james.clemence@sg.pwc.com	65 6236 3948
Margaret Duong	margaret.duong@sg.pwc.com	65 6236 3958

PricewaterhouseCoopers Worldtrade Management Services Pte Ltd

Customs and International Trade

Frank Debets	frank.debets@sg.pwc.com	65 6236 7302
John Robinson	john.p.robinson@sg.pwc.com	65 6236 7318

PricewaterhouseCoopers LLP

Private Client Services

Florence Tan-Nguyen	florence.nguyen@sg.pwc.com	65 6236 3868
---------------------	----------------------------	--------------

About PricewaterhouseCoopers Services LLP (PwC Services, Singapore)

PwC Services is one of the largest providers of professional tax services in Singapore. With more than 230 tax professionals and directors, we help individuals, businesses, both public and private organisations, with tax strategy, planning and compliance. From financial services, treasury, fund management, mergers and acquisitions, intellectual property, international tax planning (inbound and outbound) and Goods and Services Tax (GST) to transfer pricing, our tax professionals will provide you with the ideal tax solution.

Visit our Singapore tax website at www.pwc.com/sg/tax

About PricewaterhouseCoopers – Globally

PricewaterhouseCoopers (www.pwc.com) provides industry-focused assurance, tax and advisory services to build public trust and enhance value for its clients and their stakeholders. More than 155,000 people in 153 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

About PricewaterhouseCoopers – China, Hong Kong and Singapore

PricewaterhouseCoopers China, Hong Kong and Singapore operate on a combined basis, subject to local applicable laws. Taken together, we have more than 460 partners and a strength of 12,000 people.

The firm provides a wide range of services to help organisations solve business issues, identify and maximise opportunities. Our industry specialisation enables us to identify trends and customise solutions for your sector of interest. Each line of service is staffed with highly qualified, experienced professionals and leaders in our profession. These resources, combined with our global network, allow us to provide the support you need wherever you may be located.

We are located in these cities: Beijing, Hong Kong, Shanghai, Singapore, Chongqing, Dalian, Guangzhou, Macau, Ningbo, Qingdao, Shenzhen, Suzhou, Tianjin and Xi'an.

"PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

© 2009 PricewaterhouseCoopers Services LLP. All rights reserved.

8 Cross Street, #17-00 PWC Building, Singapore 048424 • Tel: 65 6236 3388 • Fax: 65 6236 3715

PricewaterhouseCoopers Services LLP (Registration No. T09LL0002L) is a limited liability partnership registered in Singapore under the Limited Liability Partnerships Act (Chapter 163A). It was converted from a company (with the name "PricewaterhouseCoopers Services Pte Ltd" and Registration No. 199902830D) to a limited liability partnership on 1 January 2009. PricewaterhouseCoopers Services LLP is part of the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

These notes are designed to keep clients up to date with tax developments and do not constitute professional advice. They are of a general nature only and are not intended to be comprehensive. Readers are therefore advised that before acting on any matter arising from these notes, they should discuss their particular situation with the Firm. No liability can be accepted for any action taken as result of reading the notes without prior consultation with regard to all relevant factors.

