

Financial Sector Incentive and Insurance Business Development Schemes Changes

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On 11 May 2017, the Monetary Authority of Singapore (MAS) issued two circulars (FDD Cir 05/2017 and FDD Cir 06/2017), detailing changes to the existing Financial Sector Incentive (FSI) and Insurance Business Development (IBD) Schemes. Following which, the changes to the FSI Scheme have been gazetted through the Income Tax (Concessionary Rate of Tax for Financial Sector Incentive Companies) Regulations 2017 on 15 May 2017 (the “2017 FSI Regulations”). The latest developments reflect the Government’s continuing efforts to fine tune Singapore’s incentives regime to ensure that it remains relevant in today’s environment.

We discuss the salient points of the MAS circulars and 2017 FSI Regulations below.

The Financial Sector Incentive Scheme

Background

The FSI Scheme was first introduced in Budget 2002 as an umbrella scheme intended to streamline the various then existing tax concessions for the financial sector, as well as to encourage the development of high-growth and high value-added financial activities in Singapore. Over the years, there have been several refinements to the FSI Scheme to ensure it continues to remain competitive, including partial relaxation of currency and counterparty requirements for certain financial activities to come within the scheme.

Key Changes – At a glance

A) Removal of currency, counterparty and investment instrument restrictions

The FSI Scheme will be streamlined to remove all currency, counterparty and investment instrument restrictions for both the FSI (Standard Tier) award and the FSI (Enhanced Tier) award. In return for the broader range of qualifying activities, the concessionary tax rate for the standard tier award has been raised from 12% to 13.5%, whereas there is no change to the concessionary tax rate for the enhanced tier award.

The revised set of the FSI qualifying activities and the applicable tax rates are summarised in Table 1:¹

Table 1: Summary of the FSI Scheme

Scheme	Tax Rate	Qualifying Activities
FSI-Standard Tier (FSI-ST)	13.5%	<p>(a) Where the financial sector incentive (standard tier) company is a licensed bank –</p> <ul style="list-style-type: none"> (i) transacting in loans, other than by way of bonds or debentures, with a body of persons, trust, company or firm; (ii) providing services in respect of loans, other than by way of bonds or debentures; (iii) transacting with any bank or branch office in respect of any of the following: <ul style="list-style-type: none"> A. placement of funds B. bankers’ acceptances on bills relating to trade transactions C. bills relating to trade transactions D. negotiable certificates of deposit (iv) transacting in or providing services relating to, trade transactions, remittances, bank guarantees or performance bonds; <p>(b) Trading in any loans and their related collaterals (excluding immovable property)²;</p> <p>(c) Trading or investing in or providing services (including securities lending or repurchase arrangements and services as a broker, nominee or custodian) in respect of debt securities or stocks, shares, or other equity securities issued by a company, collective investment scheme or business trust;</p> <p>(d) Providing services for the purpose of a listing on the Singapore Exchange to a company;</p> <p>(e) Foreign exchange transactions;</p> <p>(f) Trading in derivatives and providing services as an intermediary in connection with transactions relating to derivatives;</p> <p>(g) Transacting in or providing services in respect of transactions in gold bullion, silver bullion or platinum bullion;</p>

¹ With effect from 1 April 2016, the Tax Incentive for Trustee Companies has been subsumed under the FSI Scheme (“FSI-TC”). While no changes have been announced to the FSI-TC Scheme in the above MAS Circulars, based on clarifications with the MAS, there will be proposed changes to the FSI-TC Scheme which will be announced shortly.

² Previously, the exclusion was with respect to Singapore immovable property only

		<ul style="list-style-type: none"> (h) Managing or providing investment advisory services (including through another fund manager) to, qualifying funds; (i) Providing other advisory services relating to financial matters (other than investment advisory services in respect of fund management); (j) Providing trustee or custodian services in its capacity of a trustee of a trust; (k) Providing trustee services in respect of bond or loan stock issues, including services for monitoring loan covenants and administering loan repayments; (l) Providing trustee services in respect of issue of units of, a collective investment scheme or a business trust; (m) Providing trust management or administration services to any trustee of a trust. <p><u>Islamic Finance</u></p> <p>Lending and related activities, fund management and provision of investment advisory services in respect of fund management.</p>
FSI-Headquarters Services (FSI-HQ)	10%	<ul style="list-style-type: none"> (i) General management, risk management and administration; (ii) Strategic business planning and strategic business development; (iii) Operational processing services; (iv) Information technology support and technical services; (v) Training and personnel management; (vi) Corporate finance advisory services; (vii) Economic, financial, investment or market research and analysis; (viii) Credit control and administration; (ix) Arranging credit facilities for the approved office; (x) Providing guarantees, performance bonds, standby letters of credit and services relating to remittances where: <ul style="list-style-type: none"> A. in the case of a guarantee, performance bond or standby letter of credit, the party in whose favour the facility is issued is a financial institution B. in the case of services relating to remittances, the person to whom the remittances are made is a financial institution

		(xi) Arranging interest rate or currency swaps with a financial institution;
		(xii) Managing the funds of the approved office.
FSI-Fund Management (FSI-FM)		Providing fund management or investment advisory services to qualifying funds.
FSI-Capital Market (FSI-CM)	5%	(i) Trading or investing in, or providing services (including services as a broker, nominee or custodian, and the grant of a loan of the securities under a securities lending or repurchase arrangement) in respect of: <ul style="list-style-type: none"> A. debt securities; or B. stocks, shares, or other equity securities issued by a company, a collective investment scheme or a business trust; (ii) Providing services for the purpose of a listing on the Singapore Exchange to a company.
FSI-CFS		(i) Arranging, underwriting or granting loans under any syndicated facility which is a credit facility or a guarantee facility, subject to conditions; (ii) Arranging, underwriting or granting a loan after it has become a syndicated facility, subject to conditions; (iii) Trading in secondary loans under any syndicated facility which is a credit facility or a guarantee facility by licensed or approved banks, subject to conditions.
FSI-DM		(i) Trading in, or providing services as an intermediary in connection with transactions relating to any financial derivatives, commodity derivatives, emission derivatives or freight derivatives; (ii) Incidental physical trading where volume of the incidental physical trading does not exceed 15% of the total volume of incidental physical trading and trading in commodity derivatives; (iii) Providing project finance advisory services in connection with syndicated facilities relating to any prescribed asset or project.

Briefly, the notable changes to the scope of the qualifying activities of the FSI Scheme are as follows:

- a) Loan transactions by licensed or approved banks with individuals are excluded (unless the individuals are carrying on business through a firm);
- b) Dealing in loan collaterals where the collaterals are immovable properties are excluded;

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- c) Fund management and investment advisory services under FSI-ST and FSI-FM no longer need to be rendered in respect of designated investments or qualifying investors for the income to be FSI-qualifying; and
 - d) FSI-CFS activities now cover onshore syndication. However, all CFS activities relating to immovable properties need to be in respect of prescribed infrastructure assets or projects.³

B) Existing awards are grandfathered

The above changes will apply to new and renewal awards approved on or after 1 June 2017. Existing FSI award holders will continue to operate under the terms of their respective awards (with the existing scope and tax rate), until such time the awards expire. They may then apply for the new awards (with the new scope and tax rate) if they are able to meet the conditions.

Notwithstanding the broadening of the scope of the FSI schemes, no changes to their qualifying criteria are expected.

PwC's observations

a) Staying relevant

The changes to the FSI Scheme are an indication of the authorities' continuing efforts to ensure that the incentives remain relevant to the financial services industry, while keeping up with changes in the global tax environment.

b) Simplification of compliance process

The removal of the currency, counterparty and investment instruments restrictions should help reduce compliance burden for taxpayers, by simplifying the process of tracking income from qualifying and non-qualifying activities. Further, the removal of the investment instrument restriction and the qualifying investor tracking requirement under FSI-FM will make it administratively easier for fund managers to identify their qualifying income.

It is hoped that we can see similar refinements for the tax incentives for investment funds in due course, as that would greatly ease the incentive administration for fund vehicles.

c) Increase in tax rate

While the increase in the concessionary tax rate under the FSI-ST scheme from 12% to 13.5% is intended at maintaining tax neutrality, it may not benefit FSI-ST holders which are principally engaged in non-Singapore dollar and offshore business, if these financial institutions do not plan to expand their onshore business.

The higher rate is expected to be less attractive to new market entrants to Singapore given the difference in the rates under FSI-ST and the corporate tax rate is only 3.5%. In this regard, new entrants should weigh the benefit of any tax savings against the economic commitments required for the incentive award.

³ Prescribed asset or project means an infrastructure asset or project prescribed in regulation 5 of the Income Tax (Qualifying Project Debt Securities) Regulations 2008.

d) Loan transactions with individuals removed from qualifying activity

The removal of loan transactions (other than by way of bonds or debentures) with individuals from the list of FSI-ST activities will have an impact on the private banking business.

Additionally, FSI-ST holders will have to consider how it could distinguish income from lending to individuals and income from lending to firms, as only the latter is qualifying income.

e) Spurring Singapore-based activities

Over the years, there has been a gradual relaxation of currency related restrictions under the FSI-ST scheme. This round of changes will remove the remaining restrictions. It is as yet not known whether such relaxation will bring about any increase in Singapore-dollar activities. It is hoped that these changes may encourage banks to lend to cash-starved small and medium enterprises in Singapore given most of their funding needs are likely to be denominated in Singapore dollar.

f) Loan provisions and write-back of loan provisions

The MAS circular is silent on the treatment of write-back of loan provision under the new FSI scheme when deduction for the provision was claimed under a different tax rate. An example of this would be a SGD loan provision, for which a deduction would have been claimed under the 17% rate, but a write-back can take place when the new FSI scheme is effective. We understand that this matter is currently being considered by the Inland Revenue Authority of Singapore.

What's next?

Existing award holders whose incentives are about to expire should evaluate the impact of these changes on their business when considering the renewal of their awards after 1 June 2017. For example, most incentive holders will be relying on certain information parameters in their financial systems for tracking qualifying income. They will now need to evaluate whether their systems need to be adapted to accommodate the latest changes. Additionally, existing award holders which may benefit from these changes (for example, taxpayers who are engaging substantially in qualifying onshore activities) may wish to consider whether it is possible to renew their incentive before their existing awards expire. Although it is not mentioned in the circulars, we understand that taxpayers may broach the possibility of early renewals with the MAS.

Please contact us to discuss the impact of these changes on your business.

Insurance Business Development Scheme

Background

The concept of the Insurance Business Development Incentive (IBD) umbrella scheme was introduced in 2015 as the Singapore government extended the expiry date for the approved offshore insurance business tax incentive schemes (collectively known as the “old OIB Schemes”) to 31 March 2020. Subsequently, in 2016, the Marine Hull and Liability Insurance Scheme (IBD-MHL), Specialised Insurance Business Scheme (IBD-SI) and Captive Insurance Scheme (IBD-CI) were refined and subsumed under the IBD umbrella scheme.

Key Changes

A) All insurance incentives subsumed under IBD

Effective 1 June 2017, the Offshore Insurance Broking Business (OIBB) and Offshore Specialised Insurance Broking Business (OSIBB) schemes will be subsumed under the IBD umbrella scheme and renamed as the IBD-Insurance Broking Business (IBD-IBB) and IBD-Specialised Insurance Broking Business (IBD-SIBB) respectively. With this revision, all the insurance incentives are now included under a single IBD umbrella scheme.

The table below summarises the tax incentives under the IBD scheme (effective 1 June 2017)

IBD Scheme						
Category of Award	IBD – Standard Tier				IBD – Enhanced Tier	
Insurance Tax Incentive	IBD	IBD-MHL	IBD-CI	IBD-IBB	IBD-SI	IBD-SIBB
Tax Rate	10%	10%	10%	10%	5%/8%/10%	5%
Sunset Date	31 March 2020		31 March 2018		31 August 2021	31 March 2018

B) No changes to tax rates

The MAS has confirmed that there are no changes to the concessionary tax rates granted under awards across all IBD schemes as a consequence of the consolidation of the various insurance incentives under the IBD umbrella scheme.

C) Existing awards are grandfathered

The terms and conditions of existing IBD, IBD-MHL, IBD-CI, IBD-SI, OIBB and OSIBB award holders will continue to apply until such time that their current award term expires. Thereafter they may apply for renewal under the corresponding IBD-Standard/Enhanced Tier Awards.

D) Key changes to scope of qualifying income

The key changes under the IBD schemes relate to the scope of the qualifying underwriting and investment income.

The new IBD Scheme incentivises both onshore and offshore business and does away with identifying qualifying income using the Singapore Insurance Fund (SIF) and Offshore Insurance Fund (OIF) concept. While it appears to be a generous expansion of scope of qualifying income for the onshore business, based on the most recent industry data available, the excluded lines of business (fire, motor, work injury compensation, personal accident and health) account for approximately 70%⁴ of the total gross premiums of the Singapore Insurance Fund business.

Expanded qualifying income

The scope of activities under IBD will be expanded to cover the following income:-

- (a) underwriting income derived from insuring and reinsuring both onshore and offshore insurance risks for IBD and IBD-CI;
- (b) onshore and offshore investment income (being dividend, qualifying interest, gains from sale of onshore and offshore qualifying investment) relating to the incentivised insurance business lines for IBD, IBD MHL, IBD-CI and IBD-SI; and
- (c) onshore and offshore broking business income for IBD-IBB and IBD-SIBB.

Excluded income

To streamline the IBD schemes and keep the scope of qualifying activities targeted, the following income will be excluded for new or renewal awards approved on or after 1 June 2017:-

- (a) all underwriting income, investment income, and insurance broking commission and fee income from onshore and offshore direct life insurance;
- (b) all underwriting income, investment income, and insurance broking commission and fee income from onshore and offshore fire, motor, work injury compensation, personal accident and health insurance⁵;
- (c) interest income other than qualifying interest;
- (d) gains from sale of investments other than qualifying investments; and
- (e) investment income relating to immovable properties both inside and outside Singapore, except for those relating to any prescribed asset or project.⁶

PwC's observations

Definition of “qualifying investment income”

The definition of qualifying investment income means any of the following:

- (a) any stock or share of a company;
- (b) securities (other than stocks and shares) issued by a government, bank or company and includes bonds, notes, certificates of deposits and treasury bills that is issued by such government, bank or company (as the case may be);
- (c) any futures contract made in any future exchange.

⁴ 70% is calculated based on the General Insurance Business Gross Premiums of Singapore Insurance Fund business by line, which is published under the Insurance Statistics 2015 on the MAS website.

⁵ The definition of the excluded insurance policies will be prescribed in the regulations. The MAS envisage that the insurance policies will generally relate to direct stand-alone retail policies, following the current regulatory reporting classifications under the ambit of the Insurance Act.

⁶ Prescribed asset or project means an infrastructure asset or project prescribed in regulation 5 of the Income Tax (Qualifying Project Debt Securities) Regulations 2008.

This appears to a rather limited list. MAS should consider providing a broader definition to include alternative investments that may be made by insurers.

The challenge insurers will face is identification of income from those investments which do not directly support the incentivised lines of business. Whilst the IBD incentive is extended to include onshore business, underwriting and investment income from life business (direct and reinsurance) is specifically excluded. We expect the legislation, when introduced, to prescribe a formula (possibly by the GWP of each line of business) to apportion the investment income between qualifying and non-qualifying lines of business. The revised regulations should also provide for the application of alternative methods of apportionment taking into account the circumstance of the business of the insurer. For example, if an insurer reinsures its risks in different proportion for different lines of business, then the net written premiums (after reinsurance) would be more reflective of the risks accepted by the insurers (than GWP) and should be used as the apportionment basis.

Further, the Singapore courts⁷ has previously determined that insurance companies are capable of holding assets on capital account for tax purposes. Prior to establishing whether any gains from disposal of investments (qualifying investments or otherwise) are subject to tax (or concessionary tax) in Singapore, insurers should identify those capital investments and ensure that appropriate documentation is maintained to support their position.

What's next?

Insurers intending to apply for new or renewal awards under the corresponding IBD-Standard/Enhanced Tier Awards should evaluate if the new IBD scheme is beneficial to their business. Further, due to the exclusions, insurers will need to be able to bifurcate the underwriting and investment income earned from the incentivised and non-incentivised lines of business and ensure that their accounting systems are able to determine the split.

Existing award holders whose incentives are about to expire should analyse the impact that these changes will have on their business when considering the renewal of their awards after 1 June 2017.

Please contact any of the partners and directors in our Financial Services Tax practice or PwC colleagues to discuss the impact of these changes on your business.

⁷ *Comptroller of Income Tax v BBO* [2014] SGCA 10

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