

Details of 2010 Budget changes to tax incentive schemes

Further to the 2010 Budget presented by the Minister for Finance, the Monetary Authority of Singapore (MAS) issued two circulars on 1 April 2010 and 11 May 2010 providing details of the changes to the following incentive programmes:

- (1) Financial Sector Incentive (FSI) scheme
- (2) Tax Incentive schemes for Futures Members of the Singapore Exchange (SGX) and Members of the Singapore Commodity Exchange Limited (SICOM)

This bulletin summarises these changes and highlights their implications to financial institutions.

The FSI scheme

Background

The FSI scheme covers activities in lending, debt capital market, equity capital market, fund management, trust administration and custody as well as headquarter services. Under this scheme, income from a range of activities (known as the “standard tier (ST) activities”) enjoys a concessionary tax rate of 10 percent. The amount of income that qualifies for the 10 percent tax is, however, subject to a qualifying base (QB) adjustment. Broadly, QB entails the computation of a ratio based on the past income profile of the taxpayer. This ratio is

then applied to income from ST activities, with the amount so computed taxable at the normal corporate tax rate. The balance of the income from ST activities will be taxed at the concessionary rate of 10 percent.

Enhancements to the range of ST qualifying activities

The list of qualifying activities under the ST scheme has been updated. A comparison of the current position and the enhancements is presented below.

Table 1: Enhancements to the range of ST qualifying activities

Categories	Current	Enhancements
Lending and related activities – where FSI company is a bank or a merchant bank	Income from granting of loans, other than by way of bonds or debentures, in any foreign currency which is not repaid in Singapore dollars (“qualifying bank loan”).	Income from granting of loans would include interest income <u>and</u> other income which is incidental to and in connection with the granting of qualifying bank loan. Incidental income includes: <ul style="list-style-type: none"> • income from taking over claims/ collateral under a qualifying bank loan;

Table 1: Enhancements to the range of ST qualifying activities (continued)

Categories	Current	Enhancements
		<ul style="list-style-type: none"> • income from processing and handling any qualifying bank loan; • up-front fees and management fees in respect of qualifying bank loans; • income from arranging, advising and underwriting the qualifying bank loan; and • income from the bank's agency role in administering a qualifying bank loan.
Debt capital market	Income from arranging, managing, underwriting, selling or investing in qualifying debt securities (QDS).	<p>(Effective date: 1 January 2011)</p> <p>Income from performing services as a broker, nominee or custodian in respect of QDS.</p>
Equity capital market	Income from provision of services in respect of foreign debt equities securities.	<p>(Effective date: 1 January 2011)</p> <p>Income from provision of prescribed services in respect of units in a foreign collective investment scheme¹ (CIS) and units in a foreign business trust².</p> <p>Prescribed services means arranging, managing, underwriting, selling or providing services (including services as broker, nominee or custodian) in respect of these securities.</p>
Fund management, trust administration, custodian and other advisory services	Income from provision of trustee services in respect of foreign bond or loan stock issues, including services for monitoring loan covenants and administering loans repayments ³ .	<p>(Effective date: 1 January 2011)</p> <p>Income from provision of trustee services in respect of the issue of units in a foreign CIS and units in a foreign business trust, where the proceeds of the issue are used outside Singapore³.</p>

¹ A foreign CIS means a CIS constituted outside Singapore (excluding any Singapore permanent establishment), not resident in Singapore (other than by virtue of its Singapore trustee), whose units are not denominated in Singapore dollars, and does not carry on a business in Singapore other than issuing units of that CIS.

² A foreign business trust is one that is licensed or approved or exempt from such licensing or approval, under any written law outside Singapore administered by the agency tasked with the regulation of such a business trust.

³ Provided the payment for the trustee services are not borne directly or indirectly by a resident of Singapore or a permanent establishment in Singapore.

With the enhancements to the range of ST activities, financial institutions with FSI-ST awards (each an “FSI-ST” company) should review their accounting systems to ensure that income from the expanded list of activities can be captured so as to facilitate the preparation of tax returns.

Removal of QB and adjustment to the concessionary tax rate

With effect from 1 January 2011, the QB calculation will be removed. Instead, the concessionary tax rate for ST activities will be increased from 10 percent to 12 percent. With the removal of QB, the following transitional provisions will apply to FSI-ST companies.

Table 2: Transitional provisions

Type of FSI-ST company	Impact/action required
(1) Company that took up the concession to extend the initial QB to the period ending 31 December 2010	The relevant QB will cease to apply to income derived from ST activities from 1 January 2011.
(2) Company with subsequent QB	Instead, such income will be taxed at 12 percent.
(3) Company where the initial QB is still applicable (e.g. the company is still within the first incentive period)	
(4) Company with QB of nil	
(5) Company with QB of 100%	
Company with QB of nil or 100% that expires prior to 1 January 2011.	To approach the MAS for clarification of the tax treatment of income derived from the expiry of its QB to 31 December 2010.

If 1 January 2011 does not coincide with the first day of the basis period for the year of assessment 2012, the FSI-ST company should directly identify allowable expenses, capital allowances, donations and, where applicable, allowable impairment loss and general provisions between the first day of the basis period to 31 December 2010 and 1 January 2011 to the end of that basis period.

If direct identification is not possible, these items may be allocated to the respective periods on a time-apportionment basis. It should be noted that income from the FSI-ST activities should be specifically identified to the respective periods.

As the computation of QB can be a complex process, its removal will lessen the compliance burden of FSI-ST companies. Hence, this measure should be welcomed by financial institutions which were concerned with the cost of having to re-compute their QB as they renew their ST awards. That being said, the revised concessionary tax rate of 12 percent translates into a QB of 28.57 percent at the previous incentive rate of 10 percent. It is expected that banks with substantial offshore business may well have a lower QB. These banks will face an increase in their effective tax rate following this change.

Changes to the Tax Incentive Schemes for Futures Members of SGX and Members of SICOM

Currently, futures members of SGX and members of SICOM are taxed at the concessionary rate of 10 percent on dealing profits, fees and commissions from, as well as interest in connection with, qualifying transactions. The current incentive schemes that offer these tax concessions will lapse on 31 December 2010.

Following the expiry of these schemes, SGX futures members and SICOM members will:

- have the option to transit to the FSI scheme from 1 January 2011;
- be approved as FSI-ST award-holders;
- enjoy the concessionary tax rate of 12 percent from 1 January 2011 to 31 December 2013, subject to the rules of the FSI scheme;
- not need to make economic commitments from 1 January 2011 to 31 December 2013 to enjoy the tax concessions offered under the FSI scheme.

SGX future members and SICOM members who wish to transit to the FSI scheme must notify the MAS of the nature of their business (the type of derivatives that the firm trades in, volume of trades and existing headcount etc.) by 31 July 2010. Those who fail to notify the MAS by this deadline will be taxed at the prevailing corporate tax rate from 1 January 2011.

If the FSI scheme were to be extended beyond 31 December 2013, those FSI-ST award holders that wish to renew their incentive will be required to fulfil certain criteria (such as having a minimum of six professionals engaged in qualifying activities). They should approach the MAS at least six months before the expiry of the FSI incentive (i.e. 1 July 2013) to discuss their renewal applications.

Those exchange members who are interested in applying for the FSI – Enhanced Tier scheme (which offers a five percent tax on qualifying income) should approach the MAS to discuss their eligibility for the scheme.

While the objective of the changes announced in the 2010 Budget is to streamline the administration of tax incentives, there appears to be a gap in the qualifying activities when SGX futures members and SICOM members switch into the FSI-ST award. For example, under current law, interest from margin deposits is subject to 10 percent tax for the former but it is not a qualifying income under the FSI-ST. That being said, the counterparty and exchange restrictions under existing tax incentives will no longer apply when these companies transit into the FSI scheme, potentially resulting in a larger pool of incentive-qualifying income. Therefore, SGX futures members and SICOM members that switch to the FSI-ST award will need to review the classification of its income carefully when preparing its tax returns.

Summary

The above changes are part of the Government's on-going effort to review and streamline tax incentives for the financial services industry. They seek to ensure the continuing relevance of the tax incentives to keep up with industry changes as well as to minimise compliance cost. Financial institutions should evaluate if the changes impact the annual tax compliance process and explore opportunities to reduce their effective tax rate.

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