Answers

Note: ACCA does not require candidates to quote section numbers or other statutory or case references as part of their answers. Where such references are shown below, they are given for information purposes only.

1 Lavender Oil Pte Ltd

Tax Adviser
Firm's address

The Board of Directors
Lavender Oil Pte Ltd (LOPL)
Company address

5 December 2014

Dear Sirs

With reference to your request for advice on the tax implications of the proposed plan for the acquisition of Lavender Oil Limited (LOL) by Hector Oriental Holdings (HOH) and associated matters, we set out our comments below.

(i) Exchange of Peter Lim's shares in LOPL for shares in LOL

Stamp duty

Stamp duty is payable on the share transfer documents relating to the sale of the shares. Stamp duty is payable when:

– share transfer documents are executed in Singapore; or
– share transfer documents are executed outside Singapore, which relate to any property situated, or to any matter or thing done or to be done, in Singapore, and the documents are received in Singapore.

Stamp duty is charged based on either the consideration for the share transfer or the net asset value of the shares transferred, whichever is the higher. The stamp duty rate is $0·20 for every $100 or part thereof.

The stamp duty payable is to be paid to the Inland Revenue Authority of Singapore (IRAS) once the share transfer agreement is signed. If the share transfer is executed in Singapore, the stamp duty needs to be paid within 14 days after the date of the share transfer documents. If the share transfer agreement is signed overseas, the stamp duty needs to be paid within 30 days after the date of receipt of the documents in Singapore.

The party responsible for payment of the stamp duty is ordinarily the buyer, unless both parties agree otherwise. Hence, in the absence of a contrary agreement, LOL should be the party paying the stamp duty and not Peter Lim.

If the share transfer agreement is found to be not stamped, stamped late or insufficiently stamped during audit checks by the IRAS, a penalty of up to four times the duty may be imposed.

Goods and services tax (GST)

There are no GST implications as a transfer of shares is exempt from GST.

Income tax – Peter Lim

The exchange of shares of LOPL for shares in LOL is effectively a sale of an investment by Peter Lim. However, in practice, the IRAS will seldom tax individuals on gains arising from investments unless the individual is, by profession, a trader of investments.

If the IRAS were to regard Peter Lim as an experienced share trader, then it may regard the share exchange transaction as one of an income nature, and accordingly income tax would be payable on the gains from the disposal of his shares in LOPL to LOL.

When determining whether a transaction is of an income or capital nature, the IRAS looks at the following factors:

– subject matter of the realisation;
– profit motive;
– length of period of ownership;
– frequency or number of similar transactions;
– whether any supplementary work had been done to make the investment more marketable; and
– reason(s) for the realisation of investment.

All the above factors are taken into consideration collectively and, in general, none of them is in itself conclusive.

We understand that the investment in LOPL has been held by Peter Lim for a substantial period of time (more than ten years). The investment, being shares held in a private company, is restrictive and not easily realisable. Furthermore, the reason for the realisation of the investment is due to a reorganisation exercise for the purpose of an acquisition and Peter Lim's indirect interest in LOPL after the share-for-share exchange will remain the same.

Based on these facts, the disposal of Peter Lim's investment in LOPL shares is likely to be treated as a capital transaction. Consequently, he should not be taxed on the gains he receives from the exchange of his shares in LOPL for shares in LOL.

Income tax – LOPL

Tax incentive
We note that LOPL has been awarded the global trader programme incentive and all its qualifying income is taxed at a concessionary rate of 5%. LOPL needs to inform the relevant government agencies administering the incentive to ensure that the proposed transactions do not affect the company's incentive status.

Carry forward of unutilised trade losses and unutilised capital allowances (tax loss items)
The IRAS allows companies to carry forward tax loss items to set off against future years' taxable profits provided that the shareholders and the respective shareholdings of companies remain substantially (i.e. 50% or more) the same at the comparison dates. The dates being:

For unutilised trade losses:

– the last day of the year in which the loss was incurred (i.e. 31 December 2013); and
– the first day of the year of assessment in which the unutilised loss is to be utilised.

For unutilised capital allowances:

– the last day of the year of assessment in which the capital allowances arose (i.e. 31 December 2014); and
– the first day of the year of assessment in which the unutilised capital allowances are to be claimed.

In addition, the company must carry on the same business as that which gave rise to the unutilised capital allowances.

As the pre-transaction share exchange involves only 20% of the shares in LOPL, it will not result in a substantial change of shareholders. Hence, assuming LOPL's future assessable income is derived from the same business as that which gave rise to the unutilised capital allowances, both sets of loss items should be available for carry forward.

(ii) Sale of shares in LOL to HOH immediately after the exchange of shares in LOPL

Stamp duty
Both LOL and HOH are incorporated in Country X. Therefore, as the share transfer agreement between LOL and HOH does not relate to shares in Singapore companies and will be executed outside Singapore, the share transfer will not be subject to stamp duty in Singapore.

GST
As the share transfer agreement between LOL and HOH does not relate to shares in Singapore companies, it will be out of scope for GST purposes in Singapore

Income tax – Peter Lim
As the sale of shares in LOL to HOH is part of the reorganisation agreement, it is likely to be regarded as a capital transaction. Consequently, Peter Lim should not be subject to income tax on any gains from the sale of his shares in LOL.

Income tax – LOL
As the restructuring will be carried out in two phases, the initial phase of the acquisition for the first 50% of the share capital of LOL should not result in a substantial change in shareholders. Hence the carry forward of LOPL's unutilised trade losses and unutilised capital allowances should be preserved.

If in three years' time, when the second phase of the acquisition involving the remaining 50% of the share capital of LOL occurs, there are any remaining unutilised loss items after offsetting the intervening assessable income, then it will be necessary to carry out a further shareholding test, which may or may not be satisfied.

In the event of a substantial change in the shareholders and shareholdings of the ultimate holding company, any loss items will be disregarded for tax purposes [s.37(12)]. However, companies may apply for a ministerial waiver of the shareholders' continuity test provided that the purpose of the change in shareholdings is not for the purpose of deriving any tax benefit or obtaining any tax advantage [s.37(16)].

The IRAS has provided some guidance relating to the situations which will not be regarded as for the purpose of deriving a tax benefit or obtaining any tax advantage, one of which is where the change is carried out for genuine commercial reasons and was not tax motivated, for example, as part of a company rescue package. More information would be needed regarding the precise circumstances of the sale and the motivation of the parties for us to provide advice as to whether such a waiver is likely to be given in this case.

(iii) Goods and services tax (GST) on the secondment of staff by LOPL to Lavender Futures Pte Ltd (LFPL)

The recovery of staff costs is ordinarily treated as a provision of human resource services. Generally, the recovery of such expenses is subject to GST.

However, as a concession, the IRAS will allow companies not to charge GST if all of the following conditions are satisfied:

– no extra fees are charged to the company to which the employee is seconded;
– both companies are related;
– the assigned employee is working only for one company at any point in time;
– the company to which the employee is seconded has total control over the employee; and
– no input tax which relates to this transfer of manpower is claimed.

Based on the facts of the secondment of staff by LOPL to LFPL, the first three conditions are satisfied. Hence, provided the last two conditions are also satisfied, then LOPL was correct not to charge GST on the transaction.

We hope the above advice is helpful to you.

Should there be any questions or further advice you require, please contact me.

Yours sincerely

Tax Adviser

2 PH group

(a) Options available for the utilisation of Parental Holdings Pte Ltd's (PHPL's) current year tax loss items

PHPL has the following options or combination of options available for the utilisation of its unutilised loss items for the year of assessment (YA) 2014:

Group relief
Under group relief, current year loss items in respect of unutilised capital allowances (UCA); unutilised trade losses (UTL) and unutilised donations (UD) can be set off (in that order) in the same period against the assessable income of another group member.

In order to claim group relief, the companies forming the group must all be incorporated in Singapore and have the same year end. In addition, the transferor company (i.e. the loss company seeking to transfer losses) and the claimant company (the profitable company utilising the losses) must satisfy a minimum 75% ordinary shareholding level, which must be maintained during the continuous period ending on the last day of the basis period of the YA for which the losses were incurred/are claimed. All these conditions are satisfied in the case of the three PH group companies.

In addition, both the transferor and claimant companies must make a written election at the time they lodge their income tax returns.

As both Subsea One Pte Ltd (SOPL) and Subsea Two Pte Ltd (STPL) have assessable income, the entire $300,000 of loss items can potentially be transferred to SOPL and/or STPL. PHPL will need to rank these two companies in order of claim.

If group relief is claimed, then STPL should be the claimant company as it has sufficient assessable income in YA 2014 ($600,000) to offset the entire $300,000 of loss items, while still enabling STPL to claim the maximum partial tax exemption of $152,500 and the 30% corporate income tax rebate. The effective tax saving would therefore be $35,700 ($300,000 x 17% x 70%).

By contrast, as SOPL's assessable income in the YA 2014 is only $150,000, the tax saving which would be achieved by a claim for group relief by SOPL for this amount would be only $8,628 [($150,000 – $7,500 – $70,000) x 17% x 70%]. Even if a further group relief claim were made to set off the remaining $150,000 of loss items against STPL's assessable income, resulting in a tax saving of $17,850 ($150,000 x 17% x 70%), the total tax saving achieved would only be $26,478 ($8,628 + $17,850).

Tutorial note:

	STPL – no group relief	*STPL – $300,000 group relief (note 1)*	*STPL – $150,000 group relief (note 2)*	*SOPL – no group relief*
	$	*$*	*$*	*$*
Chargeable income (CI) before partial tax exemption	*600,000*	*300,000*	*450,000*	*150,000*
Less: *partial tax exemption*				
– *75% of first $10,000 of CI*	*(7,500)*	*(7,500)*	*(7,500)*	*(7,500)*
– *50% on the next $290,000 of CI*	*(145,000)*	*(145,000)*	*(145,000)*	*(70,000)*
CI after partial tax exemption	*447,500*	*147,500*	*297,500*	*72,500*
Tax at 17%	*76,075*	*25,075*	*50,575*	*12,325*
Less: *30% corporate income tax rebate*	*(22,822)*	*(7,522)*	*(15,172)*	*(3,697)*
Net tax payable	*53,253*	*17,553*	*35,403*	*8,628*

Note 1: Reducing CI from $600,000 to $300,000 results in tax saving of $35,700 (i.e. $53,253 less $17,553). As shown in the answer, using an incremental analysis, this same amount is arrived at by multiplying $300,000 by 17% x 70%.

Note 2: Reducing CI from $600,000 to $450,000 results in tax saving of $17,850 (i.e. $53,253 less $35,403). As shown in the answer, using an incremental analysis, this same amount is arrived at by multiplying $150,000 by 17% x 70%.

Carry back to the previous year of assessment
UCA and UTL (in that order) but not UD may be carried back to the immediately preceding year of assessment, i.e. YA 2013, of PHPL and set off against the assessable income of that year. The maximum amount of loss items which can be carried back is $100,000.

For UCA, both the shareholding test and the business continuity test must be satisfied. For UTL, only the shareholding test needs to be satisfied. Relief by carry back is given after any claim for group relief has been given effect and again, a written election is required at the time the company lodges its income tax return.

Based on its assessable income for YA 2013 of $900,000, PHPL can potentially carry back the maximum $100,000 of UCA/UTL, resulting in an effective tax saving of $17,000 ($100,000 x 17%). However, if carry back is the only loss relief claim made, a balance of $200,000 of loss items will have to be carried forward to YA 2015 (UCA $50,000 + UTL $100,000 + UD $50,000). Not only will relief for these loss items be delayed, but in the future relief at the full tax rate of 17% will only be obtained if PHPL's assessable profits in YA 2015 exceed the amount at which the maximum 30% corporate income tax rebate of $30,000 can be claimed by at least $200,000. PHPL will therefore need to have YA 2015 assessable profits of at least $940,735 ($200,000 + $740,735), as the chargeable income at which the maximum corporate income tax rebate of $30,000 is claimable is $740,735, calculated as follows:

	$
Chargeable income (CI) before partial tax exemption	740,735
Less: partial tax exemption	
– 75% of first $10,000 of CI	(7,500)
– 50% on the next $290,000 of CI	(145,000)
CI after partial tax exemption	588,235
Tax at 17%	100,000
Less: 30% corporate income tax rebate	(30,000)
Net tax payable	70,000

The amount of the loss to be carried forward can be reduced to $50,000 (the UD) if PHPL were to make a claim for group relief in respect of the $150,000 UCA. However, as a group relief claim must be made for the lesser of the amount of available loss items in the transferor company or the available income of the claimant company, the group relief claim would have to be made in SOPL (not in STPL). As determined above, this would result in a tax saving from group relief in SOPL of $8,628 and a total tax saving of $26,478 ($8,628+ $17,850). Similarly, the relief for $50,000 (the UD) will be delayed and in the future relief at the full tax rate of 17% will only be obtained if PHPL's assessable profits in YA 2015 are at least $790,735 ($50,000 + $740,735).

Carry forward to future years of assessment

Any of the residual loss items (UCA, UTL and UD) after applying group relief and/or carry back can be carried forward to set off against PHPL's future assessable income, i.e. for YA 2015 onwards. The loss must be deducted against the first available income on a FIFO basis and the offset is automatic (i.e. no election is required).

In the case of all three loss items, the shareholding test must be satisfied. In addition, to carry forward UCAs, the business continuity test must be satisfied.

If no election is made for either group relief or carry back, then the entirety of the $300,000 current year loss items will be carried forward until they can be offset against the first available assessable income in PHPL. This is unlikely to be tax efficient as not only will relief be delayed but PHPL will need to generate substantial profits of at least $1,040,735 ($300,000 + $740,735) in its first profit making year for relief to be obtained at an effective tax rate of 17%.

Recommendation

The most beneficial course of action, i.e. the one which gives the maximum certainty of obtaining relief at the highest possible effective tax rate of 17%, is for PHPL to use group relief to transfer all of the current year loss items, totalling $300,000, to STPL.

(b) (i) Tax implications for Subsea One Pte Ltd (SOPL) of the disposal of the assets in 2013

The disposal of the office equipment will have resulted in a balancing charge of $4,000 (i.e. sales proceeds of $24,000 less tax written down value of $20,000) which will have increased SOPL's chargeable income by the same amount. As SOPL's assessable income for YA 2014 including the balancing charge is more than $10,000 but not exceeding $300,000, the tax payable as a result of the disposal will be $238 (i.e. $4,000 x 50% x 17% x 70%). The net book value of the office equipment will be acceptable as the disposal proceeds as it is close to the open market value.

The sales of the computer notebooks will not result in any balancing adjustments as SOPL opted for productivity and innovation credit (PIC) cash payouts in respect of these assets.

However, the sale of the two HP computer notebooks which were purchased in October 2012 breached the minimum required holding period of one year, so the PIC cash payout of $3,600 on these items will have been recovered by the IRAS. The PIC cash payout of $3,000 for the two Fujitsu computer notebooks will not have been recovered by the IRAS as the minimum holding period of one year has been met.

(ii) Effect of electing to transfer or sell the assets at their tax written down value [s.24]

An election to transfer assets at their tax written down value (TWDV) is only possible between related entities. Hence, only the office equipment transferred from SOPL to STPL can potentially be considered for such an election. The computer notebooks were sold to unrelated parties, so are not eligible. Further, even if they had been sold to related parties, an election would still not have been applicable because PIC cash payouts have been opted.

If SOPL and STPL were to make an election for the office equipment, there would be no balancing adjustment and the buyer, STPL, will merely take over the tax written down value of $20,000 from SOPL and claim capital allowances on it, equally, over the next two years of assessment, i.e. YA 2015 and YA 2016. The election is possible as both companies are under the common control of the same parent company, i.e. PHPL.

The immediate tax saving which would be derived by SOPL from the election is the tax payable if the balancing charge of $4,000 were applicable, i.e. $238 (as calculated in (i) above). However, STPL will suffer an increased tax charge as a result of the election as it will now have a reduced capital allowance base of $20,000, compared to the amount of $24,000 without the election. As STPL's annual income is higher than that of SOPL, the additional tax payable by STPL in YA 2015 and YA 2016, due to the reduced capital allowance base of $4,000, is likely to be more than the $238 tax saving in SOPL. Hence, it is unlikely to be beneficial for the PH group to make an election to transfer the office equipment at TWDV.

3 (a) Eve

Tax relief is available to a Singapore citizen or Singapore permanent resident taxpayer who makes a cash top-up to their Central Provident Fund (CPF) in their Special Account (SA) [for a recipient below age 55] or Retirement Account (RA) [for a recipient age 55 and above] under the CPF Minimum Sum (MS) Topping-Up Scheme. Relief is also available to a taxpayer if their employer makes a contribution to their CPF SA or RA. The amount of relief available is the lower of the amount of the cash top up and $7,000.

In addition, the taxpayer is also entitled to claim an additional $7,000 of cash top-up relief if cash top-ups have been made to the CPF SA or RA of the taxpayer's parents/parents-in-law, grandparents/grandparents-in-law, spouse and siblings. To qualify for this additional tax relief for cash top-ups to spouse or siblings, the spouse or siblings must not have an annual income exceeding $4,000 in the year preceding the year of the top-up. For this purpose, income includes salary or tax exempt income such as bank interest, dividends, rental income, directorship income and pensions. This income threshold does not apply to parents/parents-in-law, grandparents/grandparents-in-law, handicapped spouse or handicapped siblings of the taxpayer.

Therefore, in aggregate, a taxpayer can claim a maximum total relief of $14,000 yearly if the maximum cash top-ups are made to eligible relatives; or the taxpayer's own SA or RA. The maximum tax saving per year is thus $2,800 if the taxpayer is in the highest tax bracket of 20%.

Though this incentive is attractive, the following points should be noted:

- Top-ups through the transfer of funds from a taxpayer's own CPF account to a dependant's SA or RA do not qualify for tax relief.
- There is a limit to the amount which a recipient can receive under the CPF MS Topping-Up Scheme. For recipients who are 55 years old and above, the limit is the difference between the current MS ($148,000 since 1 July 2013) and the balance in their RA, excluding amounts such as interest earned since the taxpayer was 55 years old, and any government grants received and amounts withdrawn. Hence, if this amount has already been reached, there is no scope for tax relief. For recipients below 55 years old, the limit is the difference between the current MS and the balance in the SA and any amounts withdrawn from the SA under the CPF Investment Scheme (CPFIS-SA).
- Passing money to her children to top up her CPF account may not be possible if Eve has already reached her MS. Even if Eve has not contributed up to the MS level, her children can only save tax if they have significant chargeable income. This may not be the case if the children have just commenced employment.

(b) Adam

With chargeable income in excess of $400,000, Adam's highest marginal tax rate is 20% which means any additional income will be taxed at 20%.

The interest income derived from both the structured deposit and the qualifying debt securities are both exempt from tax. Hence, the respective net returns after tax remain at 3% and 4%.

The interest income derived from the pawnshop and the Singapore company are both taxable, so their respective net returns after tax will be 2·8% (i.e. 80% of 3·5%) and 3·6% (i.e. 80% of 4·5%).

Therefore, with regard to these four options, the qualifying debt securities yield the best return.

As for Option 5, although the interest earned from a deposit in a Supplementary Retirement Scheme (SRS) account is not taxable, 100% of any withdrawals when Adam leaves Singapore will be fully taxable. Also, while every $1 of contributions to his SRS account entitles a foreigner to claim $1 of relief, this is subject to a cap of $29,750 per year. This annual limit, when compared to the large principal amount of $5 million Adam has available, is likely to make this option less attractive than any of the first four options.

(c) Not ordinarily resident (NOR) scheme

A foreigner can qualify for the NOR Scheme from any year of assessment (YA) in which the individual meets the following criteria:

– tax resident for that YA; and
– non-resident for the three consecutive YAs immediately before that YA.

Upon successful application, the NOR status will be granted for a period of five consecutive YAs, starting from the YA in which the applicant first meets the criteria.

A NOR taxpayer can elect, irrevocably, to enjoy one or more of the following tax concessions during the NOR period provided he is a tax resident of Singapore in the relevant YA:

1. **Time apportionment of Singapore employment income**
Under this concession, a NOR taxpayer will not be taxed on that portion of their Singapore employment income which corresponds to the number of days spent outside Singapore for business reasons. To enjoy the above concession, the NOR taxpayer must have spent at least 90 days outside Singapore for business reasons and their total Singapore employment income must be at least $160,000. However, if the tax on the apportioned income is less than 10% of their total Singapore employment income, the individual will still be subject to a tax of 10% of their total Singapore employment income.

2. **Tax exemption of employer's contributions to non-mandatory overseas pension fund or social security schemes**
Under this concession, a NOR tax resident with Singapore employment income of at least $160,000 for that particular YA will be able to enjoy tax exemption (subject to a cap) on the contributions made by their employer to any non-mandatory overseas contribution scheme. This is provided the employer (if their remuneration is borne by a Singapore company) only claims tax deduction on contributions made to non-mandatory overseas pension or provident funds and social security schemes in excess of the NOR cap.

4 (a) Boston Appliances Limited (BAL)

Generally, an entity incorporated and conducting its business outside Singapore should not be taxed in Singapore on its trading profits. This is unless the entity is regarded as having a permanent establishment (PE) in Singapore by virtue of its activities, when taxable profits directly attributable to the PE will be taxable. If this is the case, the entity has to write to the IRAS and declare its taxable income for each year.

A PE may arise through a direct presence, such as the incorporation or registration of a physical presence, or through an indirect presence, such as the presence of an agent, employees or other personnel carrying out business activities in Singapore, unless the activities are limited to those of a preparatory or auxiliary nature. The indirect presence could amount to the carrying on of a business in Singapore and so create a taxable presence therein.

The general definition of a PE is contained in the Singapore Income Tax Act (SITA) [s.2]. Also, depending on the country of tax residence of the recipient, a comprehensive tax treaty concluded between Singapore and the country concerned may provide for a more specific definition of a PE, in which case if the tax treaty provisions offer a more tax-favourable position to the recipient, the tax treaty will take precedence over the domestic law. However, in the case of Country Z, Singapore has not concluded any comprehensive tax treaty and, hence, guidance can only be found in the SITA.

Under the SITA, a PE means a fixed place where a business is wholly or partly carried on including amongst others a warehouse. Notwithstanding that a warehouse constitutes a fixed place of business, the IRAS has clarified that the mere storage of goods in a warehouse by a person without carrying on any business in Singapore will not give rise to a PE in Singapore.

A person will also be deemed to have a PE in Singapore if that person:

– carries on supervisory activities in connection with a building or work site or a construction, installation or assembly project; or

– has another person acting on that person's behalf in Singapore who:

  – has and habitually exercises an authority to conclude contracts;

  – maintains a stock of goods or merchandise for the purpose of delivery on behalf of that person; or

  – habitually secures orders wholly or almost wholly for that person or for such other enterprises which are controlled by that person.

Based on the information provided, the sales generation activity for BAL is undertaken entirely by the sales team of BAL in Country Z, i.e. outside Singapore. Also, all of BAL's physical business operations and administrative support services are carried on outside Singapore. Hence, on the premise that the business operations of BAL are not carried out in Singapore, none of the income derived from these sales activities should be considered as giving rise to a PE or a taxable source in Singapore and, as such, will not be liable to Singapore tax.

The use by BAL of 3PL should also not create a PE, given the independent manner in which 3PL operates. The inventories are merely stored with 3PL to be closer to BAL's customer. So long as 3PL's warehouse is used primarily for storage and no trading of the inventories is conducted from this warehouse, the risk of BAL creating a PE and consequently a taxable source

in Singapore, whether directly or indirectly, through the use of 3PL to store its inventories nearer to its Singapore customer, is low.

The possible PE risks lie in the frequency with which inventories are drawn down from the 3PL warehouse and the visits to Singapore by the personnel from BAL. The PE risks will increase correspondingly to the frequency with which the inventories are drawn down to facilitate trading, and the personnel from BAL carry out substantial sales-related activities during their trips to Singapore. Hence, to eliminate or substantially reduce such PE risks, BAL should: (1) limit the frequency with which inventories are drawn down from the warehouse storing the inventories; and (2) ensure that the personnel from BAL do not carry out any sales-related activities, e.g. concluding contracts or securing orders, during their trips to Singapore.

(b) Tax considerations of setting up a Singapore subsidiary as opposed to a Singapore branch

There are several factors which Westgate Trading Limited (WTL) needs to consider in setting up either a Singapore subsidiary or a Singapore branch. There are a few similarities with a subsidiary and a branch, such as:

– Both are taxed at the prevailing corporate tax rate of 17%.
– Both are eligible for the partial tax exemption on up to the first $300,000 of chargeable income.
– Both are eligible for the 30% corporate income tax rebate for the years of assessment 2013 to 2015.
– Foreign income derived by both is taxed when remitted to Singapore.

However, there are many differences between a subsidiary and a branch which would also need to be considered, such as:

– A branch is normally regarded as a non-resident entity, whereas a subsidiary can be regarded as a resident in Singapore if it conducts its board meetings in Singapore.

– A branch is not able to enjoy the benefits and privileges available under any comprehensive tax treaties concluded by Singapore, whereas a subsidiary can, if it is regarded as a resident of Singapore.

– A branch is not able to qualify for the foreign-sourced income exemption as it is not normally regarded as a resident of Singapore, whereas a subsidiary may qualify.

– A branch is not able to claim unilateral tax credit as it is not normally regarded as a resident of Singapore, whereas a subsidiary may be able to claim unilateral relief.

– A branch cannot qualify for the start-up tax exemption as it is not normally regarded as a resident of Singapore, whereas a subsidiary may qualify.

– Being a non-resident, certain income received by a branch from Singapore entities may be subject to Singapore withholding tax. As a Singapore tax resident, Singapore withholding tax is not required to be withheld when a subsidiary receives payment from other Singapore entities.

5 (a) Alabaster Trading Pte Ltd (ATPL)

Singapore adopts a modified territorial system of taxation meaning that only Singapore-sourced income of a revenue nature and foreign-sourced income of a revenue nature which is received or deemed received in Singapore is taxable in Singapore.

Under the foreign-sourced income exemption (FSIE) scheme [s.13(8)], Singapore resident taxpayers receiving foreign-sourced dividends, foreign-sourced branch profits or foreign-sourced service income will be granted tax exemption on the above specified foreign income received if they meet the following qualifying conditions:

– the income has been subject to tax under the law of the territory from which the income is received;

– at the time the income is received in Singapore, the headline tax rate in the country from which the income is received is not less than 15%; and

– the Singapore tax authority is satisfied that the tax exemption would be beneficial to the resident taxpayer in receipt of the income.

In the case of service income (which refers to professional, technical, consultancy or other services provided by a person in the course of their trade, profession or business), such income would be considered foreign-sourced only if the services are provided through a fixed place of operation in a foreign country. If the services are not provided through a fixed place of operation in a foreign country, the service income will be considered Singapore-sourced even though:

– the income is derived from services rendered outside Singapore; and
– tax is payable in the foreign country in accordance with the provisions of a comprehensive tax treaty with that foreign country.

According to the further guidance provided by the IRAS, a 'fixed place of operation' refers to a place of management, an office, or a certain amount of floor space at the disposal of a person carrying on a trade, business or profession of rendering services through which they or their employees perform the activities which produce the profits of their trade, business or profession in the rendering of services. Such a place must also have features of permanence, i.e. it is not of a temporary nature, but should be at the disposal of the person on an ongoing basis and be used regularly by the person to carry on their trade, business or profession of rendering services. For example, a place of operation where only activities which are auxiliary or preparatory in character are performed will not qualify as a fixed place of operation.

Also the mere presence of a person in a particular location does not necessarily mean that the premises or facility is at the disposal of the person. For example, regular visits by a person to a major customer to render audit services at the premises of the major customer does not cause the major customer's premises to constitute premises at the person's disposal for the purpose of his profession and the major customer's premises in such a case will not constitute a fixed place of operation of that person. Whether the premise or facility which is at the person's disposal has features of permanence is a question of fact.

Based on the information provided, ATPL only has a representative office in Country W. On the premise that the only activities which are carried out in this representative office are auxiliary or preparatory in character, then the representative office is unlikely to meet the 'fixed place of operation' test and, accordingly, the foreign service income is unlikely to qualify for exemption under the FSIE scheme.

(b) Tax considerations arising from international debt financing and equity financing

When deciding on the alternative sources of financing, Telepathy Singapore Pte Ltd cannot ignore the tax effects of the alternative sources of funding, as any taxes will directly affect the overall cost of funding. The objective in planning a financing structure would normally be to ensure that the company incurs the minimum cost of funding after any applicable taxes, which is why debt financing is usually preferred to equity financing, as interest is ordinarily tax-deductible.

Interest incurred on debt financing is deductible for tax purposes if it is incurred on capital employed in acquiring taxable income, i.e. whether the money borrowed is used to purchase business assets or meet outgoings incurred in carrying on the business. Deduction is also extended to other qualifying borrowing costs where such costs are incurred to substitute for or reduce an interest expense, e.g. a discount on the issue of a bond or loan note. Should a loan be taken to finance a non-income producing activity, then the interest incurred will not be deductible. Although there are no thin capitalisation rules in Singapore, the tax authority may seek to disallow a portion of the interest which is attributable to non-income producing assets.

Where interest is paid to a non-resident of Singapore, then the impact of withholding tax needs to be considered. The domestic withholding tax rate is 15%, but this rate may be reduced if the recipient of the interest is tax resident in another country which has concluded a comprehensive tax treaty with Singapore. Although withholding tax is ordinarily borne by the recipient of the interest income, the payer may be concerned if the loan is obtained from a related company, which may be the case with an international group. Also, if tax is not withheld or not withheld at the correct rate, the paying company will become personally liable for the amount it failed to deduct and may also incur penalties for late payment.

Repayment of the loan does not give rise to any tax consequences, even in the case of a cross-border loan denominated in a foreign currency, as foreign exchange gains/losses are only taxable/deductible if they are on revenue account.

In the case of equity financing, dividends paid are not tax deductible and there is no withholding tax applicable when the Singapore company pays dividends to its shareholders, even if those shareholders are non-residents. However, any changes in a company's share capital may expose the buyer to a stamp duty, based on 0·2% of the consideration or the market value of the shares, whichever is higher.

Professional Level – Options Module, Paper P6 (SGP)
Advanced Taxation (Singapore)

December 2014 Marking Scheme

		Available	*Maximum*
1	**Lavender Oil Pte Ltd (LOPL)**		
(i)	**Tax implications of the exchange of Peter Lim's shares in LOPL**		
	Stamp duty:		
	Documents on which payable	1·5	
	Duty payable and time of payment	2·5	
	LOL responsible for payment	1·0	
	Penalty regime	1·0	
	GST implications	1·0	
	Income tax – Peter Lim:		
	Exchange of shares constitutes a sale	1·0	
	Gains taxable only if the individual selling the shares is a share trader	1·0	
	Factors to be taken into consideration	2·0	
	Correct application and conclusion	2·0	
	Income tax – LOPL:		
	Need to notify the government authorities administering the tax incentive	1·0	
	Identification of the substantial shareholding test and its relevance	1·0	
	Relevant dates for the carry forward of unutilised tax losses/capital allowances	2·0	
	Identification of the same trade test for unutilised capital allowances	1·0	
	Conclusion that the shareholding test is passed	1·0	
		19·0	17·0
(ii)	**Tax implications of the sale of shares in LOL to HOH**		
	Stamp duty implications	1·0	
	GST implications	1·0	
	Income tax – Peter Lim	2·0	
	Income tax – LOL		
	Substantial shareholding test applied to each phase separately	1·0	
	Phase 2 may not qualify and consequences	2·0	
	Ministerial waiver option	2·0	
	Comment regarding likely applicability in this case	1·0	
		10·0	8·0
(iii)	**GST on secondment of staff by LOPL to LFPL**		
	Recovery of staff cost ordinarily subject to GST	1·0	
	Conditions for GST not to apply	4·0	
	Correct application and conclusion	2·0	
		7·0	6·0
	Appropriate format and presentation of the letter	1·0	
	Structure including relevant headings	1·0	
	Effectiveness of communication	1·0	
	Logical flow	1·0	
			4·0
			35·0

		Available	Maximum
2	PH group		
(a)	**Options for the utilisation of PHPL's current year tax loss items**		
	Group relief:		
	Relevant loss items and order of offset	1·0	
	Conditions including election requirements	3·0	
	Application	4·0	
	Carry back:		
	Relevant loss items	1·0	
	Conditions/restrictions	2·0	
	Application	4·0	
	Carry forward:		
	Conditions	2·0	
	Application	1·0	
	Recommendation	1·0	
		19·0	15·0
(b)	**Disposal of assets by SOPL**		
(i)	Tax implications of disposal of office equipment	2·5	
	Tax implications of disposals of computer notebooks	3·0	
		5·5	5·0
(ii)	Election possible only for sale of office equipment	1·0	
	Implications of election	2·0	
	Correct analysis and logical conclusion	2·5	
		5·5	5·0
			25·0

		Available	Maximum
3 (a)	**Eve**		
	Relief for top-ups to taxpayer's account, including by employer	1·0	
	Relief for top-up of eligible relatives' accounts also	1·0	
	Income ceiling for top-ups to non-handicapped spouse and siblings	2·0	
	Cap of $7,000 for self and another $7,000 for eligible relatives per year	1·0	
	Maximum savings $2,800 per year	1·0	
	Only cash top-ups qualify for relief not transfers	1·0	
	Limits on the amounts which recipients can receive	2·5	
	Correct conclusion on availability of tax breaks for money passed to children to top up	2·0	
		11·5	10·0
(b)	**Adam**		
	Additional investment income taxed at 20%	1·0	
	Interest from a structured deposit and qualifying debt securities exempt from tax	1·0	
	Interest from pawnshop and a Singapore company is taxable	1·0	
	Calculation of after tax returns and identification of best option	1·0	
	Tax implications of SRS contributions/withdrawals	2·0	
			6·0
(c)	**NOR scheme**		
	Criteria to qualify for the scheme	2·0	
	Tax concessions under the scheme	3·0	
		5·0	4·0
			20·0

			Available	*Maximum*
4	**(a)**	**Boston Appliances Limited (BAL)**		
		Taxable profits only arise if there is a PE	1·0	
		Different ways of creating a permanent establishment	2·0	
		No tax treaty in this case so only SITA definitions relevant	1·0	
		Guidance provided by SITA	3·0	
		Application to BAL:		
		Business operations/sales activities	2·0	
		Use of 3PL for storage of goods	2·0	
		Possible PE risks and ways to mitigate such risks	2·0	
			13·0	12·0
	(b)	**Tax considerations of Singapore subsidiary vis-à-vis a Singapore branch**		
		Similarities	3·0	
		Differences	6·0	
			9·0	8·0
				20·0
5	**(a)**	**Alabaster Trading Pte Ltd (ATPL)**		
		Basis of taxation of foreign income	1·0	
		Types of income qualifying for FSIE	1·0	
		Conditions to be satisfied	3·0	
		Special rules for service income, including the 'fixed place of operation' test	5·0	
		Logical conclusion on availability of exemption	2·0	
			12·0	10·0
	(b)	**Tax implications of debt financing v equity financing**		
		Any taxes will impact on the cost of financing	1·0	
		Debt financing:		
		Deductibility of interest, etc	3·0	
		Withholding taxes	3·0	
		Repayment, including forex position	1·5	
		Equity financing	2·5	
			11·0	10·0
				20·0