

# You and the Taxman

Insights on tax issues that matter

Issue 3, 2011



Time barred assessments: don't get caught

Pooling excess foreign tax credits to generate cash

Tax deductions for going global

Through a global lens: paving the way for cross-border taxpayer information exchange

Deduction for purchase of trademarks, copyrights and registered designs in Hong Kong

Investing in Philippine infrastructure projects

The big shake-up: deciphering India's new Direct Tax Code

A litmus test for anti-avoidance





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The year is fast drawing to a close. The last day of the year - 31 December - is significant for taxpayers because it is the deadline for the Singapore tax authorities to raise assessments which will become time barred. If you cannot resolve your issues with the tax authorities, you are likely to receive what is known as a "protective" assessment - which is an assessment based on the Inland Revenue Authority of Singapore's best judgement of your final tax position for the year of assessment concerned.

**"Time-barred assessments: don't get caught"** highlights that the reduction in the record-keeping period means that 2011 and 2012 could be crunch years for taxpayers because of the bunching of deadlines to raise assessments.

Read this article for tips on how to prevent "protective" assessments from being raised on you.

Uncertain economic conditions mean that it is always good to manage your cash flow effectively. The foreign tax credit (FTC) pooling system, an initiative announced in Budget 2011, is a means which can help you unlock trapped cash. **"Pooling excess foreign tax credits to generate cash"** shares how you can take advantage of the FTC pooling system to improve your cash flow.

If you are planning to make inroads in overseas markets, **"Tax deductions for going global"** is a useful article which discusses the details of the merger of the double tax deductions for promoting internationalisation.

**"Through a global lens: paving the way for cross-border taxpayer information exchange"** stresses that tax authorities worldwide are increasingly joining forces by sharing information to enforce tax laws. Read on for more on how the Organisation for Economic Co-operation and Development's Multilateral Tax Convention on Mutual Administrative Tax Matters impacts global companies.

Keeping to the international flavour, **"Deduction for purchase of trademarks, copyrights and registered designs in Hong Kong"** compares Hong Kong's intellectual property regime with Singapore's while **"Investing in Philippine infrastructure projects"** keeps us up-to-date on the Philippine government's infrastructure program.

Meanwhile, the tax landscape is in for a major overhaul in India. **"The big shake-up: deciphering India's new Direct Tax Code"** discusses the significant changes in the proposed new tax legislation and how this affects foreign businesses in India.

Lastly, **"A litmus test for anti-avoidance"** reviews the *AQQ v Comptroller of Income Tax* case. This interesting case has some insights into interpretation of section 33 of the Income Tax Act by the Singapore tax authorities and the Courts.

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MICA (P) 176/12/2010  
Printed by Hock Cheong Printing Pte Ltd

# Time-barred assessments: don't get caught

“With YA2005 assessments already slated to be time-barred by 2011, the bunching of the deadlines in both 2011 and 2012 means that you may be in for a flurry of desktop queries and assessments from the IRAS between now and 2012.”

*Chia Seng Chye and Aw Hwee Leng remind taxpayers why 2011 and 2012 are years of the crunch.*

For many of us, 31 December is a time to make our resolutions for the coming year. For taxpayers, the last day of the year is also an important one.

In the 2006 Singapore Budget, the Singapore government announced that it would cut the time for businesses to retain their records from seven to five years in 17 statutes, including the Income Tax Act. This step of reducing the regulatory record-keeping burden and compliance costs for businesses was aimed at enhancing the attractiveness of doing business in Singapore.

This change took effect from the year of assessment (YA) 2008, which assesses tax on income earned in the financial year 2007. This means that taxpayers need not keep records pertaining to financial year 2007 beyond 31 December 2012 (unless under enquiry). In a similar vein, 31 December 2013 will be the last date that taxpayers need to maintain their records for the financial year 2008, and so on.

With this change, the statute of limitation, which is the maximum time allowed according to the law to raise tax assessments, has been reduced accordingly. Prior to YA 2008, the Inland Revenue Authority of Singapore (IRAS) had up to six years after the expiry of a YA to raise assessments or additional assessments before being time-barred. In line with the reduction in the timeframe for record keeping, the statute of limitation is confined to four years from YA 2008. The exception is where fraud or wilful default is involved.

As a consequence, there will be a convergence of the statutory time limit for the IRAS to raise assessments for YA 2006 to YA 2008 in 2012. This is because for both YA 2006 and YA 2008, the statute of limitation falls on 31 December 2012. Even though the statute of limitation for YA 2007 falls on 31 December 2013, the IRAS will have to review and take into consideration, if necessary, the tax matters for YA 2007, when assessing YA 2008. This is particularly so where there are carried forward items such as loss items or tax written down value of assets.



To ease the potential crunch and manage its workload and resources better, the IRAS announced in August 2010 that it would be staggering the completion of assessments as follows:

- ▶ YA 2005 and YA 2006 to be completed by 2011

and

- ▶ YA 2007 and YA 2008 to be completed by 2012

In Singapore, after the taxpayers submit their corporate tax returns, the IRAS will issue a notice of assessment, and may perform a desktop review and raise queries (with or without issuing tax computations) to obtain details or clarifications from taxpayers on certain items reflected in the returns and financial statements through written correspondences. After the queries are resolved, the IRAS will issue additional or amended notices of assessment to either collect additional taxes or refund excess taxes to taxpayers, as the case may be.

You should note that once the IRAS issues a notice of assessment, you will only have a month to pay the tax assessed unless you can persuade the IRAS to amend the assessment to a lower tax within the 30-day period or obtain the IRAS' agreement to extend the date of payment.

At the same time, you will only have 30 days to object to the assessment if you disagree with it. Failure to do so will mean that the assessment is final and

conclusive. The IRAS is not obliged to amend the assessment even if a lower tax amount is later found to be due.

With YA 2005 assessments already slated to be time-barred by 2011, the bunching of the deadlines in both 2011 and 2012 means that you may be in for a flurry of desktop queries and assessments from the IRAS between now and 2012. If the issues and queries raised by the IRAS cannot be satisfactorily resolved by the stipulated dates under the statute of limitation, the IRAS is likely to raise assessments based on its best judgement of what the final tax position of the taxpayer should be for the YA concerned.

Therefore, to avoid having the IRAS raise such "protective" assessments on you, which in practice could be excessive and affect your cash flows, you should take the following steps for the YAs which will be time-barred, particularly for YA 2005 and YA 2006:

**Start early and don't procrastinate**

- ▶ Obtain commitment and support from the relevant personnel to attend to the IRAS queries as early as possible.
- ▶ Ensure that sufficient resources are available in the finance and tax functions to retrieve and extract information or perform reconciliations to respond to the IRAS queries. This may also be necessary to defend any objection to notices of assessments that may be lodged.
- ▶ Discuss with your tax advisor whether you should approach the IRAS to expedite the review of the tax returns,

where the IRAS may not have completed the tax assessments and did not raise any queries on a timely basis. This is all the more crucial for YAs that would be time-barred fairly soon.

**Strategise and decide on the approach**

- ▶ Seek the assistance of your tax advisor early in relation to the IRAS' correspondences or queries to understand the questions and their rationale as well as the adjustments made.
- ▶ Explore the possibility of discussing or meeting with the IRAS officer in-charge to clarify and agree on the information or documents to be furnished. This could help to minimise the likelihood of protracted correspondences and multiple queries from the IRAS.
- ▶ Review the IRAS' queries and tax computations for the YAs concerned, and decide whether the IRAS adjustments should be accepted. Otherwise, lodge a valid objection to the notice of assessment raised as appropriate.
- ▶ Determine the impact of the IRAS' queries and adjustments on your open years' tax returns, e.g., whether the treatment of income or expense items adopted in your tax returns can be supported or otherwise amended.

**Execute timely and monitor the status**

- ▶ Ensure that complete information (and supporting documentation

where required) is furnished on a prompt and timely basis in response to the IRAS queries. This is to minimise the possibility of further queries being raised by the IRAS.

- ▶ Monitor the IRAS' subsequent response and follow up if necessary.
- ▶ Consider engaging the IRAS in dialogues or meetings for early resolution and completion of outstanding tax matters, especially if there are more than a few rounds of queries.

With increasing stock market volatility and looming uncertainty in the economy, the axiom "cash is king" has become even more significant. If you have outstanding tax issues to be resolved with the IRAS for YA 2005, these should take immediate priority to minimise the possibility of being handed a "protective" assessment and to prevent excess cash outflow. And if you are making your new year resolutions for 2012, you might wish to include the expeditious and timely completion of your tax matters up to YA 2008 as one of them!



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# Pooling excess foreign tax credits to generate cash

“The appropriate use of the new FTC pooling system could well generate cash tax savings to help you during uncertain economic conditions.”

*Poh Bee Tin and Chester Wee discuss how companies make use of the new foreign tax credit pooling system to improve their cash flow*

The global economy is poised to fly through another round of turbulent weather, no thanks to economic woes in the US and Europe. As businesses struggle to respond to the challenging economic situation and continuing turmoil in the financial markets, they need to remember the old adage ‘cash is king’. Maximising your cash earnings and efficiently managing cash deployment could help tide you over the rough patch.

Tax planning has become a corporate priority in helping to reduce costs and unlocking significant levels of new and trapped cash. There are various ways where tax can help to generate cash or improve cash flow. The new foreign tax credit (FTC) pooling system which takes effect from the tax year 2012 is one such opportunity.

## How does the FTC pooling system work?

Currently, the FTC is computed on a “source-by-source and country-by-country” basis, for each particular stream of foreign income received in Singapore. If the foreign tax paid exceeds the Singapore tax payable on a particular foreign income, the excess will be disregarded and cannot be used to reduce the Singapore tax payable on other foreign income received in Singapore.

Under the new FTC pooling system, businesses may elect to selectively pool their foreign taxes paid on various streams of foreign income for the purpose of computing the FTC. The FTC will be computed on a pooled basis instead of a “source-by-source and country-by-country” basis. This allows the excess of foreign tax paid over the Singapore tax payable on a particular foreign income to be used to reduce the Singapore tax payable on other foreign income selected for pooling, thereby reducing the overall Singapore tax payable.

### Illustration 1

	Foreign income 1	Foreign income 2	Foreign income 3	Total
Foreign tax paid (S\$) (A)	50,000	70,000	60,000	180,000
Singapore tax payable (S\$) (B)	30,000	90,000	80,000	200,000
Lower of (A) or (B)	30,000	70,000	60,000	160,000

Under the existing FTC system, the FTC will be computed as follows:

	S\$
Singapore tax payable	200,000
Less: FTC [based on lower of (A) and (B)]	<u>(160,000)</u>
Net Singapore tax payable	<u>40,000</u>

Under the new FTC pooling system, the FTC will be computed as follows:

	S\$
Singapore tax payable	200,000
Less: FTC [based on lower of total Singapore tax payable of S\$200,000 and pooled foreign tax paid of S\$180,000]	<u>(180,000)</u>
Net Singapore tax payable	<u>20,000</u>

In this example, by electing for the new FTC pooling system, the taxpayer can easily create a tax saving of S\$20,000 (i.e., S\$40,000 less S\$20,000), which translates into additional cash flow.

### What are the conditions to be met?

To pool your FTCs, you can make an election to do so in the tax computation submitted to the Inland Revenue Authority of Singapore (IRAS) together with the annual income tax return for each tax year. In the absence of the election and relevant FTC computation, the IRAS will compute the FTC using the current "source-by-source and country-by-country" basis.



Only resident taxpayers are entitled to claim FTC. They may elect for the FTC pooling system for foreign income received during the basis period for the tax year 2012 or thereafter. The following conditions must be fulfilled:

- ▶ Income tax must have been paid on the foreign income in the foreign country from which the income is derived
- ▶ The headline tax rate (or the highest corporate tax rate) of the foreign country from which the foreign income is derived is at least 15% at the time the foreign income is received in Singapore
- ▶ There must be Singapore tax payable on the foreign income
- ▶ If Singapore has a double tax agreement (DTA) with the foreign country from which the foreign income is derived, the foreign tax has been paid or is payable in accordance with the provisions of that DTA

or

If Singapore does not have a DTA with that foreign country, the foreign income is specified under section 50A of the Income Tax Act

## Food for thought - how to make best use of FTC pooling

1. *Plan early.* Tax planning is an ongoing process and not an afterthought. Prior to remitting the foreign income, you should analyse the tax implications. If the remittance results in incremental Singapore tax payable, can the new FTC pooling system reduce your taxes? If it cannot, can you utilise the funds outside Singapore without triggering the deemed remittance under section 10(25) of the Income Tax Act?
2. *Time your remittance.* If the remittance of a particular foreign income results in incremental Singapore tax payable, can you defer this remittance or can you remit another stream of foreign income with excess foreign tax paid over Singapore tax payable earlier so that you can further reduce your overall tax payable?
3. *Opt out<sup>1</sup> of section 13(8) exemption.* Foreign dividends received in Singapore may be exempt from tax in Singapore if certain conditions are met. Dividends from a foreign country with a headline tax rate or dividend withholding tax rate higher than 17% may be a source of foreign income with excess foreign tax paid over Singapore tax payable. You need to consider whether it is beneficial to opt out<sup>1</sup> of the section

13(8) exemption so that the excess foreign tax paid for such foreign dividends could be utilised against the Singapore tax payable on other foreign income under the new FTC pooling system.

4. *Consolidating various streams of foreign income.* There will be limited opportunities to generate tax savings under the new FTC pooling system if each company derives a single source of foreign income. Thus, you should consider consolidating the various streams of foreign income under a single company.

The introduction of a new tax system often provides added tax planning opportunities. To reap the maximum benefits from the new FTC pooling system, you should pay more attention to your foreign income remittances. The appropriate use of the new FTC pooling system could well generate cash tax savings to help you during uncertain economic conditions.



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<sup>1</sup>Strictly speaking there is no option in or out of section 13(8). However, the foreign income exemption does not apply unless the Comptroller is satisfied that the exemption is beneficial to the taxpayer.

# Tax deductions for going global

“The move to allow businesses to submit their applications to IE Singapore up to the day of their overseas marketing trip should make it easier for businesses to claim these additional deductions.”

*Chai Wai Fook and Teh Swee Thiam discuss the merger of the existing double tax deductions for overseas market and investment development into a single scheme for promoting internationalisation*

Entering new growth markets and adding revenue sources are compelling reasons for Singapore companies to expand beyond their home turf. Tax breaks can make the journey easier.

With the spotlight on the enhanced Productivity and Innovation Credit scheme, businesses may have easily overlooked another initiative in Budget 2011: the proposal to merge the double tax deduction (DTD) schemes under sections 14B and 14K of the Income Tax Act (ITA) for eligible expenses incurred in promoting the export of goods or services<sup>1</sup> and exploring overseas investment opportunities.

The key purpose of the DTD schemes under sections 14B and 14K is to help businesses defray certain costs incurred in promoting the trading of goods or provision of services and seeking investment opportunities overseas. The DTD schemes grant:

- ▶ Additional deductions over and above those expenses incurred for qualifying trade promotion activities or overseas investment development activities already allowed under the general deduction rules

or

- ▶ Twice the eligible expenses incurred for qualifying overseas investment development activities if such expenses are not deductible under the general deduction rules

Under section 14B of the ITA, expenses which can qualify for additional tax deductions are those relating to approved trade fairs, trade exhibitions, trade missions or maintenance of overseas trade offices and market development expenditure. Under section 14K of the ITA, expenses eligible for double tax deductions include studies to identify investments overseas, feasibility or due diligence studies and maintenance of an approved project development office.

Businesses must apply for approval from the relevant authorities before incurring the expenses. However, companies which are already enjoying other forms of tax concessions or grants from the government are not eligible for the DTD schemes.

In the Budget 2011 statement, the government announced that it will merge the DTD schemes under sections 14B and 14K into a single scheme, given their common objective of assisting businesses to internationalise and expand overseas. The merged scheme will also be simplified to allow more businesses to benefit from the scheme.

<sup>1</sup>Including services provided under a master franchise or master intellectual property licence



## Merged DTD scheme for internationalisation under sections 14B and 14K

The International Enterprise (IE) Singapore released a *“Double Tax Deduction for Internationalisation”* brochure on 1 April 2011, providing details on the qualifying criteria, qualifying activities and application of the newly merged scheme for overseas expansion. The brochure also provided illustrations of the potential tax savings under the enhanced DTD scheme.

Under the newly merged DTD scheme for internationalisation administered by IE Singapore, the qualifying activities for overseas business expansion are categorised as follows:

Market preparation	Market introduction	Marketing and promotion	Market presence
Engaging external consultant or professional for: <ul style="list-style-type: none"> <li>▶ Design of packaging for overseas markets</li> <li>▶ Products or services certification for overseas markets</li> <li>▶ Overseas market survey or feasibility study</li> </ul>	<ul style="list-style-type: none"> <li>▶ Participating in overseas business or market development trips or missions</li> <li>▶ Exhibiting in overseas and approved local trade fairs</li> </ul>	<ul style="list-style-type: none"> <li>▶ Overseas advertising and promotion</li> <li>▶ Printing of corporate brochures for overseas distribution</li> <li>▶ Advertising in approval local trade publications</li> </ul>	<ul style="list-style-type: none"> <li>▶ Establishing overseas marketing offices</li> <li>▶ Promoting the company's master license and franchise overseas</li> <li>▶ Engaging external consultant or professional for:               <ul style="list-style-type: none"> <li>Investment feasibility or due diligence studies</li> </ul> </li> <li>▶ Participating in overseas investment development trips or missions</li> </ul>

- ▶ Overseas market development activities
- ▶ Overseas investment development activities

To simplify the application process, companies can apply online for overseas market development activities via the "DTD Online System" at IE Singapore's website<sup>2</sup>. However, they still need to submit hard copy applications for overseas investment development activities. IE Singapore has indicated that online applications for overseas investment development activities may be available in the future<sup>3</sup>.

In addition, businesses can now submit their applications up to the day of their overseas marketing trip instead of seven days before the trip. The applications must not be after the date of departure as IE Singapore will not consider late or retrospective applications. Upon receipt of complete information, IE Singapore will process applications within five working days. For successful applications, an evaluation report or post-project report needs to be submitted via the "DTD Online System".

## A smoother application process

The streamlining of the DTD schemes for overseas expansion is a positive step towards helping businesses applying for additional tax deductions on their overseas expansion expenditure. In particular, the move to allow businesses to submit their applications to IE Singapore up to the day of their overseas marketing trip should make it easier for businesses to claim these additional deductions.

To take advantage of the DTD schemes under sections 14B and 14K to reduce their tax bills, businesses should familiarise themselves with the eligibility criteria, qualifying expenses, application procedures and conditions imposed depending on the type of project or activity for which the additional tax deduction is sought.

It is also important for businesses to take note that:

- ▶ Applications must be submitted to IE Singapore or the relevant authority before the commencement of projects.
- ▶ Certain applications must still be made within a specified number of days before the qualifying project or activity commences depending on the type of project or activity. For example, applications for participating in international trade-oriented exhibitions held in Singapore that are supported by the Singapore Tourism Board (STB) must be submitted to the STB at least seven days before the commencement of the event<sup>4</sup>.
- ▶ To claim the additional tax deductions, the letter of approval from the relevant authority would have to be submitted to the Inland Revenue Authority of Singapore together with invoices and receipts when filing the annual income tax return.



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<sup>2</sup>[www.iesingapore.com/dtd](http://www.iesingapore.com/dtd)

<sup>3</sup>Reference: IE Singapore's brochure "Double Tax Deduction for Internationalisation"

<sup>4</sup>Source: Website of Singapore Tourism Board

**When looking to  
enter new markets, it  
sometimes helps to  
narrow your horizons.**

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# Through a global lens: paving the way for cross-border taxpayer information exchange

“At a minimum, companies should clean up internal procedures by ensuring that all pre-controversy strategy, processes and documentation procedures are in place and functioning as they should.”

*Nico Derksen and Jasmine Chu discuss how the OECD's Multilateral Tax Convention on Mutual Administrative Assistance in Tax Matters may affect global companies*

As multinational corporations (MNCs) develop into global corporate enterprises, tax administrations are attempting to stay in step by shifting to a global perspective. Tax authorities worldwide are now joining forces to better position themselves to address the challenge of more complex structures and cross-border transactions. They have expressed their intention to increase their level of cooperation with other countries. This includes not just more dialogues between countries, but also the development and adoption of compliance programmes that go beyond correspondence-based requests and responses.

It is evident that tax authorities are now translating their intent into actions, especially after the Organisation for Economic Cooperation and Development (OECD) recently announced on 1 June 2011 that the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (the Convention) is now open to all countries.

## Paving the way for greater international cooperation

The foundations for international cooperation among tax administrations go back more than 20 years ago. On 25 January 1988, the OECD and Council of Europe opened the Convention for signature by their member states. The purpose of the Convention is to help governments enforce their tax laws by creating an international framework for cooperation among countries to counter international tax avoidance and evasion.

The Convention provides for exchange of information, simultaneous tax examinations, tax examinations abroad, assistance in recovery and measures of conservancy, and the service of documents. It can also facilitate joint audits. It covers all taxes and compulsory payments to the general government other than customs duties.

The opening of the Convention reflects that tax administrators are increasingly



viewing global companies through a “global lens” in order to be more effective in their enforcement efforts. The multilateral pact establishes and reinforces the protocols that allow for this level of collaboration and information sharing among countries.

Under the Convention, national law rights and safeguards that limit obligations to provide assistance still apply. The Convention also imposes a number of safeguards to protect the confidentiality of the information exchanged. Signing states are also free to make reservations regarding the taxes covered and the type of assistance to be provided.

In May 2010, a Protocol amending the Convention was opened for signature. The Protocol extends the opening of the Convention beyond the OECD and Council of Europe Member States to all countries. The Protocol also aligns the Convention to the OECD international standard on information exchange, including requiring the exchange of bank information on request. The amended convention entered into force on 1 June 2011.

As specified in Article 28 of the Convention, a country interested in becoming a party must first request an invitation. The existing parties to the Convention must then make a decision by consensus to invite the country. The Convention will then enter into force after signature, ratification, deposit of the instrument of ratification, and notification of any reservations.

Article 21 of the Convention as amended by the Protocol provides for protection of persons and sets limits to the obligation to provide assistance. It specifies that nothing in the Convention will affect the rights and safeguards that national laws have secured to persons, and lists the safeguards and limitations to the obligation to supply information and provide administrative assistance. Article 21 also states that in no case should the provisions of the Convention be construed to permit a requested state to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency

or a fiduciary capacity or because it relates to ownership interests in a person.

Since then, 20 countries have signed the amended Protocol so far: Belgium, Denmark, Finland, France, Georgia, Iceland, Italy, Korea, Mexico, Moldova, the Netherlands, Norway, Poland, Portugal, Slovenia, Spain, Sweden, Ukraine, the UK and the US. Azerbaijan, Canada and Germany have signed the Convention, but have not yet signed the amended Protocol.

### Impact on MNCs

While the Group of 20's call to address tax havens has influenced the expansion and broadening of the OECD multilateral treaty, it appears the OECD has also used this initiative to make further changes to the Convention designed to address the challenges posed by global enterprises. Heads of tax administration for major countries have in the past year called for

joint and simultaneous audits as a means of addressing the tax compliance of large international businesses.

According to the September 2010 OECD Joint Audits Report, there is much global activity developing in this area and the continuing development of the Convention will further deepen the push in this area. The main impact to most MNCs is with regards to the confidentiality of their information, when that information is the subject of a treaty-based exchange of information.

These are questions that have yet to have clear answers:

- ▶ Are the laws of the requesting country sufficient to prohibit the authorised disclosure of taxpayer data?
- ▶ Do the national laws of the countries in which they operate provide that they are notified before their tax data is shared with another country?
- ▶ Do the national laws protect the sharing of trade secrets?
- ▶ Will a taxpayer know they are under a Joint Audit?

It is therefore undeniable that tax authorities in the relevant countries need to assure taxpayers that they are protected, especially when the Protocol can potentially triple the number of countries that will be able to access a taxpayer's return information from another tax administration.

Any uncertainties or insecurities to the taxpayer in this arena can be detrimental and potentially result in a lose-lose situation for both the tax authorities and the taxpayers. For one, taxpayers may stop investing or even divest their investments in the respective countries. This will result in a decrease in the amount of funds and resources available to finance infrastructure to encourage other investments, schools, hospitals and other programmes as part of the sustained development framework for the countries.

Having said the above, taxpayers will also need to play their part in protecting themselves by increasing their awareness and discipline around requests for their tax data, as this may be shared with another tax authority. More tax audits and queries may arise, if there are any real or perceived discrepancies in the information provided to the various authorities. Further, each tax authority may have their own interpretation and application of the information provided and this could lead to additional tax liabilities. The efficient exchange of information among tax authorities also means that any tax planning that is based on segmentation and non-disclosure should be avoided.

While the initiation of joint audits will undoubtedly create new challenges for global businesses, the future landscape is not all bleak. There are still significant opportunities and benefits available to taxpayers, if they are able to make use of available tools for issue resolution

and rely on appropriate communications and relationships with the tax authorities. This will apply primarily to the areas of transfer pricing and value-added tax (VAT).

At a minimum, companies should clean up internal procedures by ensuring that all pre-controversy strategy, processes and documentation procedures are in place and functioning as they should. For example, if the tax function has been in its own island, it is time to integrate it with other business units and ensure that it is involved in important decision making. Companies should look into adopting a sound tax risk management strategy, if they have not done so, to improve channels of communication between the tax function and other business units, increase the efficiency and effectiveness of tax function resources, prevent mistakes, improve corporate governance and reduce risks.

Companies which have a sound tax risk management strategy and want to achieve greater certainty may even wish to leverage on a joint audit to obtain bilateral and multilateral resolution of global issues. This may help to resolve complicated issues more quickly and efficiently and more importantly, will provide certainties that would aid in business decision making.

## In the context of Singapore

Closer to home, it seems unlikely that Singapore will request to be invited to join the Convention in this time, particularly since it has already endorsed the enhanced OECD standard for exchange of information (OECD EOI) on 6 March 2009.

The main intention for Singapore to implement the OECD EOI was to remove itself from the OECD grey list, which comprised countries which have not substantially<sup>1</sup> implemented the agreed standard on exchange of information for tax purposes. It was critical for Singapore to enter the OECD white list to avoid the stigma of being classified as a tax haven. Otherwise foreign investors could be scrutinised by their home countries' tax authorities. This would mar Singapore's appeal as a base for MNCs and might even strain the relationship with the respective treaty partners.

Further, being on the white list might prove to be a positive development for Singapore if the US and the Singapore are able to conclude a double taxation agreement, so that US MNCs may enjoy tax benefits when investing into Singapore. In this regard, the Singapore government had taken substantial steps to prove that Singapore was not a tax haven country. This would include making legislative amendments in the domestic tax laws, which mainly related to the following two key principles:

- (a) The lifting of the domestic interest requirement, which used to only allow the provision of information under a DTA where the interest is to enforce Singapore tax law
- (b) Access to confidential information held by banks and trusts - statutory confidentiality rules will be amended in cases related to prescribed foreign crimes and only through the approval of a Singapore Court.

The Inland Revenue Authority of Singapore (IRAS) is also given greater powers to obtain and access formerly confidential information. Further, instead of taking the easier route by concluding tax information exchange agreements with treaty and non-treaty partners, the Singapore government chose to amend its existing double taxation agreements (DTAs) that Singapore had entered into and further DTAs may also be concluded to consistently embed the OECD EOI in all of its DTAs.

Having said the above, if we were to take a step back and consider a purely tax point of view, it would seem probable that there would not be a significant increase in revenue arising from the Singapore government deciding to adopt the OECD EOI. Singapore has an extra-territorial taxation system, where income accruing in or derived from Singapore, or received in Singapore from outside

Singapore will be subject to tax in Singapore, unless otherwise exempted under the domestic tax laws. Income considered to be foreign sourced is taxable in Singapore only when received or deemed received in Singapore. Therefore, the exchange of information with another overseas tax authority for a given Singaporean taxpayer may not really help the IRAS in the collection of tax.

Besides, in order to boost its attractiveness as an important financial centre, for tax purposes, Singapore generally does not tax trusts and bank accounts established in Singapore for foreign clients. This explains why it is not necessary for the IRAS, in the first place, to gather information on such trusts and bank accounts and to have provisions under the existing law to allow the exchange of such information. As such, Singapore was previously able to maintain statutory confidentiality for banks and trust companies (though not any more).

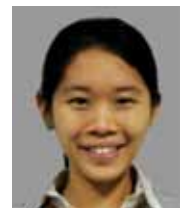
Therefore, Singapore's treaty partners seem likely to be the ones to reap the most benefits from the OECD EOI in the DTAs concluded with Singapore, particularly for those OECD countries which typically tax income on a worldwide basis. Accordingly, they should be more motivated to work together with other tax jurisdictions

<sup>1</sup>A jurisdiction is said to have substantially implemented the internationally accepted OECD standard on exchange of information, if it has signed a minimum of 12 tax information exchange agreements with other jurisdictions.

to enter into exchange of information with regards to the tax affairs of a given taxpayer. In this regard, the OECD EOI seems to be merely another tool used by the OECD to reinforce their capital-export neutrality ideal (whereby tax should not influence the flow of capital) and works more towards facilitating the tax collection of the resident states than the source states. This also applies to the Convention.

Overall, Singapore's adoption of the OECD EOI is already a major step in demonstrating its willingness to work together with other tax authorities on the bona fide exchange of information, despite the likelihood that it will not stand to gain much from it in terms of taxation. Taking this to a bigger scale by entering into the Convention, which also provides for joint tax examinations and audit, may add an extra burden to Singapore, particularly when there are currently no incentives to motivate Singapore to do so at this juncture.

Singapore may not be a party to the Convention, but that does not necessarily mean that Singapore companies with overseas operations, particularly in countries that have signed the Convention and the amended Protocol, will drop off the radar of the relevant overseas tax authorities. This is especially so if the Singapore companies have set up branches in those countries. Potentially, the financial information of the Singapore head office of the branch may still be unknowingly divulged to the tax authorities if they request for it.



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# Deduction for purchase of trademarks, copyrights and registered designs in Hong Kong

“Hong Kong is quickly catching up with Singapore, given its increased efforts to enter into tax treaties and proposing relevant tax schemes in the IP-related area.”

*Rex Young and Toh Shuhui highlight the key tax changes in Hong Kong's intellectual property rights and compare them with the existing tax schemes in Singapore*

With the objective to promote creativity and innovation, Hong Kong announced in its Budget 2010-2011 in March 2011 enhancements to its current tax schemes pertaining to deductions on intellectual property (IP) rights.

In this article, we highlight the key changes and compare them with the current tax schemes that exist in Singapore.

## Enhancements to existing deductions on IP rights in Hong Kong

The Hong Kong government understands that one key area to enhance competitiveness in the business sector is to reduce costs and has provided tax incentives in specific areas to address this area. In its efforts to promote wider application of IP rights by enterprises and to facilitate development in creative industries, the Hong Kong government introduced into the Legislative Council on 9 March 2011, legislative amendments

to the Inland Revenue Ordinance to effect the proposal to enhance the deductions on IP rights.

These are some of the important changes to the existing tax provisions for IP rights:

- (i) Currently, tax deductions are available for two existing categories of IP rights - patent and industrial know-how. With the enhancement, tax deductions would now be allowed for capital costs (including legal fees and valuation fees) incurred on the purchase of three new categories of IP rights - registered trademarks, copyrights, and registered designs.

While costs incurred on the purchase of patent and industrial know-how rights qualify for 100% tax write-off in the year of purchase, those incurred for the three new categories of IP rights would be amortised and qualify for tax deductions over five years. The first deduction is to be made in the year of assessment when the purchase takes place.



- (ii) Currently, in order to claim tax deductions for cost incurred on the purchase of patent and industrial know-how rights, the relevant rights must be used in the production of profits chargeable to tax in Hong Kong and the rights themselves have to be used in Hong Kong.

Recognising that many of these rights are typically used by Hong Kong taxpayers in their manufacturing processes outside Hong Kong for the production of profits which are nonetheless chargeable to tax in Hong Kong, changes are now made to remove the requirement that the relevant rights must be used in Hong Kong.

- ▶ Under the new provisions, the costs incurred for the purchase of patent and industrial know-how rights would be tax deductible to the extent that they are used in the production of profits chargeable to tax in Hong Kong, regardless of where the rights are used.

- (iii) Provisions to claw-back the IP rights previously claimed for the new three categories in the form of balancing adjustments are in place to address situations where the relevant IP right is sold. Any balancing charge is limited to the total amount of tax deductions previously claimed. Where the unclaimed costs exceed the sale proceeds, the difference would then be allowed as a tax deduction in the form of a balancing allowance in the year of disposal.

Changes are also made to restrict the recapture of tax deduction when a patent or industrial know-how right is sold to the amount previously claimed (currently, there is no such limitation under the existing provisions).

- (iv) Tax deductions for all categories of IP rights would be subject to anti-avoidance provisions, which include the disallowance of tax deductions on purchases made from persons associated with a purchaser.

Other anti-avoidance provisions introduced in Hong Kong pertaining to the tax deduction on IP rights include:

- ▶ Sale-and-license-back arrangements between associated persons

and

- ▶ Where the whole or predominant part of the consideration for the purchase of a relevant IP right is financed directly or indirectly by a non-recourse debt.

## Tax deductions and incentives for IP rights in Singapore

Singapore has been increasing its efforts to develop itself as an IP hub. In line with this, the relevant tax schemes surrounding the creation, management and exploitation of IP rights have

been introduced with continuous enhancements so as to position Singapore as an attractive location for creativity and innovation.

Table 1 summarises the relevant tax deductions and incentives that are currently in place.

**Table 1: Summary of the relevant tax schemes in Singapore pertaining to IP rights**

Description	Tax treatment	Conditions
<p>Expenditure on acquisition of IP rights. Qualifying IP rights comprise:</p> <ul style="list-style-type: none"> <li>▶ Patent</li> <li>▶ Copyright</li> <li>▶ Registered trademark</li> <li>▶ Registered design</li> <li>▶ Geographical indication</li> <li>▶ Lay-out design of integrated circuit</li> <li>▶ Trade secret</li> <li>▶ Information that has commercial value and</li> <li>▶ The grant of protection of a plant variety</li> </ul>	<p>Automatic writing-down allowances (WDA) to be claimed over five consecutive years (on a straight-line basis) on the cost of IP acquired.</p> <p>Enhanced allowance under Productivity and Innovation Credit (PIC) to include an additional 300% allowance (i.e. total of 400%) on the first S\$400,000 of qualifying expenditure incurred per qualifying year of assessment (YA). In addition, for the YA 2011 and YA 2012, the combined cap is S\$800,000 and for the YA 2013 to YA 2015, the combined cap is S\$1.2m.</p>	<p>(i) WDA is available to a company carrying on a trade or business and the IP is used in that trade or business</p> <p>(ii) Legal and economic ownership of the IP lies with the Singapore entity. If otherwise, approval from the Economic Development Board of Singapore (EDB) is required.</p> <p>(iii) An undertaking to be given by the company that it is an assignee of the IP rights.</p> <p>(iv) For enhanced allowance under PIC, the IP right must be held for a minimum period of one year from the date of acquisition. Otherwise, claw-back of the enhanced allowance is applicable.</p>
<p>Expenditure on registration of certain IP rights. Qualifying IP rights comprise:</p> <ul style="list-style-type: none"> <li>▶ Patent</li> <li>▶ Copyright</li> <li>▶ Registered trademark</li> <li>▶ Registered design and</li> <li>▶ Grant of protection of a plant variety</li> </ul>	<p>100% tax deduction for patenting costs and registration costs incurred for trademark, design, and plant variety.</p> <p>Enhanced allowance under PIC to include an additional 300% deduction (i.e. total of 400%) on the first S\$400,000 of qualifying expenditure incurred per qualifying YA. In addition, for the YA 2011 and YA 2012, the combined cap is S\$800,000 and for the YA 2013 to YA 2015, the combined cap is S\$1.2m.</p>	<p>(i) Tax deduction is available to a company carrying on a trade or business and the IP is used in that trade or business.</p> <p>(ii) An undertaking to be given by the company that it is the proprietor or owner of the IP rights.</p> <p>(iv) For enhanced allowance under PIC, the IP right must be held for a minimum period of one year from the date of filing. Otherwise, claw-back of the enhanced allowance is applicable.</p>

## Comparison between Hong Kong and Singapore on the tax schemes for IP rights

In light of the rival economies stepping up their efforts to encourage and facilitate IP application in their countries, we have made a comparison of the relevant tax schemes in the respective countries as follows:

### (i) *Scope of IP rights covered*

Singapore appears to have an edge over Hong Kong in this aspect in view that the grant of writing-down allowance (WDA) for qualifying capital expenditure in Singapore is available to a more extensive list of IP rights, including geographical indication, lay-out design of integrated circuit, plant variety, trade secret or information that has commercial value.

In practice, the more common types of IP rights in Singapore for which WDA is claimed by Singapore taxpayers include patents, trademarks, and copyrights (which are also provided for under the Hong Kong tax legislation). This may be due to the relevant infrastructure in the industry being still in its infancy in the country, as well as companies still exploring the feasibility of having their IP-related activities being carried out in Singapore.

In addition, the scope of the last two categories of IP rights provided for

in Singapore, namely trade secret or information that has commercial value, could be quite broadly interpreted. With no clear guidance provided under the Singapore tax legislation or guidelines given by the Singapore tax authorities, it can be challenging for Singapore taxpayers to explore the benefits under these two categories in light of the uncertainty in treatment. In practice, it is the onus of the Singapore taxpayers to substantiate to the satisfaction of the Singapore tax authorities the basis for claiming that certain IP rights fall within the scope of trade secret or information that has commercial value in the event of any dispute over the availability of the WDA claim. In order to obtain certainty in the tax treatment on the IP rights, the Singapore taxpayer may consider an advance ruling or seek formal clarification from the IRAS.

### (ii) *Quantum of tax deductions and claims available*

▶ With the introduction of the broad-based Productivity and Innovation Credit (PIC) scheme in Singapore's Budget 2010 and its enhancements in Budget 2011, Singapore provides a more generous deduction package with an additional 300% enhanced allowance on qualifying expenditure incurred on qualifying IP rights and registration on certain IP rights.

However, given that the enhanced allowance is subject to a cap of S\$400,000 per year of assessment (YA), although this limit can be combined for the relevant YAs, the extent of the tax benefits accruing to the Singapore taxpayers may not be significant especially for the acquisition of high-value IP rights. In addition, the enhanced PIC scheme is only available from the YA 2011 to YA 2015, and there is currently no indication whether this scheme may be extended beyond YA 2015.

▶ Although the quantum of claims may be higher in Singapore in light of the PIC scheme as discussed above, Hong Kong provides an upfront 100% tax deduction on the capital costs incurred on the purchase of patent and industrial know-how in the year of purchase.

In comparison to Hong Kong which provides for tax deductions on the full acquisition costs of the relevant qualifying IP rights, Singapore only provides for 100% tax deduction on registration costs incurred for patents, trademarks, registered design and plant variety. The capital expenditure associated with the purchase of the qualifying IP rights would be allowed as WDA claim over five years.

In view of this, the Hong Kong provisions, though limited to only two categories of IP rights, appear to give a more favourable treatment from a cash-flow perspective as the relevant taxpayers would be able to enjoy the benefits of the tax deductions in the year of purchase of the IP rights. However, this may not be a critical issue for start-up companies that may not have the level of taxable income during the initial years of operations to offset against the tax deductions.

- ▶ In addition, the qualifying capital costs available for tax deduction in Hong Kong is wider with the inclusion of legal fees and valuation fees while for Singapore, the WDA is restricted to the capital expenditure incurred in the purchase of the IP rights and does not include legal fees, registration fees, stamp duty and other costs related to the acquisition of the IP rights. Such incidental costs in connection with the acquisition of the IP rights would also not be allowed for tax deduction based on the normal deduction rules for expenses under the Singapore tax legislation. In view of the difference in tax treatment, the Singapore taxpayers would therefore be required to segregate the relevant expenses from the actual acquisition costs of the IP rights.

(iii) *Conditions to be met*

- ▶ Although the quantum of claims available to Singapore taxpayers under the PIC scheme is higher as highlighted above, a key point to note is that the relevant IP rights must be held by the Singapore taxpayers for at least one year from the date of acquisition or registration. Otherwise, the enhanced allowance granted previously will be deemed as income chargeable to tax in the year of disposal.
- ▶ Singapore provides for an automatic WDA claim of the IP rights so long as the Singapore taxpayer (i.e., the transferee) acquires the legal and economic ownership of the IP rights. Although the claim is automatically granted, a declaration must be submitted by the transferee to the Economic Development Board (EDB), which is the governmental body administering this scheme. For cases where legal ownership is not acquired, which is typical in the case of multinational companies based overseas that continue to retain the legal ownership of the IP rights, WDA may still be granted to the Singapore taxpayer subject to approval from the EDB upon application.

In addition to the declaration required to be made by the Singapore taxpayers, third party independent valuation reports on the value of the IP rights acquired are required to be submitted for related party transactions (where the capital expenditure incurred in acquiring the IP rights is equal to or greater than S\$500,000) and unrelated party transactions (where the capital expenditure incurred in acquiring the IP rights is equal to or greater than S\$2m).

These administrative procedures and documentation requirements can place an onerous responsibility on the Singapore taxpayers.

In comparison, to the extent that the specified IP right concerned is purchased for use in the trade or business in the production of profits chargeable to tax in Hong Kong, tax deduction will be granted for the capital costs incurred. The current provisions governing the tax deduction for the specified IP rights do not specify whether a declaration needs to be submitted to the relevant Hong Kong governmental bodies to substantiate the claim. Where there is no requirement for such declaration or documents to be submitted to the Hong Kong tax authorities, the process of making such tax deduction claims will likely be administratively easier to the Hong Kong taxpayers.

(iv) *Anti-avoidance provisions*

One of the various anti-avoidance provisions set forth in Hong Kong relates to tax deductions being denied for the purchase of a relevant IP right from an associate. This would preclude group restructurings from taking advantage of the tax deduction, given that the term "associate" is widely defined.

In Singapore's context, WDA may still be allowed in the transfer of IP between related parties, unless: (a) tax deduction was previously allowed to the related party on the expenses incurred in the creation of the IP and the proceeds arising from the sale or transfer are not subject to tax; or (b) if the related party acquired the IP previously from another related party referred to in (a). In such instances, WDA on IP rights would not be applicable to the transferee where the transfers are made between related parties. Overall, the transfer of IPs must be made on bona fide commercial grounds and must be sufficiently supported with documentary evidence.

## How they stack up

Apart from the tax allowances and deductions provided for IP rights as discussed above, both countries also provide for a slew of tax measures in the area of research and development activities to nurture innovation.

In addition, Singapore has an extensive network of tax treaties which provides for favourable tax treatment on royalty income received from the relevant foreign countries. It also provides a comprehensive range of grants to subsidise qualifying expenditure incurred on IP-related activities and tax incentives which provide for a concessionary tax rate on qualifying income and tax exemption on royalty payments made to non-residents.

In view of the above, it does appear that Singapore may still be ahead of Hong Kong in securing its position as the preferred location for the setting up of an IP holding company. However, Hong Kong is quickly catching up with Singapore, given its increased efforts to enter into tax treaties and proposing relevant tax schemes in the IP-related area.



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# Investing in Philippine infrastructure projects

“The Philippines has set the stage for a well-thought out infrastructure program that rectifies the mistakes of the past and provides assurance to investors that their contract with the Government will be respected.”

*Veronica Santos discusses the Philippines' initiatives to boost investment infrastructure projects*

In November 2010, the President of the Philippines launched his administration's Public Private Partnership (PPP) Program, the key to inducing private sector participation in infrastructure development. Not a few have pointed out that a PPP project appears to be a re-branded Build Operate Transfer (BOT) project. The reference is quite apt. The Philippine BOT law (Republic Act No. 6957 as amended), enacted in 1990, brought the Philippines “out of darkness” by enabling the commissioning of several power plants which ended the energy crisis the country was then experiencing. The President last November called his strategy “Daylight” and boldly announced a way forward that is “clear, honest, and transparent.” Almost one year later, the PPP strategy is more deliberate, funding is (almost) in place, and bidding for the projects is about to commence.

Infrastructure projects are implemented by a national government agency (NGA), such as the Department of Transportation and Communications (DOTC) and the Department of Public Works and Highways (DPWH), or a local government unit (LGU), or a government-owned and controlled corporation.

Of the 11 infrastructure projects announced for a 2011 roll-out, four are to be implemented by the DPWH, and seven by the DOTC. The most recent DOTC plan, however, is for its projects to be delivered the traditional way, i.e., with government funding sourced from Official Development Assistance (ODA) Loans, but with the operation and maintenance services to be bid out to a private contractor. The ODA Loans may have a maturity of up to 30 or 40 years and are subject to concessionary interest rates. The ODA Law (Republic Act No. 8182 as amended) mandates, among others, that the ODA Loan contain a grant element of at least 25% and that Government counterpart funds necessary to implement each ODA project, together with the proceeds of the loan, be included in the Annual Expenditure Program submitted to Congress. The Investment Coordination Committee of the National Economic and Development Authority (NEDA-ICC) sees to it that ODA is obtained for previously identified national priority projects which are urgent or necessary. The NEDA Secretariat conducts an annual review of the status of all projects financed by ODA; the 2010 review identified implementation issues



which may be common to Philippine infrastructure projects, i.e., cost overruns, delays in the issuance of budget authorisations, delays in the procurement of civil works and consulting services through public bidding, and problems in the acquisition of right-of-way (ROW) for the project, including the relocation site for families affected by the ROW acquisition.

A PPP arrangement is still indicated for other infrastructure projects. The DPWH is on schedule to bid out a concession agreement covering the financing and construction of a new four-kilometer, four-lane toll road (Daang Hari SLEX Link Road) and to invite comparative bids or proposals for a 13.4 kilometer four-lane elevated expressway which starts at Caloocan City and ends at Makati City (NLEX-SLEX Connector Road). The infrastructure projects of the Department of Education, the Department of Health, and the Department of Agriculture call for private sector innovation and efficiencies in the delivery of school buildings, the rehabilitation of hospitals, and the design and construction of a corn bulk handling and transshipment system, a cold chain system covering strategic areas in the country, a rice processing and facility service center, and logistics for the agri-fishery products supply chain.

The proposed amendments to the Implementing Rules and Regulations of the BOT Law (BOT-IRR) and the pending bills in Congress for the amendment of the BOT Law should be able to address the remaining issues on the legal and regulatory framework of PPP projects.

One issue is the government support or contribution to a PPP project. Such support or contribution may be extended only to solicited projects, i.e., those projects identified by an NGA or LGU and included in the list of priority projects of the Philippine Development Program, Public Investment Program or Comprehensive and Integrated Infrastructure Program published by the NEDA. Thus the NGA or LGU may bear a portion of the capital expenses associated with the establishment of the project, including the provision of access infrastructure or ROW and the LGU may waive or grant special rates of real property taxes due from the project proponent and waive charges or fees relative to business permits or licenses that are to be obtained for the construction of the project. The current BOT-IRR provides that the total government undertaking shall not exceed 50% of the project cost.

Another issue is the determination of the Filipino ownership of the project company. The Constitution provides that only Philippine citizens or corporations organised under the laws

of the Philippines at least 60% of the capital of which is owned by such citizens: (a) shall be granted a franchise to operate a public utility; (b) may be qualified to acquire title to private lands; and (c) may enter into co-production, joint venture, or production-sharing agreements with the State for the exploration, development and utilisation of natural resources. The Securities and Exchange Commission (SEC) has in the past opined that 60% of such Project Company may be held by another corporation which qualifies as a Philippine national, as defined in the Foreign Investments Act (Republic Act No. 7042 as amended). The SEC, however, has recently sought to apply a more stringent determination of compliance with the 60% Filipino ownership requirement. And in light of recent Supreme Court pronouncements, the pending bills should also clarify whether or not the term "capital" as basis for computing the 60% Filipino ownership refers only to shares of stock entitled to vote.

Infrastructure projects (whether or not pursuant to a PPP arrangement) and PPP projects are in the list of preferred activities of the 2011 Investment Priorities Plan. However, projects with sovereign guarantee (including a direct or indirect subsidy on prices of raw materials and supplies), or guaranteed rate of return (including guaranteed profit margins approved by the

regulatory boards or agencies), or with take or pay provisions, are not entitled to an income tax holiday (ITH). But if the sovereign guarantee is for risks other than commercial risks, then the project may still be granted an ITH. Such fiscal incentives may be able to encourage efficiencies (both in the delivery of the project and in its operations) in the long term without burdening the Government with contingent liabilities.

The Philippines has set the stage for a well-thought out infrastructure program that rectifies the mistakes of the past and provides assurance to investors that their contract with the Government will be respected. The bidding for the first projects should be able to showcase that the Government means business and is prepared to do business in a manner that is, as promised, "clear, honest, and transparent."



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In conversation with

# The big shake-up: deciphering India's new Direct Tax Code



"The thrust of the DTC is to improve the efficiency and equity of India's tax system by eliminating distortions in the tax structure, introducing moderate levels of taxation and expanding the tax base."

*Gagan Malik explains what India's new Direct Tax Code means for foreign businesses*

**India plans to introduce the new Direct Tax Code on from 1 April 2012. Can you tell us what it is all about.**

India's current tax legislation that was introduced in 1961 has been amended every year through Finance Acts. The tax administration, taxpayers and tax practitioners have raised concerns on the complex structure of the legislation. Besides, there have been frequent policy changes due to the changing economic environment, complexity in the market, increasing sophistication of commerce, development of information technology and attempts to minimise tax avoidance.

The problem has been further compounded by a multitude of often conflicting judgements rendered by courts at different levels. Any complex tax legislation increases the cost of compliance as well as administration which can not only be regressive in nature, but also undermine the equity and efficiency of the tax system.

In drafting the Direct Taxes Code (DTC) the Indian Government has to the extent possible started on a clean slate and adopted principles that have gained international acceptance. Tax policies that would promote growth with equity have been reflected in the DTC.

## **What does the Indian government hope to achieve with the implementation of the Direct Tax Code?**

The thrust of the DTC is to improve the efficiency and equity of India's tax system by eliminating distortions in the tax structure, introducing moderate levels of taxation and expanding the tax base. The attempt is to simplify the language to enable better comprehension and remove ambiguity and foster voluntary compliance. The new code is designed to provide stability in the tax regime as it is based on well accepted principles of taxation and international best practices.

**From a foreign investor's perspective, what is the most significant about the Direct Tax Code?**

I think that the most important development in the Direct Tax Code is the introduction of general anti-avoidance rules, also known as GAAR. Previously, there was no such concept in Indian tax law.

GAAR will provide the tax authority with a framework to tackle tax avoidance in India. The provisions are aimed at keeping aggressive tax planning in check and preventing treaty shopping among foreign companies. In a way, this is also an attempt at broadening the tax base.

The GAAR provisions cover both capital and business transactions. I would like to highlight an important point - that is, GAAR can override the provisions of Double Taxation Avoidance Agreements or tax treaties.



GAAR will disregard arrangements which are not carried out for legitimate business purposes. In other words, the tax authorities can invoke GAAR on businesses which lack commercial substance.

But the line between legitimate tax planning and tax avoidance has not yet been determined. I hope that when the specific guidelines for GAAR have been hammered out, these would be in line with international standards which would give comfort to foreign investors.

The introduction of GAAR means that foreign businesses and investors have to be very careful in the way they structure their businesses transactions. The onus is on taxpayers to prove that their transaction has substance, keeping it from being classified as avoidance.

### What do the changes to the concept of residency mean for foreign businesses?

Currently, a foreign company is considered a tax resident in India if control and management of the company is **wholly** situated in India.

The Direct Tax Code modifies this concept of residency by introducing the concept of place of effective management. A foreign company will be considered a resident of India, if its place of effective management is situated in India "at any time in the year", making it liable to income tax in India.

The place of effective management is where the board of directors or executive directors make their decisions.

If the board routinely approves commercial and strategic decisions made by executive directors or officers, the place of effective management is then where the executive directors or officers carry out their duties.

The shift in the concept of tax residency brings India in line with internationally accepted standards.

At the same time, such a wide concept means that foreign companies with operations or subsidiaries in India, now have to be very careful so as not to create an unintended or accidental residence there for a foreign group company.

## **An implication of the Direct Tax Code is that of “treaty override”. Please elaborate.**

Under the old tax rules, foreign companies have the option of choosing between treaty law or domestic tax law, whichever was more beneficial to them.

But in the earlier proposals for the Direct Tax Code, there would be neither preferential treatment for treaty law or domestic tax law. It was proposed that the law “later in time” would prevail. In other words, new laws supersede old laws.

This created concerns about “treaty override”. And very justifiably so, because it means that pacts between India and other countries would no longer be relevant as they would not be recognised under the Direct Tax Code.

Due to these concerns voiced by industry forums as well as tax consultants, a newer and better version has been created. Treaty override will be limited to three situations: where GAAR is invoked, where the Controlled Foreign Corporations or CFC rule is applied, or where branch profits tax is levied. Only under these scenarios would domestic tax laws prevail over tax treaties.

## **The Direct Tax Code introduces Advance Pricing Agreements or APAs for the first time. How would this benefit foreign companies?**

Transfer pricing is an extremely litigative area in India right now. So, APAs are beneficial for foreign companies because they can protect them from double taxation. The taxpayer and the tax authority agree on the criteria and assumptions for the determination of transfer prices and deciding the arm’s length price upfront for transactions between related parties.

The only problem, at present, is that the proposed APAs seem to envisage a unilateral or one-way between the taxpayer and the tax authority only. The level of certainty for a unilateral APA is lower than that offered by a bilateral or multilateral APA, which involves the tax authorities of other countries as well.

## **How can foreign companies prepare for the implementation of the Direct Tax Code?**

Well, many details of the new code have not yet been finalised, so this creates some uncertainty. But the consultative

process is a step in the right direction. We are hoping that the government will thrash out any issues that remain and will be able to come up with the detailed legislation soon.

For multinationals and foreign companies with a presence in India, it would be good, irrespective of this law, to examine the structure of the holding company and the way operations are funded to see whether defensible structures can be put in, including documentation, which will uphold commercial substance.

In the meantime, we just have to wait and watch. But the short term uncertainty is more than made up for by the long term certainty the code will provide - or this is what I sincerely hope for.



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**Having lots  
of dots on the map  
doesn't mean  
anything if they're  
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# A litmus test for anti-avoidance

“The AQQ case affirms that all tax planning and structuring should be conducted based on sound commercial justification or else it may come across to the Comptroller as being artificial or contrived.”

*Latha Mathew and Ow Yeong Khai Hon examine a tax case which sheds some light on how the Singapore tax authorities and the Courts may interpret and apply the anti-avoidance provisions under section 33 of the Singapore Income Tax Act*



In any tax planning and structuring of an arrangement, one should be mindful of the anti-avoidance provisions under section 33 of the Singapore Income Tax Act. These empower the Comptroller of Income Tax to disregard an arrangement or make adjustments under certain circumstances. This section does not apply to any arrangement that is carried out for bona fide commercial reasons and which does not have as one of its main purposes the avoidance or reduction of tax. However, other than foreign case law, there has been limited guidance on when a taxpayer might have “crossed the line” causing this provision to be invoked.

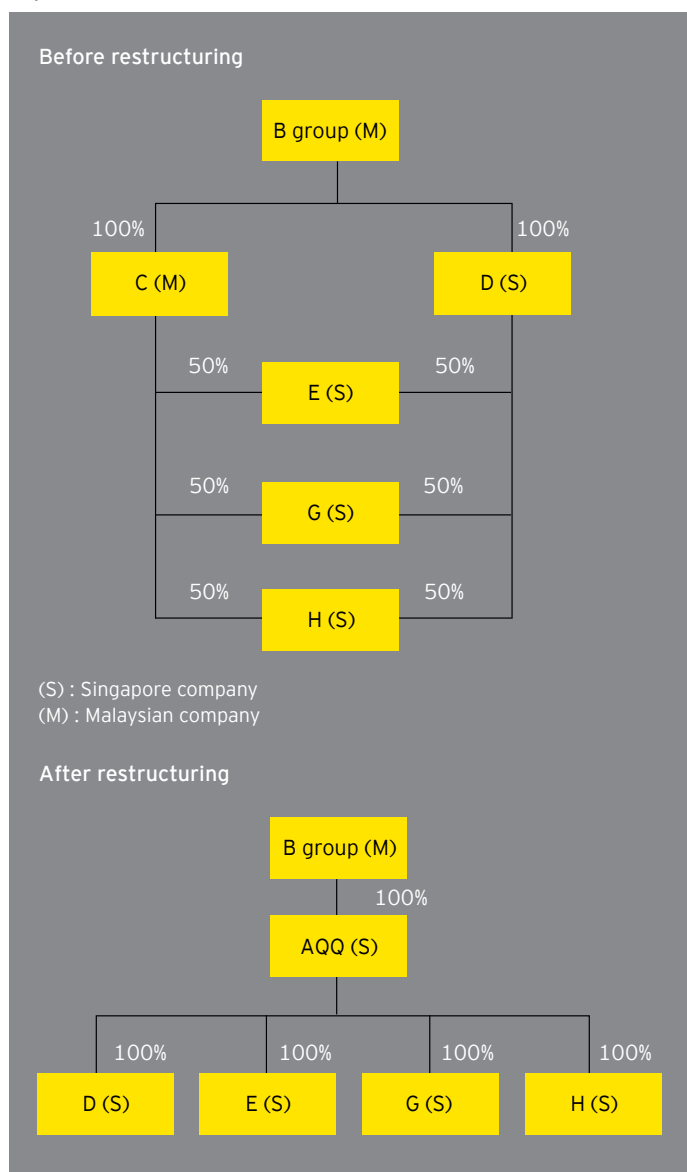
In this article, we examine a Singapore Income Tax Board of Review (BoR) case: *AQQ v Comptroller of Income Tax [2011] SGITBR 1* where the Comptroller invoked section 33 of the Act.

## Facts of the case

- ▶ The Appellant, AQQ, is a Singapore-incorporated company that is a wholly-owned subsidiary of B, which is public company listed on the Kuala Lumpur Stock Exchange.
- ▶ In May 2003, AQQ was incorporated to be the proposed immediate holding company of the Singapore subsidiaries of B. This was pursuant to an internal reorganisation to streamline the corporate structure of the entities in Singapore, to be in line with the operational structure in Malaysia.
- ▶ With the help of N, a bank in Singapore (the Bank) and an unrelated party to the Group, a financing structure was put in place to enable AQQ to fund the acquisition of the Singapore subsidiaries.
- ▶ In a discussion paper presented by the Bank, it was stated that the main objective of the proposed restructuring was to enable B to streamline its operations in Singapore by having a flatter corporate structure. In addition, AQQ’s 100% direct ownership of the shares of the Singapore subsidiaries would allow the Group to avail itself of the group relief provisions under the income tax legislation.

Refer to Figure 1 for the corporate structure before and after the restructuring.

**Figure 1**



#### *The financing arrangement*

- ▶ The financing structure involved AQQ issuing fixed rate convertible notes of 8.85% per annum to the Bank on 18 August 2003. AQQ used the proceeds of the Notes to acquire all the issued shares in the existing Singapore subsidiaries of the Malaysian parent company, B.
- ▶ On the same day, i.e., 18 August 2003, the Bank sold the principal component of the Notes at par (while the interest component of the Notes was structured as a forward sale agreement) to the Bank's Mauritius Branch. The latter then on-sold the same Notes to B's subsidiary, C, a Malaysian company which used to be one of the shareholders of the Singapore subsidiaries acquired by AQQ.
- ▶ The Bank entered into a Conditional Payment Obligation (CPO1) with its Mauritius Branch, under which the Bank promised to pay an amount equivalent to 8.845%, conditional upon the Bank receiving payments under the Interest Notes from AQQ. Similarly, the Mauritius Branch also entered into a Conditional Payment Obligation (CPO2) with C, and promised to pay an amount equivalent to 8.84%, conditional upon payments being made by the Bank under CPO1.

Essentially, the transactions were structured in such a manner which allowed C to pay the Mauritius Branch from its own funds and intercompany borrowings arising from proceeds from the sale of the Singapore subsidiaries to AQQ. The Mauritius Branch then in turn paid the Bank for the purchase of the Notes.

#### *The claims*

After the reorganisation, the Singapore subsidiaries paid dividends to AQQ for the year of assessments (YA) 2004 to 2007. These dividends carried tax credits under the full imputation system<sup>1</sup>.

For the YAs 2004 to 2007, AQQ paid interest on the Notes at 8.85% per annum and claimed interest deduction against the franked dividends received from its subsidiaries. As a result, a refund of the tax credit was made to AQQ.

<sup>1</sup>The full imputation system was replaced by the one-tier corporate tax system with effect from 1 January 2003. However, a five-year transitional period between 1 January 2003 and 31 December 2007 was provided for companies with unutilised tax credits. Under the imputation system, the tax paid by a Singapore resident company was not a final tax; it would be passed on to its shareholder by way of a tax credit attached to the dividends paid to the shareholders. Dividends carrying such a credit, known as franked dividends, were taxable in the hands of the shareholders but the tax credit could be set off against their tax payable.

Following further queries, the Comptroller invoked section 33 of the Act and disregarded the dividend income as well as the interest expenses incurred, as he was not satisfied that there were commercial justifications for the financing arrangement. Consequently, AQQ had to repay the tax refund.

AQQ appealed to the BoR contending that the Comptroller had wrongly applied section 33.

## The arguments

AQQ argued that:

- ▶ There was no reduction of tax as the receipt of the dividend income increased both the taxable income and the tax assessed.
- ▶ There was nothing objectionable in trying to obtain a tax refund as AQQ was doing no more than obtaining the clear consequences of receiving dividend income. The tax consequences are as intended by the Act and section 33 cannot be applicable. The payment of dividend was entirely a commercial decision and it could not be predicated that the purpose and effect of the transactions was the avoidance of tax.
- ▶ The financing arrangement and reorganisation of the corporate structure in Singapore were carried out for bona fide commercial reasons. All the transactions were genuine and real: lawyers were engaged to draw up the legal documents which created real and enforceable legal rights and

obligations; it indeed purchased the shares in the Singapore subsidiaries and incurred a liability to pay for them; loans were actually disbursed through bank accounts and dividends were actually paid.

The Comptroller:

- ▶ Did not dispute that the financing arrangement did occur and was supported by proper legal documentation, nor did he take any objection to the reorganisation of the corporate structure per se.
- ▶ Noted that there was never any borrowing outside the Group as AQQ's borrowing was in substance provided by C as it was C which ultimately purchased the Notes. All the transactions took place within the same day on 18 August 2003. The Bank was merely the facilitator of the financing arrangement and did not bear the credit risks of a lender as it had from the onset transferred both the Notes and the risks to C. The above features were described as artificial and contrived and together with other factors (such as AQQ being a S\$2 company, the bank accounts of parties to the financing arrangement were maintained by the Bank, the lack of valuation for the price of the shares in the subsidiaries and the absence of any credible or concrete business plans), showed that one of the main purposes of the financing arrangement was to reduce or avoid tax and to obtain cash refunds of the tax credits.

- ▶ Argued that section 33 (as well as sections 14, 44, 44A and 46) should not be read literally but should be interpreted purposively and in a manner which would promote the purpose or object of the provisions. Section 33 is meant to apply to artificial and contrived transactions. AQQ's circular scheme in which money was borrowed from the Bank and repaid within a day (except for S\$20 million) satisfied the requirement of artificiality and that the interposition of the Bank and its Mauritius Branch had no commercial basis.

## The BoR's decision

The BoR made reference to a High Court case, *UOL Development (Novena) Pte Ltd vs Commissioner of Stamp Duties* (the UOL Case) concerning anti-avoidance provisions under section 33A of the Stamp Duties Act, which is in all material aspects similar to section 33 of the Act. In the UOL case, the judge cited the speech made by the Minister for Finance during the second reading of the Stamp Duties Bill which introduced section 33A:

*"Tax avoidance schemes are purely tax-driven with little or no commercial value or rationale ..... In assessing whether a particular scheme or arrangement would fall under the ambit of section 33A of the Act, the Inland Revenue Authority would amongst other things look at the presence of artificiality or contrived transactions to reduce or avoid tax liabilities but which have little or no commercial basis."*

The BoR dismissed AQQ's appeal.  
The BoR:

- ▶ Found the financing arrangement to be structured in a contrived and artificial way to enable AQQ to obtain a tax refund through the utilisation of tax credits.
- ▶ Argued that the arrangement was not carried out for bona fide commercial reasons but had as one of its main purposes the avoidance or reduction of tax. It were not persuaded that there was any real commercial justification for the loan, other than as part of an arrangement entered into so as to obtain tax benefits. For a loan of this magnitude, they had expected AQQ to have produced more documentation showing discussions by its directors regarding the commercial considerations justifying taking of the loan. There was also no valuation for the shares of the subsidiaries that it acquired. Further there was a discussion paper of the Bank which indicated that the purpose of the financing arrangement as a whole and the loan in particular was to obtain or extract tax benefits. The bank was merely a facilitator and not really a lender as it did not bear any risk for the loan.
- ▶ Noted that there was no documentary of contemporaneous evidence of the group's intention for restructuring. Although the Banks' discussion paper stated that the main objective of the proposed restructuring of B's operations in Singapore was to create a "flatter" corporate structure, it does not go on to explain how this

objective could be met, in particular, with the financing arrangement. No commercial justification was provided as to why the transactions must occur on the same day or how the occurrence on the same day will advance the objectives or purposes of the reorganisation. It agreed with the Comptroller's view that AQQ could have simply borrowed internally from C without involving the Bank as an intermediary.

### Lessons learnt

The AQQ case affirms that all tax planning and structuring should be conducted based on sound commercial justification or else it may come across to the Comptroller as being artificial or contrived.

Documentation on how a structure is effected is important. However, merely involving legal and other professionals in executing the legal documents may only provide support that these documents are genuine contracts that are legally executed. These documents by themselves, will not provide the needed commercial rationale for the transactions. The objective of the restructuring and how it is supported by commercial motivation, including detailed elaboration on how the proposed arrangement purports to support the advancement of the commercial objective, would be more important.

It is also interesting to note that, in arriving at the decision, the BoR had

made references to a discussion paper and an internal document prepared by the Bank which may appear to have revealed the "real" intention for entering into the financing arrangement. An important lesson is that one should never carry out structuring for the main purpose of avoidance or reduction of tax. All tax planning should only be built upon sound commercial justification!

The AQQ case also considered the relationship between the anti avoidance provision (section 33) and the provision in the Act which allow reliefs, deductions, exemptions or concessions. Taking guidance from a New Zealand case, the Board's view was that although on a literal application of a specific provision, the tax payer is entitled to a relief in respect of an arrangement, that arrangement can nevertheless be regarded as having the purpose or effect of tax avoidance and therefore be disregarded by the tax authority.

The AQQ case is currently under appeal to the High Court. We shall see what the Court's judgement will be and whether it will provide more guidance on how section 33 is to be interpreted and applied.



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25 May 2011	GST: guide For visitors on tourist refund scheme (fourth edition)
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**Double Taxation Agreements (DTAs) signed or ratified from 1 January 2011 to 30 September 2011**

<b>DTAs signed</b>	
24 June 2011	Singapore - India (protocol)
14 June 2011	Singapore - Uzbekistan (protocol)
24 May 2011	Singapore - Italy (protocol)
13 April 2011	Singapore - Spain
24 February 2011	Singapore - Switzerland (revised)
3 February 2011	Singapore - Estonia (protocol)

<b>DTAs ratified</b>	
12 August 2011	Singapore - India (protocol)
19 July 2011	Singapore - Albania
26 May 2011	Singapore - Saudi Arabia
8 April 2011	Singapore - Ireland

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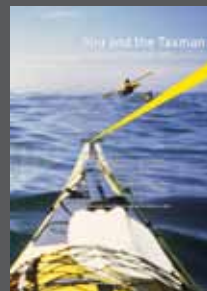
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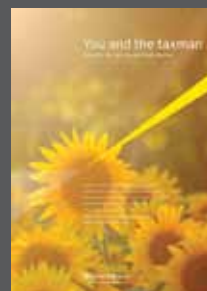
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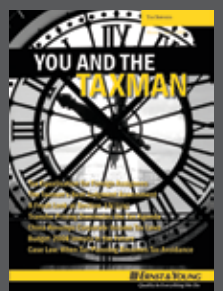
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