Tax Bulletin

Draft amendments to the Income Tax Act

September 2015

Introduction

On 26 June 2015, the Ministry of Finance (MOF) issued the draft Income Tax (Amendment) Bill 2015 (the draft Bill) for public consultation.

The draft Bill mainly contains tax changes proposed at the 2015 Budget. In addition, a number of non-Budget changes to existing tax policies and administration have been proposed. These arose from the on-going review of Singapore's income tax system.

Complete lists of the proposed Budget and non-Budget changes, as well as further details on the public consultation exercise, are available on the MOF's website.

The consultation exercise ended on 24 July 2015, and as always, PwC has provided our feedback to the MOF, some aspects of which are set out below.

Double tax deduction for internationalisation

The draft Bill proposes a new section 14KA to expand the scope of the existing double tax deduction (DTD) for internationalisation (provided for under section 14B)[1] to include qualifying salary expenditure incurred from 1 July 2015 to 31 March 2020 for Singaporeans posted to newly set-up or acquired entities overseas.

Salary expenditure must be incurred for the Singapore firm's or company's employees

The proposed section 14KA(1)(a) requires that salary expenditure must be incurred by the Singapore firm or company for employees posted to an overseas establishment.

As announced in the Budget Speech, the objective of this enhancement is to provide support to businesses venturing overseas by co-sharing their risks and initial costs of expanding overseas, as well as creating skilled jobs for Singaporeans. Overseas postings are usually done by way of secondment to the overseas establishment, in order to avoid creating a permanent establishment (PE) exposure for the Singapore firm or company. There are also immigration, personal tax and other considerations which warrant a secondment arrangement. This gives rise to the following issues:

1. For the duration of the overseas posting, the employee will cease to be an employee of the Singapore firm or company. This gives rise to the question of whether the Singapore firm or company can be considered to have incurred the relevant expenditure.

2. In the draft Bill, the Singapore firm or company is precluded from claiming the DTD if the overseas establishment has been allowed a deduction for those expenses.[2] It is useful to clarify whether a deduction is available to the Singapore firm or company in the following scenarios:

    - The individual's salary expenditure is borne by the overseas establishment (which may or may not claim a deduction for the expenditure) and recharged to the Singapore firm or company with a mark-up for services provided to the latter.

    - The overseas establishment does not charge a service fee, but is taxed on a deemed service fee (i.e. a mark-up on the salary expenditure) under the overseas country's domestic tax rules.

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[1] Section 14B of the Income Tax Act provides for further tax deduction of qualifying expenses relating to approved trade fairs, exhibitions or trade missions or to maintenance of overseas trade office.

[2] The proposed section 14KA(10) provides that the Singapore firm or company is not be entitled to claim DTD on any salary expenditure that the overseas establishment has been allowed a deduction for.

Expand definition of qualifying salary expenditure

The term "salary expenditure" in the proposed section 14KA(15) means expenditure comprising wages and salary for the employee, but excluding any bonus, commission, gratuity, leave pay, perquisite, allowance, or any other prescribed payment (whether in cash or kind).

This definition should be expanded to include all cash and non-cash remuneration. For example, start-ups may not be able to pay high basic wages, but may give their employees share-based awards or options or emphasise performance-based bonuses.

Consistency with the statute of limitations

The draft Bill (sections 14B(6), 14K(5), 14KA(12), 14KA(13) and 14KA(14)) states that if the Singapore firm or company fails to comply with certain conditions, the deduction allowed previously will be treated as income for the year of assessment in which the Comptroller discovers the non-compliance.

The imposition of conditions subsequent will introduce additional compliance burden and complexity to tax incentive schemes and should be avoided. As such, consistent with the statute of limitations, any revisions or adjustments of assessments should be made to the year of assessment in which the deduction is allowed.

International Growth Scheme

During the 2015 Budget, a new tax incentive, the International Growth Scheme (IGS), was introduced to support larger Singapore companies in their internationalisation efforts. Under the IGS, qualifying Singapore companies will enjoy a concessionary tax rate of 10% for a period not exceeding five years on incremental income from qualifying activities (i.e. income in excess of a base amount). The approval window is from 1 April 2015 to 31 March 2020. A new section 43ZH is proposed to provide for this incentive.

Remove reference to audited accounts from calculation of base income

The proposed section 14ZH(6) prescribes how the base income should be ascertained, and subsection (a) specifies that the base income should be computed using the total net profit before tax as shown in the company's audited accounts that is derived from carrying on the activity or activities for a specified period.

The total net profit before tax as shown in the audited accounts may include passive income and/or income from unrelated businesses which should not be included in the computation of the base income. Further, certain companies (private exempt companies) are not required by statute to have their accounts audited. We suggest fixing the level of base income separately and removing the reference to audited accounts.

Clarify definition of qualifying activities

An international growth company in section 43ZH(9) means a company which carries on, or intends to carry on, a trade or business which involves the export of goods to or the performance of services in a country outside Singapore.

It would be helpful if the MOF could clarify (in a circular or press release) that a company in the business of licensing intellectual property to a country outside Singapore would qualify as an international growth company.

Limited relief for foreign-sourced service income

The IGS provides for a 10% concessionary tax rate on income from carrying on qualifying activities, which include the provision of services outside Singapore.

Service fee and royalty income derived from outside Singapore are usually subject to foreign withholding tax on the gross amount. This will significantly reduce the attractiveness of the IGS to companies which derive such income, as foreign tax credit available on such income often exceeds the corresponding Singapore tax payable, particularly where there are deductible expenses. Unless the foreign withholding tax rates are significantly reduced under a tax treaty, this is likely to be the case as long as Singapore's tax rates remain comparable to foreign (domestic) withholding tax rates.

Transparent qualifying conditions

In the 2015 Budget, it was stated that this incentive is meant to provide greater and more targeted support to Singapore companies in their internationalisation efforts, and aims to support high potential companies in their growth overseas, while they continue to anchor their key functions in Singapore. In the light of the need for greater transparency arising from international base erosion and profit shifting concerns, it will be useful for certain basic qualifying criteria to be prescribed.

Maritime Sector Incentive

It was proposed in the 2015 Budget that the Maritime Sector Incentive-Shipping Enterprise (Singapore Registry of Ships) (MSI-SRS) and MSI-Approved International Shipping Enterprise (MSI-AIS) awards will now cover mobilisation and demobilisation fees, holding fees, and incidental container rental income that are derived in the course of qualifying shipping operations.

In practice, mobilisation and demobilisation income may have been accepted as qualifying income on a case-by-case basis, typically where such income is incidental to qualifying shipping operations. It should be clarified that the tax treatment of such income earned prior to the effective date will not be disturbed if the tax authorities had agreed to treat it as qualifying in the past.

Safe harbour rule

Notably missing from the draft Bill (as well as the 2015 Budget) was an extension of the safe harbour rules in relation to gains made from the disposal of ordinary shares. When this was first introduced in the 2012 Budget, it was welcomed by the business community and continues to provide significant stability for businesses wanting to use Singapore as the holding location for their operations. However with the sunset clause in section 13Z, the rules will cease to apply to ordinary shares acquired after 1 June 2015.

It would benefit businesses wishing to use Singapore as a holding company location if section 13Z could be amended to allow the safe harbour rules to continue to apply to ordinary shares acquired after 1 June 2015 and sold after 31 May 2017.

On a related note, it is not uncommon for investments to be undertaken via instruments other than ordinary shares, e.g. preference shares. Therefore, it would be relevant to consider expanding the definition of qualifying shares to include other equity-like instruments and for the exemption to apply accordingly.

Conclusion

We do not typically expect that the MOF will make significant changes at this stage of the legislative process (although there have been rare exceptions in the past). Changes to the draft Bill are more likely to relate to suggested changes to the wording of the legislation, where they are consistent with the policy intent of the proposed amendments. Nonetheless, we are optimistic that the MOF will take into consideration the above feedback, even if the amendments are not effected in the upcoming amendment act.

The MOF has also indicated that it will provide a summary of the feedback received, and its response to that feedback, i.e., which changes have or have not been accepted and the MOF's reasons for doing so, by the end of August 2015. These responses often provide useful insight into the policy intent behind the proposed changes. Finally, it should be noted that the documents issued for consultation do not represent the final legislation and cannot be relied on at this stage, even if they do provide an indication of the changes that may eventually be introduced.

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