Income Tax (Amendment) Bill 2018

PwC Singapore Tax Bulletin – Income Tax (Amendment) Bill 2018

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The Income Tax (Amendment) Bill 2018 (the Bill) was passed in Parliament on 2 October 2018.

The Bill mainly contains tax changes announced in the 2018 Budget Statement, such as enhancement of the tax deduction for costs on intellectual property (IP) licensing. In addition, it introduces a number of measures which arose from the on-going review of Singapore's income tax system. These include enhancements to the Inland Revenue Authority of Singapore's (IRAS) powers which are intended to strengthen a whole-of-government approach to law enforcement, clarification of the tax treatment for leases arising from the adoption of Financial Reporting Standard (FRS) 116 Leases and the introduction of secondary mechanism for Country-by-Country Reporting (CbCR). Lastly the Bill proposes legislation relating to changes that were first announced in the 2017 Budget, such as the IP Development Incentive and a transitional measure for existing recipients of the Aircraft Leasing Scheme (ALS).

These changes are discussed in further detail below:

Enhance the deduction for costs on IP licensing

The Bill proposes a new section 14WA to increase the tax deduction from 100% to 200% for the first $100,000 incurred on qualifying IP licensing costs. Qualifying costs include payments made by a qualifying person to publicly funded research performers or other businesses, but exclude related party licensing payments. Also excluded are licensing costs in respect of any IP rights for which a section 19B writing down allowance has previously been made to that person.[1]

It is heartening to note that the Ministry of Finance (MOF) has taken on board our feedback to tweak the last restriction to mirror that in section 14W(6)(c).[2]

As initially drafted, the provision had proposed excluding licensing costs in respect of any IP rights for which a section 19B writing down allowance had previously been made to any person, regardless of whether that person is a related party. This would have been unduly onerous as it is practically difficult and cumbersome for the taxpayer to ascertain if the licensor or any other person has previously claimed writing down allowance on the intellectual property rights.

Introduce the IP Development Incentive

The Bill introduces a new section 43ZI to legislate the new IP Development Incentive (IDI) and its administration. The IDI incorporates the internationally-agreed standard on the design of preferential tax regimes for IP income (i.e. the modified nexus approach) under the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting project. The IDI scheme was first announced

[1] Proposed section 14WA(4)(c).
[2] Section 14W concerns the deduction for expenditure on licensing intellectual property rights.

in the 2017 Budget Statement to incentivise IP income. More details of the scheme are available in the subsidiary legislation.[3]

Transitional measure for aircraft leasing

In the 2017 Budget Statement, the concessionary tax rate under the ALS was streamlined from 5% and 10%, to a single rate of 8%. This revised rate was intended to apply to ALS awards approved or renewed from 1 April 2017.

The Bill proposes a transitional measure for existing ALS recipients which will be allowed to elect to continue applying their current concessionary tax rate to qualifying income derived from the leasing of aircraft and aircraft engines acquired during their existing award tenure. This transitional measure will end when the said aircraft and aircraft engines are disposed of or 31 December 2027, whichever is the earlier. This measure is required as the disposal of aircraft and aircraft engines may take place after the tenure of the 5% and 10% awards, which would result in ALS recipients being subject to tax on the balancing adjustment at a different tax rate from that at which the capital allowances were claimed.

This transitional measure is available to ALS recipients approved on or before 31 March 2017, subject to their meeting the commitments under their respective awards.

Enhance the IRAS's powers to investigate tax crimes and to share information

The Bill proposes various enhancements to the IRAS's powers as part of wider measures to strengthen whole-of-government law enforcement. When the draft Bill was first published, there was, some concern as it appeared to grant the Comptroller powers beyond what is required for tax collection, as evidenced by the feedback received.

The proposed changes include enhancing IRAS's powers for investigation of serious tax crimes, or where the suspect attempts to destroy evidence, by introducing the powers of forced entry, arrest without warrant and to perform a body search. The MOF assures that "(t)hese powers will be exercised only by trained IRAS investigation officers and where necessary", and that there will be proper safeguards.

The IRAS's powers will also be expanded to enable it to gather all information that is relevant to its investigations from any person. These changes are intended to allow the IRAS to deal more effectively with fraud syndicates and recalcitrant taxpayers who refuse to cooperate with tax investigations.

Following the concerns expressed in the public feedback, the MOF has responded that further details will be published on the IRAS website after the legislation is passed by Parliament.

In addition, the Bill proposes to permit the IRAS to share information with prescribed officers in other law enforcement agencies for the investigation or prosecution of specified serious crimes (i.e. offences listed in First and Second Schedules of the Corruption, Drug Trafficking and Other Serious Crimes (Confiscation of Benefits) Act). The MOF has clarified that this amendment is intended to facilitate enforcement against serious non-tax crimes such as drug dealing and corruption; hence requests to notify taxpayers of the information shared or how information may be shared were

[3] Economic Expansion Incentives (Relief from Income Tax) (Intellectual Property Income) Regulations 2018.

rejected as this would alert potential suspects of ongoing investigations, thereby prejudicing effective law enforcement.

Clarify the tax treatment for leases arising from the adoption of FRS 116 Leases

FRS 116 Leases will be effective for annual periods beginning on or after 1 January 2019. It supersedes FRS 17 – Leases, INT FRS 104 - Determining whether an Arrangement contains a lease, INT FRS 15 - Operating Leases – Incentives, and INT FRS 27 - Evaluating the Substance of Transactions involving the Legal Form of a Lease.

The Bill proposes consequential amendments to sections 10D, 10F, 12 and 45 to prescribe the tax treatment for leases following the adoption of FRS 116.

For example, the amendments to section 10D (Income from finance or operating lease provides that, in the case of a finance lease that is treated as a sale for taxation, the part of any payment that is attributable to repayment of the principal, is not considered the income of the lessor. The amendment to section 12 (Sources of income) states that the reference to "interest" in section 12(6) includes payments made under such finance leases that are considered income of the lessor under the amended section 10D. These amendments also state that the reference in section 12(7) to "payment made under an agreement or arrangement for the use of movable property", includes any payment that is made under a finance lease that is not treated as a sale.

In the past, it was arguable whether section 10D, which "provide[s] for the circumstances in which the Comptroller may direct that [capital] allowances in respect of any machinery or plant… under a finance lease shall not be made to the lessor but to the lessee", operates to recharacterise part of the lease payments to interest for withholding tax purpose. The language of regulation 4 of the Income Tax (Income from Finance Leases) Regulations is also confined to the allocation of capital allowances claims, and not for all purposes of the Act. With these changes, the position as regards the characterisation of finance lease payments as interest or royalties is now made clear.

However, the new provision does introduce practical issues for lessees in determining the amount of withholding tax. For example, in a finance lease treated as a sale for taxation, income (i.e. total payments due from the lessee less the principal amount in the payments) of the lessor, as defined in the proposed section 10D(2A), may not be equal to the interest expense recorded by the lessee. Thus, the lessee would not know the amount of income recorded by the lessor on which tax is to be withheld. If the lessee withholds based on the interest expenses it records, this could result in withholding tax being applied on a sum that is different from the income of the lessor.

Guidance on practical implementation matters has been provided by the IRAS through an e-Tax Guide "Tax Treatment Arising from Adoption of FRS 116 or SFRS(I) 16" published on 8 October 2018.

Country-by-Country Reporting

The Bill also proposes amendments to allow the IRAS to implement the secondary mechanism for CbCR.

Generally speaking, affected multinational enterprise (MNE) groups will file their CbCR templates in the jurisdiction where their ultimate parent entity (UPE) is tax resident. These reports will then be automatically exchanged with territories which have the requisite exchange relationships with that jurisdiction. Secondary filing (e.g., in the location of a subsidiary) is typically triggered when (i) the home country where the UPE is tax resident does not have CbCR rules; (ii) there is no exchange relationship between the territories involved; and (iii) there is a systemic failure in the exchange mechanism between the two territories.

CbCR in Singapore currently applies to Singapore-headquartered MNEs. Singapore subsidiaries of foreign MNEs do not have to perform secondary CbC filing. Conditions for invoking the secondary mechanism will be set out in the regulations, and the MOF has stated that they will be in line with the OECD's CbCR guidelines.

Currently, Singapore has exchange agreements in place with 55 countries. However, Singapore still does not have exchange relationships with a number of major trading partners (notably the US and Switzerland). This would therefore mean that foreign MNCs with UPEs in these jurisdictions may need to be prepared for local filing in Singapore.

Closing thoughts

Besides provisions relating to the various Budget announcements, the Bill contains a number of other measures that cater to new accounting standards introduced in recent years, as well as the shift in the international tax landscape through the work promulgated by the OECD. The effect of these global developments on Singapore is evident, from accounting and tax compliance to domestic tax system design and international cooperation.

Some of the considerations brought forth by the Bill include:

- Have we tapped on the concessions to enhance our research and development capability and to commercially exploit IP from Singapore?

- What is the accounting and tax impact with the introduction of FRS 116: e.g. how will finance leases be determined for lessees if they adopt Right of Use classification, have we reviewed lease agreements to determine how withholding tax is calculated for cross border leases?

- Will the local filing of CbCR apply to the Singapore operations of a foreign-headquartered MNE?

Companies today operate in a far more complex and dynamic environment than before. Senior management will need clear appreciation of how these tax changes affect business operations so as to manage risk and maximise enterprise value.

Contacts

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