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Proposals to enhance Singapore's economy

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Proposals to enhance Singapore's economy

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01

Executive summary

Businesses today operate amidst uncertain global economic conditions, heightened geopolitical risks and a backlash against globalisation. At the same time, the digital economy is rapidly transforming business and disrupting operating models. Against this backdrop, the Committee on the Future Economy will unveil its recommendations for Singapore by end-January 2017. In the meantime, PwC suggests the following changes to enhance the fiscal environment to make it more conducive for Singapore to continue to develop a digital economy, to encourage innovation and promote entrepreneurship .

Key recommendations to help Singapore embrace digital disruption include liberalising the tax deduction scheme for angel investors to boost funding for start-ups, introducing tax reliefs to help businesses "go digital" and reviewing tax treaties to provide specific guidance for electronic commerce activities to alleviate double taxation. In addition, we propose enhancements on the research and development (R&D) front to promote creating a more conducive environment to anchor high value added activities and intellectual property ownership (IP) in Singapore. We also submit measures to encourage local businesses to reinvent themselves to expand their footprint locally and overseas; these include liberalising certain deduction and loss carry-forward rules to encourage risk taking, reintroducing incentives for employee share plans to attract talent and introducing new tax breaks to support collaboration and overseas expansion.

We have separately provided the Monetary Authority of Singapore (MAS) with suggested tax measures relating to the financial sector and some of our past proposals which we believe are still relevant. These are attached as Appendix A and B respectively.

01

Digital economy

Embracing digital disruption to remain competitive

- ***Extend the Angel Investors Tax Deduction (AITD) Scheme to venture capital firms and companies***

  Access to funds is crucial for start-ups. Many start-ups are eligible for the early stage financing and co-investing programme which the government has implemented. However, to boost the growth of start-ups particularly in the technology industry, the government can consider liberalising the AITD scheme to make it easier for individual investors to qualify. A suggestion could be to waive the eligibility conditions and approval requirements for an angel investor under the AITD scheme for certain classes of wealthy individuals e.g. Accredited Investors as defined in the Securities and Futures Act. In addition, the scheme should be extended to companies and venture capital funds that provide financing to help the qualifying start-ups in such industries and help them to commercialise their product. This will help in the marketing of Singapore as a global venture hub on the international stage.

  On a related note, more needs to be done to build the talent pool. As such, employment rules for work visas could be eased for certain employers in the venture fund and technology start-up space.

  To help promote a vibrant ecosystem for start-ups in the digital and technology space, the government should also consider the following measures:

  – Payments for technology licences by start-ups engaged in innovative activities should be exempt from withholding tax or be subject to a reduced withholding tax rate for a fixed duration to help them tap into and build on existing technologies.

  – A Technology Problem Statement Bank could be introduced where funding is provided to start-ups to encourage innovative inventions that provide a solution to the problems entered. Such funding should not be taxable.

- ***Singapore's role in the global value chain***

  The main driver for Singapore companies in this digital age to move up the value chain is to develop knowledge-intensive, high value-added activities which lead to the creation of unique and valuable intangibles. To this end, our tax incentive regime should be reviewed to ensure that it continues to attract those substantive activities that are recognised internationally as high-value adding in relation to businesses' entire value chain. For example, section 19B of the Income Tax Act requires only the acquisition of legal rights to the IP in order to qualify for an automatic tax deduction. This could be supplemented by an IP box regime to encourage exploitation of IP in Singapore. This is discussed further in the "Encourage innovation" section below. Attracting companies and intermediaries to manage their IP portfolios and site IP management functions in Singapore will also add to high-end employment creation and knock-on demand for IP support services.

- ***Tax concessions to help companies "go digital"***

  There are hefty costs involved for a company to move into a digital environment. With the expiry of the Productivity and Innovation Credit (PIC) scheme in Year of Assessment (YA) 2018, companies including start-up enterprises that have yet to benefit from the scheme will incur expenditure that span from the hardware infrastructure to labour costs of digitising data, information migration and staff training.

  In this regard, tax reliefs (e.g. enhanced deductions or capital allowances) would help businesses alleviate the investment cost of "going digital" and would encourage them to digitise their data and modernise their processes.

- ***Certainty of treatment in tax treaties***

  As enterprises expand and transact cross-border, they could potentially face double taxation as different countries characterise the different income streams (e.g. royalty income, income from the sale of goods and services in digitised format) from digital businesses differently and there could be different interpretations of permanent establishment thresholds in the e-commerce context. To minimise uncertainty arising from such differences and risk of double taxation, treaty definitions in new or revised tax treaties should include specific guidance for electronic commerce activities to ensure consistent treatment across jurisdictions.

Encourage innovation

Create a conducive fiscal environment to anchor R&D and IP ownership in Singapore

- ***Allow enhanced deduction for overseas R&D activities***

  We must acknowledge that certain aspects of R&D activities cannot be carried out in Singapore for practical reasons such as inadequate sample size and different geographical environment. By necessity, these activities must be carried out overseas by businesses intending to locate and exploit the resulting IP in Singapore.

  With the expiry of the PIC scheme, qualifying R&D activities conducted overseas would not qualify for enhanced deduction. This would be non-competitive and section 14DA of the Income Tax Act should be amended to include qualifying R&D activities conducted overseas so long as the activities have a nexus to the Singapore business, e.g. the majority of the IP developmental activities will be carried out in Singapore or the IP developed out of the R&D will be owned by a Singapore resident enterprise.

- ***Enhanced deduction for R&D after PIC expires***

  With the expiry of the PIC scheme, qualifying R&D expenditure would only be allowed 150% tax deduction. This is not competitive, particularly in light of the onerous documentation required to prove that the project is a qualifying one. By way of comparison, UK provides a 225% "super" deduction for qualifying R&D expenditure by SMEs. In order to maintain an attractive fiscal regime for R&D in Singapore, qualifying R&D expenditure should be allowed at least 200% tax deduction.

- ***Improve evaluation process to give upfront certainty on eligibility for R&D tax claims***

  R&D tax claims often involve protracted discussions on the eligibility of the projects, or are stalled because of a lack of appreciation for the technical aspects of the R&D process.

  We acknowledge that the Inland Revenue Authority of Singapore (IRAS) has made laudable efforts to address these issues by introducing the Technical Advisory Panel and the pre-claim evaluation scheme for large and complex R&D projects. With the exception of those

on the pre-claim evaluation scheme, however, most taxpayers still do not have upfront visibility or certainty over the outcome of their R&D tax claims as it can take four to five years to arrive at an assessment outcome. In order to expedite the R&D project evaluation and give taxpayers greater upfront certainty over their eligibility for R&D tax claims, the following measures should be considered:

1. **Administration by economic agency**
   The technical merits (as regards advancement in the field of science and technology) of the project should be evaluated by the relevant economic agency which is responsible for awarding funding or tax incentives (e.g. A*STAR for life sciences). The IRAS can then administer the tax claims without having to concern itself with the technical aspects of the project.

2. **Allow taxpayers to meet IRAS's Technical Advisory Panel**
   We understand that currently, only the IRAS interacts with the Technical Advisory; taxpayers may not request a meeting with the Panel. It would facilitate the review process if the taxpayer could be allowed to call on its experts to explain or clarify the technical aspects of the project to the Panel, if necessary.

3. **Lower threshold for pre-claim evaluation scheme**
   The scheme is currently available for large and complex R&D projects above $20 million. As a suggestion to make the scheme more accessible to taxpayers, the government may consider lowering this threshold to say, $5 million.

- ***Encourage exploitation of IP from Singapore***

  Measures should be introduced to encourage exploitation of IP from Singapore, and not just the acquisition and development of IP. An IP box regime which grants a competitive effective tax rate on income and gains arising from the exploitation of qualifying IP (such as patents, trademarks and copyrights) should be considered.

- ***Introduce safe harbour rules for gains on disposal of IP***

  Singapore's attractiveness as an IP hub is affected by the possibility that such gains may be subject to tax if they are viewed as trading profits. Extending the safe harbour rules for gains on disposal of equity investments to gains on disposal of IP would provide certainty to taxpayers who are looking to develop IP in (or import them into) Singapore.

- ***Align IP ownership requirements with OECD standards***

  Section 19B of the Income Tax Act should be amended to align the IP ownership requirement with that recommended in the intangibles chapter of the OECD Transfer Pricing guidelines. It should include a requirement for control and management of the IP to be located, and for the related risks to be borne, in Singapore. With this, the legal ownership requirement under section 19Bmay be removed.

Promote enterprise

Encourage local businesses to grow and venture overseas

Local enterprises should be encouraged to expand overseas whilst continuing to anchor key strategic business activities and their headquarters in Singapore. Measures could be introduced to help them to reinvent themselves to expand their footprint locally and overseas.

- ***Liberalise deduction rules for new ventures***

  The tax treatment of expenses relating to new ventures should be liberalised. Such expenses are currently not deductible as they are considered capital in nature.

  Companies should be allowed to deduct expenses incurred in respect of new business ventures against profits from their existing trade or business. This would encourage businesses to take the extra step to develop innovative capabilities.

  As a further incentive, new companies in industries with long gestation periods (e.g. technology, pharmaceuticals and healthcare) should be allowed to carry forward such expenses as trade losses beyond the period contemplated in section 14U of the Income Tax Act, notwithstanding that they may be pre-commencement expenses.

- ***Liberalise requirements for carry forward of losses***

  It is not uncommon for these companies to bring in new investors at different stages of their development. This may result in a change in shareholders and possible forfeiture of the unutilised losses. Whilst it is possible to seek a waiver of the continuity of shareholders test from the IRAS, losses preserved by such an avenue are subject to the same trade test. Although genuine investors typically should not be deterred by the potential inability (or otherwise) of the company to utilise past losses, these rules could deter companies from venturing into new fields and seeking investors.

  The same business test and continuity of shareholdings test were introduced as anti-abuse measures; however, they inhibit change and innovation and may be removed as the general anti-avoidance rules are sufficient to clamp down the trading of loss-making companies.

  The cap on the amount of unutilised loss items a company is allowed to carry back should also be removed altogether and companies should be allowed to carry back losses to any year of assessment that has not been time-barred. This is of particular relevance to insurers with exposure to natural catastrophe risks as they typically find themselves in cycles of profitable years and when a significant disaster occurs, in significant loss positions. The current carry-back loss relief system is grossly inadequate in view of the cyclical nature of writing natural catastrophe risks. The offshore and marine sector is also facing a downturn which is expected to last several years. The ability to carry back losses would also provide some relief to these companies.

- ***Liberalise deductions for borrowing costs***

  In today's uncertain economic climate, businesses may take up standby credit and similar facilities to better manage financing costs and cash flow in order to ensure they can sustain business operations. The upfront cost of securing these standby facilities could be viewed as capital in nature and hence not deductible. As such, the list of prescribed borrowing cost should be expanded to cover such borrowing costs regardless of whether the facilities are drawn down.

- ***Help SMEs attract talent by reintroducing incentives for employee share plans***

  Cash-strapped start-ups and smaller companies often resort to share option and stock award schemes to attract talent and reward entrepreneurship.

  The government should consider reintroducing an incentive for employee share option and stock award schemes (similar to the employee equity-based remuneration scheme for SMEs and start-ups that was previously available under sections 13J and 13M of the Income Tax Act). This could be restricted to employees of start-ups or SMEs.

- ***Enhance the double tax deduction scheme for internationalisation to support overseas expansion***

  The objective of the double tax deduction for internationalisation (DTDi) scheme is to support businesses expanding overseas through deploying Singaporeans to work outside Singapore.

  Our suggestions to enhance the scheme are as follows:

  1. Overseas postings are usually done by way of secondment to the overseas establishment, in order to avoid creating an overseas tax exposure (via a permanent establishment) for the Singapore employer. Instead of requiring that the salary expenditure must be incurred for the seconded employee, the condition should be revised, requiring the individual to be an employee of the Singapore employer prior to the secondment. Alternatively, a contractual bond to require the individual to return to work for the Singapore employer should be in place.
  2. DTDi should be applicable to scenarios where the salary expenditure is recharged to the Singapore company with a mark-up to meet transfer pricing requirements, and where 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 domestic tax rules.
  3. The scope of the deduction should include non-cash remuneration, e.g. tax equalisation bore by the employer.

- ***Collaborative partnership with consultants and advisors to facilitate overseas expansion***

  Lack of familiarity with overseas markets and difficulty in identifying suitable local partners are cited as two of the top challenges SMEs face when expanding overseas.[1] Collaborative partnerships with experienced business consultants and advisors can help local businesses address these challenges by helping them identify suitable partners and implement the right framework, governance structure and business plans to expand overseas.

  An enhanced tax deduction scheme to help local businesses to offset the cost of obtaining advice for business growth would facilitate overseas expansion.

1 SME Growth and Financing Survey 2016 by Singapore Business Federation and Standard Chartered Bank at https://www.sbf.org.sg/images/pdf/2016/SME_Growth_and_Financing_Survey.pdf

- ***Encouraging collaboration and the centralisation of resources***

  The government is advocating collaboration between SMEs and sharing of resources such as centralised back-office functions, data centres or central kitchens to help them benefit from economies of scale and to make more efficient use of scarce resources.

  Local businesses could be encouraged to invest in shared infrastructure by allowing them to claim enhanced capital allowances or deductions (depending on the nature of the expenditure) for the cost incurred to develop or purchase the equipment and technology, and to put such arrangements in place.

- ***Stamp duty on tenancy agreements***

  It is debatable whether stamp duties on short leases are capital in nature, as the practical effect of such expenditure is not to secure any benefit of an enduring nature, but only short-term tenancy. It is however, the current practice of the IRAS not to allow deductions for stamp duties incurred for new tenancy agreements on the grounds that a lease is a capital asset.

  Commercial lease agreements are typically of a short duration (most commonly, two to three years or less), after which the business will need to renegotiate rents or move to new premises. To help SMEs, particularly retailers which are facing a slowing environment, a safe harbour provision could be introduced to allow a tax deduction for stamp duties incurred on short-term new tenancy lease agreements. A timeframe of three years (for example) could be specified if the government does not wish to extend this provision to longer leases.

Tax regime rationalisation

- ***Medical benefits***

  With growing longevity and consistent with the government's initiative to encourage older workers to remain in the workforce, the cap on employers' tax deductions for medical benefits should be increased to reflect the rising costs for healthcare and to encourage employers to provide for their employees' healthcare needs.

  Alternatively, the government could remove the cap altogether as it is complex and a disproportionately large administrative burden given the revenue it collects.

- ***Lowering cost of access to Income Tax Board of Review***

  We suggest allowing accredited tax advisers registered with the Singapore Institute of Accredited Tax Professionals to represent taxpayers at the Income Tax Board of Review. This will make it more cost effective for taxpayers to use the Board of Review as a forum to resolve disputes in an independent quasi-judicial forum. Such registered tax advisers would have the necessary technical competence to represent their clients at such a forum, and have the added advantage of being familiar with the facts of the case as they are often tax agents who have been corresponding with the IRAS on the items in dispute. Hence, taxpayers will not have to incur additional costs to instruct lawyers. This is practised in other countries such as Hong Kong and India, and is already the case for the Goods and Services Tax Board of Review where there is no requirement for the client's representative to be a public accountant or a practising lawyer.

- ***Withholding tax exemption to help global trader companies access financing***

  Very large global trading companies generally have difficulty in obtaining local financing. As a result, they will need to raise loans from overseas banks to fund their activities in Singapore.

  Broadening the Global Trader Programme to exempt withholding tax on the interest paid to foreign banks would help to reduce these borrowing costs, as such taxes are typically contractually passed on to the borrower.

- ***Exemption of interest from debt securities under the list of specified income for funds***

  To promote the fund industry further, an exclusion to the deemed source rules under section 12(6)(b) of the Income Tax Act should be introduced for debt securities which are listed on any exchange, or which are issued by borrowers outside Singapore, which may use banking facilities in Singapore to receive such funds. This will reduce the tax compliance burden on taxpayers. Further details are available in Appendix A.

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

  – **GST registration**
  Currently, under paragraph 1(3) of the First Schedule to the Goods and Services Tax Act (GST Act), a person will not have a GST registration liability under paragraph 1(1)(a) if the Comptroller is satisfied that his taxable supplies in the next four quarters will not exceed $1 million. We suggest to change the rules so that a person that is liable for GST registration under section 1(1)(b) of the First Schedule to the GST Act should be given an option not to register if he believes that the supplies that exceed $1 million is an on-off event that will not be repeated in the subsequent 12 months.

  – **Simplified tax invoice for GST**
  While the IRAS has administratively allowed GST on entertainment expenses relating to food and drinks to be claimed based on a simplified tax invoice regardless of the value, to take into account the inflation factor since this rule was introduced, our recommendation is to increase the dollar value from $1,000 to $2,500 to allow more transactions to come within the requirement for a simplified tax invoice to be issued.

- ***Personal tax***

  – **Boost adequacy of retirement savings**
  The government should consider simplifying retirement planning by aligning the Supplementary Retirement Scheme (SRS) and section 5 pension schemes to allow tax deductible employee contributions into section 5 plans, as well as allow employer to claim deductions on contributions to these schemes that are not taxable on the individual. In addition, a 50% tax exemption for withdrawals from SRS could be allowed.

  An inherent disincentive to implementing a private pension plan is the initial set up costs that employers would have to incur, which can be substantial. An enhanced tax deduction for employer contributions will encourage more companies to sponsor such schemes and boost the take up rate.

  Finally, qualifying conditions for section 5 plans should also be made more transparent.

  In addition, the SRS scheme should be enhanced to encourage more Singaporeans to contribute to the scheme by removing the contribution cap or introducing an enhanced deduction for SRS contributions.

  – **Personal relief**
  Individual tax relief for life insurance should be de-linked from CPF relief to encourage individuals to take up these policies.

  – **Align taxation of gains from employee share plans with global norms to avoid double taxation**

  Most countries' tax authorities follow the guidance of the Organisation for Economic Co-operation and Development (OECD) on sourcing of share-based reward in cross-border situations, i.e. that stock options (and other stock-related awards) should be sourced based on the number of days an individual has spent working in each country during the vesting period.

  However, Singapore does not follow the global norm in this respect. Singapore tax legislation currently defines the source of an employee's rights to acquire shares based on whether the right or benefit to acquire shares is granted in respect of employment exercised in Singapore. Shares granted to an individual whilst working in Singapore which vest after he has been transferred to an overseas entity will still be considered fully taxable in Singapore, either under sections 10(6) or 10(7) of the Income Tax Act. As Singapore's basis of taxation is not aligned to the OECD Model Tax Convention's recommended approach, this may give rise to double taxation.

02

Proposals for the Financial Sector

Appendix A

- *Asset management*
- *Banking and capital markets*
- *S-REITS*
- *General*

02

Asset management

- ***Specified income – Interest from debt securities***

  Specified income does not include payments that fall within the ambit of section 12(6) of the Income Tax Act (ITA), with certain exceptions.

  In particular, section 12(6)(b), if interpreted too widely, may cause unintended tax consequences for funds with the 13CA, 13R and 13X status. The following are some scenarios that may be caught under the section 12(6)(b) provision if the provision is to be interpreted widely:

  - Where the proceeds (or part of the proceeds) are used by the issuer or its affiliates to make purchases from Singapore vendors.

  - The debt issuance may be arranged by a Singapore financial institution such that although the proceeds are not used in Singapore, they may be temporarily transferred into a Singapore bank account.

  Bonds / multi-asset funds typically make portfolio investments in a huge portfolio of debt instruments. Such funds find it difficult to ascertain whether the interest would be caught within section 12(6) of the ITA.

  Firstly, as a portfolio investor, they are not able to obtain any representation or confirmation from the issuer on whether the payment falls under the ambit of section 12(6) of the ITA.

  Secondly, even if the funds seek to perform their own due diligence, in some instances, they have found that the bond prospectus is not available.

  Thirdly, carrying out the due diligence by reviewing each bond prospectus is neither commercially feasible nor efficient, taking into account the huge volume of trades entered into.

  Lastly, such due diligence and analysis may not yield conclusive results for the purpose of the tax exemption scheme. Most prospectuses only indicate a broad purpose for the issuance (e.g. for general corporate purposes) which may not be indicative of whether 12(6) is triggered.

  As such, the section 12(6) exclusion from specified income results in increased compliance costs for bonds / multi-assets funds which are typically portfolio investors.

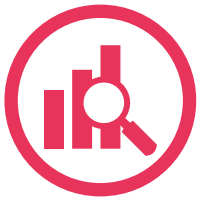
  We suggest to include the following sentence as another exception to part (b) of the list of specified income for tax certainty:

  "(b)(vii) interest and other payments from debt securities which are
  (i) listed on any exchange; or
  (ii) issued by issuers which are incorporated or constituted under the laws of a jurisdiction other than Singapore and the investment in the debt security is not made in connection with an arrangement referred to in section 33(1) of the Act"

  Making the above proposed amendments would achieve the following objectives:

  - reduce tax compliance burden on taxpayers and simplify tax administration for the IRAS; and
  - promote the fund industry.

02



- ***Designated investments should not be tied to legal forms***

  The current scope of designated investments is tied to legal forms which results in disparate tax outcomes simply due to the different legal forms of the business.

  Examples of scope of designated investments being tied to legal forms are:

  - Only debt securities which are issued by companies (item b of Part A of the Third Schedule of the Income Tax (Exemption of Income of Prescribed Persons Arising from Funds Managed by Fund Manager in Singapore) Regulations 2010);

  - Only where loans are granted to offshore companies and trusts (items k and v of Part A of the Third Schedule of the Income Tax (Exemption of Income of Prescribed Persons Arising from Funds Managed by Fund Manager in Singapore) Regulations 2010).

  Another example is that unit trusts and private trusts can only be considered designated investments if they invest wholly in designated investments.

  Currently, this requirement imposed on unit trusts and private trusts result in some practical challenges:

  i) It requires a significant amount of resource and time to trace depending on the fund structure (e.g. if the investor fund is a fund of fund which invest in say 20 unit trust funds, work has to be undertaken to review the income/ investments of those 20 unit-trust funds and if the unit trust funds invest in other unit trust funds, the tracing goes on).

  ii) Information is not available to the investor fund and public information may not provide sufficient details for the tracing.

  iii) The investee unit trust fund may have an insignificant amount of investments which may not qualify as designated investments and the whole investment will become non-qualifying.

  Qualifying funds may invest in unit trusts that are managed by external fund managers. The underlying investments of these unit trusts are not within the control of the Singapore fund manager who may not be able to obtain confirmation from the external fund managers that the unit trusts invest wholly in designated investments.

  The scope of designated investments should not be tied to legal form of the business. There is a strong basis for this since the rules seem to force the taxpayers to structure investments in a certain way and compromise on legal and commercial pressures. From a Singapore policy standpoint there is no disadvantage to Singapore if the link to the legal form is removed. In fact it helps reduce compliance cost and burden. For example, item b of Part A of the Third Schedule of the Income Tax (Exemption of Income of Prescribed Persons Arising from Funds Managed by Fund Manager in Singapore) Regulations 2010 can be amended by changing the reference to "company" to "person".

- ***Section 13R and Section 13X fund tax exemption schemes***

  The rules for the tax exemption schemes can be simplified to reduce compliance costs and attract more asset managers to carry out their activities in Singapore.

  - Allow applicants to choose conditions they want to comply with. For example, they can choose to comply with either fund size of S$50m test or global AUM test of say S$1B for FMC group. Also, instead of applying S$200k expenditure test at fund level, allow to choose an alternative of S$500k expenditure at FMC level.

  - Remove reporting obligations if there are no non-qualifying investors in a section 13R structure (e.g. Remove need to issue annual statements to investors).

  - Remove the section 13R 30/50 investor rule for listed funds. Most importantly, given that these are retail funds, it is entirely possible that the S$50M AUM requirement for section 13X scheme (which then does away with the 30-50 condition) will be reached by such listed funds.

- ***Deeming provision for designated unit trust - Section 10(20B) of the Income Tax Act***

Based on section 10(20B) of the ITA, the amount of income that is considered to be derived by the unit holders on the "corresponding date" is the amount of income which enjoyed the DUT tax deferral and is yet to be distributed to any unit holder.

The Statement of Distributable Income (SODI) tracks the amount of income earned by the DUT fund, net of distributions made to unit holders. When redemptions are made by unit holders during the life of the DUT fund, these redemptions are treated as sale of investments by investors.

Upon triggering of the deeming, the amount of income considered to be distributed to the unit holders on the "corresponding date" does not take into account a portion of the DUT fund's income then actually relates to the units which have already been redeemed. This results in an unfair outcome to the unit holders standing at the corresponding date such as on termination of the unit trust.

Furthermore, it would be an odd outcome for the deemed distributed amount to be greater than the actual amount that the unit trust has for distribution upon termination.

As such, we suggest:

- Legislative changes to make it more equitable for the investors standing on the corresponding date (e.g. termination date).
- Capping the deemed distributed amount at point of termination to the actual amount that the unit trust has for distribution upon termination.

Banking and capital markets

- ***FSI-ST qualifying activities (Fifth Schedule of the Income Tax (Concessionary Rate of Tax for Financial Sector Incentive Companies) Regulations 2005) ("FSI Regulations")***

The list of FSI-ST qualifying activities should not depend on the legal form of the investment.

For example, the definition of foreign equity securities for the purpose of FSI Regulations is confined only to issuers that are set up as companies whereas Singapore listed entities with more than 50% turnover derived from outside Singapore need to be companies (hence, registered business trusts or other unit trusts are excluded).

We propose amending the definition of foreign equity securities for the purpose of the FSI Regulations to take into account the fact that businesses can be in many legal forms and the scope of qualifying securities should not be confined to situations where the issuer is a company. The crux is to confine it to businesses that have at least 50% of its annual turnover derived from outside Singapore. For example, items (f)(ii) and (h) of the Fifth Schedule of the FSI Regulations should include listed registered business trusts with more than 50% of turnover derived from outside Singapore.

- ***Approved Trustee Companies scheme subsumed under Financial Sector Incentive***

Pursuant to Budget 2016, the Approved Trustee Companies (ATC) scheme has been subsumed under the Financial Sector Incentive (FSI) with effect from 1 April 2016. The scope of qualifying activities under the new FSI-Trustee Companies (FSI-TC) Scheme will be expanded to align with trustee and custodian activities covered under the FSI-Standard Tier (FSI-ST) scheme pursuant to the Fifth Schedule of the Income Tax (Concessionary Rate of Tax for Financial Sector Incentive Companies) Regulations 2005 ("FSI Regulations").

Under regulation 3(f) of the Income Tax (Concessionary Rate of Tax for Approved Trustee Companies) Regulations ("ATC Regulations"), income derived by an ATC company from providing trust management or administration services to trustee of philanthropic purpose trust in respect of a foreign account qualifies for the ATC incentive.

Such activity is currently not covered in the FSI Regulations.

To ensure that the existing scope of qualifying activities under the ATC Regulations will be covered under the new FSI-TC Scheme, for example trust management or administration services to trustee of philanthropic purpose trust in respect of a foreign account should be a qualifying activity under the FSI-TC Scheme.

S-REITS

- ***Exemption of foreign-sourced income received by REITs under section 13(12) of the ITA***

  The current condition in section 13(12A)(b) is that the company incorporated in Singapore must be 100% owned by a trustee of a REIT. For high-value assets, in practice it may be preferable to have multiple investors.

  We suggest amending the conditions for section 13(12) exemption on foreign-sourced income received by REITs to extend the scope to cover situations where a REIT may not own 100% of the company incorporated in Singapore.

General

- ***Tax rates for incentives***

  There appears to be an international trend towards reducing headline corporate tax rates. In addition, the attractiveness of lower tax rates under tax incentives has diminished over the years with the falling Singapore corporate income tax rates.

  We recommend that Singapore does not increase the tax incentive rates given the already diminished attractiveness of the incentivised tax rates which come with attendant economic conditions and compliance costs.

Past proposals that are relevant for consideration

Appendix B

- *Insurance*
- *Asset management*
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Insurance

- ***Offshore Insurance Business (OIB) under the IBD Scheme for life insurers - inclusion of fee income as qualifying underwriting income***

  Under the current OIB scheme, fee income derived from the underwriting of offshore life business is not currently a qualifying income. It is currently limited to premium only. The OIB scheme does not work well at incentivising life insurers writing non-traditional offshore life business.

  Review the scheme as it applies to life insurers to maximise its application and reach.

  The scope of qualifying underwriting income for offshore life business should include fee income. Limiting the qualifying underwriting income for life business to only premium also limits the attractiveness of the scheme to life insurers targeting the offshore wealth business.

- ***OIB scheme: Allow an alternative method of allocating common expenses, allowances and donations for approved general insurers and approved life insurers***

  Under existing regulations, insurers conducting stand-alone general or life insurance business must use gross premiums to allocate common expenses, allowances and donations.

  However, the regulations were amended for composite insurers (but not direct insurers) in 2009 to allow them to use alternative methods if reasonable in the circumstances of the business.

  All insurers should also be allowed to apply alternative methods of apportionment if such allocation would be more reasonable.

- ***OIB scheme: Introduction of a loss carry back system for offshore risks***

  Currently, the loss carry back system only allows a one year carry back for $100k of tax losses. This loss carry back system is inadequate for insurers/reinsurers who find themselves faced with catastrophic losses as a result of natural disasters around the region, such as what happened in 2011 with the Thai floods, Japan earthquake, Queensland floods, NZ earthquakes, etc.

  Also, given that the nature of the insurance/ reinsurance business is cyclical in nature, the limited ability to carry back losses does not help our insurers/reinsurers much at times of huge catastrophic losses.

  We suggest the following:

  a) allow an unlimited carry back of tax losses for 5 years (to time-bar years) or at least to the 3 preceding years;

  b) allow an unlimited quantum of losses to be carried back. If this is not tenable, then consider allowing unlimited carry back to the year immediately before the year of loss, and as for the earlier two years, limit the carry back to half the chargeable income of those earlier two years.

  This loss carry back scheme may be limited to offshore risks as an enhancement to the OIB scheme incentive as most natural catastrophic losses are in OIF anyway.

- ***Lower the OIB incentive tax rate***

  The existing tax rate for OIB has been at 10% for the last 30 years at least. At the same time, the normal corporate tax rate has reduced from about 40% to 17% currently.

  Hong Kong now levies an 8.25% tax rate (being half of its corporate tax of 16.5%) on offshore reinsurance business.

  Malaysia – while its corporate tax rate may be 25%, it offers a concessionary tax rate of 5% on inward reinsurance and offshore insurance business.

  Labuan – which is actively promoting itself – offers a near-zero percent tax regime with flexibility to base various operations in Kuala Lumpur.

  Singapore should consider reducing the OIB incentive tax rate to 5% or one third of the corporate tax rate. Pegging the incentive to one third of the corporate tax rate would ensure that the incentive rate is continually adjusted in line with the corporate tax rate.

  This will ensure Singapore remains competitive and attractive vis-à-vis locations like Hong Kong, Kuala Lumpur and Labuan.

- ***Expansion of scope of qualifying investment income under all the IBD schemes, such as the OIB scheme, the Marine and Hull incentive scheme, the Offshore Specialised Risks scheme, Offshore Captive scheme, etc***

Investment activity is a big part of insurance business. Funds received from writing policies are usually invested to support the insurance business. Currently, only certain types of income supporting the incentivised business enjoy the same lower tax rate or exemption. In particular, the qualifying investment income are:-

- offshore dividends and interest;
- interest from ACU deposits; and
- gains from offshore investments.

There are two issues here:

i. only certain offshore investment income is incentivised. This means that any investment made in Singapore (other than ACU deposits) would not be incentivised. The direct impact of this is that all insurers enjoying incentive schemes will be encouraged to invest offshore. While we understand that there are policy reasons behind the exclusion of local investments, we view this rule as negative to the insurance and the Singapore fund management industry.

ii. The list of offshore investments as it stands is very dated. In today's investment market, more and more types of instruments and vehicles are used by insurers. The narrow list of investments specified is too limiting and make the task of investment and identifying what is incentivised and what is not an administrative burden for insurers.

Ideally, the tax concession should not be applied to only selected types of investment income. Rather, it should be applied to all investment income (whether onshore or offshore) which supports the incentivised business. Such a move would also promote the growth of the onshore investment management industry in Singapore.

It should be made clear that all income derived from the "offshore investments" as defined in the S43C Tax Regulations are part of the list of incentivised income.

As a minimum, the list of investment income in the insurance regulations should be enhanced to include the following income:-

- offshore rental;
- offshore trust distributions, (including unit trusts, business trusts and real estate investment trusts);
- income from any financial derivative contracts in foreign currencies, including interest rate or currency contracts on a forward basis, interest rate or currency options, interest rate or currency swaps;
- discounts from offshore debt securities; and
- gains from trading in any debt securities.

Expanding the pool of incentivised investment income under our insurance incentive schemes would allow the approved insurers to have more investment options available to meet their expected returns on investments.

It would also promote the growth of the onshore investment management industry in Singapore.

The inclusion of gains from trading in any debt securities would specifically help promote the growth of the debt market in Singapore as insurers are one of the major institutional investors in Singapore.

- ***Deduction for contingency provisions set aside under the Insurance Act***

  Under the Insurance Act, insurers writing certain types of risks (eg mortgage insurance and trade credit insurance risks) are required to set aside specified contingency reserves. These reserves are not tax deductible as they are not incurred losses.

  Allow a deduction for the contingency reserves at same amount as that required to be set aside under the Insurance Act. When the reserves are released or withdrawn, tax treatment should follow accordingly.

- ***Section 13Z of the Income Tax Act (ITA) - Certainty of non-taxation of disposal of equity investments – safe harbour rule - 20% equity holdings held for 24 months not taxable***

  In Budget 2016, the Minister for Finance announced that certainty of non-taxation on gains derived by a company from the disposal of equity investments (Section 13Z) will be extended till 31 May 2022.

  However, insurance/reinsurance companies continued to be excluded from the above rule.

  We are of the view that excluding insurance companies from this tax certainty and safe harbour rule is unfair. It does little to encourage insurance groups to set up their holding company and regional management companies in Singapore. It certainly makes Singapore less competitive as a location vis-à-vis Hong Kong.

  There is no reason to single out insurers for exclusion from Section 13Z given that it has been held in CIT v BBO (judgment dated 4 February 2014) that insurance companies like, all other taxpayers, can hold shares as capital assets.

  In light of the above developments, we would recommend that the earlier policy decision be reviewed, and the scope of the rules amended so that insurers are not excluded from Section 13Z.

Asset management

- ***Designated investments - Financial derivatives***

  Currently, financial derivatives can only be designated investments if they are entered into with specified counterparties, one of which is banks and securities companies that are financial sector incentive (FSI) companies. We note that there are a number of FSI companies giving up their awards.

  We suggest that the definition be refined such that banks and securities companies need not be FSI companies to be specified counterparties.

- ***Designated investments - Emission allowances***

  The current list of designated investments includes “emission derivatives”. However, there are funds that invest in both emission derivatives and emission allowances (e.g. carbon credits).

  We note that the term “commodity” for the purpose of the GTP scheme has already been amended to specifically include carbon credits, but not in the case of the fund management schemes.

  We suggest covering this item in the current definition.

- ***Designated investments***

  - Interest in a cooperative (co-op)
  - Trade acceptances
  - Choses in action
  - Precious metals
  - Guarantees, revolving credit facilities and risk participation arrangements
  - Insurance products
  - Loans granted to Singapore entities so long as the underlying investments relate to designated investments, e.g. real estate located outside Singapore such as Australia and UK
  - Partnership structures (including variations of it)
  - Contractual or joint venture arrangements where the investor is passive and does not partake in the management of the arrangement
  - Collective investment schemes that are not in the form of companies, unit trusts and limited partnerships and are not listed on any exchange

  The array of financial investments and instruments continue to develop and increase. These are investments that our clients encounter.

  We suggest covering these items in the current definition.

- ***Persons liable for penalty under section 13CA and section 13R of the ITA***

  a) There may be co-investors in some fund structures and hence it is not always possible for a section 13R approved company to have 100% ownership in an approved company/ prescribed person.

     The risk of tax leakage is low for the following reasons:

     o Where an approved company (AC1) invests in a prescribed person or an approved company (AC2), income derived by AC1 from this investment will be exempt from Singapore tax, to the extent that the income is specified income from designated investments (e.g. dividends). Any non-specified income will be subject to tax in Singapore as AC1 is required to file annual Singapore tax returns.

     o Any financial penalty will be applied to the relevant owners of AC1, where applicable.

  b) Statutory boards may invest in approved companies and prescribed persons. While statutory boards are exempt from paying tax on income, they will be subject to a financial penalty if the ownership threshold is breached.

  c) Consider removing financial penalty on an approved company (AC1 in this example) with less than 100% ownership in an approved company / prescribed person.

  d) Consider excluding statutory boards from being liable to the financial penalty.

- ***Qualifying income for DUTs***

  It is common for DUTs that invest in bonds to receive income other than items of income specified under section 10(20A) of the ITA.

  We suggest broadening the list of qualifying income for DUTs to cover all income from bonds.

- ***Interest-free loans***

  Given the inflexibility around distributions and capital redemption based on current Singapore corporate law, it is common for Singapore fund companies to be partially capitalised by interest-free loans. Therefore, the use of interest-free loans by Singapore fund companies is to address a corporate law restriction and not for tax purposes.

  Furthermore, given the withholding tax exemption for interest payments by qualifying funds, any interest paid to non-resident shareholders will be exempt from Singapore tax in any case.

  On the basis that there is no tax leakage, suggest introducing an administrative safe harbour under the Singapore transfer pricing rules for related party loans, as long as the funds meet the conditions of the section 13R and section 13X schemes. This is not unlike the administrative practice accorded to domestic interest-free loans given by a lender not in the business of borrowing and lending money, where the IRAS will accept interest adjustment as a proxy for the arm's length principle.

- ***Financial Sector Incentive (Fund Management) (FSI-FM)***

  The rules for the tax incentive scheme can be simplified to reduce compliance costs and attract more asset managers to carry out their activities in Singapore.

  - Reduction of tax incentive rate below 10%; considering the small differential from current corporate tax rate of 17%.

  - Simplify the FSI-FM regulations to remove sections which are no longer applicable.

Banking and capital markets

- ***Funding for SME***

  To expand the sources of SME funding in Singapore, banks can be encouraged to extend loans to SMEs.

  We suggest allowing enhanced deduction for losses on loans extended to SMEs.

- ***Developing Singapore as an intellectual property (IP) hub***

  An IP hub master plan has been issued to develop Singapore as a global IP hub in Asia. It was also noted in the master plan that several countries have implemented or will be implementing IP-backed loan programmes to help their domestic SMEs obtain financing using their IP as collateral while in Singapore, local banks are generally more conservative, and have concerns accepting IP assets as collateral. One of the recommendations in the master plan is to introduce an IP financing scheme, where the Government partially underwrites the value of IP used as collateral.

  To encourage banks to accept IP as collateral, another suggested approach is to allow enhanced deduction for losses on loans with IP as collateral. This can also help to encourage an increase in the range of assets that banks can consider accepting as collateral, which can in turn help to expand the sources of SME funding.

- ***Qualifying income from QDS***

  Currently, only certain income from QDS qualifies for exemption or lower tax rate, although the legislation allows the Minister to prescribe other classes of qualifying income.

  We suggest aligning the list of qualifying income from QDS with the prescribed list of deductible borrowing costs or including all payments made by the QDS issuers.

- ***Have a database of publicly available list of QDS and QDS+***

  Currently, for a taxpayer to determine if a security is a QDS or QDS+, it has to write in to the MAS to seek a confirmation. This is extremely time-consuming, especially when the taxpayer invests significantly in QDS and QDS+.

  MAS should maintain and make publicly available a list of QDS and QDS+ securities.

- ***Exemption of foreign dividend received from foreign companies listed in Singapore***

  Section 13(8) of the ITA was introduced to provide for tax exemption of certain income derived from outside Singapore by a Singapore resident company, subject to the satisfaction of certain conditions.

  Foreign-sourced dividend is one of the categories of income included under the scope of section 13(8) exemption and for the purposes of this exemption, a dividend is a foreign-sourced dividend if it is paid by a non-Singapore tax resident company.

  There is a growing number of foreign companies (which are incorporated outside of Singapore) listed in Singapore. Today, it is not uncommon for a Singapore resident company to hold an investment in the shares of a foreign company listed on the Singapore Exchange (SGX).

  Given that such dividends are considered foreign-sourced for Singapore tax purposes, it is necessary to ascertain if the section 13(9) conditions are met to determine if the dividend can be exempted from Singapore tax in the hands of a Singapore resident company.

  As a portfolio institutional investor, it is a tedious and time-consuming process to gather information and/or the documentary evidence (which may be required by the IRAS) to ascertain if the above section 13(9) conditions are met. As a mere minority shareholder of the foreign companies, the portfolio investor is often unable to obtain the specified documentary evidence required for tax purposes. We recommend introducing a rule to treat all dividends of foreign companies listed on the SGX as tax exempt.

  This will help promote the capital market in Singapore and to encourage institutional investors in Singapore to invest in foreign companies listed on SGX. It will also reduce tax compliance burden on the taxpayers and simplify tax administration for the IRAS.

  The exemption can be applied by way of deeming that the section 13(9) conditions are met for such dividends received or as a section 13(12) exemption (by order of the Minister).

General

- ***Definition of professionals***

Currently a "professional" for the purpose of headcount requirements for tax incentives is defined to be one who is "engaged substantially in the qualifying activity". This is typically taken to refer to front-office personnel.

However, in practice, middle-office personnel (e.g. risk management, legal, finance) can be substantially involved and often play important roles in deals and transactions.

We understand that while front-office and middle-office personnel are considered in the headcount requirements for FSI-ST and FSI-HQ incentives, for FSI-FM, FSI-CFS, FSI-CM and FSI-DM, only front-office personnel are considered. This will not take into account middle-office personnel who play important and substantial roles in deals and transactions.

The definition of "professional", for the purpose of the FSI-FM, FSI-CFS, FSI-CM and FSI-DM schemes, should be broadened to include middle-office personnel.

- ***Headcount requirements for incentives***

Currently, the headcount requirements for FSI schemes depend on the number of "professionals" employed by incentivised companies. "Professionals" refer to persons who are earning more than S$3,500 per month and must be engaged substantially in the FSI qualifying activity.

The method can be too narrow as it does not take into account the quality of the professionals. For example, a senior employee with a monthly salary of S$7,000 is more likely to contribute more than two junior employees who each draw a monthly salary of S$3,500 put together.

We suggest broadening the method of calculating headcount to give higher weighting to senior/more experienced employees. The designation and/or monthly salary of the individual in question can be taken into consideration.

S-REITs

- ***Tax incentive for S-REITS managers***

Tax on investment management income is one factor that is generally considered by international real property fund managers when evaluating where to establish themselves within the region. The introduction of a tax incentive for S-REIT managers could make the difference between new entrants to the Asian property funds management space establishing themselves in Singapore, rather than in Hong Kong or elsewhere within the region. REIT managers with a presence in Singapore are naturally going to be more familiar with S-REITS as a viable investment platform and are likely to promote the use of these vehicles.

We suggest providing a concessionary tax rate for fee income of S-REITS managers derived from managing S-REITS which invest in offshore investments.