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The Singapore 2017 Budget: Tax Updates

The 2017 Budget was delivered by the Minister for Finance Heng Swee Keat on 20 February 2017 against the backdrop of a transitioning Singapore economy. The Budget measures are aimed at rationalization, ensuring sustainability, and preparing Singapore for a changing world of digitalization and intellectual property ("**IP**") creation and management from research and development ("**R&D**") activities. Previous incentive measures that are no longer relevant have been dropped. New measures have been introduced to comply with Base Erosion and Profit Shifting ("**BEPS**"), consistent with Singapore being a BEPS Associate since 2016. We highlight the key tax changes below.

1. Key Tax Changes Impacting Multinational Corporations ("MNCs")

A. Introduction of the Intellectual Property Development Incentive (the "IDI")

Singapore has brought on various measures to encourage MNCs to conduct R&D activities in Singapore and to house their IP in Singapore. These have been tweaked as time went by but with the pace of other countries introducing measures for similar purposes, it is timely that Singapore looks at moving forward. Some countries have introduced IP incentives under various names such as "Patent Box" and "Innovation Box".

The Budget Speech introduced the IDI which lowers tax rates for certain types of income from IP rights ("**IP income**"), and will follow the BEPS-compliant modified nexus approach.

The IDI will be administered by the Singapore Economic Development Board ("**EDB**"), and will be effective on or after 1 July 2017. The EDB will release further details on the IDI by May 2017.

The introduction of the IDI will also have an impact on the Pioneer-Services/Headquarters Incentive (the "**Pioneer Incentive**") and the Development and Expansion Incentive-Services/Headquarters (the "**DEI**"). The Pioneer Incentive currently offers a corporate tax exemption on qualifying activities for a maximum of 15 years, whereas the DEI offers companies a reduced tax rate of 5% or 10% on incremental income from the expansion of operations in Singapore.

The above incentive awards will no longer cover IP income, if approved on or after 1 July 2017. Incentive awards approved before 1 July 2017 will continue to cover IP income up till 30 June 2021.

Comments: The IDI as described in Annex A-5 to the 2017 Budget speech is unlikely to be the broad-based regime envisioned by the 2013 IP Hub Master Plan, and may potentially be subject to negotiations like other tax incentives administered by the EDB.

There is currently no definition of IP income. If the OECD approach is adopted, IP income may cover income from the sale of products and services that have IP embedded in them, and not just royalties and license fees. An interesting question is whether the royalty embedded in the product price would be subject to withholding tax in the foreign country. It is also currently unclear what will be the qualifying assets under the IDI. The scope of the qualifying assets may be limited if the BEPS Action 5 approach is adopted.

We hope the IDI package will address the following issues:

(a) to the extent that it is BEPS-compliant, the IDI should be broad in scope, so as to maximize the attractiveness of the regime. This could be done by adopting an expansive definition of the scope of R&D and recognizing the commercial limits that impact businesses; and

(b) the legislative changes introducing the IDI should provide clear guidelines (based on transfer pricing principles) to separate IP-related income from non-IP-related income.

Companies that are looking to onshore IP and undertake R&D activities in Singapore may want to consider the timing implications of doing so, specifically:

(a) companies whose Pioneer Incentive or DEI awards extend beyond 30 June 2021 will need to review their income streams in relation to royalty or other income falling within the scope of IP income after 30 June 2021, as their incentive awards will only cover IP income for the transitional period till 30 June 2021, notwithstanding their agreement with the EDB;

(b) companies intending to apply for the Pioneer Incentive or DEI, or who are negotiating such incentives with the EDB will need to consider whether to sign the EDB's Letter of Offer for these incentives *before* 1 July 2017, or wait till 1 July 2017 and then apply for the IDI. This will also depend on the IDI rate (which has not been announced, but which we are hopeful will be comparable to the DEI rate of 5% to 10%); and

(c) all companies will need to consider if their income falls within the scope of IP income, as they may risk falling outside the scope of *both* the Pioneer Incentive or DEI on the one hand, and the IDI on the other hand.

B. Introduction of safe harbour rule for payments under Cost Sharing Agreements (“CSAs”) for R&D projects

The Singapore tax experience of CSAs has travelled along the road with various stops where approval was required under section 19C of the *Income Tax Act (Cap. 134)* ("**ITA**") and then moving on to where no approval is required under section 14D. The deductions claimed under section 14D have been subject to review by IRAS to pick out individual expenses which IRAS considers to be disallowable expenses, and deny a deduction thereon. As a corollary, it is also uncertain how IRAS would treat such individual expenses from a Singapore withholding tax perspective.

The 2017 Budget will introduce a safe harbour rule to ease compliance for taxpayers. Taxpayers may opt to claim tax deduction under section 14D for 75% of the CSA payments made (on or after 21 February 2017) for qualifying R&D projects, without having to provide a breakdown of the individual expenses incurred under the CSAs.

IRAS will release further details of the change by May 2017.

Comments: We hope that the changes announced will clarify whether the decision to opt for the safe harbor treatment is irreversible, or if the taxpayer may choose to opt in or not from year to year.

Depending on the industry, some taxpayers who are parties to CSAs may incur expenses (which IRAS considers disallowable) amounting to less than 25% of the total CSA payments. This practically means that in such circumstances, these taxpayers would be worse off by opting for the safe harbour rule.

Taxpayers should consider their legal position, and whether there is legal basis for IRAS to deny a deduction in respect of the individual expenses incurred under the CSAs.

C. Evaluating the imposition of Goods and Services Tax ("GST") on digital transactions and cross-border trade.

The e-commerce market has been taking off over the years and this is expected to continue to grow. Some countries already have, or are in the midst of levying GST on digital transactions and cross-border trade. This has also been an attempt to level the playing field between local businesses and foreign-based businesses.

The Minister for Finance announced that the Singapore government is studying these moves with a view to imposing GST on digital transactions and cross-border trade.

The Singapore government has not released any discussion or consultation paper at this stage. Based on the approach taken in other jurisdictions, the Singapore government may potentially seek to broaden the GST base for digital transactions and cross border trade by adopting any of the following measures:

(a) reducing or removing the import GST exemption for low value goods (the current threshold is at SGD 400); and/or

(b) requiring foreign providers of digital services to local consumers (B2C) to register for GST in Singapore, and to charge and account for GST on the supplies of such services.

It will be interesting to see the outcome of the study and if (or how) the Singapore government will operationalize the imposition of GST on digital transactions and cross-border trade. There are much wider implications than merely leveling the playing field between local and foreign businesses. With the growing consumer retail trends and the forecasted potential size of the digital economy, the

government cannot ignore the potential of the GST revenue foregone by not taxing this segment. The GST revenue collection has been increasing in recent years and this would suggest a higher reliance on such a revenue source for the government's overall revenue collection. Therefore, it will be imperative for the government to be able to maintain and even increase this to meet the growing demands from the expenditure side. One of the ways to achieve this is to broaden the tax base to include such transactions instead of simply increasing the GST rate.

Notwithstanding the above, the government will face a number of challenges. For example, if the government decides to impose GST on such transactions, they will need to consider the cost implications both to operationalize and enforce the rules from the government's standpoint, as well as the compliance and operational costs to the affected service providers or e-commerce suppliers located outside Singapore. It will be a delicate balance to get it right but it is something which cannot be ignored in the digital age where conventional transactions are evolving, and the GST rules need to keep up with such developments in order to be effective and relevant.

2. Expansion and Extension of Schemes

A. Streamlining qualifying counterparties under the Finance and Treasury Centre (“FTC”) scheme

The FTC scheme, which is administered by the EDB, encourages companies to use Singapore as a base for treasury management activities. The concessionary tax rate under the FTC Scheme was lowered from 10% to 8% in the 2016 Budget. In addition, the FTC would be allowed to conduct qualifying activities using funds obtained indirectly from approved network companies, but these funds would have to originate from qualifying sources, and safeguards would be introduced to address round-tripping risks.

The 2017 Budget seeks to ease the compliance burden of approved FTCs by streamlining the qualifying counterparties for certain transactions of approved FTCs.

The change will apply to new or renewal incentive awards approved on or after 21 February 2017. The EDB will release further details of the change by May 2017.

Comments: The reduced compliance burden strengthens Singapore's credentials as an attractive base for MNCs to conduct treasury management activities. The present enhancement comes at an opportune moment, as MNCs are increasingly looking to establish or expand their strategic Regional Treasury Centers to enhance operational efficiency, mitigate financial risks, and optimize financing costs and capital.

Further, for MNCs looking to restructure their debt financing arrangements, the FTC and enhancements to the FTC should be considered as viable options to marry substance with financing transactions in the post-BEPS world.

B. Enhancement of the Global Trader Programme (“GTP”)

The GTP was introduced to encourage global trading companies to establish their principal trading base in Singapore.

The GTP grants a concessionary tax rate of 5% or 10% on qualifying income derived by approved global trading companies from qualifying transactions.

The 2017 Budget extends the concessionary tax rate to cover the following:

(a) income derived from qualifying transactions with *any* counterparty. This removes the current requirement for qualifying transactions to be carried out with qualifying counterparties;

(b) physical trading income derived from transactions in which the commodity is purchased for the purposes of consumption in Singapore, or for the supply of fuel to aircraft or vessels within Singapore; and

(c) physical trading income attributable to storage in Singapore or any activity carried out in Singapore which adds value to commodity by any physical alteration, addition or improvement (including refining, blending, processing or bulk-breaking).

This will apply to qualifying income derived on or after 21 February 2017 by approved global trading companies from qualifying transactions.

In addition, the 2017 Budget increases the substantive requirements to qualify for the GTP for new or renewal incentive awards approved on or after 21 February 2017.

International Enterprise Singapore, which administers the GTP, will release further details of the changes by May 2017.

Comments: The changes to the GTP scheme follows the general trend of changes made to the scheme over the years, namely an increase in substance requirements, and a relaxation of the criteria for qualifying transactions.

It is not surprising that the substantive requirements have been tightened, given Singapore's commitment to the BEPS project as a BEPS Associate. The substantive requirements are brought into focus in the commodities trading industry, as it is possible for companies in the industry to make large profits with limited physical presence of employees.

The GTP will be more attractive with the removal of the requirement for qualifying counterparties, as this is more reflective of the commercial reality for global trading companies. Trading companies are increasingly engaging in more sophisticated strategy to hedge their physical trades with paper trades, and it is administratively burdensome to require these companies to keep track of transactions which are entered into with qualifying counterparties (from which income qualifies for the concessionary tax rate), and those which are not.

C. Extension of withholding tax (“WHT”) exemption on payments for international telecommunications submarine cable capacity under an Indefeasible Rights of Use (“IRUs”) agreement

The WHT exemption on such payments was introduced to encourage broadcasting and telecommunications operators to provide international connectivity.

The scheme was scheduled to lapse after 27 February 2018. To entrench Singapore's position as a key hub for data flow, the WHT exemption will be extended till 31 December 2023.

D. Integrated Investment Allowance (“IIA”) scheme

The scheme provides an additional allowance (on top of capital allowance) in respect of the fixed capital expenditure incurred on qualifying productive equipment placed with an overseas company for an approved project.

The scheme was scheduled to lapse after 28 February 2017, but will now be extended till 31 December 2022.

In addition, qualifying productive equipment for projects approved on or after 21 February 2017 no longer has to be used solely for manufacturing products for the qualifying company under the approved project; it is sufficient that the qualifying productive equipment is primarily used for such a purpose.

E. Corporate Income Tax (“CIT”) Rebate

The CIT rebate cap will be increased from $20,000 to $25,000 for YA 2017 (with the rebate rate unchanged at 50%).

The CIT Rebate will also be extended to YA 2018 at a reduced rate of 20% of tax payable, capped at $10,000.

3. Other Tax Changes

A. Schemes to be phased out

(a) Tax Deduction for Computer Donation scheme
The scheme will be withdrawn after 20 February 2017.

(b) Accelerated Depreciation Allowance for Energy Efficient Equipment (“**ADA-EEET**”) scheme
The ADA-EEET scheme will be withdrawn after 31 December 2017.

(c) Accelerated Writing-Down Allowances (“**WDA**”) for acquisition of Intellectual Property Rights (“**IPRs**”) for Media and Digital Entertainment (“**MDE**”) content scheme

The scheme allowing for accelerated WDA (i.e., 2 years) will lapse in respect of IPRs acquired for MDE content after the last day of the basis period for YA 2018.

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(d) International Arbitration Tax Incentive ("**IArb**")
The IArb will lapse after 30 June 2017.

(e) Approved Building Project (“**ABP**”) scheme
The ABP scheme will lapse after 31 March 2017.

4. Tax Implications for the Financial Services Industry

A. Extending the WHT exemption on payments made to non-resident non-individuals for structured products offered by Financial Institutions (“FIs”)

Payments made to non-resident non-individuals for structured products offered by FIs are currently exempt from WHT. The 2017 Budget extends this exemption to 31 March 2021. There are no changes to the qualifying conditions.

B. Extending and refining the Aircraft Leasing Scheme ("ALS")

The ALS seeks to promote Singapore as a regional aircraft leasing center and currently offers:

(a) a concessionary tax rate of either 5% or 10% on income derived by approved aircraft lessors from the leasing of aircraft or aircraft engines and qualifying ancillary activities; and

(b) a concessionary tax rate of 10% on income derived by approved aircraft managers from managing the approved aircraft lessor and qualifying activities.

In addition, automatic WHT exemption is granted on qualifying payments made by approved aircraft lessors to non-tax-residents (excluding a permanent establishment in Singapore) in respect of qualifying loans to finance the purchase of aircraft and aircraft engines, subject to conditions.

The scheme was scheduled to lapse after 31 March 2017. The 2017 Budget will extend and refine the ALS as follows:

(a) the ALS will be extended till 31 December 2022;

(b) the scope of qualifying ancillary activities for approved aircraft lessors will cover incidental income derived from the provision of finance in the acquisition of aircraft or aircraft engines by any lessee. This will apply to income derived on or after 21 February 2017 for all incentive recipients; and

(c) the concessionary tax rates will be streamlined into a single concessionary tax rate of 8% with a harmonized set of conditions. This will apply to new or renewal incentive awards approved on or after 1 April 2017.

In addition, the automatic withholding tax exemption regime will be extended to qualifying payments made on qualifying loans entered into on or before 31 December 2022.

The EDB will release further details of the change by May 2017.

C. Tax Incentive Schemes for Project and Infrastructure Finance (Qualifying Project Debt Securities)

The exemption of qualifying income from qualifying project debt securities will be extended till 31 December 2022, with no changes in the qualifying conditions. The Monetary Authority of Singapore will release further details by May 2017.

The other tax incentive schemes for Project and Infrastructure Finance will also be extended till 31 December 2022 with no changes to the qualifying conditions, except for the stamp duty remission granted under the scheme, which will lapse after 31 March 2017.

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