

Dear Clients & Friends

Budget 2010 - Analysis of Major Tax Changes

The Minister for Finance, Mr Tharman Shanmugaratnam, delivered the Budget Statement for the Financial Year 2010 ("**Budget 2010**") on 22 February 2010.

Budget 2010 seeks to look beyond the present improvement in the economy and focuses on building up Singapore's capabilities for a "phase shift" in the Singapore economy over the next decade, with a key goal being to grow the productivity of the Singapore workforce by 2% to 3% per year over the next decade and raise real incomes by one-third in 10 years. This will allow Singapore to maintain an economic growth rate of 3% to 5% a year.

Budget 2010 represents a major investment by the Government for the future and contains a number of important tax changes which are generally targeted more at small and medium enterprises.

In this Tax Update, we highlight and analyse a number of significant tax changes announced in Budget 2010.

New Productivity and Innovation Credit scheme

A centrepiece of Budget 2010 is the introduction of a new Productivity and Innovation Credit scheme that provides enhanced tax deductions for businesses incurring expenditure in activities that boost productivity and innovation.

In Budget 2008, enhanced tax deductions were introduced allowing businesses to deduct up to 150% of expenditure on research and development activities ("**R&D**"). Budget 2008 also introduced the Research and Development Tax Allowance scheme (which provided for additional deductions for incremental expenditure on R&D over a base level) and the Research and Development Incentive for Start-up Enterprises scheme (which provided for cash grants for start-up companies which had incurred a specified level of expenditure on R&D and had a tax adjusted loss).

The Productivity and Innovation Credit scheme may be seen as a development from the changes introduced in Budget 2008. Enhanced tax deductions are now available for expenditure on a broader range of activities. The quantum of the enhanced tax deductions available is also much greater under the scheme.

Under the Productivity and Innovation Credit scheme, six categories of expenditure that would promote productivity and innovation have been identified, namely:

- expenditure on R&D;
- expenditure on the registration of intellectual property;
- expenditure on the acquisition of intellectual property;
- expenditure on design activities;

- expenditure on the automation of processes; and
- expenditure on the training of employees.

Businesses can claim enhanced tax deductions (or allowances) of 250% of the amount of qualifying expenditure incurred in each category, up to a maximum of S\$300,000 of qualifying expenditure in each category for each year of assessment. Normal tax deductions or allowances are available for any balance expenditure in excess of S\$300,000 for each category in each year of assessment (i.e. up to 150% tax deduction for any balance expenditure in excess of S\$300,000 on R&D). Hopefully, any unutilised deductions or allowances will be available to be carried forward during the five-year duration of the scheme at least.

In addition, businesses with at least three local employees may convert the tax deductions (or allowances) under the Productivity and Innovation Credit scheme into a cash grant equal to 7% of the amount of tax deductions (or allowances) allowed, i.e. up to a maximum cash grant of S\$21,000 per year of assessment. There was no mention of a business needing to have a tax adjusted loss in order to convert its tax deductions (or allowances) into the cash grant.

With the introduction of the Productivity and Innovation Credit scheme, the Research and Development Tax Allowance and Research and Development Incentive for Start-up Enterprises schemes will cease from Year of Assessment 2011 (with transitional measures available for taxpayers with unutilised Research and Development allowances). It is not clear whether the existing scheme for writing-down allowances for the acquisition of intellectual property rights will also cease to apply.

The Productivity and Innovation Credit scheme will be available from Year of Assessment 2011 to Year of Assessment 2015. Further details will be released by the Inland Revenue Authority of Singapore (the "IRAS") in June 2010.

New Merger and Acquisition Allowance and remission of stamp duty

The second major tax change announced in Budget 2010 is a new Merger and Acquisition Allowance ("**M&A Allowance**") and stamp duty remission designed to help defray the costs of acquiring companies. More efficient and competitive companies may grow through mergers with or acquisitions of other companies, and reducing fiscal disincentives for doing so would promote the progressive restructuring of the economy generally.

In Budget 2009, a new tax framework for corporate amalgamations was introduced to promote a tax neutral treatment for amalgamating companies. However, companies are generally unable to claim tax deductions for any financing costs incurred in the acquisition of shares in other companies because the shares would only produce non-taxable income in the form of dividends. The M&A Allowance provides a company that has acquired another company in a qualifying acquisition with a tax allowance equal to 5% of the value of the acquisition. At present, it is not clear what would be a qualifying acquisition and how the value of the acquisition is to be determined.

The maximum M&A Allowance that will be granted to a company for qualifying acquisitions in a year of assessment is S\$5 million. The amount of M&A Allowance granted will be deductible against the company's taxable income in annual instalments over five years of assessment. It is not clear if any unutilised M&A Allowance may be carried forward after the fifth year of assessment.

In addition to the M&A Allowance, stamp duty is also remitted for a qualifying acquisition where the shares acquired are unlisted shares (stamp duty is generally not applicable in an acquisition of listed shares since usually no instrument of transfer is required). It is not clear what a qualifying acquisition will be and whether a qualifying acquisition must be for 100% of the shares in the acquired company. The maximum amount of stamp duty that can be remitted in a year is S\$200,000 for all qualifying acquisitions in the year.

The M&A Allowance and remission of stamp duty will be available for qualifying acquisitions executed from 1 April 2010 to 31 March 2015 (both dates inclusive). Further details will be released by the IRAS by June 2010.

Phasing out of the Industrial Building Allowance

The Industrial Building Allowance (the “**IBA**”) was first introduced in the 1940s to encourage industrialisation and provides a taxpayer with allowances for capital expenditure on industrial buildings and structures. As the IBA does not differentiate between efficient and inefficient uses of industrial land, it is no longer adequate and will be phased out.

Taxpayers with an existing IBA may continue to claim the IBA until such allowances are fully written down. The IBA will not be granted for capital expenditure incurred after 22 February 2010, except in certain specified circumstances where there is a demonstrable intention on or before 22 February 2010 to acquire, construct, extend or improve an industrial building.

Further details will be released by the IRAS in April 2010.

New Land Intensification Allowance

With the phasing out of the IBA, a new Land Intensification Allowance (“**LIA**”) will be introduced to provide a more targeted scheme to enhance industrial land productivity.

An important point to note is that the new LIA scheme is targeted at specific industry sectors, unlike the IBA.

Under the LIA, allowance is provided for qualifying capital expenditure incurred for the construction of a qualifying building or structure where:

- (i) the user of the building or structure falls under one of nine specified industry sectors;
- (ii) the land on which the building or structure is to be built is zoned as Business 1 or Business 2 (excluding Business 1 White and Business 2 White) under the Urban Redevelopment Authority Master Plan; and
- (iii) the building or structure meets the Gross Plot Ratio benchmark for the relevant specified industry sector.

The person incurring the qualifying capital expenditure will be able to claim an initial allowance of 25% and an annual allowance of 5% and will be able to fully claim the qualifying capital expenditure in 15 years. At present, it is not clear what would be qualifying capital expenditure or a qualifying building or structure.

The LIA scheme commences from 1 July 2010 onwards and expires in five years unless extended. Further details will be released by either the Economic Development Board or the Jurong Town Corporation by June 2010.

Tax incentives for the financial sector

Changes for listed real estate investment trusts

The existing income tax, stamp duty and goods and services tax (“**GST**”) concessions for listed real estate investment trusts (“**REITs**”) will be extended until 31 March 2015.

Similar to certain other changes announced in Budget 2010, a sunset clause has been added and the existing exemption for foreign-sourced income of listed REITs and wholly-owned Singapore subsidiaries of listed REITs will expire on 31 March 2015 (unless extended). Any

relevant foreign-sourced income should be remitted to Singapore on or before 31 March 2015 for the exemption to apply. REIT Managers should take note that the sunset clause is tagged onto the remittance of the foreign-sourced income and not merely the earning or accrual thereof.

The existing stamp duty remission for a transfer of immovable property or a property holding company to a REIT will now be available if the REIT is listed in Singapore within six months (instead of one month previously) from the date of completion of the agreement for the sale of the immovable property or property holding company.

Changes to the Financial Sector Incentive scheme

Currently, under Financial Sector Incentive Standard Tier (“**FSI-ST**”), the amount of income of an incentive holder up to a qualifying base is taxed at the prevailing corporate tax rate and the amount of income in excess of the qualifying base is taxed at a concessionary tax rate of 10%. To reduce compliance costs, with effect from 1 January 2011, the qualifying base will be removed and the concessionary tax rate will be changed to 12%. This higher rate may prove less attractive to new FSI-ST entrants since their qualifying base may be zero prior to this change. The list of qualifying activities under the FSI-ST will also be updated.

Review of tax incentives for futures members of Singapore Exchange and members of Singapore Commodity Exchange Limited

Futures members of Singapore Exchange (“**SGX**”) and members of Singapore Commodity Exchange Limited (“**SICOM**”) currently enjoy a concessionary tax rate of 10% on income from qualifying transactions. This tax incentive will cease on 31 December 2010. From 1 January 2011, tax incentives for these activities will be granted under the FSI scheme instead. Existing futures members of SGX and members of SICOM will be allowed to transit to the FSI-ST scheme automatically by notifying the Monetary Authority of Singapore before 31 July 2010.

Review of tax incentive for offshore insurance business

Approved insurers currently enjoy a concessionary tax rate of 10% on certain income derived from any offshore insurance business carried on in Singapore with no sunset clause. With effect from 1 April 2010, this tax incentive will be awarded for a period of 10 years and will be subject to a headcount requirement to encourage approved insurers to grow their presence in Singapore. A transitional period will be given for existing approved insurers to meet the headcount requirement by 31 March 2013. Similar to certain other changes announced in Budget 2010, a sunset clause has been added and the tax incentive will expire on 31 March 2015 unless extended.

Removal of Approved Start-up Fund Manager Scheme

The Approved Start-up Fund Manager Scheme expired on 17 February 2010. Existing approved start-up fund managers will not be affected by the expiry of the scheme.

Tax incentives for the maritime and aviation sector

Extension of Maritime Finance Incentive

Currently, approved shipping investment enterprises enjoy tax exemption on certain income from chartering or finance leasing of ships or incidental activities, and approved shipping investment managers enjoy a 10% concessionary tax rate on income from managing approved shipping investment enterprises. These incentives will be extended until 31 March 2016 and new approvals under these incentives will be for a period of not more than five years.

New tax incentive for ship brokers and forward freight agreement traders

To promote ship broking and forward freight agreement trading activities in Singapore, income derived by a company carrying out only ship broking or forward freight agreement trading in Singapore will be subject to a concessionary tax rate of 10%, subject to conditions to be announced by the Maritime and Port Authority of Singapore.

Exemption of ship management fees

Income derived on or after 22 February 2010 from the rendering of ship management services to related qualifying ship owning special purpose vehicles will be exempt from tax, similar to the existing tax exemption of shipping profits, subject to conditions to be announced.

Expanding GST zero-rating for marine industry and qualifying aircraft

From 1 July 2010, zero-rating of GST is extended to ships for recreational or pleasure purposes that are wholly used for international travel regardless of whether the ships call on a port outside Singapore. Zero-rating will apply to the transport of goods or passengers on a qualifying ship to or from international waters (regardless of whether the ship calls on a port outside Singapore) and supplies of goods for use on board or for installation on a qualifying ship (regardless of whether the ship calls on a port outside Singapore) or qualifying aircraft.

Investment allowance scheme for aircraft rotables

The existing investment allowance scheme for aircraft rotables is extended until 31 March 2015. There will no longer be a requirement for specific aircraft rotatable parts to be tracked and recovered by approved aircraft maintenance, repair and overhaul companies from their clients at the end of service contracts.

Extension of GST remission for qualifying listed registered business trusts

The existing GST remission granted to listed registered business trusts in the sectors of infrastructure, ship leasing and aircraft leasing, which allows the registered business trusts to reclaim GST incurred on their business expenses, is extended until 31 March 2015.

Other tax changes

Other tax changes announced in Budget 2010 include:

New tax deduction for angel investors

A new tax incentive scheme for angel investors is introduced to encourage the provision of financing to young companies in their early stages of growth, which is when they would generally face problems in obtaining financing.

Under the tax incentive, an individual who is an approved angel investor and who invests a minimum of S\$100,000 in a qualifying start-up company in a year of assessment may enjoy a tax deduction of 50% of the amount invested at the end of the second year of holding the investment. The maximum tax deduction allowed to an approved angel investor for all his investments is S\$500,000 per year of assessment.

It is not clear what are the criteria for approval as an angel investor or for qualifying as a start-up company under the tax incentive. It is also not clear if an approved angel investor will be required to provide any contribution to a qualifying start-up (other than financial investment) under the tax incentive.

The tax incentive will apply to investments made from 1 March 2010 to 31 March 2015 (both dates inclusive) and further details will be released by SPRING Singapore by June 2010.

Deferral of import GST

Currently, GST is payable on the import of any goods into Singapore at the point of importation. If the importer is registered for GST, it may reclaim the import GST paid when it accounts for GST for the relevant accounting period. However, due to the time lag between the import of the goods and the accounting of GST, cashflow difficulties may be encountered. From 1 October 2010, approved GST registered business with good compliance records and who files GST returns on a monthly basis will be permitted to defer payment of import GST for at least a month. Further details will be released by the IRAS by March 2010.

Simplification of GST accounting rules

Currently, for GST purposes, the time of a supply is the earliest of (a) when the tax invoice is issued, (b) when payment for the goods or services is received, or (c) when goods are delivered or made available or services are performed. These rules may result in complexity and compliance difficulties if goods are delivered or made available or services are performed some time before a tax invoice is issued or payment is received.

To simplify GST accounting and compliance, from 1 January 2011, the time of a supply is generally simplified to be the earlier of (a) when the tax invoice is issued, or (b) when payment for the goods or services is received. The time of supply will therefore be consistent with the accounting records of billing and receipt of payment for the supply. Further details will be released by the IRAS by May 2010.

Withholding tax rate for non-resident public entertainers

From 22 February 2010, the withholding tax rate for payments made to non-resident public entertainers is reduced to 10% from 15% previously.

Change in property tax rate for owner-occupied residential properties

From January 2011, the property tax rate for owner-occupied residential properties will be changed from a flat 4% tax rate to tiered tax rates ranging from 0% to 6%.

Donations to Institutions of Public Character

The tax deduction of 250% of the amount of any donation made to an Institution of Public Character is extended until 31 December 2010.

Reference material

Please [click here](#) to read the full text of the Budget Statement for 2010, which is posted on the Singapore Budget website www.singaporebudget.gov.sg

Further information

Should you have any further queries as to how this may affect your business, please do not hesitate to get in touch with any member of our Tax Practice Group:

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