

Tax Bulletin

Draft Income Tax (Amendment) Bill 2011

In this issue, we share some thoughts on the Draft Income Tax (Amendment) Bill 2011.

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Draft Income Tax (Amendment) Bill 2011: Some thoughts

On 8 July 2011, the Ministry of Finance released the draft Income Tax (Amendment) Bill 2011 (“Bill”) for public feedback. It is a 98-page document, incorporating both Budget 2011 and non-Budget changes to the Income Tax Act. This bulletin looks at some of the changes proposed in the Bill.

Budget 2011 changes

Productivity and Innovation Credit

When first introduced in Budget 2010, the Productivity and Innovation Credit (PIC) scheme gave an enhanced deduction or allowance of 150% (in addition to the base 100% deduction or allowance) for the first \$300,000 of qualifying expenditure. Responding to feedback on the anticipated slow take-up of the scheme – it was seen as too complicated for small and medium-sized enterprises while not being attractive enough for multi-nationals – the Minister for Finance enhanced the scheme significantly in the 2011 Budget. The enhanced deduction or allowance was increased to 300% (giving a 400% deduction or allowance) and the cap was raised to the first \$400,000 of qualifying expenditure for each qualifying activity. The cash grant option was similarly enhanced.

The details relating to some of the changes were given in the revised IRAS (Inland Revenue Authority of Singapore) circular published on 15 July 2011. Set out in the table below are some of the salient changes:

Carrying on of a trade	The combined expenditure cap [ie \$800,000 for Years of Assessment (YAs) 2011 and 2012 and \$1.2 million for YAs 2013 to 2015] applies only if a taxpayer carries on a trade or business in the basis period relating to each qualifying year of assessment. Otherwise, the enhanced deduction available must be adjusted accordingly.
Common expenditure/assets for businesses with both normal and concessionary rates	Common expenditure: the expenditure cap is applied first to common expenditure allocated to the normal tax rate and any expenditure cap not exhausted is applied to the concessionary rate. Common assets: enhanced allowances are computed before being allocated to each stream of income.
Mechanism of the tax deferral option	This option of deferring payment of tax payable for a current year of assessment for qualifying PIC expenditure incurred in the current financial year is available for taxes relating to YAs 2011 to 2014.

Waiver of claw-back for disposal of qualifying equipment	<p>For enhanced capital allowance to apply to qualifying equipment, a taxpayer has to own the equipment for at least one year.</p> <p>A waiver is given automatically if, in the year of disposal, the total cost of qualifying equipment (excluding the cost of the equipment disposed of) acquired in the same basis period as the equipment disposed of, is more than or equal to the expenditure cap applicable for that basis period. If otherwise, a taxpayer may apply to the IRAS for a waiver citing the commercial reasons leading to the disposal.</p>
Enhanced deduction available for the leasing of software	The enhanced deduction is now available to a lessee if he leases software as an end-user. Payments made for the right to commercially exploit software do not qualify for enhanced deduction.
Research and development (R&D) activities conducted outside Singapore	Qualifying costs incurred for R&D activities conducted abroad are now eligible for PIC. A taxpayer who does R&D both in Singapore and overseas is free to decide which group of expenditure (ie local or overseas) is to be claimed first for PIC purposes.
Design activities primarily conducted in Singapore	A design project is considered to be conducted primarily in Singapore if at least three out of five design phases (design research, idea generation, concept development, technical development and communication) are done wholly in Singapore.

Most of the above changes found in the IRAS circular are provided for in the draft Bill though not so for the application of the expenditure cap for a taxpayer with both normal and concessionary tax rates. This application mechanism is clearly provided for in section 14D(4) (expenditure on R&D) but not so in the other relevant sections e.g. sections 14R (deduction for qualifying training expenditure) or 14S (deduction for qualifying design expenditure). It is unclear why the tax treatment is not being legislated. Taxpayers will thus simply be relying on the goodwill of the IRAS.

One non-Budget update related to the PIC is that enhanced writing-down allowance under section 19B will not be available to a person acquiring intellectual property rights in software for commercial exploitation purposes; he will still qualify for the basic allowance. The policy behind this denial of the PIC claim is that only the person putting the software to “productive use” should be entitled to PIC.

Enhancement to concession for enterprise development: pre-commencement expenses

For income tax purposes, it is important to ascertain the date on which business commences. It is this date that determines the point from which a tax deduction can be claimed for revenue expenses incurred. Expenses incurred before a business commences cannot be said to have been incurred in the production of income. When a business commences is a question of fact. As a general rule, a business does not usually commence until it is both in a position to offer the goods or services, and actually does so, or offers to do so, by way of trade.

The concession of allowing a deduction for (revenue) expenses based on a "deemed date of commencement" – the day a business earns its first dollar of income – was first

introduced in Budget 2003. In short, it allowed a taxpayer to deduct revenue expenses incurred from the first day of the accounting year in which it earned its first dollar of income. This was enhanced in Budget 2011 and has been included within the draft Bill.

Beginning YA 2012, a business may claim a deduction for revenue expenses incurred in the 12 months immediately before the accounting year in which the first dollar of trade income is earned. So if a company were to earn its first dollar in financial year ending 2011 (YA 2012), revenue expenses incurred in the 12 months immediately preceding that financial year will be allowed a deduction in its YA 2012 tax computation.

This all seems relatively straightforward so far, except that under the concession introduced in 2003, the IRAS takes the view that an existing company starting a new business is not entitled to the concession. Why that is so has never been clear. However, as it is a concession, there was no legal basis for a taxpayer to argue otherwise, at least in the IRAS's view. Now that this is being legislated, the language in the draft Bill does not seem to prohibit such an entity from claiming a deduction.

Foreign tax credit pooling

Singapore taxes foreign-sourced income received in Singapore, unless exemptions apply. Foreign-sourced income may potentially be taxed twice, once in the country where it arises and again when it is received in Singapore. To avoid such double taxation, Singapore typically grants the Singapore resident taxpayer a credit for the foreign tax paid. This credit could be given unilaterally or under a tax treaty concluded between Singapore and the country from which the income arose.

Singapore has all along been granting foreign tax credit on a "source-by-source and country-by-country" basis. This means that credit for foreign tax paid on a particular stream of income is restricted to that income and any excess cannot be used as a credit against another income stream. Clearly, this creates a less than happy situation for taxpayers with excess foreign tax credits. After much lobbying, the law will soon allow the pooling of foreign tax credits.

While the IRAS has clarified in its circular¹ that a taxpayer "may elect to pool the foreign taxes paid...on any items of [its] foreign income",² the proposed language in the draft Bill is far from clear. The draft provision states that a person is entitled to credit in respect of two or more sources of income, among other things.³ If it is intended to mean types of income (which appears so from the wording of the sub-section), it would be preferable to refer to the types of income set out in section 10(1) of the Income Tax Act.

Non-Budget changes

Fund management incentives and letter of approval

Tax incentives in Singapore are usually the result of rounds of negotiation between taxpayers and the authorities. Conditions are typically stipulated in a letter of approval or award. It has been generally accepted practice for a taxpayer to comply with all conditions prescribed in these letters, in addition to the tax laws and regulations governing the taxpayer. If there is any possibility of a taxpayer not meeting certain conditions within the timeline agreed, he will usually notify the authorities and discuss how the issue is to be resolved.

Apparently, the need to comply with conditions stated in the letter of approval is not a view shared by some taxpayers. This might explain the need to now amend the Income

¹ *Income Tax: Foreign Tax Credit Pooling* published on 22 June 2011

² *Ibid*, paragraph 4.1

³ Clause 52 of the Bill

Tax Act to provide that certain fund management tax incentives are subject to conditions prescribed in the relevant regulations as well as those specified in the letter of approval. For consistency, this provision should be replicated for other incentives (eg Global Trader Programme, Finance and Treasury Centre) although so far it has not been. Otherwise, it seems to suggest that such other taxpayers are not required by law to comply with the conditions stated in their letters of approval or award, which surely cannot be Parliament's intention.

Statutory appeal procedures for tax assessments

A taxpayer is required by law to object to a notice of assessment should he disagree with it. The draft Bill proposes to limit a taxpayer's right to object to an assessment to the revised items only.

It is unclear how this proposed change in the law affects a taxpayer's right to object to items not directly amended in an assessment but which may, as a result, require a consequential adjustment. For example, a taxpayer may have deferred capital allowance claims if he was making losses in the year. However, the IRAS's adjustment may put him in a taxable position for that year. Does the language preclude him from claiming capital allowances or even revising his group relief claims?

To these questions, we await the answers come September, when the Ministry of Finance publishes its response to feedback given on the draft Bill.

Get in touch

Contact us

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