Budget Commentary

Singapore • 15 February 2008

Meeting expectations

The content of the 2008 Budget unveiled by the Finance Minister Tharman Shanmugaratnam on 15 February was largely predictable. Our view had been that there was no need to bring down corporate taxes further as a general proposition, and in the face of a pick-up in inflation, it was not likely that the Finance Minister would risk additional retail liquidity through personal tax reductions. It was also clear that there would be subsidies for the lower income group, as well as for education and workforce training. The rest we thought, would be tweaking and tidying up around the edges. Broadly, that was what we got.

But there was one surprise, and it was a pleasant one. Estate duty, which had battled away for many years was finally delivered the coup de grâce and removed from the fiscal landscape. This was an archaic tax which produced comparatively little in revenue. Its demise will be welcome, obviously for the wealthy, but also for the wealth management industry. Whilst in actual fact, estate duty should have been of little real concern for foreign high net-worth individuals, as moveable property is outside the scope for non-domiciled persons, it still casts a shadow over an otherwise tax-free wealth management environment.

Other beneficiaries of the Budget were the small and medium-sized enterprises (SMEs). Further income tax exemptions were given to start-ups, and enhancements were made to the Employee Equity-based Remuneration Incentive Scheme by introducing a new tier for such entities. It is not clear how significant this initiative will be. Exemptions were introduced originally back in the dot-com era when remunerating employees in this way was the flavour of the month. With the demise of that episode, it is not clear that employees in new enterprises today have the same level of confidence in the entrepreneurial flair of their bosses or in the goldmine that the dot-com business thought it was.

Attraction and retention of talent is another vital area for Singapore. To assist in the constant search for foreign talent, the timeframe for the double deduction for recruitment and relocation costs was extended. The Not Ordinarily Resident (NOR) scheme was given a bit of an upper, although sadly the five-year qualifying period was not extended, and so little was done to enhance the retention qualities of the scheme which is really an area that needs much more attention than it is getting.

On the retirement front, an employer can now make contributions to the Supplementary Retirement Scheme (SRS) in addition to those of the employee. The tax mechanics of this are not clear though. Clarification will therefore be needed before it will be possible to confirm that the changes will make any noticeable difference.

In an attempt to enhance the attractiveness of Singapore as a research base as well as to encourage innovation and new products, research and development activity was given a boost. This area was given a range of (somewhat complex) tax breaks, all of which are helpful and move things in the right direction.

Finally, the financial services sector, which never leaves the table empty-handed, received some tweaks and, in the main, largely expected extensions to qualifying periods for a range of incentives that expire today.

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Contents

Promoting research and development (R&D) activities in Singapore **4**
- Liberalisation of R&D tax deductions 4
- R&D tax allowance 4
- R&D Incentive for Start-up Enterprises (RISE) 6

Financial services **6**
- Banking and capital markets 6
- Islamic finance 6
- Asset securitisation 7
- Private wealth management 7
- Debt and derivative markets 8
- Project finance 8
- Incentives to promote offshore insurance businesses 9

Enhancing the maritime sector **10**
- Certainty of tax treatment of gains on divestments 10
- Risk management activities 10
- Maritime Finance Incentive (MFI) 10

Promoting enterprise and supporting the growth of companies **11**
- Liberalisation of the start-up exemption scheme 11
- Allowance for fixtures, fittings and installations 11

General tax changes **12**
- Unilateral tax credits 12
- Further tax deduction for talent relocation expenses 12
- Portable medical benefits 12

Personal tax changes **12**
- Tax rates 12
- Course fee relief 12
- Central Provident Fund (CPF) 12
- Not Ordinarily Resident (NOR) scheme 13
- Pensions 14
- Employee equity-based remuneration schemes 16

Goods and Services Tax (GST) **17**

Estate duty **17**

2007 in retrospect **18**

PricewaterhouseCoopers thought leadership **25**

Appendices **34**

A. Comparison of Asia-Pacific effective tax rates on repatriated corporate profits 34

B. Comparison of Asia-Pacific individual tax liabilities 35

C. Resident individual tax rates 36

Promoting research and development (R&D) activities in Singapore

In today's knowledge-driven economy, significant time, effort and resources are expended by businesses on R&D, and in harnessing the fruits of such activities. Before spending top dollars to fund their R&D projects, taxpayers aim to identify and conduct their R&D activities in a location that not only offers a pool of talented scientists and engineers, but also provides attractive tax incentives and grants to support their R&D projects. As such, a favourable tax regime can play an important role in attracting investors and inventors to conduct R&D in a particular location.

The 2008 Budget acknowledges the power of fiscal measures to stimulate R&D activities, and has introduced three key tax reform measures for making innovation through R&D pervasive throughout the Singapore economy. Variants of two of these measures were proposed by PricewaterhouseCoopers in thought leadership articles prior to the announcement of this year's Budget (refer to page 32).

Liberalisation of R&D tax deductions

Presently, under section 14D of the Income Tax Act (ITA), and subject to certain conditions, taxpayers carrying on a manufacturing or services trade or business are able to deduct 100% of expenditure on R&D (as defined) activities. This is irrespective of whether the R&D is performed in-house, or by a contract R&D service provider in Singapore or overseas.

To bolster Singapore's attractiveness as an R&D hub, the Finance Minister has proposed to allow a deduction for 150% of the expenses incurred for R&D activities carried out in Singapore (whether in-house or outsourced to a contract R&D service provider) under section 14D of the ITA. This enhanced tax deduction scheme will be available for five years starting from Year of Assessment (YA) 2009. What this means is that for every $100 of relevant spending, there will be a tax saving of $27, rather than the current $18.

Further, it has been clarified that this enhanced tax deduction under section 14D, as well as the approved further tax deduction available under section 14E, would be available even when the R&D expenses are not incurred in respect of the existing trade or business of the taxpayer. This liberalisation is designed to encourage taxpayers to embark on R&D projects in Singapore even if the R&D activities are not in respect of their existing trade or business. Ultimately what it must mean though is that the R&D is in respect of a prospective business if the R&D produces results.

However, where the R&D activities are performed by a contract R&D service provider outside Singapore, the enhanced 150% tax deduction will not be available under section 14D. Instead, the 100% tax deduction will only be available provided such R&D activities are related to the trade or business of the taxpayer.

These measures will encourage taxpayers to conduct as much of their R&D activities as possible in Singapore rather than overseas. Obviously, taxpayers should consider appropriate measures to identify and record their R&D costs and maintain necessary documentation to support their claims for the enhanced tax deduction.

R&D tax allowance

Under this new incentive, companies with chargeable income will be provided an R&D tax allowance for five years of assessment, commencing from YA 2009, at a prescribed rate calculated by reference to the chargeable income for the relevant year of assessment. The R&D tax allowance will be limited to 50% of the first $300,000 of a company's chargeable income for each qualifying year of assessment. Such R&D tax allowances cannot be transferred between related companies under the group relief system. However, the allowance can be carried forward and utilised against chargeable income of the next three years of assessment, provided the company incurs, during those three years, qualifying R&D expenditure in excess of a base amount. The base amount is the qualifying R&D expenditure incurred for the base year,

which for existing companies is the basis period for YA 2008. Any unutilised allowances at the end of the third year of assessment will be lost.

The application is relatively complex, thus an example of the mechanics of the scheme, provided by the Ministry of Finance, is reproduced below.

	YA2009	YA2010	YA2011	YA2012
Tax Computation				
Chargeable income (before Partial Tax Exemption (PTE))	500,000	300,000	250,000	400,000
Less: R&D Tax Allowance utilised (A) = lower of (B-C) or D	0	100,000	98,750	36,563
Adjusted chargeable income before PTE	500,000	200,000	151,250	363,437
Adjusted chargeable income after PTE	347,500	97,500	73,125	210,937
R&D Expenses **(B)**	100,000	200,000	300,000	400,000
Base Year R&D **(C)**	100,000	100,000	100,000	100,000
Incremental R&D Exp (B-C)	**NA**	**100,000**	**200,000**	**300,000**
R&D Tax Allowance Account				
R&D Tax Allowance b/f:				
YA2009	0	150,000	50,000	0
YA2010	0	0	48,750	0
YA2011	0	0	0	36,563
Total R/D Tax Allowance b/f (D)		150,000	98,750	36,563
Less: R&D Tax Allowance utilised **(A)**	0	-100,000	-98,750	-36,563
Add: Current year R&D Tax Allowance **(E)** = 50%* adjusted chargeable income after PTE	150,000	48,750	36,563	105,469
R&D Tax Allowance c/f = D-A+E	150,000	98,750	36,563	105,469

Notes:

A = Utilisation of R&D tax allowance is capped at the lower of incremental R&D expenses or the R&D tax allowance brought forward (i.e. excluding R&D tax allowance earned in current YA).

B = This refers to the actual amount of R&D expenses incurred, and not the quantum of the tax deduction.

C = R&D expenses incurred in basis period for YA 2008 i.e. financial year 2007.

D = Unutilised R&D tax allowance brought forward from up to the preceding three YAs.

E = Capped at 50% of the first $300,000 chargeable income (after R&D tax allowance utilised (if any), start-up exemption (where applicable) and partial tax exemption (PTE)), or such lower amount where the chargeable income (after R&D tax allowance utilised (if any), start-up exemption (where applicable) and partial tax exemption (PTE)) is less than $300,000.

The incentive will only be available for qualifying expenditure incurred on in-house (and not outsourced) R&D activities performed in Singapore. It is primarily meant to support SMEs to enable them to continue and expand their R&D activities in a sustained manner. It may be worthwhile to extend this incentive even for cases where the R&D activities are outsourced to R&D organisations in Singapore.

R&D Incentive for Start-up Enterprises (RISE)

The RISE scheme is a new incentive which effectively provides a cash grant for research-intensive start-up companies that do not produce taxable profits or chargeable income in their first three years of assessment. The scheme allows qualifying start-up companies to convert up to $225,000 of tax losses into a maximum cash grant of $20,250 in a particular year of assessment, provided they incur at least $150,000 of qualifying expenditure in that year on ongoing, in-house R&D activities carried out in Singapore.

This incentive provides the flexibility for start-up enterprises to cash in tax losses upfront rather than carrying forward losses arising from R&D deductions for utilisation in subsequent years. Effectively, the scheme provides a subsidy for further R&D activities of these companies while they seek to grow their businesses.

Interestingly, the taxpayer has a choice not to convert the tax losses into cash under the RISE scheme but instead to carry the losses forward for offset against chargeable income in future years. The decision would ultimately depend on an analysis of the time value of the upfront cash grant vis-à-vis the future benefit that can be derived from subsequent utilisation of such losses. What this means also is that R&D expenditure, which may not otherwise have been given as a deduction at all as it was pre-commencement capital expenditure, will now qualify for relief. It remains to be seen however, what conditions might be imposed.

The Singapore Government's effort to proactively introduce tax reform measures to enhance the attractiveness of Singapore as a global R&D hub is to be applauded. Further implementation details (including anti-avoidance measures) for the above fiscal measures are expected to be released by the Inland Revenue Authority of Singapore (IRAS) by September 2008.

Financial services

Banking and capital markets

Tax concessions have played an integral role in the development of Singapore as an international financial centre. It is therefore not surprising that the Finance Minister announced the renewal of the following incentives that expire in 2008:

- Financial Sector Incentive (FSI)
- Qualifying Debt Securities (QDS)
- Primary dealers in Singapore Government Securities
- Approved Special Purpose Vehicle (ASPV) incentive
- Project Finance incentive

What is of interest is that further enhancements have been made to some of these incentives, no doubt to ensure that they continue to stay relevant and keep pace with changes in the global financial scene. These measures are outlined in the following sections.

The Monetary Authority of Singapore (MAS) will be releasing more details in due course.

Islamic finance

Since 2005, the Government has progressively introduced a number of measures to boost Singapore's development into a hub for Islamic finance. The overall policy intent is to align the tax treatment of Islamic financing arrangements with that of conventional financing contracts to which they are economically equivalent. To that end, the concessions introduced to date have largely focused on individual transactions, with the aim of achieving parity in tax outcome.

The Finance Minister has now taken another step forward in promoting Islamic finance, by proposing to incentivise financial institutions that undertake Islamic financing activities. In recognition of the fact that this market is a high value-add, high growth industry segment, he has proposed creating a new incentive award – the FSI–Islamic Finance award. Holders of this award will, for a period of five years, enjoy a concessionary tax rate of 5% on income from qualifying Shariah-compliant lending and related activities, as well as fund management and other advisory activities. Companies interested in applying

for this award should do so between 1 April 2008 and 31 March 2013. Unlike most other incentives, there will be no extension of the approval period beyond 31 March 2013 or the incentive tenure beyond five years. It is unusual for such a definitive statement to be made, however, it also seems to be made in relation to the Islamic insurance incentive below.

In addition, it has been proposed that qualifying income of all investors derived from Islamic bonds (sukuks) that are QDS will be exempt from tax under the enhanced QDS scheme (see 'Debt and derivative markets' below). This is subject to the condition that any amount payable by the issuer of the sukuks to the investors is not deductible against its Singapore-sourced income, and that proceeds from the issue are used outside Singapore. Given the conditions imposed, it would appear that this incentive is targeted at positioning Singapore as a regional / international hub to undertake Islamic financing activities. With the increasingly important role sovereign wealth funds play in global finance, and the fact that a number of them originate from the Middle East, this incentive appears most timely, as it seeks to capture a slice of a fast growing Islamic finance market.

Asset securitisation

To develop the asset securitisation market in Singapore, details of the tax incentive scheme for ASPVs were announced in 2005 after much consultation with the industry. The scheme grants concessionary tax treatment that was intended to facilitate the setting up, in Singapore, of special purpose vehicles used for the issue of asset-backed securities. Among other things, it provides for tax exemption for the ASPV, thus minimising tax leakage in an asset securitisation transaction.

To obtain the ASPV status, a special purpose vehicle used for the issue of asset-backed securities will have to meet a number of conditions, including the condition that all of the debt securities issued by it must be QDS. The rationale for imposing such a condition was to ensure that the ASPV scheme would bring about economic spin-offs to Singapore as this condition requires the securities issued by ASPVs to be substantially arranged by financial institutions in Singapore.

While this condition may have had a well-meaning policy intent, it has inadvertently resulted in certain securitisation vehicles not being able to qualify for the scheme. For certain securitisation transactions, such as collateralised debt / loan obligations (CDOs / CLOs), in which different tranches of debt securities with different risk-return profiles are issued, there is typically a subordinated tranche of securities that are wholly subscribed for by the sponsor of the transaction. If the sponsor is considered to have control over the special purpose vehicle, they will be considered related parties. As a result, the tranche of debt securities subscribed for by the sponsor will not qualify as QDS, and hence the special purpose vehicle will not be able to qualify for the ASPV scheme.

As this is still a rather nascent sector that the Government is keen to develop, it is not surprising that the Finance Minister has proposed that the ASPV scheme will be extended for another five years, i.e. from 1 January 2009 to 31 December 2013 (both dates inclusive).

Further, he has proposed to remove the condition that all debt securities issued by the ASPV have to be QDS, with effect from 16 February 2008. This should be welcomed by financial institutions looking to set up securitisation vehicles in Singapore for transactions that entail the issue of different tranches of securities, as some of these vehicles would otherwise not have been eligible for the ASPV status. However, it should be noted that such debt securities, when issued to a non-resident note holder, will not have the benefit of the interest withholding tax exemption currently enjoyed by QDS.

Private wealth management

To encourage further development of the wealth management industry in Singapore, the Finance Minister has announced a tax exemption scheme for family-owned investment holding companies (FIHCs). This is to extend the tax exemption that individuals currently enjoy for qualifying Singapore-sourced investment income and foreign-sourced income to an FIHC.

This measure should facilitate the making of investments by individuals through the use of companies as investment vehicles. The use of a

corporate vehicle could be for a variety of reasons, e.g. individuals may not wish to invest directly in their own names or they may wish to allow their family members to partake in the returns of the investments.

The Government had already extended a similar tax exemption to locally-administered private trusts in 2006. However, under the tax exemption scheme for locally-administered trusts, there is no requirement that the trusts be 'family-owned'. It only requires the beneficiaries to be either individuals or charities. It would be interesting to see how the Government will define 'family-owned' for the purpose of the FIHC tax exemption. This has been set as a requirement presumably because the Government does not wish to see this exemption being extended to investment holding companies of corporate groups and fund companies (the latter group being granted tax exemption under another incentive scheme for Singapore-resident funds).

Interestingly, similar treatment has not been accorded to partnerships as an investment vehicle. Most classes of qualifying Singapore-sourced investment income and foreign-sourced income are exempt from tax for individuals except when they are received through partnerships in Singapore. The only income streams that continue to be exempt when received by individuals through a partnership in Singapore are interest income from deposits with approved banks in Singapore and foreign-sourced income from any professional, consultancy and other services rendered outside Singapore.

Nevertheless, the exemption for the FIHC should offer individuals more flexibility in the way they carry out wealth planning in Singapore, and provide private bankers another option when structuring investments and doing succession planning for their clients.

Debt and derivative markets

The QDS regime introduced in 1998 has been instrumental in developing Singapore into a debt capital markets hub in the region. It has been fine-tuned over the years to keep pace with innovation in the financial markets and now accords withholding tax exemption for prescribed payments to non-residents in a number of specified scenarios, as well as a concessionary tax rate for income received by Singapore-based bondholders (who are not otherwise exempt from tax on their investment income). This regime has been extended for another five years to 31 December 2013. The period of tax exemption for income derived by primary dealers from trading in Singapore Government Securities, a class of QDS, is also extended from 28 February 2008 to 31 December 2013.

Along with these extensions, the Finance Minister has proposed two enhancements in relation to debt securities:

- With effect from 16 February 2008 to 31 December 2013, the QDS scheme is enhanced to exempt all investors from tax on qualifying income derived from QDS that have a tenure of at least 10 years. While this is a welcome change, as income from QDS derived by non-individual investors in Singapore is currently taxed at 10%, the introduction of a different treatment for a particular class of QDS (based on tenure) will unfortunately add a layer of complexity in the administration of distributions.

- The scope of qualifying activities under the FSI-Bond Market award, which currently accords a 5% concessionary tax rate on income from arranging, underwriting or distribution of QDS, will be expanded to include trading of QDS as well as qualifying project debt securities, with effect from 16 February 2008.

The Finance Minister has also proposed an enhancement to the FSI-Derivative Market award. With effect from 16 February 2008, income from trading of exchange traded financial derivatives will qualify for a 5% tax rate. It will be interesting to see, when the details are announced by the MAS, whether this extension will come with any qualifying conditions. As a comparison, it should be noted that the tax concession accorded to futures members of the Singapore Exchange for income from exchange traded derivatives only apply to certain transactions.

Project finance

The project finance tax incentive was introduced on 1 November 2006, with a view to catalysing the development of the project finance industry through Singapore's capital markets. It provides, among other

things, a tax exemption for interest from qualifying project debt securities for investors, exemption for prescribed foreign-sourced interest income of qualifying entities listed on the Singapore Exchange, and remission of stamp duty payable on instruments of transfer relating to prescribed assets to entities listed or to be listed on the Singapore Exchange. With the continuing growth of infrastructure assets as an independent asset class, the Finance Minister has proposed to extend the incentive from 1 January 2009 to 31 December 2011.

In addition, he has introduced a new tax incentive, with effect from 1 April 2008 to 31 December 2011, to grant a 10% tax concession (for a period of 10 years) for income derived by a company from the provision of management services to business trusts and funds that own offshore infrastructure assets. It appears that the Government has now expanded the scope of qualifying activities from pure investment / fund management-type services to other types of services such as asset / property management. However, there is a need for the business trust or fund to be listed, which may be a bridge too far for some funds.

Incentives to promote offshore insurance businesses

Under current rules, an insurer or reinsurer may apply to the MAS for an incentive to pay tax on the business it derives from writing offshore insurance and reinsurance business at the reduced rate of 10%. This rate on an insurer's offshore business may be further reduced to 0% under the following incentives, all of which are subject to qualifying conditions and are available only upon application and approval:

a) Tax exemption for up to 10 years on qualifying income derived from writing marine hull and liability business;

b) Tax exemption for up to five years on qualifying income derived from writing certain offshore specialised risks (e.g. terrorism, political, energy, aviation, aerospace risks); and

c) Tax exemption for up to 10 years on qualifying income derived by an approved captive from writing offshore captive insurance business.

The Finance Minister announced two proposals to give a boost to the offshore insurance segment.

Firstly, he introduced an incentive scheme offering a 5% incentive tax rate for five years to qualifying insurers on income derived from writing offshore takaful and retakaful business. This incentive aims to stimulate the growth of Islamic insurance in Singapore and ensure that it does not miss out on the exponential growth of Islamic insurance in the region. The incentive is available upon application to, and approval from, the MAS. The window period for approval is five years from 1 April 2008 to 31 March 2013. Once approved, the incentive period is five years. There will be no further extension of the approval period beyond 31 March 2013 and no extension of the approval period beyond five years. More details on this incentive, such as the qualifying criteria, will be released by the MAS by the end of May 2008.

Secondly, the Finance Minister introduced an incentive scheme offering a 10% incentive tax rate for up to 10 years for qualifying insurance and reinsurance brokers on income derived from the provision of insurance broking and advisory services to non-Singapore based clients. This incentive, which aims to internationalise Singapore's insurance industry is available upon application to, and approval from, the MAS. The window period for approval is five years from 1 April 2008 to 31 March 2013. More details on this incentive, such as the qualifying criteria, will be released by the MAS by the end of May 2008.

The above new incentives are obviously intended to promote and realise Singapore's ambition to be the insurance hub for the Asian region. They will certainly be welcomed by the insurance sector. The question, however, is whether the incentive rates offered are low enough. For the offshore Islamic insurance incentive, the reduction is from the current 10% offshore rate to the new 5%. As for the offshore brokers incentive, the reduction is from the normal corporate tax rate of 18% to the new 10%. Much may depend on whether the qualifying criteria and conditions for the new incentives will be worth the reduced tax rate.

Related to this is the current incentive rate of 10% offered for offshore insurance business not subject to any other special incentive. This 10% incentive rate has

remained unchanged since the late 1970s. Given the fact that corporate tax rates have more than halved over the years, it is perhaps time that this incentive rate was reduced to, say, 5%. Insurance business is becoming increasingly globalised and mobile. Singapore is not just competing in Asia, but also competing for the international insurance market with popular tax-favoured locations such as Bermuda.

Enhancing the maritime sector

Certainty of tax treatment of gains on divestments

To provide further certainty to the growing shipping industry in Singapore's push to be Asia's premier international maritime centre, the Finance Minister has extended the "administrative concession" to exempt any gains derived by shipping companies on the sale of vessels. The extension is for another five years up to YA 2014.

In addition, the concession will also be expanded to include gains from the sale of ships which are subsequently leased back and gains from the sale of shares in a special purpose vehicle which holds the vessels.

Whilst the question of whether the disposal of an asset, at a profit, which had been held as a fixed asset should have been straightforward, this concession at least removes the need for argument.

The extension to include special purpose vehicles is welcome in recognition of industry practice.

Risk management activities

Risk management is an important value-added maritime ancillary activity. The Finance Minister had earlier granted a five-year administrative concession to exempt from tax any gains made from undertaking risk management activities. Under that concession all gains (hedging or speculative) from these activities were automatically treated as hedging gains relating to the shipping trade.

With effect from YA 2009, foreign exchange gains, and gains from risk management activities derived by shipping companies in respect of Singapore-flagged ships or foreign-flagged ships owned by Approved International Shipping companies will be exempt under Sections 13A or 13F of the ITA respectively. However, the new exemption is actually more restrictive than its predecessor, as only foreign exchange gains and gains from risk management activities in connection with and incidental to the core shipping operations will qualify for tax exemption. This is provided the shipping companies do not engage in activities that are considered as trading in derivatives.

Maritime Finance Incentive (MFI)

In 2006, the MFI scheme was introduced in response to the changing market need for more sophisticated ship financing solutions which tap on funds from the market (institutional investors as well as the general investing public), instead of relying only on owners' equity and debt financing.

The MFI scheme provides, inter alia, for:

- A 10% tax rate on qualifying management-related income for Approved Ship Investment Managers for a period of up to 10 years; and

- Tax exemption for qualifying income (from both finance and operating leases) derived by an Approved Shipping Investment Enterprise (ASIE) from:

  (i) Ship leasing activities to non-tax residents of Singapore;

  (ii) Leasing of Singapore-flagged vessels;

  (iii) Leasing of foreign-flagged vessels operated by companies under the Approved International Shipping Enterprise Scheme.

When introduced, the MFI scheme was for ship leasing companies, shipping funds or shipping business trusts that provided financing for all types of vessels, including those used for the offshore oil and gas sector.

To continue the thrust to be Asia's premier international maritime centre, the MFI will be enhanced on two fronts with effect from 1 April 2008 as follows:

(a) Partnerships will now be able to apply for and enjoy the MFI;

(b) The leasing of containers will now be included under the MFI. However, instead of granting a tax exemption for income from leasing containers (from both finance and operating leases) derived by an Approved Container Investment Enterprise (ACIE), qualifying income will instead be subject to tax at a concessionary rate of 5% or 10% depending on the level of business spending and headcount commitments. The tenure for the ACIE status is a period not exceeding 10 years for applications made from 1 April 2008 to 28 February 2011. Qualifying management fees of an approved container investment management company will be taxed at 10%.

Further details of the above enhancements will be released by the Maritime and Port Authority in May 2008.

Promoting enterprise and supporting the growth of companies

Liberalisation of the start-up exemption scheme

The start-up exemption scheme was introduced a few years ago to promote entrepreneurial activities in Singapore. Under the existing scheme, eligible start-up companies enjoy full tax exemption on their first $100,000 of chargeable income. After last year's Budget, the IRAS improved what had been announced in the Budget and added a partial exemption of 50% of the next $200,000 of chargeable income. Therefore, for such companies, the maximum exempt income is $200,000.

In order to enjoy this exemption, one of the conditions to be met is that the company must be beneficially held only by individuals. Given that start-up companies do sometimes require external equity finance, it is not unusual for venture capitalists and / or companies to acquire strategic equity stakes in promising start-up ventures. Recognising this need, the Budget seeks to liberalise the current start-up exemption scheme. According to the proposed change, the start-up company will enjoy the exemption, so long as there is at least one individual shareholder with at least a 10% shareholding.

It is also encouraging to note that the change will apply to existing start-up companies that are still within their first three years from incorporation.

Allowance for fixtures, fittings and installations

Claiming a tax deduction or capital allowance in respect of expenses incurred on fixtures, fittings and installations has been the subject of great debate over the years. Generally, expenditure laid out on capital assets which form part of the building will not qualify unless the building itself qualifies as an industrial building. What does and does not form part of the building can be subjective.

To put the controversy to rest, at least up to a certain level, a special allowance will be granted for all expenditure incurred on fixtures, fittings and installations. The special allowance is subject to a cap of $150,000 every three years and must be incurred any time over the next five years, i.e. by 15 February 2013. The proposed incentive is valid only until the year 2013. It looks therefore as if the maximum possible allowance that any business entity can claim will be $300,000. The incentive is clearly aimed at the SMEs.

However, it is worth noting that expenses relating to "structural works" and "expansion of space" have been excluded and such expenses would not qualify for the above special allowance. The issue of whether fixtures and fittings are "structural works" or "expansion of space" could be contentious. In short, it is not entirely clear what has been given away with this initiative; just because an asset is fixed or attached to a building, does not mean it forms part of it.

Given the cap on the expenditure, it would have been more effective just to say that all capital expenditure in relation to business premises would qualify for an allowance up to that level.

General tax changes

Unilateral tax credits

Currently, most (but not all) of the foreign-sourced income received by a Singapore tax resident from a non-treaty country (i.e. a country with which Singapore does not presently have a double taxation agreement) enjoys unilateral tax credit in respect of foreign tax paid on such income. This income includes foreign-sourced service income, royalties, dividends, employment income and foreign branch profits.

The Budget proposes to extend unilateral tax credits to all types of foreign-sourced income that is remitted into Singapore from a non-treaty country. The most obvious exclusion from the earlier list was interest income. Its inclusion now should lower the overall cost of group financing arrangements.

Further, given the comprehensive coverage for all types of income, double tax will be avoided, especially in situations where the characterisation of income remitted from the non-treaty country is not clear.

This is a step nearer to exempting foreign-sourced income from Singapore tax, but the Government seems to have shied away from "going the whole hog".

Further tax deduction for talent relocation expenses

The existing scheme to allow further tax deductions under the Overseas Talent Recruitment Scheme has been extended for an additional five years to 2013. While this may help local companies go overseas for their resources, it does little to compel the resulting foreign talent to remain here.

Portable medical benefits

The Budget seeks to align employers' provision of portable medical shield plans or ad-hoc contributions to the employees' Medisave accounts, with the Portable Medical Benefits Scheme and Transferable Medical Insurance Scheme. Accordingly, with effect from YA 2008, expenses incurred by employers for providing inpatient medical insurance benefits in the form of portable medical shield plans will qualify for tax deduction up to a maximum of 2% of the total wage bill.

Personal tax changes

Tax rates

Traditionally, corporate and personal tax rates in Singapore have always been closely aligned. The 2007 Budget bucked that trend. The corporate tax rate was reduced to 18%, but the top personal tax rate stood unchanged at 20%. This disparity was expected by many to be addressed in the present Budget. However, the Finance Minister decided to keep the personal tax bands and rates unchanged.

But it is not all bad news. A one-off income tax rebate of 20% was introduced for YA 2008. This is however subject to an overall cap of $2,000 which means it is targeted at the lower end of the income scale.

Course fee relief

In a positive step aimed at encouraging the continual upgrading of professional skills, with effect from YA 2009, taxpayers can claim tax relief for course fees leading to a vocational qualification, regardless of whether the course is relevant to his / her current trade, business, profession, vocation or employment.

Further, the condition that the claim for courses leading to an academic, professional or vocational qualification can only be made in the year the expense is incurred, has been liberalised to allow such claims to be made within two years of assessment from the year of assessment relating to the year in which the course is completed. This measure is intended to benefit taxpayers who have no assessable income in the year in which the expense is actually incurred, which is quite likely.

Central Provident Fund (CPF)

In a welcome move directed at making it easier for Singaporeans to top up their CPF accounts for

themselves and their family members, members below the age of 55 will be permitted to top up their CPF savings up to the minimum sum. Further, employers will now be allowed to make top-ups to the employees' minimum sum on their behalf.

The regulatory changes will be accompanied by a broadening of tax reliefs currently available. Presently, a single $7,000 tax relief is available for all top-ups made, but only if the beneficiary is 55 or above.

With effect from YA 2009, two separate tax reliefs will be granted; up to $7,000 for top-ups by a taxpayer or his employer to his own minimum sum, and up to another $7,000 for top-ups to the family members' minimum sum. Both reliefs will be available regardless of the age of the taxpayer. Employers will now also enjoy a full tax deduction for such qualifying top-ups.

The employee will be taxable on the employer's top-up, but will be eligible to claim tax relief in this regard, thereby ensuring tax neutrality from the employee's perspective.

Likewise, voluntary contributions made by members specifically to their own Medisave Accounts will also be eligible for full tax relief up to the specified cap ($26,393 less mandatory contributions) per year of assessment.

Not Ordinarily Resident (NOR) scheme

The NOR scheme introduced in 2002, was expected to go a long way in attracting and retaining foreign talent, which is increasingly being seen as necessary to sustain the competitiveness of the Singapore economy.

While the scheme has met with reasonable success in attracting foreign talent to Singapore, retention has not necessarily been achieved, primarily because the benefits are only available for a period of five years. Naturally, a removal of this sunset clause was being sought by most companies and interested individual taxpayers. Other wish list items included the removal of the minimum effective tax rate of 10% and an extension of the time-apportionment concession to all benefits-in-kind.

The Finance Minister has done a fine balancing act in this regard. While the key wish of an indefinite extension to the scheme was not granted, all benefits-in-kind (except directors' fees) will now be eligible for the time-apportionment concession under the scheme with effect from YA 2009. Depending on individual tax rates, these changes could result in substantial tax savings as this table below illustrates.

Scenario 1
Taxpayer receives a gross salary of $250,000 and benefits-in-kind of $100,000.

Scenario 2
Taxpayer receives a gross salary of $500,000 and benefits-in-kind of $200,000.

Assumptions
Taxpayer is a Singapore tax resident married with two children under both scenarios.

Taxpayer has 90 business travel days outside of Singapore.

	Scenario 1		Scenario 2	
	Current $	Proposed $	Current $	Proposed $
Pre-apportioned salary income	250,000	250,000	500,000	500,000
Benefits-in-kind	100,000	100,000	200,000	200,000
Total employment income	350,000	350,000	700,000	700,000
Apportioned income	288,356	263,699	576,712	527,397
Tax payable	36,130.52	31,938.83	92,642.40	82,779.40
Tax savings		4,191.69		9,863.00

Interestingly, another change relates to the replacement of the minimum effective tax rate (10%) threshold condition by an employment income threshold limit of $160,000. This reduction will now mean that eligible taxpayers can now potentially benefit from the time apportionment concession without any minimum effective floor tax rate. The minimum savings that a taxpayer having an employment income of $160,000 will enjoy is illustrated below:

Taxpayer (resident) - married with two children		
	Current $	Proposed $
Pre-apportioned salary income	160,000	160,000
Apportioned salary income	160,000	120,548
Tax payable	14,520.00	8,996.72
Tax savings	5,523.28	
Effective tax rate (%)	9.08%	7.46%
Assumed no benefits-in-kind or directors' fees Assumed 90 business travel days outside Singapore		

While the NOR scheme benefits have been widened at least in part, the changes seem to be once again directed towards attraction of foreign talent. However, the perennial dilemma faced by companies on the long-term retention of such talent remains unaddressed, given that the sunset clause of five years is firmly in place.

Another change to the NOR scheme relates to the tax exemption of employer contributions to non-mandatory overseas pension schemes which NOR taxpayers are eligible for.

A glaring anomaly in this benefit was that contributions to mandatory overseas pension schemes were exempt for all taxpayers, only if, among other conditions, no corporate tax deduction was claimed. NOR taxpayers on the other hand were eligible for an exemption (subject to capping limits) for contributions made to non-mandatory overseas pension schemes, even though the employer had claimed a full deduction for corporate tax purposes.

There was therefore an urgent need to align the concession to allow contributions to mandatory schemes to be on an equal footing with that of non-mandatory schemes. It was also expected that the condition that a corporate tax deduction should not be taken would be dispensed with.

However, in a surprise move, while the tax treatment for the two types of schemes has indeed been aligned, this has been done by stipulating that the exemption for contributions to non-mandatory overseas pension schemes will be allowed only if no corporate tax deductibility claim is made. More details are expected in May 2008 when the IRAS releases a circular on the revised NOR scheme.

Pensions

Over the past few years, the Government has reiterated that Singaporeans cannot hope to rely on their CPF savings to fully provide for their retirement. This is somewhat of a paradox in the face of declining contribution limits.

However, towards this end, the SRS which enables employees to save for their retirement, was created and employers were encouraged to provide for their employees' long-term retirement through the setting up of appropriate tax-approved employer-funded pension plans, popularly known as Section 5 plans.

But Section 5 plans and the SRS have not had the desired effect, primarily because:

- The Section 5 plan has to be entirely employer funded, i.e. employees cannot make any contributions. On the other hand, the SRS scheme is entirely employee-funded.

- The withdrawals from the Section 5 plan are fully taxed (this means investment gains which are ordinarily tax free for individuals are brought to tax).

Enhancement of the Section 5 plans on these two fronts was therefore on the wish list of employers and employees alike. Unfortunately, the Budget does not contain any enhancements to the Section 5 plan regime. Instead, the scope of the SRS is being broadened to allow employers to contribute to it on behalf of employees, up to the current contribution limits.

While such contributions are fully taxable on the employee at the time of contribution, the employee will get a corresponding tax deduction, which is the same as not taxing the contribution in the first place.

The change is being touted as an inexpensive method for employers to provide retirement benefits without the need to set up costly company pension funds. While this may be true in part, it may not give the full picture. Admittedly, there is a cost to setting up a company pension fund, which the SRS seemingly avoids.

However, what is not recognised is that the ongoing investment costs (e.g. entry / exit loads, switching fees, management fees) are much higher in a SRS than a Section 5 plan. Further, the investment returns that a Section 5 plan can deliver on an ongoing basis far exceed those in the SRS. This is simply because the Section 5 plan enables collective pooling of funds which can help to reduce ongoing costs and enable higher returns.

That aside, the proposed SRS enhancement will not fully address the need for having a separate company pension fund, for the following reasons:

- The employer contributions to the SRS are capped at $11,475 per year for Singapore citizens and Permanent Residents, and $26,775 for foreigners. This limit may not be adequate for many employers who would ordinarily make greater contributions to a company pension fund.

- A Section 5 plan corpus is usually managed by professional fund managers who deliver an above average return on investment. On the other hand, the SRS rules allow the employees to make investment decisions on their own, which experience has shown involves higher risk. This could prejudicially affect the intention of the employer to provide for long-term retirement for the employee.

- The SRS scheme, being portable, does not allow vesting deferral or forfeiture provisions, thus is less effective in talent retention.

The proposed SRS amendment may not be terribly effective in addressing the longstanding demand which allows both employers and employees to contribute towards an employee's long-term retirement planning.

A comparison of the pros and cons of the two schemes is set out on the next page.

(A) Employer perspective		
Relevant factors	Section 5 plan	SRS
Corporate tax deduction	Full deduction available	Full deduction available
Contribution limits	No prescribed limits	Limited to $11,475 for Singapore citizens and Permanent Residents and $26,775 for foreigners
Target employees	To all employees	Can be individual employee
Start-up costs	High start-up costs	Minimal start-up costs
Effectiveness as retention tool	Flexible to build in vesting condition to better achieve retention objective	Fully vested, portable, not linked to employment, no risk of forfeiture
Potential growth of retirement nest	Appointment of third-party experts to manage the plan. Potentially higher return on investment	Investment decisions often made by employee and limited to permissible assets / investment under CPFIS
(B) Employee perspective		
Relevant factors	Section 5 plan	SRS
Taxability of employer contributions	Not taxable	Taxable
Taxability of employee contributions	Not applicable	Taxable as part of gross income
Tax relief on employer contributions	Not applicable	Claimable
Tax relief on employee contributions	Not applicable	Claimable
Taxability of withdrawal	100% taxable	Qualified withdrawals – 50% taxable Non-qualified withdrawals – 100% taxable
Early withdrawal	No penalty (subject to plan rules)	Penalty applies
Withdrawal period	Depending on plan rules	Can be spread over 10 years if amount is withdrawn after statutory retirement age
Total payout	Higher if employer is willing to contribute beyond SRS limits. Potentially higher return on investment as plan managed by professionals	Limited by contribution cap. Possible erosion of funds from bad investment decisions by employee
Portability	Tied to employment. Risk of forfeiture depending on plan rules	Portable. No risk of forfeiture

Employee equity-based remuneration schemes

Presently, gains from employee stock options and employee share awards are accorded beneficial tax treatment under the Company Employee Equity-based Remuneration Scheme (CEEBR) or the Entrepreneurial Employee Equity-based Remuneration Scheme (EEEBR), both of which have their own qualifying criteria.

These schemes will now be repackaged under one umbrella incentive to be called the Employee Remuneration Incentive Scheme (ERIS). There will be three tiers of incentive as follows:

- The erstwhile CEEBR scheme will be re-christened the ERIS (All Corporations) and made more broad-based by stipulating that the present key qualifying criteria whereby the scheme should be extended

to at least 50% of the employee population, will be reduced to 25%. This change will apply to all equity grants after 15 February 2008. More details on this scheme will be released by April 2008.

- There will be no changes to the EEEBR scheme except for the change in name to the ERIS (SMEs) scheme.

- In an interesting development, a new category of incentive tier, (the ERIS (Start-Ups)) will be introduced, which will allow qualifying employees of qualifying start-up companies to enjoy relief for 75% (up from 50% under the ERIS (SMEs)) of qualifying gains from stock options and share awards for up to $10 million of qualifying gains over 10 years. More details on this scheme are expected by March 2008.

While the introduction of the new ERIS (Start-Ups) scheme seems to be directed towards enabling start-up companies to incentivise their employees through innovative non-cash modes like stock options and stock awards instead of traditional cash payouts, it remains to be seen whether employees will take the bait, especially given that this remuneration model may bring back haunting memories of the dot-com saga.

Goods and Services Tax (GST)

There was no significant announcement in the Budget in relation to GST, except for one initiative in relation to real estate investment trusts listed on the Singapore Exchange (S-REITs) and registered business trusts involved in infrastructure or ship and aircraft leasing.

Currently, S-REITs and registered business trusts that primarily derive dividends or distributions (which are not taxable supplies for GST purposes) from special purpose vehicles or sub-trusts may not be able to register for GST and thus are not able to claim input tax on their business expenses. Under the new proposals, GST incurred on business expenses incurred during the qualifying period (from 17 February 2006 to 17 February 2010) is now claimable by way of remission. This should help in reducing the costs incurred by S-REITs and registered business trusts.

What is disappointing is that this change was not also given for approved resident funds under Section 13R of the ITA, as the GST cost, particularly in relation to the management fee, risks undermining this incentive altogether.

The IRAS will release more details by the end of February 2008.

Estate duty

Recognising the changing times and with the aim of promoting the wealth management industry in Singapore, the Finance Minister has taken the bold step of abolishing estate duty with immediate effect.

The abolition of the duty will remove what may be the final remaining tax on life insurance proceeds paid on the death of a Singapore policyholder. It will certainly be welcomed by the life insurance industry. There will no longer be a need for policyholders to make irrevocable nominations of beneficiaries for their life policies (also known as Section 73 policies) with the intention of creating separate estates to circumvent the $600,000 exemption limit.

Although the threat of estate duty was more apparent than real for wealthy foreign individuals (non-domiciled individuals have an exclusion for all moveable property), it was about time to tidy up. It did, after all, net only $75 million a year and cast a shadow over what is otherwise an exempt investment environment.

2007 in retrospect

Tax cases

2007 saw some interesting tax cases, in particular, those dealing with the issue of whether gains on the sale of real property are capital or revenue in nature.

In *NO v Comptroller of Income Tax*, the Income Tax Board of Review ('the Board') found in favour of the taxpayer by concluding that a gain on the sale of a property held for a very short period of time was capital in nature and thus not taxable (with particular emphasis on the "circumstances responsible for realisation" and the "motive" badges of trade).

In *NP and Another v Comptroller of Income Tax*, the Board was prepared to accept "bad feng shui" as a possible reason for a taxpayer selling real property in the context of considering the capital / revenue distinction. However, the Board did not find the evidence sufficiently credible to support the assertion of "bad feng shui". The taxpayers then appealed to the High Court, which accepted the assertion that one of the properties was sold because it had "bad feng shui" and concluded, based on the badges of trade, that the gain from divestment was capital in nature. This is another example of the "circumstances responsible for realisation" and "motive" badges being emphasised vis-à-vis the other badges of trade.

Another case where the Board found in favour of the taxpayer was *TN v Comptroller of Income Tax*. Here, the Board accepted that gains from an en bloc sale of 17 property units were capital gains. Factors such as accounting classification, the holding period of six years and the ability to hold property for the long term, were considered to be persuasive by the Board.

It is promising to observe that the case law for the year appears to suggest the trend of a more expansive approach to the characterisation of real property gains as being capital in nature, and an increasing number of taxpayer wins.

Tax deductibility of borrowing costs

In line with the announcement made in the 2007 Budget, the ITA was amended to effect the position that prescribed borrowing costs (other than interest) are deductible, provided these costs are paid as a substitute for interest or to reduce interest costs.

To clarify what this meant, the IRAS issued a circular on 21 June 2007 on the scope of tax deductions for borrowing costs other than interest, and provided examples of such costs in an annex to the circular. Examples included extension fees, cancellation fees, prepayment fees / early redemption fees, guarantee fees, etc.

However, even if a particular borrowing cost is not on the specified list, taxpayers may still seek an advance ruling on the deductibility of such cost.

Revision to China-Singapore double taxation agreement (DTA)

The China-Singapore DTA was revised in 2007 (and ratified on 18 September 2007). The effective date of the revised DTA is 1 January 2008.

Amongst other things, the revised DTA provides for a potential reduction in Chinese dividend withholding tax to 5% of the gross amount of the dividends. This is especially important as China has introduced tax reform measures that are effective from 1 January 2008, one of which relates to the abolition of the practice of exempting dividends paid to non-resident shareholders from withholding tax under certain situations.

The above potential DTA benefit may encourage multinational corporations (MNCs) to use Singapore as a location for the holding of equity investments in China and is timely given the growing importance of China as a major world economic player.

Expanded scope for deferral of capital allowance claims

Currently, capital allowances under Section 19A of the ITA (accelerated capital allowances provision) have to be claimed on a consecutive annual basis once the initial claim has been made. This section has been amended to allow claims to be deferred, as is allowed under Section 19 of the ITA (non-accelerated capital allowances provision), with effect from YA 2009.

This change clearly offers additional flexibility to taxpayers in deciding when to claim capital allowances (and makes Section 19A more congruent with Section 19). Such flexibility could provide benefits such as preservation of capital allowances (which may be important in the context of a change in ownership structure or business of the taxpayer).

Changes to tax incentive schemes for fund management - removal of the 80:20 rule

The MAS issued a circular on 31 August 2007 on the removal of the 80:20 rule, as announced in the 2007 Budget. The incentives affected include the tax exemption schemes for funds managed for foreign investors and for resident funds under Sections 13C and 13R of the ITA respectively, as well as the Financial Sector Incentive Scheme - Fund Management (FSI-FM) incentive.

The new framework replacing the 80:20 rule applies to funds existing before 1 September 2007 as well as those set up thereafter. For the former, there is an option of applying the new framework with effect from 1 September 2007 or from the next financial year beginning on or after 1 September 2007.

On the whole, the new framework should help to alleviate some of the compliance issues and uncertainty previously faced by fund managers in Singapore. To a certain extent, the new framework will also facilitate access to funds of Singapore investors for Singapore fund managers. Nonetheless, some areas of the new framework will have to be clarified in order to facilitate its implementation.

Broadly speaking, a qualifying fund will now be granted tax exemption at the fund level, regardless of the residency status of its investors, provided it is not 100% owned by Singapore investors. Tax, if any, will be collected from the investor depending on his specific profile.

The key distinguishing features between the old and new regimes include:

- A fund that has more than 20% of its issued securities held by Singapore investors can now have access to the tax exemption scheme that was previously only available to funds that meet the 80:20 rule;

- The new framework still carries conditions, but unlike the 80:20 rule, the conditions under the new framework are more within the control of the fund manager;

- The new framework separates investors of a qualifying fund into two categories – qualifying and non-qualifying. If the fund has any non-qualifying investors, such investors will be required to account for a ‘quasi’ tax (known as the ‘financial amount’) on their share of the fund’s profits, without affecting the tax exempt status of the fund or the qualifying investors.

In addition, it has been clarified that the above changes will also apply to approved Singapore-resident fund companies. This is an improvement from the 2007 Budget. This is also a welcome announcement since it puts Singapore domiciled funds on an equal (or even better) footing than their offshore counterparts.

With the introduction of the new framework, the FSI-FM will now grant the 10% concessionary tax rate imposed on fund management or investment advisory fees derived in respect of a qualifying fund that does not have any non-qualifying investors. If a qualifying fund has any non-qualifying investors in any year, the entire fee paid to the fund manager will not qualify for the 10% tax rate whether the manager holds the FSI-FM status or not.

2007 in a snapshot

As usual, 2007 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 2007 Budget. Some highlights of the year's tax changes are set out below.

January	Employee equity-based remuneration scheme	The IRAS issues a supplementary circular on the use of treasury shares to fulfil obligations under an employee equity-based remuneration scheme. This circular was revised in February.
	Tax legislation	The Economic Expansion Incentives (Relief from Income Tax) (Amendment) Bill 2007 is published.
	Tax cases	Two Income Tax Board of Review cases, dealing with the issue of whether gains on the sale of real property are capital or revenue in nature, are published.
	Goods and Services Tax (GST)	The IRAS issues a preliminary guide to prepare GST-registered traders for the increase in the GST rate.
	Double taxation agreements (DTAs)	Singapore signs DTAs with Ukraine and Morocco.
February	Corporate tax rate	The corporate tax rate is reduced to 18% from the year of assessment YA 2008.
	Tax exemption	The partial tax exemption threshold is increased from YA 2008 and the sunset clause for the tax exemption for new companies is removed.
	Intellectual property (IP)	The writing down allowance scheme for acquired IP is extended to 31 October 2013.
	Investment allowance (IA) scheme	The qualifying period is extended for equipment acquired on hire purchase.
	International arbitration	A new tax incentive is introduced for international arbitration work.
	Not-for-profit organisations (NPOs)	A new tax exemption scheme is introduced for approved NPOs.
	Shipping logistics	The incentive period for Approved Shipping Logistics (ASL) companies is extended to 10 years.
	Aircraft leasing	Enhancements to the Approved Aircraft Leasing Scheme (ALS) are announced, including a new 5% concessionary tax rate on lease income and extension of the scheme to aircraft or aircraft financing arrangements.
	Qualifying debt securities (QDS)	The scope of the QDS scheme is expanded to cover prepayment fees, redemption premiums and break costs.
	Personal tax	Tax relief is allowed for cash top-ups to the Central Provident Fund (CPF) Retirement Account of siblings from YA 2008.
	Insurance	The Monetary Authority of Singapore (MAS) issues a circular detailing a new tax exemption scheme for the underwriting of offshore qualifying specialised insurance risks, i.e. terrorism, political, energy, aviation and aerospace risks.

February	Trade and professional associations	The IRAS issues a circular on the changes to allow companies limited by guarantee that carry on a trade or professional association to be accorded the tax treatment of mutual concerns and to liberalise the basis used to determine how receipts of a trade or professional association are taxable.
	Tax legislation	The Income Tax (Amendment) Act 2007 is published.
	GST	The IRAS issues a press release on the assistance available to taxpayers relating to the GST rate increase and issues the finalised version of its circular on the GST rate increase.
	Stamp duties	The IRAS issues a circular on the extension of relief granted under Section 15(1)(b) of the Stamp Duties Act to statutory boards, unlimited companies and limited liability partnerships.
March	Tax legislation	The Statutes (Miscellaneous Amendments) Act 2007 amends the Income Tax Act to shorten the record-keeping period to five years and the Economic Expansion Incentives (Relief from Income Tax) (Amendment) Act 2007 is published.
	GST	The IRAS issues a circular on the zero-rating of container services and the sale and leasing of containers.
April	Over-the-counter (OTC) financial derivatives	The MAS issues a circular on the extension of the tax exemption for payments on OTC financial derivatives to 19 May 2012, or 31 December 2008 for payments made by Approved Special Purpose Vehicles. In addition, payments for the entire duration of contracts entered into between 15 February 2007 and 19 May 2012 will be exempt.
	Finance & Treasury Centres (FTCs)	The MAS issues a circular on the expansion of the scope of qualifying activities for the FTC tax incentive scheme.
	GST	The IRAS issues a circular explaining the application of zero-rating relief to telecommunication and related services, and a draft circular on the GST advance ruling system which was subsequently finalised in June 2007.
May	Global Trader Programme (GTP)	The Minister for Trade & Industry announces enhancements to the GTP including the introduction of a 5% concessionary tax rate for LNG trading and the inclusion of emissions trading as a qualifying GTP trade. The list of qualifying transactions is also expanded.
	Commodity Derivatives Trader (CDT) scheme	The Minister for Trade & Industry announces the inclusion of qualifying OTC trades conducted through SGX AsiaClear as qualifying transactions for the CDT scheme.
June	Capital allowances	The IRAS issues a circular on the one-year write-off for new diesel-driven goods vehicles and buses acquired to replace existing vehicles that do not meet Euro IV emissions standards.
	Withholding tax	The IRAS issues a circular on the new withholding tax requirements for payments to non-resident public entertainers. This requirement is mainly intended to reduce administrative requirements for non-resident public entertainers and local payers.
	Fund management	The MAS issues a circular on enhancements to the fund management tax incentive schemes, which include expansion of the list of designated investments for tax exemption and of the scope of the schemes to include collateralised debt and loan obligation funds. In addition, the 10% tax rate for qualifying fund managers is extended to include fees and commissions derived from the provision of investment advisory services under a fund management delegation.

June	Borrowing costs	The IRAS issues a circular on the tax deduction for borrowing costs other than interest expenses, including a list of the types of allowable borrowing costs.
	Structured products	The Ministry of Finance (MOF) grants exemption for income derived by non-resident non-individuals from structured products.
	Tax administration	The IRAS announces that it will start paying interest to taxpayers for late income tax or property tax refunds.
	Tax legislation	The Goods and Services Tax (Amendment) Act 2007 is published.
	Tax cases	The Income Tax Board of Review rules on whether gains from the sale of real property are capital or revenue in nature.
	GST	The IRAS finalises the circular on the GST advance ruling system.
July	Withholding tax	The withholding tax exemption for payments for the lease of space satellite capacity is extended to 10 July 2012.
	Tax administration	The IRAS issues a supplementary circular explaining changes relating to the requirements to file an estimated chargeable income (ECI) for partnerships and exemptions from the filing requirements.
	Tax cases	The Income Tax Board of Review rules on whether gains from the exercise of stock options granted prior to 1 January 2003 are taxable when the options are exercised. Unfortunately, they are.
	GST	The increase in the GST rate to 7% takes effect. The IRAS issues a circular on the Compliance Assurance Programme (CAP) for GST-registered businesses and revises the circular on zero-rating relief for tools or machines used in the manufacturing of goods for export.
	Stamp duties	The IRAS issues a circular clarifying the stamp duty treatment of leases with variable rent and of an acceptance to a letter of offer for leases.
	DTAs	Singapore signs a new DTA with China, a key feature of which is a reduction in the withholding tax rates for dividends and equipment lease payments.
August	Fund management	The MAS issues a circular on changes to the tax incentive schemes for fund management, including the removal of the 80:20 rule.
	Tax cases	The High Court rules on an appeal against a Board of Review decision published earlier in the year on the issue of the taxability of gains on the sale of real property.
	GST	The IRAS issues two new circulars on the Tourist Refund Scheme, for retailers operating the scheme and for visitors.
	DTAs	The DTA with Kazakhstan is ratified.
September	Dividend franking	The IRAS issues a press release detailing the conditions that must be fulfilled in order for dividends with attached rights issues to be considered franked dividends.

September	Advance ruling system	The IRAS issues a revised circular on the advance ruling system mainly to provide deadlines for submission of applications.
	DTAs	The DTA with China is ratified.
October	Tax administration	The IRAS revises the ECI manual filing deadlines for taxpayers wishing to pay by instalments.
	GST	The IRAS issues a new guide for the insurance industry. In addition, the threshold for filing a GST F7 return is increased, and an administrative concession for public liability insurance is introduced.
	Stamp duties	The High Court rules that properties acquired on the basis of an en bloc sale should be assessed as a single transaction, thus allowing use of the lower rate bands only once.
	DTAs	The DTA with Qatar is ratified.
November	Donations	The MOF issues guidelines on public and private donations, and a circular on the double tax deduction for grantmaking organisations.
	FTCs	The EDB takes over the administration of the FTC scheme from MAS.
December	One-tier corporate tax system	The five-year transitional period for the move to the one-tier corporate tax system ends.
	Capital allowances	From YA 2009, deferral of accelerated capital allowances claimed over three years is allowed even after the taxpayer has commenced his claim. In addition, accelerated capital allowances will be allowed for certain vehicles.
	Industrial building allowance (IBA)	IBA is not allowed to hotels on Sentosa not approved before 1 September 2007.
	Real estate investment trusts (REITs)	The tax transparency treatment for REITs is enhanced.
	Offshore leasing	The rules for set-off of unabsorbed capital allowances and losses from offshore leasing are relaxed.
	Personal tax	The IRAS announces tax concessions for certain benefits-in-kind (BIK) and a new two-year administrative concession for determining the residency status of foreign employees. In addition, the eligibility for Working Mother Child Relief (WMCR) and Parenthood Tax Rebate (PTR) in the case of reconstituted families is clarified.
	Tax administration	The statutory time-bar period is shortened with effect from YA 2008.
	Tax legislation	The Income Tax (Amendment No. 2) Act 2007 and the 2008 revised edition of the Income Tax Act, incorporating these amendments, are published.
	Tax cases	The Income Tax Board of Review rules on the tax treatment of a serviced apartment operator's rental income.
	GST	The IRAS issues a circular on changes to the partial exemption rules for input tax claim, and revises the circular on the construction industry.
	DTAs	The DTA with Estonia is ratified.

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

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/

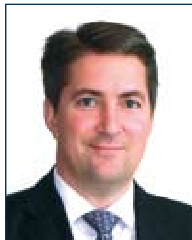
PricewaterhouseCoopers thought leadership

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 Singapore Budget 2008.

A pension scheme – the long-term answer to retaining our top talent?

Authored by



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Singapore remains incredibly effective in attracting foreign talent to its shores. But is it doing enough to keep them here in the long term?

The most recent population statistics suggest that more than one in five of Singapore's 4.6 million population is a 'foreigner' and that this group is growing faster than Singapore citizens and permanent residents. If we accept that not all of this one million plus group of people are brain surgeons or rocket scientists, and that fewer still receive the rich 'expatriate packages' of yesteryear, we are left with a significant number of locally employed (but nonetheless talented) foreigners working here in roles that are crucial to the continued success of the economy.

Foreigners currently comprise more than 30 percent of the employment market in Singapore. Not only has a series of government initiatives helped to sustain this trend in recent years, now employers too are increasingly looking to foreign shores to continue fuelling their business growth.

Schemes like the Not Ordinarily Resident (NOR) provide tax breaks for foreign nationals working in Singapore and the Personalised Employment Pass (PEP) launched last year provides them with the flexibility of changing jobs whilst working in Singapore, hence, encouraging a longer-term stay.

Weighing up the costs of losing foreign talent

As Singapore becomes increasingly reliant on foreign talent, an important issue to consider is the cost of losing that talent – be it to local or overseas competition.

You may ask then, what are we doing to retain this talent in the long term? In view of the increasingly tight labour market, staff recruitment and retention should be top priorities for HR Directors and CEOs. This begs the question of whether companies are being truly innovative when designing reward systems for their employees. We could take it one step further and ask ourselves if the economic and legislative framework is keeping pace with the tight international labour markets and is it effective in terms of preventing a long-term 'brain drain' in Singapore?

Sometimes we allow ourselves to become distracted from the main issue. Perhaps if we paused for a moment to glance up at the horizon and see the macro picture, it might occur to us that the obvious solutions can also be most effective. In this scenario, a simple 'pension' scheme could provide a partial solution. In fact, more and more companies are favouring this strategy. After all, a pension is arguably one of the most committed forms of a long-term reward and could also prove effective from a tax as well as retention perspective. Yet despite these obvious advantages and the media spotlight highlighting people having insufficient savings for their retirement, this remains a much underutilised tool in Singapore for both attracting and retaining talent.

So who should take the lead in addressing the problem? Surprisingly a recent AXA survey found that 90 percent of working Singaporeans feel it is their own responsibility to save for their retirement. So how can the government or employers play their part in encouraging savings for our old age?

Firstly, when we examine the existing employment rules, we learn that Employment Pass (EP) holders, unlike their local counterparts, are simply not allowed to make contributions to the CPF. This puts locally employed expatriates at a disadvantage.

But what about the other concessions for expatriates you may ask? When we look more closely at the very tax rules created to attract foreign talent in the first place (the NOR scheme), we see that these same rules may deter them from staying in Singapore for the long term. All the NOR incentives fall away after five years (incidentally at precisely the same time as the personalised employment pass expires without an option to

renew) meaning that their income tax rate may actually increase at this point. The rules may only be effective in retaining talent in the short term and may force this group of employees to reconsider their long term options.

The NOR pension rules may not be especially helpful for one of the most important subsets of talented foreigners - locally employed EP holders. This 'overlooked' group cannot contribute to CPF and are not likely to be able to participate in the pension scheme from their home country as Singapore is their home country as far as their new employer is concerned.

More effective alignment of employee and shareholder interests

And so at first glance, you would be forgiven for concluding that the law is not especially helpful. However, the government will allow for the creation of approved company 'Section 5' pension plans and so, perhaps the onus is very much on the employer and employee to use the existing frameworks to make adequate provision for retirement.

The 'employer of choice' could do well by taking the lead in this area to differentiate itself from its competitors. Section 5 of the Singapore Income Tax Act allows for tax free employer contributions and for all employees to participate with no differentiation between EP holders and Singaporeans. Furthermore, employers are given considerable flexibility to determine their own contribution rates, to think creatively and to mould the plan to their existing reward philosophy. For example, contributions can vest over time and be contingent upon length of service, continued employment or corporate performance, and this can create a more effective alignment of employee and shareholder interest.

How Singapore might lose its foreign talent to its competitors

So why then aren't we seeing employers fall over themselves to offer these schemes to employees? The devil lies in the details and if we scratch below the surface, one will discover some elements in the tax laws that may make Singapore a less attractive tax environment than some of its competitors. These are some examples:

1. Unlike CPF, employees cannot themselves contribute to a Section 5 plan and so, with no personal stake in the plan, the effectiveness of the plan in retaining the employee may be limited.

2. When expatriates reach retirement and wish to withdraw their money from their Singapore Section 5 pension scheme, the final payout is fully taxable in Singapore at the prevailing rate of income tax. This compares unfavourably with CPF distributions (tax free) and indeed with the Supplemental Retirement Savings plan (SRS) which taxes only 50 percent of the final payout.

3. Although the gains and investment income earned within the Section 5 plan are not taxed on a yearly basis, given that the final distribution is fully taxable when the retirement benefit is paid – this element of the income is 'effectively' taxed and this would otherwise be tax free if it was from a personal investment.

4. Finally, there are many examples of Singapore's international competitors providing attractive tax 'favoured' environments for pension payouts making these destinations comparatively attractive in the long term.

Making our tax rules expat-friendly in the long term

The legislative framework in this area already exists, however, it is not widely used. With the budget announcement due shortly, what reforms should be on our 'wish list' to encourage employers to move towards a longer term reward philosophy?

1. The NOR scheme should not be limited to five years.

2. Employee contributions to Section 5 pension plans should be both permitted and encouraged.

3. The same tax rules as for personal investments should apply to Section 5 pensions and any investment growth in the final payout of the retirement plan should be tax free.

4. The tax rules applying to all retirement plan distributions (Section 5, CPF and SRS) should be made more consistent with each other to avoid confusion.

Through these reforms the government could provide even more encouragement for employers to look again at the issue and help to sustain Singapore's position as a destination of choice for foreign talent in the short and the long term. Wherever the answer lies, the most effective way to resolve is for the government and employers to work together in tandem.

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Turning silver into gold

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According to an annual list of words and phrases that deserve to be banned by the Lake Superior State University in Michigan, a 'surge' of overused words and phrases formed a 'perfect storm' of 'post-9/11' cliches in 2007. To that list, I would like to add another – 'Wish list'.

As the Budget comes around each year, I wonder what I am going to say this year that is different from the last? I also suffer from an inherent conflict of interest here. On the one hand as a tax consultant I wish for high taxes, complexity and confusion; on the other, as a beneficiary of the wonderful place Singapore is, I want to maintain and enhance low taxes, a great transportation system, world-class healthcare, low cost of living and sensible property prices. A veritable rabbit in headlights.

Obviously, no tax system in any country can provide all of the latter, but the one in this country can perhaps play its part in incentivising enterprise and investment which is the bedrock of all economic development and stability. When you think about it though, there are only limited things you can do with a tax system to stimulate this enterprise and investment: you can exempt the resultant income from tax; you can reduce the rates at which tax is imposed; you can throw tax deductions or allowances at it. Finally, you can give targeted rebates, credits or handouts from the revenue coffers.

Although the Prime Minister in his New Year message spelled out the government's priority areas over the next few years, I am not in a position to dictate how these mechanisms within the system should be applied, if at all (although I do have some personal preferences). That is for each of the interested industry lobby groups to deal with, and as tax consultants, we can only provide the relevant technical support.

All I think I can do is look back at the progress that has been made over the last few years as a means of working out how much more one can squeeze out of the fiscal budget.

As all should be aware, the corporate tax rate is now down to 18 percent and though not a betting man, I would expect the top personal tax rate to follow suit in the Budget. This compares with an almost incredible (looking back now) 40 percent in 1986. This came down quite dramatically to 31 percent by 1990, but after that, there was very little activity during the nineties. Perhaps the major enhancements worth mentioning were the ability to effectively frank dividends with taxes paid overseas, and unilateral foreign tax credits (that is credit against Singapore tax on income taxed overseas where a tax treaty did not provide the relief). It was not until the Economic Review committee was set up in 2001 to take a 'clean sheet of paper' look at the tax system and the role it had to play in sustaining Singapore's economic growth that the significant changes came about.

The cornerstone of these changes were the phasing out of the imputation system, whereby corporate tax is a prepayment of tax paid by shareholders on their corporate profits, and the introduction of a group relief system which allowed a group's profits and losses to be set off between different entities operating in them. This was in conjunction with a planned reduction in long-term corporate and individual tax rates.

There was no doubt that group relief came as just that – a relief, as it had been on the table for a long time. There are some rough edges yet to smoothen out the system, but by and large it delivers its objective.

The demise of the imputation system is perhaps more controversial. It makes life easier for companies, and speeds up the ability of getting dividends up through a group. It also allows capital gains to preserve their tax free nature when distributed. But no tax system in the world is free of pitfalls, hence, these following scenarios may raise a few eyebrows.

The first is that the man on the Tampines MRT who may already be facing some deficiencies in his retirement savings is now paying tax on returns from corporate investment at 18 percent (whereas that might have been as low as nil in the past). But having said that, the consolation is that his other forms of investment savings should be tax free. Yet another giant leap in the last few years I neglected to mention previously.

The second is that the cost of M&A deals has increased. In the context of a leveraged share acquisition, there is no tax deduction for interest expense if things are left as they are; and a post deal reorganisation to remedy this is inevitably costly and disruptive. This encourages the use of overseas finance from where deductions can be given even for a Singapore deal (for example, the United Kingdom), which may erode the appeal of Singapore's banking sector.

Nobody has objected to the reduced tax rates for obvious reasons, but I do not see any further reductions this time round; and I do not see the government getting into a tax rate beauty contest with Hong Kong, particularly in view of the anticipated bumpy ride this year. So, apart from a reduction in the top marginal rate for individuals to align them with the corporate 18 percent – that is as much as I can realistically wish for.

There are other areas to address, such as the distinction between tax free capital gains and taxable income, stodgy interest expense deductions in general, a tax system for Public Private Partnerships, review and further consolidation

of incentives legislation, incentives for ‘green’ activities... I could go on. However, to my mind, demographics and the “silver generation” (put this on the banned list) are Singapore’s greatest challenges. Economic good times will come and go – and come again; but grandads these days are tending to stick around, seemingly forever. These issues will obviously be on the agenda, and we can expect some further initiatives out of the Budget. However, my concern is that these may be too CPF-centric. What is really needed is some enhanced fiscal support for employer sponsored pension schemes. A mature and flexible pension scheme environment will not only help fill the increasingly widening pension gap, but also go hand-in-hand with Singapore’s aim to be to be king of wealth management in Asia. This will, hopefully, then allow the silver generation of the future to enjoy its golden years.

Giving M&A more tax appeal

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While there is much uncertainty surrounding the United States-led sub-prime crisis which continues to cast a long shadow over merger & acquisition (M&A) prospects globally, it is arguable whether M&A activity in Asia is likely to be muted. With more M&A deals likely to be driven out of emerging markets such as China, the Middle East and India, M&A in Asia is likely to continue on cruise-control mode.

In Asia, Singapore's low corporate tax rate of 18 percent, extensive tax treaty network and tax incentives already makes it one of the most conducive locations to set up regional headquarters. But the stodgy interest expense deductions rule is a blemish that can turn off M&A players looking to acquire a Singapore target or use Singapore to host an acquisition vehicle. To get a greater piece of the M&A pie, Singapore needs a little nip and tuck to enhance its appeal as an attractive destination for acquisition and holding companies.

Stodgy interest expense deductions and the burden it adds

Currently, when a Singapore acquisition company (referred as 'Singapore Buyer' in this article) has acquired a Singapore target (referred as 'Singapore Target' in this article) and it receives dividends, such dividends are not taxable. Where Singapore Buyer borrows (as is mostly the case for any financial or strategic player) to buy Singapore Target, the interest costs are also not tax deductible.

Where Singapore Buyer makes profits and pays taxes, on consolidation of the performance of both Singapore Target and Singapore Buyer, the group actually makes less profit after taking into account the interest costs. But the tax costs remain the same. As a result, the tax rate would be bloated and can reach staggering levels of 30 percent or more. This is a glaring cost that can kill any appetite for a deal.

An ideal position is where the interest costs of Singapore Buyer reduce the profits of Singapore Target, and therefore the consequent tax. Alas, such a diet is not easily available.

What we need are new and simple rules to allow the plump profits of Singapore Target to be reduced by the emaciated Singapore Buyer's interest costs before tax comes in.

Allowing interest costs deductions under the Grouping Provisions

The tax group relief system was introduced to treat group companies as a single entity allowing the current year's business losses of one company to reduce the assessable income of another company belonging to the same group.

The existing provisions could be widened to allow borrowing expenses incurred by Singapore Buyer to purchase shares in Singapore Target to be characterised as business costs and made available to such a group to reduce the taxable operating profits of Singapore Target Co. It would thus help balance the combined diet of Singapore Buyer and Singapore Target, and consequently the tax costs.

Acquisition Interest Expense deductions under an Amalgamation

Under current corporate law, Singapore Buyer and Singapore Target may amalgamate after the acquisition, and continue as one company. Either Singapore Buyer or Singapore Target could remain.

As an alternative or in addition to the revision to group relief rules, new provisions could be introduced such that it makes sense for Singapore Buyer and Singapore Target to amalgamate and allow the debt costs of Singapore Buyer to reduce the taxable profits of Singapore Target.

M&A tax appeal and the benefits to Singapore

What are Singapore's motivators for allowing such interest expense deductions to reduce taxes and the benefits of using Singapore as a M&A pivotal point?

Some conditions could be specified before the proposals outlined above would apply:

- Singapore Buyer must obtain third-party loans from Singapore-based banks. This would further promote the lending industry in Singapore. Alternatively, debt from an affiliate may be allowed where the interest expenses are paid to another related Singapore entity with treasury activities in Singapore (which would be taxed in Singapore on such income) or the payments to an offshore affiliate are subject to Singapore withholding tax of at least 5 percent.

- Certain holding company activities and/or a certain number of additional employees to Singapore must be relocated here to be placed in either Singapore Target or Singapore Buyer within a certain period. In a situation where Singapore Target has foreign subsidiaries or affiliates, it may be possible to restructure operations that would cause Singapore Target to derive more profits. Under most valuation rules, this should allow a greater portion of the purchase costs to be allocated to the Singapore Target. The Singapore Buyer

would be encouraged to undertake this restructure where it would borrow more against the Singapore Target and can claim the interest deduction accordingly. This is especially the case where the borrowing costs for any non-Singapore target cannot be used in those jurisdictions outside Singapore. This win-win condition would result in greater value-added activities and employment in Singapore.

- Singapore Buyer must reinvest a portion of the dividends received. Such additional investments may either be in activities or property in Singapore, or additional share equity to be held by Singapore Buyer. This would encourage buyers to recycle capital and earnings through or in Singapore.

- Interest cost deductions may only be applied against profits earned after the acquisition. Accordingly, only taxable income derived after the completion date of the acquisition would enjoy the benefits of the relevant borrowing costs.

- In order to ensure the deduction provisions are applied to encourage the set up of a Singapore acquiring vehicle to purchase a Singapore-based company, the proposed provisions would only be available where Singapore Buyer is not related to Singapore Target Co and/or the vendor.

The setting of specific conditions can be used to generate specific upsides. A tax appealing M&A environment can also provide for other benefits.

- The value of Singapore companies would be enhanced.

- Stamp duty collections would rise from a more vibrant M&A market in Singapore - a greater number of transactions and better transfer values.

- Global and regional entrepreneurs together with venture capitalists should be further encouraged to set up a holding entity in Singapore.

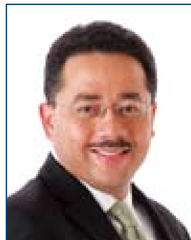
More tax appeal?

The budget wish list never stops growing. There are a few more issues in the M&A arena that could help Singapore take bolder steps forward to position itself as an even more attractive destination for acquisition and holding companies. These range from more clarity on whether gains from the sale of shares would be taxed in Singapore to a widening of the stamp duty relief provisions.

However, a measured increase to one's tax appeal is probably a better approach by providing more interest expense deductions for the M&A market as a start. Let's hope the 2008 budget gives us just that.

Unleashing the value of intellectual property from Singapore

Authored by



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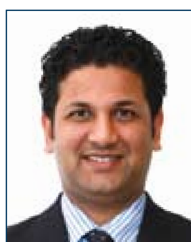

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Intellectual property (IP) has moved to the top of boardroom agendas today because it has become a core business asset and strategic driver of competitive advantage for companies throughout the world. This elevated status of IP has been fuelled by rapid evolution of technology, increased market competition and the swift pace of globalisation.

Singapore recognises the importance of IP and endeavours to develop an attractive and conducive environment for IP management throughout the IP lifecycle. There has been significant commitment to encouraging IP-driven industries (such as the biomedical sciences and clean energy industries) to expand their business footprint to Singapore. One of the primary benefits of using Singapore as an IP management hub is the robust IP protection and enforcement provided by the governing laws and legal infrastructure. Multinationals can locate their IP in Singapore with the comfort of knowing that their strategic business assets will be well protected.

The use and value of IP grows exponentially when tax considerations are brought into the picture. Tax planning is particularly important for IP because of its portability feature and the value that can be attributed to it. Effective tax planning for IP, including location of IP in favourable tax jurisdictions, can substantially reduce a company's effective tax rate and thus significantly enhance shareholder value.

A variety of tax incentives, deductions, grants and other benefits are currently in place to encourage the creation, acquisition, protection and commercialisation of IP in Singapore. These include:

- Approved royalties incentive to reduce withholding tax on royalties paid to non-residents;
- Writing-down allowances (WDA), 20 percent per annum, straight-line over five years on the cost of acquiring both legal and economic ownership of IP - Economic Development Board (EDB) approval needed if only economic ownership of IP is acquired;
- WDA (over one year) on research and development (R&D) cost sharing payments upon approval from the EDB;
- Deductibility of R&D (including contract R&D) expenditure, as well as possible further deductions for R&D expenditure with approval from the EDB;
- Wide Tax Treaty network, to reduce foreign withholding tax on royalties received from overseas;
- Deductibility of patent costs; and
- Various IP and R&D related grants – for example, the Innovation Development Scheme (IDS), Patent Application Fund Plus (PAF Plus) and Initiatives in New Technology (INTECH).

The authors have previously suggested tax reform measures to further improve Singapore's status as a global IP management hub. Taking into account recent changes to Singapore's tax regime, whilst also reiterating some of the prior suggestions, the authors would now like the following tax reform proposals to be considered for making Singapore even more appealing for the centralisation of IP management activities:

- As a starting point to stimulate R&D spending in Singapore, an automatic deduction of say 150 percent for qualifying R&D expenditure should be considered. An additional automatic deduction of say 50 percent may be provided for substantial R&D spending above a specified annual threshold.
- It may also be beneficial to introduce an R&D tax credit scheme, similar to what countries like Australia have introduced. Under this scheme, a company with less than a specified annual turnover in a tax loss position could forgo deductions for R&D expenditure in return for a cash credit or refund (that is equal to the prevailing corporate tax rate multiplied by the amount of R&D expenditure). Effectively, the credit would act as a subsidy for further R&D activities of these companies. The scheme would be particularly useful where group relief is not available and would encourage research-intensive, start-up companies which may be in a tax loss position for some time whilst they seek to grow their business.

- Currently, there are two separate provisions dealing with tax deductibility of R&D cost sharing payments and other R&D (or contract R&D) expenditure. It is suggested for simplification purposes that these provisions be merged into one provision, as there does not appear to be the need for two separate provisions, so long as the company has at least economic ownership of any IP resulting from the R&D activities. Even if the two provisions are not merged, it is suggested that the requirement for EDB approval in the case of WDA for R&D cost sharing payments be removed.

- The R&D and IP management hub scheme grants a tax exemption for foreign sourced royalties and interest remitted to Singapore, provided that this income is reinvested in R&D activities (and certain other conditions are met). However, the efficacy of this scheme is debatable, given the practical difficulties associated with the scheme. For example, companies do not necessarily want the restriction of ploughing back the royalty and interest income into R&D activities. Further, there is lack of clarity on whether royalties from licensees in non-Treaty countries will be treated as foreign sourced royalties and thus qualify for tax exemption. A significant overhaul of this incentive scheme or alternatively, the possibility of providing an outright exemption for all royalties received in Singapore from overseas parties, should be explored.

- There is presently no capital gains tax in Singapore. As IP is inherently not an asset that is 'traded', in most cases it should be possible to demonstrate (based on the 'badges of trade') that a gain made upon divestment of IP is capital in nature and hence non-taxable. However, lack of complete certainty can be an impediment to multinationals with large IP portfolios looking for a suitable location to house their IP. To attract these kinds of dominant IP players, the tax rules may be modified to specifically exempt gains from divestment of IP. Alternatively, it may be worthwhile introducing an 'Approved IP Holding Company' status for approved companies (akin to Approved Holding Company status), so that all gains made from divestment of specified IP by such companies are automatically treated as capital in nature.

- Another related issue is that if IP is transferred after an incentive period, the balancing charge or 'claw-back' of previously claimed WDA is taxed at the prevailing corporate tax rate, rather than at the concessionary incentive tax rate (i.e. the rate at which the WDA were originally claimed). Taxation of the balancing charge at the former concessionary tax rate, even though the IP is transferred after the tenure of the incentive, would produce a more congruent outcome.

- Multinationals may not wish to transfer legal ownership of their valuable IP to a Singapore group entity, but they may be keen to provide long-term territorial rights to exploit such IP (i.e. economic ownership). Two years ago, the rules were modified to allow WDA over five years for capital expenditure to acquire only economic ownership of IP, provided EDB approval is granted. As the next step in encouraging multinationals to shift economic ownership of IP to Singapore, this requirement to obtain prior EDB approval for WDA in such cases could be done away with.

- 'Information that has commercial value' is included within the current definition of IP rights for WDA purposes. However, there is lack of clarity on the precise ambit of this somewhat nebulous term. Perhaps greater clarity can be provided on its meaning – for example, would customer lists be included?

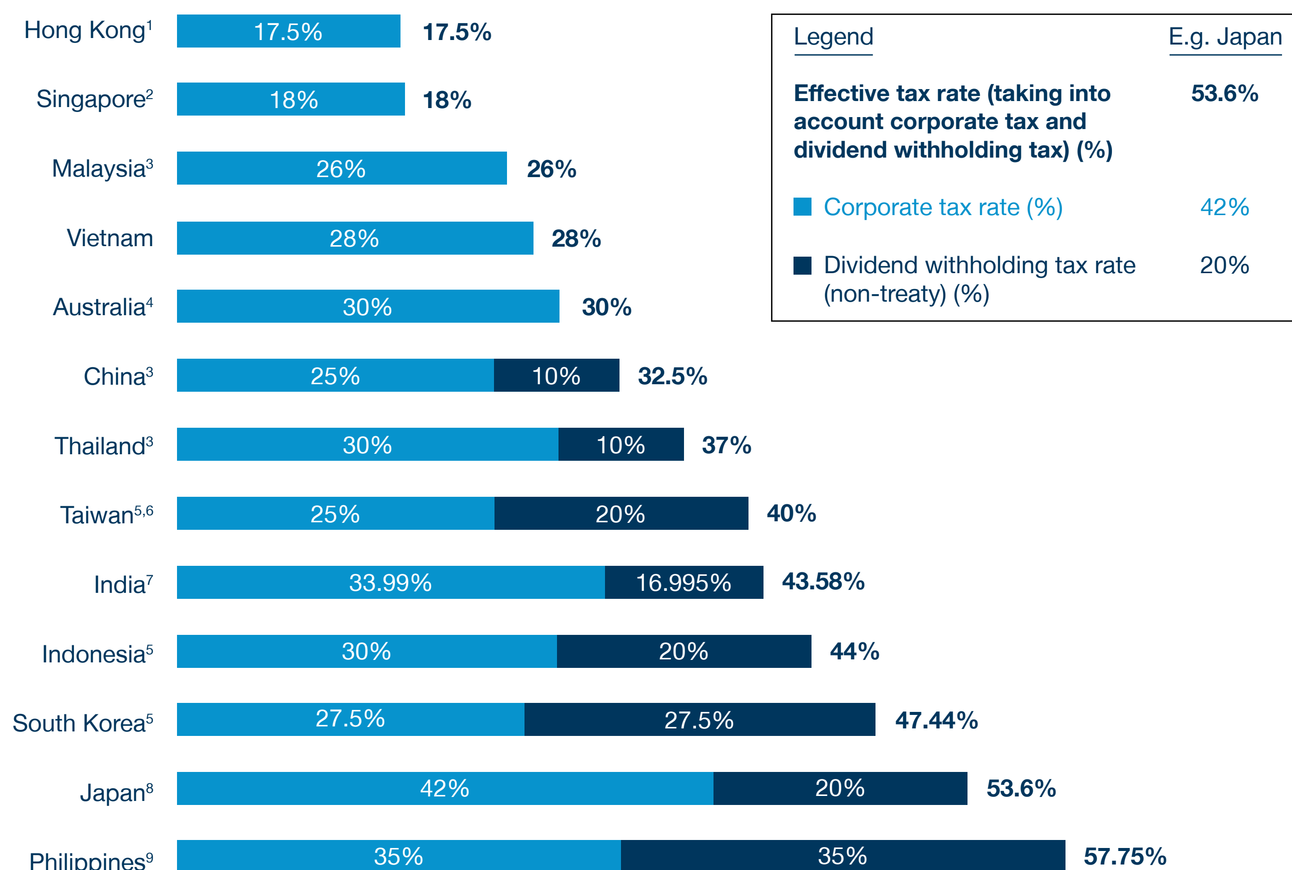
- Royalties received from overseas parties by a Singapore IP holding company will generally be subject to foreign royalty withholding tax. Singapore's favourable Tax Treaty network generally reduces such withholding tax. However, if the Singapore IP owner has been given a tax incentive with a low concessionary tax rate (for example, 5 percent), the foreign royalty withholding tax rate is likely to be greater than the Singapore tax rate and thus the benefit of the incentive is somewhat eroded. This is because 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 if pooling of foreign tax credits against other sources of income and carry forward of excess foreign tax credits is allowed.

Singapore has created a robust base for genuine recognition as a knowledge-based economy. It is a favoured springboard for unleashing the value of the vital business asset we know as IP. Tax reform is an essential tool to catalyse and propel Singapore's progress towards its objective of becoming a global IP management hub. Some of the above proposals could be reviewed in the upcoming Singapore Budget to further boost Singapore's already beneficial fiscal regime for IP management activities.

Appendices

Appendix A

Comparison of Asia-Pacific effective tax rates on repatriated corporate profits (for income year 2008)



Notes:

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

1. The corporate tax rate is expected to be reduced to 16.5% from 1 April 2008.
2. Partial exemption of up to $152,500 applies to the first $300,000 of chargeable income.
3. Lower rates of tax apply to small and medium-sized enterprises.
4. Fully-franked dividends paid to non-residents are not subject to dividend withholding tax, but to the extent that a dividend paid to a non-resident is unfranked, withholding tax of 30% will generally apply.
5. Lower rates of tax apply to income below certain levels.
6. The dividend withholding tax rate is 20%, but in some cases, it would be 25% if the taxpayer did not obtain approval from the authority. An additional 10% tax will be imposed on any current earnings that remain undistributed by the end of the following year. However, the 10% surcharged amount may be used to offset the dividend withholding tax.
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. This is an approximate statutory effective rate of tax due to the varying influence of national and local taxes, which may vary depending on the capital base, size and nature of the company's business. The 20% withholding tax applies to private (unlisted) companies; a lower rate applies for withholding tax on dividends from listed Japanese companies.
9. Dividends paid to a non-resident corporation are subject to a lower rate of 15% 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 20%. In addition, a 10% improperly accumulated earnings tax is imposed on the improperly accumulated earnings of a corporation which allows its earnings or profits to accumulate beyond its reasonable needs.

Appendix B

Comparison of Asia-Pacific individual tax liabilities (a married man with two dependent children for income year 2007)

	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[5]	3,398	5	6,416	6	22,866	11
Australia[3]	19,917	27	30,292	30	75,276	38
China	14,590	19	22,091	22	61,193	31
Hong Kong	4,606	6	8,856	9	25,856	13
India[4]	24,030	32	32,527	33	66,517	33
Indonesia	21,480	29	30,103	30	64,592	32
Japan	7,373	10	14,017	14	52,352	26
Malaysia	15,128	20	22,098	22	50,098	25
Philippines	22,451	30	30,451	30	62,451	31
South Korea	8,375	11	15,167	15	49,962	25
Taiwan	9,150	12	16,101	16	52,162	26
Thailand	16,400	22	23,900	24	59,390	30
Vietnam	18,454	25	28,454	28	68,454	34

Notes:

1. Deductions for Social Security are not taken into account unless the contributions are compulsory by law.
2. Standard deductions are taken into account.
3. Based on new tax rates for year ending 30 June 2008.
4. Based on new tax rates for year ending 31 March 2008.
5. Inclusive of one-off income tax rebate of 20% granted to all resident taxpayers, capped at S$2,000.

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	

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