

Professional Pilot Paper – Options module

Advanced Taxation (Singapore)

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.

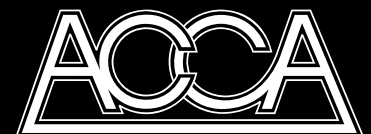
Tax rates and allowances are on pages 2–3

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.

The Association of Chartered Certified Accountants



Paper P6 (SGP)

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

Partial corporate tax regime

First \$10,000 of chargeable income is 75% exempt	\$7,500
Next \$90,000 of chargeable income is 50% exempt	\$45,000
	<u>\$52,500</u>

Corporate income tax

Year of assessment	Tax rate
2007	20%

Central Provident Fund (CPF) contributions for individuals below the age of 50 years

Rates of CPF contributions	Employee	Employer
1 January 2006 to 31 December 2006	20%	13%
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

	Year of assessment 2007		
	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	11,200
On the first	160,000		15,500
On the next	160,000	17	27,200
On the first	320,000		42,700
Above	320,000	20	

Personal income tax reliefs – Year of assessment 2007

Earned income	Normal (max)	Handicapped (max)
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)
Normal/Qualifying child relief		
1st, 2nd, or 3rd child	\$2,000	
4th child born on/after 1.1.1988	\$2,000	
Handicapped child relief	\$3,500	
Working mother's child relief	(% of mother's earned income)	
First child	5%	
Second child	15%	
Third child	20%	
Fourth child (born on or after 1987)	25%	
Maximum relief per child	\$25,000	
Life assurance	\$5,000 (max)	
NSman		
Active NSman	\$3,000	
Non-active NSman	\$1,500	
Wife/widow	\$750	
Foreign maid levy	\$7,080 (max)	

Goods and Services tax (GST)

Rate	5%
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Estate duty

Exemption limits	
Residential properties	\$9 million
Other moveable properties	\$0.6 million
Dutiable estate	Rate
First \$12 million	5%
Above \$12 million	10%

Stamp duties – rates of duty

Purchase or gift of immovable property

Conveyance:

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 or gift of shares

Share transfer:

Purchase price or net asset value	
Every \$100 or part thereof	\$0.20

Section A: BOTH questions are compulsory and MUST be attempted

- 1** HK Investment Ltd (HKIL) is an investment holding company, tax resident in Hong Kong. HKIL has three wholly owned subsidiary companies, resident in Singapore, as follows:

Holdings (S) Pte Ltd (HPL)

HPL owns the following investments, all of which are classified as 'non current assets' in its annual financial statements:

1. A hotel in Singapore which is leased to a related company, Prime Hotel (S) Pte Ltd (see further below). Despite the commercial rent charged to Prime Hotel, HPL incurs a net loss on this property for income tax purposes. HPL's tax manager has explained that the loss was due to the claim for capital allowances on plant and machinery, for items such as the air conditioning system and the generator.
2. Two good class bungalows. One of the bungalows is kept solely for use by HPL's directors and their families when they visit Singapore. The directors and their families are based in Hong Kong. The other bungalow is rented out and generates a net rental surplus annually.
3. 1,000,000 units in Suntec REIT, purchased in June 2005. The Suntec REIT unit price is currently at an all time high and HPL's broker has advised the company to liquidate its holding.
4. A piece of residential land in the Orchard area, which HPL acquired in 1999. Because the land is located in a prime district HPL had expected a significant appreciation in the value of the land. Based on development already carried out in the vicinity, HPL believes that it can submit a plan to develop two blocks of high rise apartments on the land, which will produce a further appreciation in its value.

Prime Hotel (S) Pte Ltd (PHPL)

PHPL operates the hotel leased from HPL (as above). In the last financial year, PHPL completed extensive renovations to the hotel's guest rooms and food and beverage outlets, incurring capital expenditure of \$10 million. \$8 million of this amount qualifies as expenditure on machinery and plant for Singapore income tax purposes. PHPL's accounting policy is to depreciate such fixed assets on a straight line basis over a period of five financial years.

PHPL also owns a hotel company in Brunei. The original investment in this subsidiary company of PHPL, of \$4 million was wholly funded by a term loan, which remained outstanding as at 31 March 2006. The interest paid (at the current prime rate) in the financial year ended 31 March 2006 was \$180,000. The corporate tax rate in Brunei is 30%.

Although PHPL reported an accounting profit for the year ended 31 March 2006, the notes to its audited financial statements included a statement on the carry forward of a tax loss and unabsorbed capital allowances for the year of assessment 2007

Development (S) Pte Ltd (DPL)

DPL was only incorporated in the year ended 31 March 2005. DPL is a property development company, which immediately following its incorporation purchased land for development and sale. DPL has always been profitable and in the year ended 31 March 2006, had an effective tax rate of 30% compared to the statutory tax rate of 20%. DPL has received a letter from its tax consultant highlighting the following non tax deductible expenses:

1. Interest incurred on undeveloped land.
2. Interest incurred on loans to refinance an earlier loan, which was obtained for the purpose of providing the company's initial working capital.

As at 31 March 2006, DPL had surplus funds, which it has placed on fixed deposit with a bank in Singapore. The interest rate on this fixed deposit is 2% lower than the average prime rate enjoyed by the HKIL group.

HKIL plans to expand its operations in Singapore and eventually to bring in new shareholders, most probably by a public offer of its shares through a listing on the Singapore Exchange Limited.

Required:

Prepare notes for a meeting with the directors' of HK Investment Ltd (HKIL) on the following:

- (a) The Singapore income tax issues identifiable from the information provided, in respect of each of HKIL's three Singapore subsidiary companies.** (12 marks)
- (b) Your comments on the tax advice given by the tax consultant on the two non tax deductible expenses incurred by Development (S) Pte Ltd (DPL).** (4 marks)
- (c) Your recommendations as to how the income tax efficiency of the three Singapore subsidiary companies might be improved and the overall Singapore tax liability of the HKIL group reduced. Your answer should include consideration of how capital gains treatment might be ensured for the development of the Orchard land.** (14 marks)

(30 marks)

- 2** BioChem USA Inc, an American incorporated company, has a branch in Singapore. The Singapore branch distributes health products and provides laboratory testing services to external customers in the region. The BioChem group recently engaged BigCo US to conduct a tax review of its operations. BigCo's report contains the following recommendations relating to BioChem's Singapore operations:
- 1. Set up BioChem Singapore Pte Ltd as a wholly owned subsidiary of BioChem USA Inc, to take over the entire business undertaking of the Singapore branch.
 - 2. Inject capital into BioChem Singapore Pte Ltd based on a debt-to-equity ratio of 3 to 1.
 - 3. Either charge a royalty to BioChem Singapore Pte Ltd based on 2% of its annual turnover; or allocate research and development costs to BioChem Singapore Pte Ltd based on 10% of the annual research and development costs incurred by BioChem USA Inc.

Required:

- (a) Assuming that the assets and liabilities of the Singapore branch comprise fixed assets, trade and non trade debts, trading stock, trade and non trade creditors and a bank balance, advise BioChem USA Inc on the income tax and goods and services tax (GST) consequences of recommendation 1 of BigCo's report, the transfer of the business undertaking to BioChem Singapore Pte Ltd and the action(s) that could be taken to mitigate these tax liabilities.** (13 marks)
- (b) Comment on the advice given in recommendation 2 of BigCo's report in respect of the debt-to-equity ratio.** (2 marks)
- (c) Advise on the withholding tax implications of the payments proposed in recommendation 3 of BigCo's report and suggest how any withholding tax liabilities might be mitigated.** (7 marks)
- (d) Advise on the timing of any withholding tax payment(s) identified in (c) above and state the penalty or penalties that will be incurred if payment is not made within the time limit.** (2 marks)

(24 marks)

Section B: TWO questions ONLY to be attempted

3 Timothy is the Chief Executive Officer of a Singapore incorporated company. His annual remuneration is \$500,000 per year, and he expects it to remain at the same level for the next ten years.

He has an intense interest in cooking especially French cuisine. To further this interest, Timothy intends to start operating a restaurant business, but without giving up his employment. He engaged consultants to undertake a feasibility study to determine the viability of his business plan. The consultants have concluded that the proposition is viable, based on the following financial projections.

	2007 (\$)	2008 (\$)	2009 (\$)
Initial capital injection	200,000		
Investment in plant and machinery (cumulative)	21,000	30,000	30,000
Operating results			
Gross revenue	140,000	200,000	250,000
Less:			
Tax deductible expenses	(180,000)	(150,000)	(130,000)
Depreciation	(7,000)	(10,000)	(10,000)
Net profit/(loss)	(47,000)	40,000	110,000

Timothy has ruled out a sole-proprietorship structure for the restaurant business. He is considering either forming a partnership, with himself holding a 99 percent interest in the partnership; or incorporating a company, with himself holding 99 percent of the shares in the company. He intends to gift the remaining 1% interest under each of the two structures to his chef.

Required:

(a) Advise Timothy on the income tax implications of each of the two options. You should support your advice with relevant computations.

Assume that the current tax law and practice will continue to apply. (13 marks)

(b) Comment on the tax implications of the gift of a 1% interest in the business to the chef, and suggest a more tax efficient method of ensuring the chef's commitment to the business from the partnership's/company's standpoint. (6 marks)

(c) Advise Timothy on the estate duty implications of his investment under each structure. (4 marks)

(23 marks)

- 4 Technology Singapore Pte Ltd (Technology) was incorporated in June 2000. It manufactures thumb drives and in the year 2006 was awarded the investment allowance incentive for investment in new productive equipment, subject to a maximum capital expenditure of \$20 million.

The investment allowance granted is 50% for fixed capital expenditure incurred between 1 January 2006 and 31 December 2008. In the year 2006, Technology incurred fixed capital expenditure of \$5 million and based on its investment plan, the remaining \$15 million will all be spent by 31 December 2008.

Technology is currently facing cash flow problems and its Chief Financial Officer has been asked to evaluate the following financing options:

1. Obtain a 3-year term bank loan from UOB Ltd in Singapore of \$15 million, bearing a fixed interest rate of 4.5% per annum.
2. Obtain a 3-year term loan from the Hong Kong office of Hang Seng Bank Ltd of US\$10 million, bearing a net fixed interest rate of 3.5% per annum.
3. Financing the remaining \$15 million by way of a 5-year operating lease arrangement with an investment bank located and registered in Hong Kong. The annual amount payable in respect of this lease arrangement will be \$900,000.
4. Financing the remaining \$15 million by way of a 5-year hire purchase arrangement with a finance company in Singapore. The annualised cost of the finance charges payable in respect of this agreement will be 4.75%.

Required:

Advise Technology Singapore Pte Ltd's Chief Financial Officer on the following:

- (a) **The tax implications of each of the four financing options, including their effect (if any) on the investment allowance incentive.** (8 marks)
- (b) **The withholding tax implications (if any) of each of the four financing options.** (3 marks)
- (c) **The preferred option from a tax viewpoint, taking into account the effect on the investment allowance scheme.** (6 marks)
- (d) **The two main reasons why Technology Singapore Pte Ltd would consider the investment allowance incentive preferable to the pioneer incentive.** (6 marks)

(23 marks)

5 You have received the following letter from John Lim, who is about to start an overseas assignment.

“My name is John Lim. I am a Singapore citizen and on 1 July 2007, I will be taking up an overseas assignment in Shanghai, China. My wife, who is a housewife and my two children will remain in Singapore initially, but they may relocate after the 2007 school term ends on 30 November 2007.

During the period from 1 July 2007 to 31 December 2007, I will return to Singapore monthly, but each time I will not spend more than one week here. On each trip, I will bring in cash, which will be given to my wife to meet the families living expenses. When my family is relocated to China, we will all return to Singapore once a year for a two-week vacation.

Although I will be based in Shanghai, my job will require me to travel to Hong Kong, the Philippines and Japan. These trips will take up about 50% of my time in total.

I own two apartments in Singapore; one is used by my family and the other is rented out. The net rental surplus is about \$5,000 per annum. Currently, I am using my monthly CPF contributions to repay my monthly mortgage instalments. My employer has agreed to continue with these monthly contributions as if I had remained in Singapore.

I also have unexercised stock options granted to me in respect of my Singapore employment. The company’s stock option scheme has no restrictive conditions and I can exercise and sell the options at any time. The option price is \$1.00 per share and I intend to exercise them when the market price reaches \$2.50. The shares are currently traded at \$1.80 each.

Unlike Hong Kong, the tax rates for individuals in mainland China are much higher than the tax rates in Singapore. However, at a recent tax seminar, I heard that I can avoid paying tax in China provided that I continue to subject my income to Singapore tax. This is because of the provisions of the double taxation agreement between Singapore and China.”

The China-Singapore tax treaty provides that an individual resident in Singapore will not be subject to tax in China in respect of his/her dependant personal service income if:

- the individual is in China for a period or periods aggregating 183 days or less in a calendar year;
- the remuneration is paid by an employer not resident in China; and
- the remuneration is not borne by a permanent establishment or a fixed base which the employer has in China.

Required:

Draft a letter to John Lim advising him on the following:

- (a) The Singapore tax implications of the income sourced in and/or brought into Singapore, any gain on the stock options and the CPF contributions, following the commencement of his overseas employment. (7 marks)**
- (b) The Singapore tax treatment of the stock options when he leaves Singapore to take up the overseas employment and on exercise, and how any Singapore tax liabilities arising can be reduced. (3 marks)**
- (c) His ongoing tax obligations to the Singapore Inland Revenue and the penalties for non compliance. (3 marks)**
- (d) How the employment package in respect of his assignment in Shanghai, might be structured in order to mitigate his total tax liabilities. (8 marks)**

Appropriateness of the format and presentation of the letter and the effectiveness with which its advice is communicated. (2 marks)

(23 marks)

End of Question Paper

Answers

1 (a) Holdings (S) Pte Ltd (HPL)

- (1) The rental income from PHPL is subject to tax under section 10E of the Income Tax Act. Although this section allows HPL to claim capital allowances on qualifying expenditure incurred on plant and machinery, the unabsorbed or excess capital allowances are not available for carry forward.
- (2) The expenses incurred on the bungalow kept solely for use by the directors are non tax deductible and additionally the use of the bungalow by the directors is a taxable benefit in their hands.
- (3) The gain from the disposal of the 1,000,000 units in Suntec REIT is most likely to be regarded as revenue in nature and subject to income tax, unless HPL can prove to the Singapore Inland Revenue its investment holding intention. Alternatively, the part of the gain attributable to the period prior to any change of intention may be treated as capital gains, and in the absence of a capital gains tax regime in Singapore, such gains will not be taxed in Singapore.
- (4) Similarly, HPL has to satisfy the Singapore Inland Revenue that the Orchard land was purchased as a long term investment holding. In the event that it develops the land by constructing the two blocks of high rise apartments for sale, the Singapore Inland Revenue is likely to subject the gains to income tax, on the grounds that HPL is in the business of property development. HPL will have to rely on the badges of trade tests to contest that part of the gains are capital in nature, and thus not subject to income tax.

Prime Hotels (S) Pte Ltd (PHPL)

- (1) The carry forward of losses and unabsorbed capital allowances is subject to the continuity of trade and ownership tests. Given that HK Investment Ltd (HKIL) plans to bring in new shareholders, it is possible that a substantial change in shareholders, and thus a substantial change in ownership may occur in the near future. Hence, PHPL may wish to defer claiming capital allowances in the short term, so as to avoid any restriction on the carry forward of unabsorbed capital allowances.
- (2) Profits from the hotel operations in Brunei are subject to corporate tax in Brunei at a rate of more than 15%. Hence upon remittance of a dividend from the Brunei subsidiary to Singapore, it should be exempt from Singapore income tax. As a consequence, there is no tax benefit to be derived from the deduction of the interest incurred on the loan obtained to fund the investment in the Brunei subsidiary company.

Development (S) Pte Ltd (DPL)

The interest earned on the fixed deposit will be subject to income tax.

- (b)**
- (1) The advice given by the tax consultant could be incorrect; as if DHL holds the undeveloped land as a trading stock the interest incurred should be tax deductible.
 - (2) The advice is strictly correct, ie interest incurred on a refinanced loan is not tax deductible. However, as an administrative concession, the Singapore Inland Revenue will allow it as tax deduction provided that the refinancing is done for genuine commercial reasons, for example to reduce the overall cost of financing.
- (c)**
- (1) Under section 10E, unabsorbed capital allowances are forfeited. Hence, HPL should consider deferring its capital allowance claim in years when there is insufficient rental income to offset the allowances claimable. Alternatively, the rental arrangement with PHPL could be modified to provide for PHPL to bear the cost of the plant and machinery. In this instance, PHPL will be entitled to claim the capital allowances on the expenditure incurred on the plant and machinery, and where there is insufficient income to absorb the allowances claim, the excess will be available for carry forward, subject to the continuity of ownership and trade tests.
 - (2) Instead of keeping the bungalow for use by the directors, HPL should considering renting it out in order to secure a deduction for the expenses. Further, if there is a shortfall, any deficit can be offset against the surplus rents from the other bungalow.
 - (3) As regards the Orchard land, the Board of Directors needs to evaluate if there is a business case for a change of investment intention. It is recommended that HPL transfers the land to DPL prior to the development of the two blocks of apartments. HPL should then be able to contend that the gain prior to this transfer is capital in nature. Also, following the transfer, the Board should take the opportunity to reaffirm that HPL is a pure investment holding company.
 - (4) PHPL should consider deferring any claim to capital allowances until it is clear whether or not the listing of HKIL on the Singapore Exchange will result in a substantial change of shareholders, in order to mitigate the risk of losing any carried forward unabsorbed capital allowances because of the continuity of ownership test.
 - (5) Since the Brunei dividend is tax exempt in Singapore, PHPL should consider repaying the term loan, possibly by borrowing the surplus funds from DPL. Interest need not be charged on this borrowing as DPL has no funding costs associated with the surplus funds.
 - (6) DPL should properly document the rationale for the refinancing in order to be able to take advantage of the administrative concession granted by the Singapore Inland Revenue.
 - (7) If DPL's surplus funds are not loaned to PHPL (as in (5) above) it should consider placing the surplus funds in a Hong Kong bank. As if the funds are placed offshore DPL will only be subject to Singapore income tax upon the remittance of any interest income. In this way, DPL can defer the Singapore tax liability or it may even be able to avoid Singapore income tax entirely if the funds are used for purposes other than those deemed to be received in Singapore under the Income Tax Act at some time in the future.

2 (a) Income tax

Fixed assets – A transfer of fixed assets pursuant to a transfer of a business undertaking is regarded as a ‘disposal’ under section 20 of the Income Tax Act. Thus, there will be a balancing charge or a balancing allowance arising from the disposal. The balancing charge or balancing allowance will be computed based on the difference between the open market value and the tax written down value of the assets at the time of transfer.

If the branch has unabsorbed capital allowances, any balancing charge from the transfer in accordance with section 20 of the Income Tax Act can be used to reduce the unabsorbed capital allowances, which would otherwise be forfeited upon cessation of the business.

Where the open market value is not easily ascertained and provided that the branch does not have any unabsorbed capital allowance, both the branch and BioChem Singapore Pte Ltd may choose to transfer the qualifying assets in accordance with section 24 of the Income Tax Act since both parties are under common control. Under this section, BioChem Singapore Pte Ltd steps into the shoes of the branch and will continue to claim capital allowances based on the tax written down value of the assets transferred. With a section 24 election, the branch will not have a balancing allowance or a balancing charge from the transfer.

Trade debts – before the transfer the branch will need to review the recoverability of the trade debts and make an appropriate write off or specific provision. As any loss subsequently suffered by BioChem Singapore Pte Ltd will not be tax deductible, because these debts would not have been incurred by BioChem Singapore Pte Ltd in its normal course of trade.

Non trade debts – these may be transferred at book value, as any write off or loss arising from their non payment is not tax deductible in the hands of either the branch or BioChem Singapore Pte Ltd.

Trading stock – this may be transferred in accordance with section 32 of the Income Tax Act. Under this section, the Singapore Inland Revenue will accept any value agreed between the two parties so long as the purchaser, BioChem Singapore Pte Ltd, will carry on a trade or business in Singapore and use the agreed value as the deductible cost of the stock in computing its profits for income tax purposes.

Trade and non trade creditors and bank balance - there are no income tax implications on the transfer of these items and hence, they may be transferred at their respective book values.

Goods and services tax (GST)

Transfer of a business undertaking is a standard rated supply for GST purposes. The branch will thus be required to impose GST at 5% and account for it as output GST to the Comptroller of GST.

However, if the transfer of the business undertaking is indeed the transfer of a business as a going concern, as opposed to just a transfer of assets, it may be treated as outside the scope of GST, provided that BioChem Singapore Pte Ltd is a registered person for the purposes of GST at the time of the transfer or immediately becomes so as a result of the transfer. If one or other of these conditions is met, then the transfer will be an excluded transaction and not subject to GST.

In practice, an advanced ruling can be sought from the Comptroller of GST.

- (b) The recommendation is not an appropriate one. While many tax jurisdictions specify a maximum relationship of this type, for the purpose of restricting the amount of debt interest which is tax deductible, treating the excess as a dividend, the Singapore Income Tax Act does not contain a provision specifying such a debt-to-equity ratio.

(c) Royalty

The royalty will be income deemed to be derived from Singapore, because it is borne by BioChem Singapore Pte Ltd, a Singapore resident. As the royalty is paid to BioChem USA Inc, a non-resident of Singapore, BioChem Singapore Pte Ltd will be required to withhold tax at the rate of 10%.

This 10% withholding tax rate may be reduced by tax treaty, and some of the treaties that Singapore has entered into even exempt royalties from withholding tax. Alternatively, if this is not the case, BioChem Singapore Pte Ltd may apply to the Singapore Economic Development Board for the waiver of the withholding tax under the Economic Expansion (Relief from Income Tax) Act (EEIA).

Research and development costs

Under this scenario, withholding tax will not apply to the payment provided that it is a pure reimbursement of expenses and the allocation basis used is reasonable and consistently applied within the group. The Singapore Inland Revenue will require BioChem Singapore Pte Ltd to provide a breakdown of the expenses incurred in order to ascertain if the allocation includes any non tax deductible expenses.

- (d) Any withholding tax due must be paid to the Singapore Inland Revenue by the 15th of the following month, failing which there will be a late payment penalty of 5%. An additional penalty will be imposed after 60 days at 1% per month, subject to a maximum of 15%.

3 (a) Option 1 – Partnership

In the case of a partnership, the loss in the first year can be offset against Timothy’s employment income, thereby reducing his tax payable for the year of assessment 2008. Thus, there is an immediate cash flow benefit.

In the subsequent years of assessment Timothy’s taxable income from the partnership will be taxed at the maximum marginal tax rate of 20%, as his employment income is in excess of \$320,000.

Option 2 – Company

The company is a separate legal entity, thus its trading losses cannot be relieved against Timothy’s income, and the unabsorbed capital allowances and tax loss must be carried forward in the company itself. Further, the carry forward of both losses and unabsorbed capital allowances is subject to the continuity of ownership test; and in addition, the carry forward of the unabsorbed capital allowances, is subject to a further test which requires the continuity of the same trade or business.

Because of the carry forward of losses and capital allowances, the company will first have chargeable income in the year of assessment 2010, the company will benefit from the tax exemption on the first S\$100,000 and thereafter, it will benefit from the partial tax exemption regime.

No further tax will be payable on any dividends distributed by the company, as dividends are tax exempt under the one-tier system.

Hence, Timothy should be advised to operate the business as a company, as although relief for the initial year’s loss will be deferred under this structure, it will result in a lower effective rate of tax on the profits earned in future years.

Workings

Income tax computation of the business

Year of assessment	2008	2009	2010
	\$	\$	\$
Net profit/(loss)	(47,000)	40,000	110,000
Add: Depreciation	7,000	10,000	10,000
Adjusted profit/(loss)	(40,000)	50,000	120,000
Capital allowances claim	7,000	10,000	10,000
Option 1 – Partnership			
Divisible profit/(loss) – Timothy (99%)	(39,600)	49,500	118,800
Less: Capital allowances	(6,930)	(9,900)	(9,900)
	(46,530)	39,600	108,900
Add: Employment income	500,000	500,000	500,000
Assessable income	453,470	539,600	608,900
Option 2 – Company			
Adjusted profit/(loss) as above	(40,000)	50,000	120,000
Less: Capital allowances			
Current year	(7,000)	(10,000)	(10,000)
Brought forward		(7,000)	
Less: Loss brought forward		(40,000)	(7,000)
Chargeable income	Nil	Nil	103,000
Unabsorbed capital allowances carried forward	(7,000)	0	
Loss carried forward	(40,000)	(7,000)	

- (b) Notwithstanding that the gift is made by Timothy personally, to his chef, the chef will be taxable on the value of the gift, being a benefit received in respect of his employment. The value subject to tax will be ascertained based on the net assets of the business at the time of the gift.

Also, because the gift is made by Timothy personally, the value of the gift will not be a tax deductible expense for the business under either structure. To be deductible the ‘gift’ must be made in a form that will satisfy the test set by the general deduction formula ie be incurred in the production of income. The type of payment that would both secure a deduction and provide a similar link to the success of the business as a participative share, would be a variable bonus based on 1% of the earnings of the business.

In addition, the payment of a bonus will avoid a charge to stamp duty on the transfer of an interest in the partnership/shares in the company.

- (c) For estate duty purposes, both forms of investment (partnership interest or company shares) will be regarded as movable assets, and as such subject to estate duty on Timothy’s death. The value to be included in Timothy’s estate will be based on the net asset value of the business, subject to any adjustment for goodwill.

The rate of estate duty payable will depend on the overall value of Timothy’s estate and the extent of his other moveable assets, as the first \$600,000 of moveable assets (including CPF balances) is exempt from estate duty and duty is levied at 5% on the first \$12 million of chargeable value and 10% thereafter.

- 4 (a) Option 1 – Under this option, the remaining investment will be funded by a loan from UOB Ltd. It will have no adverse impact on the investment allowance incentive and the interest cost incurred will be tax deductible.

Option 2 – The position is similar to Option 1, except that the loan is from the Hong Kong office of the Hang Seng Bank Ltd. So again, there will be no adverse impact on the investment allowance incentive and similarly, the interest cost incurred will be tax deductible

Option 3 – The payments made under the operating lease will be tax deductible but will not be regarded as qualifying fixed capital expenditure under the investment allowance scheme. Technology will therefore, need to obtain Economic Development Board (EDBs) approval for the change of investment plan, if the incentive already claimed on the initial \$5m is not to be withdrawn.

Option 4 – The interest payable under the hire purchase contract will be tax deductible and capital allowances will also be available. But, under this option, only the capital payments made up to 31 December 2008 will qualify for the investment allowance, so as in Option 3, Technology will need the EBD's approval for the change of investment plan to preserve its eligibility for the incentive.

- (b) Under options 1 and 4 there will be no withholding tax, as the payments are made to persons resident in Singapore.

Under option 2, the interest payable to Hang Seng Bank Ltd will attract Singapore withholding tax at the rate of 15%.

Similarly, under option 3 the amounts payable to the Hong Kong investment company under the lease are rentals for the use of immovable property, and thus, will also be subject to Singapore withholding tax at the rate of 15%.

- (c) To maximise the investment allowance incentive, Technology should only consider options 1 and 2. This is because only in the case of these two options is the amount eligible for the investment allowance unaffected.

Under option 1, the gross interest rate is 4.5%. Under option 2, the interest rate is 3.5% net of withholding tax, which is equivalent to a gross interest rate of 4.12%. Thus, as the interest is tax deductible under both options, option 2 is the more cost effective, both before and after tax.

However, this ignores the potential currency exposure of the overseas loan, and as the loan is on capital account, tax relief will not be available for any exchange loss that occurs.

- (d) The main reasons why the investment allowance incentive is preferable to the pioneer incentive are as follows:

- (1) Under the investment allowance scheme, the amount of tax exempt profit is based on the amount of qualifying capital expenditure. This amount is therefore, more predictable than the profits of the company during the pioneer tax relief period, particularly as this period is also longer than the qualifying period under the investment allowance scheme.
- (2) There is no time limit or other restrictions on the carry forward of the investment allowance, and tax payable can thus be further deferred while maximising the available capital allowances claim. On the other hand, a pioneer company's tax relief period is fixed and the benefit of the tax exemption may be 'eroded' by the mandatory requirement to claim capital allowances.

5

XY Tax Advisors
Address
Date

John Lim
Address

Dear John

I set out below my advice on the various issues raised with respect to your overseas assignment.

(a) Income tax position

Under Singapore's territorial basis of taxation, income derived from or accrued in Singapore or received in Singapore from outside Singapore is chargeable to Singapore income tax. However, from 1 January 2004, an individual resident in Singapore is exempt from tax on any income arising from sources outside Singapore, even if it is received in Singapore. As a Singapore citizen, you will remain tax resident in Singapore notwithstanding that your presence in Singapore in a year may be less than 183 days.

It follows from the above, that following your departure on 1 July 2007, you will be taxed only on your income sourced in Singapore. This will include the net rental income of \$5,000 and any gain from the exercise of the stock options granted to you in respect of your Singapore employment. You can however claim the wife and child reliefs, assuming that the conditions for such claims are met.

Remittance of your offshore employment income will be tax exempt. As the contractual CPF contributions are not deemed income under section 10C of the Singapore Income Tax Act, these will also be excluded.

(b) Stock options

The gain from the stock options will be taxable only upon exercise, because as a citizen of Singapore, the deemed exercise provision will not apply to you. On exercise, the gain from each the stock option is the excess of the market value of the share

at the time of exercise over the price paid for the option. Hence, I would recommend you to exercise the options as early as possible instead of waiting until the price reaches your target price of \$2.50. The reason for this is because if you exercise the options when the price is \$1.80, the gain subject to tax will be \$0.80 per share but when the share is eventually sold at \$2.50, the subsequent gain of \$0.70 should be regarded as a capital gain, and thus, be free from Singapore income tax.

(c) Ongoing tax obligations

If after deducting the available personal reliefs you still have income chargeable to tax in any year, you will be required to file a tax return with the Singapore Inland Revenue, even though you may not be physically present in Singapore.

The return must be filed by 15 April each year and can be submitted either through e filing or by sending back a hard copy of the return to the Singapore Inland Revenue. Failure to comply will make you subject to the general penalty of a maximum fine of \$1,000.

(d) Structuring your remuneration package

If you meet the conditions set out in the China-Singapore double tax treaty, your employment income will remain taxable in Singapore; if not you will be taxable in China. However, because your job requires you to spend about 50% of your time outside China you should consider mitigating your exposure to the higher China rates by structuring your employment using dual employment contract.

In a dual employment situation, one contract will be entered into with the China company for your duties in China, the income derived from which will be taxed in China. But a second contract can be entered into with your current Singapore employer for the duties undertaken outside China, elsewhere in the region. Income arising under this second contract with your current Singapore employer, will be regarded as income sourced in Singapore and hence taxable in Singapore. This is because the Singapore Inland Revenue will view it to be income from an employment exercised in Singapore.

Another alternative, might be to enter into a contract with a Hong Kong company, if the nature of your duties outside China are such that the contract can be structured so as to subject some of this income to tax at lower rates than those applying in Singapore.

If you have any further questions, please contact me again.

Yours sincerely

Tax adviser.

		Marks
1	(a) HPL	
	Rental income taxable	1/2
	No carry forward for excess CAs	1
	Bungalow expenses not deductible	1
	Taxable benefit on directors	1/2
	Gain taxable as revenue in nature	1
	Change of intention	1
	Long term investment holding	1
	Gain taxable due to other development activities	1
	Appropriate reference to the badges of trade	1/2
	PHPL	
	Potential carry forward restriction	1
	Defer claim to CAs	1
	Dividend tax exempt with reason	1
	Interest deduction of no benefit	1
	DPL	
	Interest taxable	1/2
		<hr/> 12
	(b) Undeveloped land	
	Advice incorrect	1
	Deduction available if held as trading stock	1
	Interest paid	
	Advice strictly correct	1
	Administrative concession available	1
		<hr/> 4
	(c) Defer CA claim	1
	Revise rental agreement for PHPL to claim CAs	2
	Rent out bungalow	1
	Ability to offset deficit	1
	Review intention	1/2
	Transfer to land to DPL	1
	Establish gain as capital in nature	1/2
	Reaffirm HPL's investment holding status	1
	Defer CA claim	1/2
	Repay loan	1/2
	Utilise DPL's surplus funds	1
	No need to charge interest with reason	1
	Need to document reason for refinancing	1/2
	Place funds offshore	1
	Defer tax liability until remitted	1/2
	Avoid tax altogether if used appropriately	1
		<hr/> 14
		<hr/> 30
2	(a) Income tax	
	Fixed assets: balancing adjustments on disposal	1
	use of unabsorbed allowances	1
	s24 election	1
	consequences of election	1
	Trade debts	1 1/2
	Non-trade debts	1
	Trading stock	2
	Creditors and cash	1
	GST	
	Standard rated supply	1
	Transfer as a going concern	2
	Availability of an advance ruling	1/2
		<hr/> 13

	Marks
(b) Appreciation of the nature of such a restriction/its tax implications	1
Absence of such a provision in Singapore law	1
	<hr/> 2
(c) Royalty	
Income derived from Singapore	1
Withholding tax consequences	1
Possibility of reduction by tax treaty	1
Application under EEIA	1
R&D costs	
Pure reimbursement of costs	1
Allocation basis	1
Evidence of breakdown required	1
	<hr/> 7
(d) Due date/timeline	1/2
Late payment penalty	1/2
Additional penalties	1
	<hr/> 2
	<hr/> 24 <hr/>
3 (a) Computational working	
Adjusted profit/loss	1/2
Capital allowances	1/2
Timothy's divisible profit less CAs	1
employment income	1/2
Company: CAs current year	1/2
CAs brought forward	1/2
losses brought forward	1/2
Partnership	
Offset loss against employment income	1
Immediate relief	1
Marginal rate of tax 20%	1
Company	
Carry forward in company only	1
Continuity of ownership test	1/2
Additional continuity of trade test re CAs	1
Tax exemption not applicable with reason	1
Full exemption applies	1/2
No tax re dividend with reason	1
Conclude in favour of company	1
	<hr/> 13
(b) Gift taxable with reason	1
Basis of valuation	1
Gift not a deductible expense	1
Need to satisfy general deduction formula	1
Valid alternative method eg bonus	1
Reference to stamp duty position	1
	<hr/> 6
(c) Both investments moveable assets	1
Basis of valuation	1
Rate of tax dependent on size of overall estate	1
\$600,000 exemption	1
	<hr/> 4
	<hr/> 23 <hr/>

		Marks	
4	(a) Option 1: no impact	1/2	
	interest deductible	1/2	
	Option 2: no impact	1/2	
	interest deductible	1/2	
	Option 3: lease payments deductible	1/2	
	non-qualifying expenditure	1	
	EDBs approval with reason	1 1/2	
	Option 4: interest deductible	1/2	
	CAs available	1/2	
	qualifying expenditure to 31/12/08	1	
EDB approval with reason	1		
		<hr/> 8	
(b)	Options 1 and 4 no withholding	1	
	Option 2 withholding on interest	1	
	Option 3 withholding on lease rentals	1	
		<hr/> 3	
(c)	Should only consider options 1 and 2 with reason	1 1/2	
	Compare on basis of gross interest rates	1	
	Correct re-computation of interest re option 2	1	
	Conclusion for option 2 on this basis	1/2	
	Identify potential currency exposure issue	1	
	Currency loss not deductible	1	
		<hr/> 6	
(d)	Tax exempt profit clearly determinable	1 1/2	
	Comparison with pioneer scheme	1 1/2	
	Greater flexibility to maximise allowances	1 1/2	
	Comparison with mandatory pioneer scheme	1 1/2	
		<hr/> 6	
		<hr/> 23	
5	(a) Basis of taxation	1	
	Tax exemption from 1 January 2004	1	
	Residential status of John	1	
	Position re:		
	– rental income	1/2	
	– stock options, with reason	1	
	– China income	1/2	
	– CPF contribution	1	
	– claiming of reliefs	1	
			<hr/> 7
	(b)	Stock options	
		– Taxable only on exercise	1
		– Basis of taxation	1
– Recommend early exercise, with reason	1		
		<hr/> 3	
(c)	Obligation independent of physical presence	1	
	Filing procedure/date	1	
	Penalty	1	
		<hr/> 3	

	Marks
(d) Effect of meeting/not meeting DTA conditions	1½
Use of dual employment contracts	2
Employer in China	1
Employer in Singapore	2
Possibility of contract with HK company	1½
	<hr/>
	8
Format and style:	
Appropriate format and presentation	1
Effectiveness of communication	1
	<hr/>
	2
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	23
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