Professional Level – Options Module

Advanced Taxation (Singapore)

Monday 1 June 2009

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–3

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

Paper P6 (SGP)

The Association of Chartered Certified Accountants

The Institute of Certified Public Accountants of Singapore

ACCA

Institute of Certified Public Accountants of Singapore

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below for the year of assessment 2009 will continue to apply for the foreseeable future.
2. Calculations and workings need only be made to the nearest $.
3. All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates and allowances are to be used in answering the questions.

For the years of assessment 2008 and 2009

Partial corporate tax regime	
First $10,000 of chargeable income is 75% exempt	$7,500
Next $290,000 of chargeable income is 50% exempt	$145,000
	$152,500
Full tax exemption for new start-up companies	
First $100,000 of chargeable income is 100% exempt	$100,000
Next $200,000 of chargeable income is 50% exempt	$100,000
	$200,000

Corporate income tax

For the years of assessment 2008 and 2009	18%

Voluntary Central Provident Fund (CPF) contributions of self employed
Years of assessment 2008 and 2009
Capped at $26,393 or 34·5% of s10(1)(a) assessable income, whichever is lower

Central Provident Fund (CPF) contributions for individuals below the age of 50 years and earning more than $1,500 per month

	Employee	Employer
	Rates of CPF contributions	
Up to 30 June 2007	20·0%	13·0%
From 1 July 2007	20·0%	14·5%
Maximum annual ordinary wages (OW) attracting CPF	$54,000	
Maximum annual additional wages (AW) attracting CPF	$76,500 less OW subject to CPF	

Personal income tax rates for resident individuals for the years of assessment 2008 and 2009

	Chargeable income	Tax rate	Tax
	$	%	$
On the first	20,000	0	0
On the next	10,000	3·5	350
On the first	30,000		350
On the next	10,000	5·5	550
On the first	40,000		900
On the next	40,000	8·5	3,400
On the first	80,000		4,300
On the next	80,000	14·0	11,200
On the first	160,000		15,500
On the next	160,000	17·0	27,200
On the first	320,000		42,700
Above	320,000	20·0	

Resident individuals are entitled to an income tax rebate of 20%, capped at $2,000 for the years of assessment 2008 and 2009.

Personal income tax reliefs for the year of assessment 2009

Earned income	Normal (max)	Handicapped (max)
Age		
Below 55 years	$1,000	$2,000
55 to 59 years	$3,000	$5,000
60 years and above	$4,000	$6,000

Wife relief	$2,000 (max)
Qualifying child relief (per child)	$4,000
Handicapped child relief	$5,500
Working mother's child relief	
	(% of mother's earned income)
1st child	15%
2nd child	20%
3rd child	25%
4th child and subsequent child	25%
Maximum relief per child	$50,000
Cumulative % for working mother's child relief	100%
Life assurance relief	$5,000 (max)
Nsman relief	
Active NSman	$3,000
Non-active NSman	$1,500
Wife/widow	$750
Course fees	$3,500 (max)
Foreign maid levy	$6,360 (max)

Goods and services tax (GST)

Period	Rate
From 1 July 2007	7%

Stamp duty

Purchase or transfer of immovable property	Duty payable
Purchase price or market value	
Every $100 or part thereof of the first $180,000	$1
Every $100 or part thereof of the next $180,000	$2
Thereafter, every $100 or part thereof	$3
Transfer of shares	
Purchase price or net asset value	
Every $100 or part thereof	$0·20

Section A – BOTH questions are compulsory and MUST be attempted

1 Halo plc (Halo) is a company incorporated and tax resident in the United Kingdom (UK). It plans to set up a special dye plant either in Singapore or in Malaysia. The total investment in the production plant is estimated at $300 million, which is broken down as follows:

	$ million
Production building	100
Plant and machinery	
Certified energy saving equipment	80
Automation equipment	100
Other plant and machinery	20
Total investment	300

If the special plant is located in Singapore, Halo will set up a 100% (wholly) owned subsidiary in Singapore (SingCo) to carry out the manufacturing of the special dye. SingCo will engage contractors and consultants based in Singapore to build the production facility. These contractors and consultants are large local enterprises registered for goods and services tax (GST) purposes. SingCo will source the plant and machinery from countries outside Singapore. SingCo will take about two years to get the production facility ready for production

Halo has held various discussions with the Singapore Economic Development Board (EDB). EDB is excited and keen to attract Halo to Singapore. Based on SingCo's investment of $300 million, it can offer an eight-year tax holiday under the pioneer incentive scheme or an investment allowance of 100% of the investment in the new building, plant and machinery for an expenditure of up to $300 million.

Halo has surplus cash equivalent to $100 million. Mr John Smith, the chief financial officer of Halo is evaluating three financing options to finance the balance of the investment of $200 million, which is required upon commencement of production.

Option I

Borrow from the EDB, which has offered SingCo a five-year term loan bearing a fixed rate of interest of 3·5% per annum.

Based on the past performance of a similar business unit, SingCo is unlikely to generate adequate funds to repay the entire loan by the end of the fifth year. Thus, under this option, SingCo will need to refinance the loan at the end of the fifth year. SingCo has projected an interest rate of 4% on the new loan.

Option II

Borrow from Standard Chartered Bank plc, UK (SCB UK) which has offered an eight-year term loan bearing a fixed net interest rate of 3% per annum. In this option, SCB UK could grant the loan to Halo instead of SingCo.

Option III

Accept a double-dip finance lease offered by Royal Bank of Scotland plc, UK (RBS UK). In the double dip structure, SingCo will pay RBS UK fixed finance charges of 1·5% per annum for the whole finance lease period of eight years. SingCo will bear the Singapore withholding tax, if any.

Mr Smith has reviewed the double dip structure with Halo's auditors and is satisfied that SingCo can capitalise the finance lease assets as 'fixed assets' in its financial statements.

Mr Smith is aware that any dividends payable by SingCo are subject to tax in the UK. He is also aware that the UK and Singapore have a double taxation agreement, which grants tax-sparing relief under certain circumstances. The corporate tax rate in the UK is 28% and loan interest is a deductible tax expense.

SingCo will be required to make an annual royalty payment of 5% of turnover to Halo's wholly owned subsidiary company in the Netherlands, which owns the patent for the dye.

Halo is still negotiating with key raw materials suppliers and hence Mr Smith is unable to release the projected financials of SingCo.

Required:

Prepare a report to Mr John Smith, the chief financial officer of Halo plc on the proposed production facility in Singapore giving advice on:

(a) The salient features of the pioneer and the investment allowance incentives that will have an impact on the value of the tax benefits to SingCo. (9 marks)

(b) The Singapore income tax and withholding tax implications of the three financing options and of the royalty payable to the Dutch subsidiary, together with any ways in which the withholding tax liabilities can be mitigated. (10 marks)

(c) The minimum profits that SingCo will have to make in the eight years in order that SingCo will achieve similar tax benefits under both the pioneer and the investment allowance incentives for each of the three financing options. Your advice should be supported with relevant computations for the eight-year period based strictly on the financial data given.

Note: you are not required to discount the results to their net present value or make additional assumptions. (7 marks)

(d) The income tax implications if Halo plc (not SingCo) accepts the loan from Standard Chartered Bank plc UK under Option II, together with any ways in which this might result in a reduction in the group's overall tax liability. (6 marks)

(e) The goods and services tax (GST) implications during the two-year period in which SingCo will build the production facility, together with any actions to be taken. (5 marks)

Professional marks will be awarded in question 1 for the clarity, format and presentation of the report and the effectiveness with which the information is communicated. (2 marks)

Note: The withholding tax rates contained in Singapore's double taxation agreement with the Netherlands and the United Kingdom are as follows:

	Netherlands	United Kingdom
Interest	10%	0%, 10% or 15%
Royalties	0%	10% or 15%
Dividends	0%	5% or 15%

(39 marks)

2 Toyo Civil Engineering (Toyo) Limited is a civil engineering company, tax resident in Japan. It plans to tender for a piece of a job advertised by the Land Transport Authority of Singapore (LTA). It has had several rounds of discussion with interested parties, tax resident in Singapore. If the LTA accepts its tender, Toyo will allocate the job as follows:

Toyo

1. Overall supervision of the job – Toyo will send two managers to Singapore to supervise the job, which will take about 18 months.
2. Design and planning – Toyo will carry out these activities wholly in Japan.

Singapore parties

Construction of the project

In addition, Toyo plans to set up a representative office in Singapore to promote its business in the South Asian region. Toyo has appointed Mr Uno as the manager of the representative office. Mr Uno will receive an all-inclusive remuneration package of $250,000. Similar to all its other employees, Toyo will continue to contribute to the company's pension fund for Mr Uno.

While in Singapore, Mr Uno will stay in a rented apartment and is likely to exercise stock options granted to him in the year 2005.

Based on Toyo's costing, it should price its tender at $80 million, without factoring in any Singapore income tax liability. Mr Sato, the tax manager of Toyo is aware that there is a double taxation agreement between Singapore and Japan. His friend has advised him that in view of the existence of the said double taxation agreement, the profit made by Toyo from the contract should be tax free in Singapore. However, for the representative office, there will be a deemed tax of 5% based on the expenses incurred by the representative office.

Required:

Draft a letter to Mr Sato, the tax manager of Toyo Civil Engineering Limited advising him on:

(a) The Singapore income tax implications of the tender and the representative office, including any suggestions on how the Singapore income tax liabilities might be mitigated. (18 marks)

(b) The Singapore income tax issues in respect of Mr Uno's employment by the representative office. (9 marks)

Professional marks will be awarded in question 2 for the clarity, format and presentation of the letter and the effectiveness with which the information is communicated. (2 marks)

(29 marks)

Section B – TWO questions ONLY to be attempted

3 City Investment Holdings Pte Ltd (CIH) is an investment holding company, incorporated and tax resident in Singapore. Five friends hold the shares of CIH equally. The financial year-end of the CIH group is 30 June.

CIH has a 100% interest in three operating companies in Singapore. They are:

City 1 Pte Ltd (City 1)

City 1 is a trading company. It distributes herbal products and growth in the last few years has been fantastic. Turnover for the year ended 30 June 2008 exceeded $20 million and profits reached $8 million. Although its profit margin declined due to high operating expenses, City 1 is expected to continue to make profits in the year ended 30 June 2009 and subsequent years.

In the year ended 30 June 2008, City 1's tax accountant did not claim the following expenses:

1. Mileage claims reimbursed to the sales executives.
2. Club entrance and subscription fees reimbursed to the company's directors, who used the club principally for entertaining business clients.
3. Non-claimable goods and services tax (GST).
4. The interest expenses incurred on a bank overdraft, which was obtained to provide interest-free loans to the company's sales executives for financing the purchase of their cars. The sales executives are required to travel in their job.

City 2 Pte Ltd (City 2)

City 2 is a manufacturing company, which has suffered losses in recent years. The tax losses as at 30 June 2008 amounted to $6 million. City 2 recently secured a huge contract and to meet the needs of this contract, it has to invest in new plant and machinery. With this contract, City 2 expects to make a taxable profit of $8 million in the year ending 30 June 2009.

Brilliant Singapore Pte Ltd (Brilliant)

Brilliant carries on a similar manufacturing business as City 2. CIH acquired the entire share capital of Brilliant on 1 July 2008. Brilliant has spare manufacturing capacity and would be able to fulfil the needs of the new contract secured by City 2.

Brilliant also has a 30 June financial year-end and in the current financial year ending 30 June 2009, the company projects a tax loss of $1 million because it has lost a few key customers.

Required:

Review the Singapore income tax implications of the current structure and operations of the City Investment Holdings Pte Ltd (CIH) group and advise on how the income tax efficiency of the group can be improved. If applicable, clearly identify the company/companies that should be the surviving entity/entities.

(16 marks)

4 Blake Inc (BI), a company incorporated and tax resident in the United States, set up Blake Singapore Pte Ltd (BSPL), a wholly owned subsidiary company on 1 June 2009. BSPL will distribute Blake manufactured products to customers in Singapore, Malaysia, Thailand and Indonesia. BI has a factory in China and it will supply the products to BSPL.

BSPL will commence business on 1 July 2009 and will register as a goods and services tax (GST) person. BSPL's business development manager has agreed on the following billing arrangement with its five major customers:

Customer A located in Singapore – Free on board (FOB) China, as BSPL will ship the goods directly from the factory in China.

Customer B located in Singapore – BSPL will deliver the goods directly to Customer B. The goods will be despatched from BSPL's warehouse located at Genting Lane.

Customer C located in Indonesia – BSPL will deliver the goods to Customer C on a cost, insurance and freight (CIF) basis. The goods will also be despatched from BSPL's warehouse located at Genting Lane.

Customer D located in Malaysia – CIF Malaysia and BSPL will ship the goods directly from BI's factory in China.

Customer E located in Thailand – FOB Singapore and Customer E will use its own Singapore shipping agent to deliver the goods to Thailand.

Required:

Explain to Blake Singapore Pte Ltd (BSPL) the goods and services tax (GST) implications of the transactions with the five customers, including the documents that should be retained for GST audit purposes.

(16 marks)

5 **(a)** John is a tax resident in Singapore. He has heard that s.12 of the Income Tax Act deems certain types of income in respect of loans and indebtedness, which may not be regarded as sourced in Singapore, as being derived from Singapore. The recipient of the income, whether resident or non-resident, will thus be liable to income tax.

Required:

(i) **Explain the nature of the income that is deemed derived from Singapore under s.12(6) of the Income Tax Act, and any such income, which is excluded from these deeming provisions;** (8 marks)

(ii) **Explain John's obligation(s) when he makes payments deemed to be derived under s.12(6) of the Income Tax Act.** (5 marks)

(b) Mr Chan Kok Hong has been advised that with effect from 1 June 2003, no resident individual taxpayer would be subject to income tax on income sourced outside Singapore and no tax resident company would be subject to income tax on any of its foreign sourced income.

Required:

Comment on the validity and accuracy of this advice. (3 marks)

(16 marks)

End of Question Paper