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Tax Update

Dear Clients & Friends

Budget 2009 - Analysis of Major Tax Changes

The Minister for Finance, Mr Tharman Shanmugaratnam, delivered the Budget Statement for the Financial Year (FY) 2009 on 22 January 2009.

Budget 2009 delivered a Resilience Package totalling S$20.5 billion. The Minister characterised the aim of the Package as to save jobs to the maximum extent possible, to help viable companies stay afloat, and to prepare Singapore to emerge with enhanced long-term capabilities and competitiveness when the global economy recovers.

Budget 2009 also contained a number of important tax changes, including the reduction of the corporate tax rate to 17% from Year of Assessment 2010.

In this Tax Update, we highlight and analyse a number of significant tax changes announced in Budget 2009.

Enhancement of Fund Management Incentives

Income Tax Exemption Scheme

Under an existing tax incentive scheme, certain income of a qualifying fund managed by a fund manager in Singapore is exempt from tax. The conditions for a qualifying fund include restrictions on the entity that constitutes the fund. Hence, neither a company or trust that is 100% beneficially owned by Singapore resident investors nor a limited partnership may be a qualifying fund under existing rules.

Under the existing tax incentive scheme, there are also restrictions on the investors of the fund with non-qualifying investors liable to pay financial penalties. For instance, under existing rules, a Singapore resident company would not be a qualifying investor if it beneficially owns more than 30% (where there are less than 10 investors in the fund) or 50% (where there are 10 or more investors in the fund) of the interest in the fund.

With effect from 1 April 2009, there will be an “Enhanced Tier” for the tax incentive. Funds with a minimum fund size of S$50 million at the point of application may qualify for the “Enhanced Tier”.

Under the “Enhanced Tier”, there will be no restrictions imposed on the residency status of the fund vehicles as well as that of investors. The Enhanced Tier will also apply to funds that are constituted in the form of limited partnerships, i.e. there will no longer be a need to look through to the partners’ level to apply the incentive conditions. The 30% or 50% investment limits imposed on resident non-individual investors will also be lifted for funds that come under the Enhanced Tier.

This move further positions Singapore as a hub for fund management as it will allow Singapore-resident corporates to fully enjoy the benefits of tax exemption on qualifying income earned by the funds which they have invested in, instead of having to invest in funds managed offshore.

Further details and other conditions for the "Enhanced Tier" will be announced by the Monetary Authority of Singapore (the "**MAS**") by April 2009.

The introduction of the "Enhanced Tier" should be a welcome move by the authorities as it would greatly simplify the conditions for tax exemption and facilitate compliance with stipulated rules by fund managers. Fund managers may at times experience difficulty in complying with the rules of the existing tax incentive scheme because limited partnerships are commonly used as fund vehicles and because the identity of ultimate investors may not be ascertainable by fund managers. It is hoped that the detailed conditions for the "Enhanced Tier" (yet to be announced) will not be too onerous to comply with.

The existing tax incentive scheme, including the "Enhanced Tier" will expire on 31 March 2014, but funds that are on the scheme on 31 March 2014 will continue to enjoy the tax exemption as long as they continue to meet the conditions under the relevant scheme.

GST Input Tax Recovery

A GST-registered Singapore fund manager is required to charge 7% GST on its management fees charged to a Singapore-based fund but 0% GST on its management fees charged to an offshore fund. Prior to Budget 2009, the Singapore-based fund may not be able to claim any input tax refund on such GST paid to the fund manager and other Singapore-based service providers (such as brokerage firms and administrators) as the Singapore-based fund may not be able to register for GST. The additional tax burden has, in the past, made it unattractive for funds to be set up in Singapore.

With effect from 22 January 2009 to 31 March 2014, qualifying funds that are managed by a prescribed fund manager in Singapore will be allowed to claim a substantial portion of their input GST on prescribed expenses. Further details are to be released by the MAS in April 2009, including what would constitute "qualifying funds", who are the "prescribed fund managers" and what the "prescribed expenses" would be. This is an important development as it may now bring Singapore-based funds at par with offshore funds being managed from Singapore and promote the use of Singapore-based fund vehicles.

Exemption of Foreign-Sourced Income

Foreign-sourced income received in Singapore is exempt from tax if certain conditions are satisfied. For example, foreign-sourced income received in Singapore by an individual is not exempt if the income is derived from a partnership in Singapore. Also, exemption of foreign-sourced income received in Singapore by a Singapore resident non-individual is limited to certain types of income (dividends, branch profits and service income) and subject to certain conditions for the payment of foreign tax on such income.

As a temporary relief measure, Singapore resident non-individuals and Singapore resident partners of partnerships in Singapore will be exempt from tax on all foreign sourced income earned or accrued outside Singapore on or before 21 January 2009 and received in Singapore from 22 January 2009 to 21 January 2010. In other words, any condition for the exemption of foreign sourced income is temporarily lifted for a year.

Further details on the expanded exemption will be released by the Inland Revenue Authority of Singapore (the "**IRAS**") by April 2009.

As Singapore taxes foreign sourced income only if it is "received in Singapore", many Singapore resident companies may have inconvenient structures or arrangements designed to avoid the incidence of tax by having income paid to a location outside Singapore. The income may be paid to and accumulated in a low or no tax jurisdiction which acts as a tax shelter. Tax exemption of such foreign-sourced income may not be available because of a number of possible reasons, for example the foreign-sourced income may be interest or royalties income, or no foreign tax may

have been paid on the foreign-sourced income. The consequence of this is that the Singapore resident companies are also not able to invest or utilise their income in Singapore without the payment of Singapore tax on remitting the income to Singapore.

The expanded exemption in Budget 2009 may be a one-off opportunity for Singapore resident companies to remit such income to Singapore without the payment of any Singapore tax. Clearly it is hoped that the income would then be invested or used in Singapore although it is unclear as to why the temporary relief does not extend to foreign sourced income which is both earned or accrued outside Singapore and remitted to Singapore within that same window of time. Singapore resident companies may consider making use of this temporary relief to bring income accumulated offshore back to Singapore.

New Tax Framework for Corporate Amalgamations

In a corporate amalgamation, the amalgamated company takes over all assets and liabilities of the amalgamating companies, and the amalgamating companies cease to exist. Under the existing tax treatment, the amalgamating companies are treated as having ceased business and having disposed of their assets and liabilities to the amalgamated company. This may give rise to a number of unintended or unfavourable tax consequences, such as the following:

- unutilised trade losses, capital allowances and approved donations of the amalgamating companies may be lost;
- balancing charges for capital allowances made on capital assets may arise;
- a taxable gain on the transfer of trading stock may arise;
- certain future expenses for liabilities incurred by the amalgamating companies (such as provisions for doubtful debts which turn bad after amalgamation) may not be deductible by the amalgamated company; and
- there may also be stamp duty or GST payable on the transfer of assets.

To facilitate companies to restructure and re-organise, the IRAS will introduce a new tax framework for “qualifying amalgamations” to minimise the tax consequences arising from amalgamations. Details of the new tax framework are expected to be released for public consultation in February 2009.

It is hoped that the approach of the new tax framework would be for a “qualifying amalgamation" to be a tax neutral event with no tax consequences, such that the amalgamated company would step into the shoes of the amalgamating companies as follows:

- any tax asset or liability of the amalgamating companies is transferred to the amalgamated company;
- the amalgamation does not give rise to any taxable gain or balancing charge;
- the businesses of the amalgamating companies are continued by the amalgamated company as if all acts performed by the amalgamating companies in the course of their businesses had been performed by the amalgamated company; and
- any transfer of asset is to be disregarded for tax purposes.

However, it is not clear what would be a “qualifying amalgamation” for the above purpose and whether any additional conditions (separate from the conditions for such amalgamations under the Companies Act) would be imposed. Nevertheless, details of the new tax framework would certainly be helpful in encouraging and promoting the use of such amalgamations in Singapore.

Other Tax Changes

Other tax changes announced in Budget 2009 include:

1. **Reduction in corporate tax rate.** The corporate tax rate is reduced to 17% from Year of Assessment 2010.

2. **Enhancement to loss carry-back scheme**. The existing loss carry-back scheme is enhanced for Years of Assessment 2009 and 2010 by allowing carry-back for up to three years of assessment instead of one year of assessment and by increasing the limit on the amount of deductions that can be carried back to S$200,000 from S$100,000. Further, the IRAS will allow provisional claims for tax refund to be made based on estimated losses.

3. **Accelerated capital allowances**. Accelerated capital allowances may be made for plant and machinery acquired in the basis period for Years of Assessment 2010 or 2011 with a 75% allowance in the first year and a 25% allowance in the second year. Also, accelerated writing down allowances may be available for qualifying intellectual property rights acquired from 22 January 2009 to 31 October 2013 by a Media and Digital Entertainment company or partnership.

4. **Enhanced tax deduction for capital expenditure on renovation and refurbishment**. Capital expenditure incurred on renovation and refurbishment in the basis periods for Years of Assessment 2010 and 2011 may be deducted in one year instead of three years, subject to certain caps.

5. **Provisions for impairment losses required under MAS Notices**. Provisions for impairment losses required to be made by banks, finance companies and merchant banks under MAS Notices may be deducted subject to specified caps for a further three years of assessment.

6. **Financial Sector Incentive (Headquarter Services) Scheme**. From 22 January 2009 to 31 December 2013, (i) the scope of companies qualifying for the FSI-HQ scheme is expanded, (ii) the scope of income qualifying for the concessionary tax rate under the FSI-HQ scheme is also expanded, and (iii) certain interest payments made by FSI-HQ companies will be exempt from withholding tax. In addition, the existing Qualifying Processing Services Company scheme will be subsumed under the FSI-HQ scheme from 27 February 2009.

7. **Approved Commodity Derivatives Traders Scheme**. From 27 February 2009 to 31 December 2013, the existing Approved CDT scheme is subsumed under the Financial Sector Incentive (Derivatives Market) Scheme and is expanded to include trades in emission derivatives. Counter-party restrictions will be removed for qualifying trades.

8. **Global Trader Programme**. From 27 February 2009 to 31 December 2013, counter-party restrictions will be removed for qualifying trades under the Global Trader Programme.

9. **Scope of exemption under MAS tax incentives**. The categories of income exempt or subject to concessionary tax rates under various MAS tax incentives (including the tax exemption regime for fund management) are expanded to be more comprehensive from 22 January 2009, with specific attention to Islamic instruments.

10. **Block Transfer Scheme for ship financing**. The existing withholding tax exemption on interest payable by a shipping enterprise on a loan for the acquisition of a Singapore-registered ship is extended until 31 December 2013 and is expanded to include interest payable on a loan for the acquisition of a Special Purpose Company owning a Singapore-registered ship.

11. **GST zero-rating for aerospace industry**. The scope of zero-rating of GST is expanded.

12. **Donations to Institutions of Public Character**. The tax deduction for a donation made to Institutions of Public Character in 2009 is increased to 250% of the amount of the donation.

13. **Start-up exemption scheme**. The existing start-up exemption scheme for newly incorporated companies is extended to companies limited by guarantee from Year of Assessment 2010.

14. **Income tax on net annual value**. The income tax on the net annual value of properties used for residential purposes is removed from Year of Assessment 2010.

15. **Personal income tax rebate**. A personal income tax rebate of 20% capped at S$2,000 for tax resident individuals will be made for Year of Assessment 2009.

16. **Property tax changes**. Property tax on land approved for development is deferred from 22 January 2009 or the date of Written Permission or Provisional Permission (whichever is later) until 21 January 2011, the date of issuance of Temporary Occupation Permit, the date of lapsing of the Written Permission or Provisional Permission, or the date of transfer of the property (whichever is earlier). Also, the property tax assessment rate for hotel rooms will not be increased to 25% (as proposed earlier) but will stay at the current rate of 20% for 2009.

17. **Property tax rebate**. For 2009, a 40% property tax rebate will be made for industrial and commercial properties and for owner-occupied residential properties.

To read the full text of the Budget Speech 2009, please **click here**. The Budget Speech 2009 is also available from the Singapore Budget website **www.singaporebudget.gov.sg**

Should you have any further queries as to how this may affect your business, please do not hesitate to get in touch with your usual contact at Allen & Gledhill LLP or any member of our Tax Practice Group:

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