FISCAL INCENTIVES FOR INVESTMENT IN SINGAPORE: THE ECONOMIC EXPANSION INCENTIVES (RELIEF FROM INCOME TAX) ACT OF 1967 AND THE 1970 AMENDMENT TO THE ACT*

1. INTRODUCTION

a. *Economic growth and tax incentives*

Since the end of the Second World War, the expectation of significant material progress has become a powerful political and social force in many countries whose economic energies have been long dormant and whose material well-being relatively retarded. Governments and people around the world are embracing the view that such progress is immediately achieveable, and that success in that direction will open the flood gates of their own native ingenuity, vigour and discipline; that a beginning upon the road to economic prosperity will accelerate into great things.

Together with such ambitions has arisen a heightened awareness of the key role of tax legislation and tax administration in influencing the pace and direction of economic development. This is so because many countries experience insufficient revenues, a maldistribution of wealth, or a lack of refined fiscal tools for controlling inflation or guiding savings and investment trends. Such shortcomings thwart economic progress. Where the rudiments of control for implementation of a fiscal policy are absent, the necessity of reshaping the tax system so that its burden distribution is consistent with economic development becomes acute. There is also a corresponding increase in experimentation, in utilizing the tax laws as mechanisms for diverting the flow of investment

* For the text see Cap. 135, 1970 Rev. Ed., vol. 4.

A few weeks after the original manuscript on the Economic Expansion Incentives Act of 1967 was completed, the Amendment to the Act was introduced in Parliament and read for the first time on 26 June 1970. Therefore the publication of the original material on the 1967 Act was delayed to give the author time to add a "postscript" concerning the Amendment. Rather than rewrite the entire paper to conform to the Act as amended by the 1970 Amendment, the author chose to add a final section analyzing the Amendment, its effect on the Act, and has commented briefly on its usefulness to the Government and the latter's drive for economic development. This choice was based on three factors: (i) the author believes that an understanding of the Act prior to its amendment is useful in understanding the changes in economic policy presented by the amendment; (ii) the Act continues to be operative for those enterprises granted certificates under its five incentive schemes prior to the enactment of the amendment; and (iii) pressures of times prevented the author from completely reworking the original material."

away from activities that have little or no development merit into activities whose encouragement is important for development. For example, higher taxes may be used to encourage the breaking up of large holdings of inefficiently exploited land which constitute an obstacle to economic and social progress so that they may be exploited more effectively. Taxation may also be used as a means of channelling capital away from luxury imports and consumption, into economically desirable savings or investment.

However, the most common development-oriented tax legislation are tax laws that reduce taxes for persons engaging in selected activities whose encouragement is considered of particular economic or social value. Such statutes or provisions are found in many countries,[1] either as integral aspects of a development programme, or as special measures operating independently thereof. In some countries tax incentives may represent the major legislative effort made to hasten development; in others, they may represent only one among a variety of measures which may have been undertaken for this purpose. These "tax subsidies" may be cast in a variety of forms. The most common are partial or complete exemptions, ordinarily for a limited period of time, from one or several taxes, and special allowances under the individual and corporation taxes for accelerated depreciation or re-investment.

Tax preferences, cast in one or in some combination of these forms, have been enacted in many countries in order to promote a variety of non-industrial activities, such as the promotion of tourist facilities or hotel construction. But the major significance of tax incentives lies in their utilization as a means of promoting objectives associated with manufacturing activities. One such objective may be to encourage investment in selected manufacturing activities of special economic worth, as for example, enterprises which manufacture machine tools, import substitutes, or products for export or enterprises which employ or train substantial numbers of workers. Other objectives may be to encourage the improvement of product quality or the utilization of domestically manufactured raw or semi-finished goods.

b. *Tax incentives: to be or not to be ?*

It may be paradoxical that these incentive devices have attained prominence in development planning in many countries at just the time when the need for over-all tax revision has come to be widely recognized as urgent. While the usual objectives of basic tax reform are to increase revenues, eliminate arbitrary or unfair differentials in tax burden distribution, and modernize and strengthen the tax administration, the enactment of tax incentive legislation has a contrary thrust. This type

1. See the pamphlet, *Taxation and the Developing Nations* (1959), International Chamber of Commerce (ICC) publication, in which a tabular summary of tax incentives offered by fifty-five "developing countries" is provided. See also, UNIDO, *The Incentives for Industrial Development,* ID/CONF. 1/B.2, 2 May 1967.

of legislation reduces government revenues (at least in the short run), introduces new differentials in tax burden distribution for taxpayers with equal incomes, penalizes older established industries when it comes to competition, and imposes new strains on the tax administration.

Proponents of tax incentive legislation urge that the social and economic advantages accruing from incentives outweigh their disadvantages. Incentives will result in a substantially increased level of investment and economic activity whose importance to development will outweigh whatever administrative burdens of revenue and equity costs result from their adoption. Indeed, in so far as incentives stimulate investment that would not otherwise have occurred, there may be no loss in revenue. Since the tax exemptions ordinarily terminate after a fixed period of time, the result is a net increase in the size of the national tax base. In addition, a tax law which is ostensibly intended to induce investment may in reality be a much needed basic tax reform: it may, for example, eliminate a high tariff on the importation of industrially necessary machinery or equipment. Finally, modest tax incentives that are limited in time may be the politically expedient *quid pro quo* for achieving more permanent and important tax law revision.

Opponents of incentive legislation maintain, on the other hand, that while the tax reform aspects of such legislation may be desirable, incentives, *per se,* are not. They doubt that tax incentives will alter economic behaviour or investment patterns to a sufficient degree to justify the costs in revenue, tax fairness, or the diversion of limited administrative resources which their introduction require. Instead of inducing investments, incentives could well merely confer windfall benefits on taxpayers who would have made substantially similar investments without the added impetus of incentives. Again, the objectives of incentive legislation can be achieved through what are believed to be more equitable, more efficient, or less costly measures, such as over-all tax reform without unnecessary incentive features, direct subsidies, loans, or other forms of special assistance to investors.

One might go on about the advantages and disadvantages of tax incentives, and even cite examples to illustrate each point, but there is a growing realization that the question can only be resolved in the context of the particular country which is contemplating introducing tax incentives to aid the development programme and by examining the type of such incentives proposed with due regard to the country's circumstances. In any case, as the author seeks to show later in this article, evaluation of incentive devices in terms of investment encouragement is a very uncertain process.

c. *Comparative study of tax incentives in different countries*

One observation must now be made on a matter which invariably turns up whenever any analysis of tax incentives is attempted — and that is the problem of realistically comparing tax incentives offered by various countries. Such comparison is extremely difficult because the

significance and value of tax incentives for a particular country can be evaluated only by specific reference to the economy, the tax structure, and the administrative and political setting in which the particular incentive operates. Thus, the adoption of tax incentives in one country on the grounds that these devices have been successful in another, without a thorough comparative analysis of the many and possibly unique circumstances in which these incentives have operated, is probably misguided. Such analyses are outside the scope of this article. The setting in the country in which the incentive schemes have operated successfully may be so different from that in another where their use is contemplated that the experience in the former is largely irrelevant to policy planning in the latter. For example, the success of tax incentives in Puerto Rico, where they are believed to have contributed materially to the substantial industrialization within the last few years, is often cited as evidence of the general efficacy and utility of tax incentives, and as sufficient reason for their adoption in other countries.[2] However, since the crucial factor in the Puerto Rican experience with tax incentives is probably the unique relationship of that country to the United States, the generalization that tax incentives will be useful to all countries is misleading.

d. *Yet — tax incentives*

Despite the uncertainties of tax incentives, their adoption in many countries without sufficient prior analysis of the situation is perhaps understandable. Inducing economic progress in an intractable or only sluggishly responsive environment is a challenging but difficult task. The urgency of advancing economically is obvious, but the appropriate means of so doing are not. Hence, the introduction of measures that promise to hasten progress cannot await protracted theoretical study and demonstration, but must proceed upon a pragmatic experimental basis. Indeed, the common sense appeal of the simple premises upon which incentives are predicated may have had a disproportionate appeal to development planners. Incentives appear to offer a relatively straightforward, and therefore an easier and more certain, means of promoting industrialization compared to other long-term or complex measures that are more difficult to implement. Also, since little or no opposition to their enactment is likely in most countries, incentives are usually among the relatively few measures that the development planner can propose and hope to have readily adopted. Of equal importance is the additional attraction that incentives are one of the few immediately identifiable and concrete signs of "change" or "progress" that the planner can attribute directly to his efforts.

Even where tax administrators or development planners have been doubtful of the value of tax incentives for inducing investment, and in fact have objected to their adoption, for example, on the basis of their revenue costs, they probably have felt impelled to acquiesce in the adop-

2. See Bryce, M.D., *Policies and Methods for Industrial Development* (1965), Chapter 12.

tion of these measures because of taxpayer pressures or other political and extra-economic circumstances. They are then left to confine their opposition by restricting the benefits provided under the law, and in this way limit the cost or complexity of its implementation. The desire to offer as attractive an inducement package as possible, and the felt need to utilize every potentially useful development measure conflict directly with qualms as to revenue loss and doubts as to ultimate effectiveness. This is perhaps the situation in Singapore, more so than the vigorous investment brochures and the intense publicity given to foreign approval and interest would have one believe. One has only to make a cursory comparison of the incentives offered in the Economic Expansion Incentives (Relief from Income Tax) Act, 1967,[3] with those found in, say, the Malaysian Investment Incentives Act, 1968,[4] to realise that Singapore offers the investor less in the way of tax exemption or relief, than does Malaysia, if viewed on a quantitative basis. The drafting of the Singapore Statute, except for Part II,[5] is tight, particular and restrictive. The unusual limitations and programmes for computation make it very obvious that the government, at its most generous, is not giving too much away. For example, the exemption which a company manufacturing for export may win depends on its performance in the light of two unusual concepts — larger export profits, and ability to find new export markets. Blanket or automatically operative exemptions are never given, unlike the situation in many other countries.

The businessman and the economist do not always agree. For the manufacturer, the focal point upon which all his activities depend is the maximization of profits. Development planners, tax administrators and government fiscal authorities see things from a much larger perspective. Some of these latter persons very definitely feel that tax incentives are at best only a fringe benefit in so far as Singapore is concerned, and that the country can well manage without them: that the administration of a tax incentive statute is an unnecessary additional burden upon the Republic's desperately busy Inland Revenue Department. That being so, Singapore could well be offering tax incentives as (1) part of a limited keeping-up-with-the-Joneses-type attitude, in view of the superficially sparkling kindred benefits offered by other countries in the region; (2) as a signification of governmental interest and encouragement to private participation in industrialization; and (3) as a sort of rider thrown in as an additional attraction in the over-all package. Hence the limited tax exemption offered by the Act — a cautious, exploratory venture.

One thing, however, is certain: that is that tax incentives are almost never offered as the sole underpinning of an investment promotion drive. This is undoubtedly the case in so far as Singapore is concerned. The investor never bases his investment decisions upon the tax factor alone;

3. No. 36 of 1967.

4. No. 13 of 1968.

5. For a discussion of Part II, regarding the pioneer industries scheme, see *post*, pp. 10-29.

in any case, tax exemptions are almost always hedged by revenue and administrative considerations. This is the perspective from which we should look at the Act, which has a total bias towards manufacturing activity, in keeping with present development policy.

e. *Scope of the article*

The second section of the article introduces the Economic Expansion Incentives (Relief from Income Tax) Act, 1967, while the third to seventh sections deal with the various incentive schemes contained therein. An attempt has been made to describe the provisions from the aspect of policy and change. Some observations have been made as to their effect, past and/or potential. Many of the Act's provisions need no elaboration, but the operative mechanics of each scheme, especially the formulae for computing tax-exempt sums, have been explained. The eighth section lists some miscellaneous provisions under the Act, while the ninth section evaluates the Act as an instrument to achieve economic policy objectives.[6] Finally, the tenth section examines and analyzes the 1970 Amendment to the Act.

2. THE ECONOMIC INCENTIVES (RELIEF FROM INCOME TAX) ACT, 1967

a. *Introduction*

This Act[7] was passed by Parliament on 5 December 1967 and was assented to by the President on 9 December. It was published for general information on 15 December but was not brought into operation until 1 August 1968 by the Minister of Finance.[8] The Gazette notification[9] backdates the Act, which is to have retrospective effect as from 15 December 1967. Drafted after consultations between the Economic Development Board, the Minister of Finance and the Inland Revenue Department it is a piece of legislation thought to be long overdue as a part of Singapore's investment promotion programme. It was largely a result of the Economic Development Board's insistence upon the urgency of providing new bases for aid and encouragement to industry; frequent reference being made to the example (and menace) of Hong Kong and Taiwan, which offer attractive tax measures to the investor.

The preamble recites that this is an Act to amend and consolidate the laws relating to incentives for the establishment of pioneer industries and for economic expansion generally, by way of providing relief from income tax. This is an accurate description of the Act's compass, since

6. Some comments and suggestions are ventured throughout the article. The ninth section is intended as an over-all commentary regarding administrative matters, and more detailed commentary on two particular schemes contained in the Act — the pioneer industries scheme, and the export incentive scheme.

7. No. 36 of 1967. For convenience it will hereinafter be referred to as "the Act", and its provisions will be denoted by their bare section numbers.

8. Acting in pursuance of the power under s. 1(1). There is no particular reason for the delay; Economic Development Board officials acknowledge that it was due to some administrative inadvertence.

9. Government Gazette; Subsidiary Legislation Supplement No. 58, 1-2 August 1968: Vol. X, No. 76; Notification No. S. 217, p. 453.

it incorporates all the tax incentive schemes presently available to the Singapore investor.[10] The Act repeals[11] two earlier laws, which, taken together, offered the first and hitherto only tax incentives in Singapore's experience which were specifically directed towards the investors. The first of these was the Pioneer Industries (Relief from Income Tax) Ordinance, 1959 ;[12] the other, the Industrial Expansion (Relief from Income Tax) Ordinance, 1959.[13] The former had been in operation since 1959; it was originally scheduled to lapse after six years from its day of commencement i.e., some time in 1965.[14] Up to the end of 1964, while Singapore was still in Malaysia, the Inland Revenue Department in Singapore handled tax administration in the State. In 1965 tax matters became

10. With two main exceptions:

(1) s. 14B, Income Tax Act (Cap. 166), see now, Cap. 141, 1970 Rev. Ed. vol. 4, which was a measure hurriedly introduced in the first half of 1966 following closely upon Singapore's separation from Malaysia. This provision permits deduction, for the purposes of income tax, of market development expenditure incurred by way of advertising, sample distribution, market research, preparation of tenders for prospective customers outside Singapore, and travel to negotiate sales. Where the goods in respect of which the expenditure is incurred are sold in Singapore, deduction is only allowed in respect of advertising expenditure. In practice, this benefit was largely invoked in the development of domestic markets alone, which were so small that the incentive was a failure from the economic policy viewpoint, having failed to encourage export market development. The Minister now no longer entertains applications under s. 14B, and there is talk of its repeal. Present planning policy appears to be to try to withdraw all approval given under the section, one of the many instances where administration of a tax law is as important an instrument as the law itself in implementing economic development plans. Also, where a company qualifies for relief as an export enterprise under Part IV of the Act, it loses any relief to which it may have been entitled under s. 14B — see p. 51, footnote 14.

(2) Accelerated capital allowances under s. 19A, Income Tax Act (Cap. 141, 1970 Rev. Ed.). This incentive was introduced in 1965, under which an industrial enterprise (as defined in the 4th Schedule to the Income Tax Ordinance) which incurs capital expenditure in the acquisition of plant or machinery on or after 1 January 1965, can write off, in three years, the entire original capital cost of such plant or machinery. Such special capital allowances are in lieu of the ordinary initial and annual allowances accorded to taxpayers in the computation of their income for income tax purposes under s. 19 of the Income Tax Act. These latter allowances are spread over a much longer period and are at lower rates. Section 19A is presumably intended to replace the inert Industrial Expansion (Relief from Income Tax) Ordinance, No. 2 of 1959, in an attempt to encourage capital investment. Section 19A fulfils its intended purpose, and there is every intention to continue affording its benefit to the investor, it is almost invariably claimed in tax returns made by manufacturers.

These are the two main direct tax incentives available in addition to those in the Act. They are typical of that type of incentive which is incorporated into the regular tax infrastructure, being almost automatic in operation and requiring no administrative discretion. They are also intended to apply to every enterprise carrying on a business in Singapore, whether manufacturing or otherwise — not just to enterprises especially gazetted by the Minister under the Act, or otherwise selected for the conferment of benefits. Other examples of such incentives may be found in ss. 40A and 40C of the Income Tax Act, which, however, operate indirectly to assist the investor by lessening the tax burden upon industrial personnel from other countries who are helping to get Singapore's industries under way.

11. By s. 56(1).

12. No. 1 of 1959.

13. No. 2 of 1959.

14. No. 1 of 1959, ss. 4(5) and 5(4).

the responsibility of the Malaysian government and the Malaysian Parliament enacted legislation which extended the Ordinance's operation for another three years.[15] Thus, for example, declarations of new pioneer industries and products were still being made by the Minister under S. 4 of the Ordinance in July 1968. Any difficulty which might have arisen out of the fact that the Ordinance is now deemed to have been repealed as from the date of commencement of the present Act i.e., 15 December 1967 is resolved by the Act's repeal and transitional provisions, which provide that any declaration made under the Ordinance shall be deemed to have been made under the Act.[16] The other Ordinance repealed by the Act, the Industrial Expansion (Relief from Income Tax) Ordinance, 1959,[17] was never brought into operation; in any case, it would have lapsed three years from its commencement day.[18] Under this law, approved enterprises which incurred new capital expenditure of not less than S$10,000, were to be given allowances in respect of such expenditure, deductible in computing their incomes for tax purposes. Such allowances were proportional to the amount of expenditure incurred, and were to be in addition to the ordinary allowances available to any enterprise under the Income Tax Act.[19] The writer surmises that the non-operation of this scheme was due to a realization that it was of far greater economic worth to encourage *new* industries to be set up, rather than to encourage already existent companies to expand. The Jurong Industrial Estate was, in 1960, in its initial stages of development, and new industries would in turn generate other activities, as well as encourage other industries to begin. Established industries, if they were of any consequence, were quite capable of expansion without the aid of incentives. It might be noted, however, that the present scheme under the Act intended to encourage plant expansion — Part III thereof — is also for the benefit of already established industries, though the method of granting relief is on a basis different from that of the non-operational Expansion Ordinance.

Tax incentives to industry cover partial or complete exemption from a variety of taxes and special allowances for re-investment or rapid depreciation. The Act is typical of that type of incentive statute, used in many countries, which requires the exercise of administrative judgment in determining, on a case-by-case basis, whether benefits should be granted to individual applicants. Such statutes also ordinarily tailor the type, amount and duration of benefits to the particular taxpayer. There is expert opinion to the effect that statutes of this type present significant technical problems of design and difficult problems of administration, which must place their usefulness or desirability for many countries in serious question; that the disadvantages of tax incentives are seldom offset by the advantages that their use may afford to most

15. Pioneer Industries (Relief from Tax) (Variation) Act, 1965, extended throughout Malaysia, s. 2(b), Second Schedule, paragraphs 1 and 3 thereof.

16. Section 56(2)(b).

17. No. 2 of 1959.

18. *Ibid.,* ss. 4(4) and 5(5).

19. Cap. 141, 1970 Rev. Ed., ss. 16-22.

economically less developed countries.[20] This article seeks, *inter alia,* to examine whether the Act falls under the same condemnation in the light of the Singapore situation; lest condemnation appear too strong a word, it should be noted that development planners are presumed to be concerned more with schemes that enable solid grounding and long-term benefit, than with show-window devices.

b. *Outline of the Act*

Part II of the Act offers tax relief in respect of the whole income earned by a company holding a pioneer certificate. The provisions of this Part are compared with those found in the old Pioneer Industries (Relief from Income Tax) Ordinance, 1959,[21] which they supersede. The scheme is the only one offered by the Act which has had a chance of operation over a period of something like ten years.

Part III of the Act extends income tax relief to companies which have made further investment by way of new capital expenditure. A company applying for the benefit under this scheme has to fulfil a great many conditions and actual tax exemption is calculated, not upon the value of the new capital expenditure but upon the increase in income arising from the use of the new capital assets acquired with such expenditure. The scheme is one of many incentives offered to encourage capital investment and expansion in Singapore, but the benefit thereunder is not overly generous.

Part IV was viewed by many as potentially the most important addition to tax incentive legislation in Singapore. It offers total tax exemption on a certain computed portion of the total profits derived from the export sales of an export enterprise, provided such sales exceed a certain level in terms of both percentage and proportion. When this scheme was first announced by the Minister of Finance prior to its enactment, it created considerable enthusiasm amongst Singapore manufacturers, for what was evidently expected was a simple cut in company tax from 40% to 4% on export profits. However, the scheme as it finally appears in the Act is the cause of some disappointment on the part of those who had received its initial announcement with approval, for the amount of profit exempted from tax is to be calculated on the basis of better performance rather than upon the attainment of a fixed level of exports, or even income therefrom. Other restrictions have also been introduced; indeed, one thing that the reader may well notice in due course is the almost contorted formulae for the calculation of exempt income laid out in the schemes found in Parts III and IV of the Act, which may raise doubts as to their potential effectiveness as incentives and/or ease of administration.

Parts V and VI are intended to assist the Singapore investor in the purchase of foreign-made capital equipment under private foreign loans and in the importation of foreign experience and technology. This is

20. Heller, J. and Kauffman, K.M., *Tax Incentives for Industry in Less Developed Countries* (1963), Harvard Law School International Programme in Taxation Chapter 2.

21. No. 1 of 1959.

done by offering fiscal incentives to these foreign sources in an apparent attempt to induce them to grant the Singapore investors more favourable terms in their transactions.

The four new incentive devices contained in Parts III - VI are to operate in respect of the year of assessment 1967 and subsequent years of assessment.[22] The Act is to be construed as one with the Income Tax Act;[23] how this works out will be seen in subsequent chapters. Section 3 is the interpretation section to which continuous reference will be made.

Part VII contains miscellaneous provisions as to powers and offences under the Act, including the very important (and new !) power of revocation of certificates given to the Minister by S. 46. Part VIII makes possible a smooth transition from the Pioneer Industries (Relief from Income Tax) Ordinance, 1959,[24] to the Act; enterprises holding a pioneer certificate granted under the Ordinance come under the provisions of this Act.[25] This is unlike the position under the Malaysian Investment Incentives Act of 1968, where S. 34 provides that a pioneer company holding such status immediately before 1 January 1968, under the older legislation, should continue thereunder; but have leave to apply for extension of its relief period under S. 14 and take advantage of the notional allowance scheme under S. 18(3).

It might be noted that the Act, unlike the two Ordinances which it repeals, does not have its operation limited in time — which, it is submitted, is a sensible approach in view of the contemplated length of the Republic's development programme, and the continuing need to attract investment. At the time the Pioneer Industries (Relief from Income Tax) Ordinance, 1959,[26] was enacted, it was thought that after a period of six years, there might be little or no necessity to give any more incentives: if there still remained such necessity, there would be time in any case to review the provisions. In administering the pioneer industries scheme under the Ordinance, the Inland Revenue Department found that it had cost the Republic a substantial amount of revenue, but also concluded that incentives still had to be offered in view of the ever-increasing problem of providing employment, and the intensely competitive pace at which neighbouring countries in the region were proceeding with their investment attraction programmes.

3. PIONEER INDUSTRIES

a. *Introduction*

Part II of the Act replaces the Pioneer Industries (Relief from Income Tax) Ordinance, 1959.[27] Even at the time of enactment of the Ordinance, the idea of granting pioneer status to new enterprises had been tried

22. Section 1(2).
23. Section 2.
24. No. 1 of 1959.
25. Section 56(2) (a), (3).
26. No. 1 of 1959.
27. *Ibid.,* hereafter referred to as "the Ordinance."

out in many countries, and some guidelines for the drafting of the Ordinance had been found in some African, Central American and Caribbean tax incentive legislation. Part II of the Act contains such changes as were found to be necessary through the experience gained during the scheme's initial eight years of operation. Basically the tax incentive scheme in this Part is meant to affect the decisions of potential investors — local and foreign — by encouraging them to establish industries in Singapore to either manufacture or process goods which are not being produced in Singapore, or which are being so produced but in insufficient quantities.[28] The incentive is meant first and foremost to encourage industry that will provide more job-opportunities for Singapore's labour force, which is growing at a critical rate. Therefore, since current development policy is to look towards more employment opportunity, enterprises intending to engage in labour-intensive processes have had their applications for pioneer certificates received favourably by the Minister of Finance. Of course, this is not to say that the Minister does not entertain applications from enterprises outside such a description, particularly from export-oriented enterprises. Indeed, in the past two years there appears to have been an increasing shift away from using labour-intensiveness as the major criteria.[29]

It should be noted in passing that under the Ordinance, the investor eligible to apply for pioneer status was an "enterprise",[30] which was defined as meaning (a) any company incorporated or registered under any law in force in Singapore; (b) any company incorporated outside Singapore; (c) an individual carrying on trade or business as sole proprietor; (d) an association or body of persons carrying on trade or business in partnership.[31] Under Part II of the Act, the eligible investor is a "company",[32] which is defined as "any company incorporated or registered in accordance with the provisions of any written law relating to companies".[33] The reason for this narrowing of the field of potential beneficiaries brings out a lesson learned through the years. The individual and the partnership have been cut out of the picture because they are too small to justify the added cost and burden of administration that would result if they were accorded relief under the scheme. Such enterprises can hardly employ a substantial labour force; their whole scale of activity and profit-making is not sufficiently large to make their inclusion under the scheme worthwhile.

28. Section 4(1).

29. Emphasis on labour-intensive operations can be carried only so far, particularly where production by machinery is more efficient than by labour-intensive methods. In addition, production by labour-intensive processes is likely to be less standard in terms of out-put flow and quality than capital-intensive production.

30. The Ordinance, s. 5(1).

31. *Ibid.,* s. 3.

32. *Ibid.,* s. 5(1).

33. *Ibid.,* s. 3(1).

The other reason for their exclusion is that it was found impossible to supervise them satisfactorily; not having to meet the stringent requirements of corporation law, their accounts could not be accurately checked for the purpose of determining correct profits for tax relief. They were found to indulge in activities other than the manufacture of the pioneer products to which their pioneer certificates related, without the Minister's consent, in contravention of S. 12 of the Ordinance. The first time the authorities knew of such side-line activity was when annual accounts were submitted to the revenue department. Attempts were then made to control such activities by imposing conditions, etc., in the pioneer certificate, but these proved ineffective. The authorities had no instrument of coercion; under the old Ordinance the Minister had only a very limited power of revocation of the certificate. In many cases, even where non-pioneer activities were carried on with leave, tax-exempt profits grew suspiciously; and because of poor control over accounts, these were allowed. Generally, the Ordinance's stipulations were not followed too closely. There was therefore a policy decision that in future, all pioneer enterprises should be companies, either incorporated in Singapore under the current Companies Act,[34] or registered thereunder, so that they would come under such Act's requirements and benefits. It should be noted that this "company-bias" runs throughout all the schemes in the Incentives Act. Companies incorporated outside Singapore may partake of the tax benefit when they have places of business, or carry on business, in Singapore; the Economic Development Board, however, encourages the potential investor-company to incorporate a subsidiary or an associate company in Singapore under Singapore law.[35]

34. 1967; formerly the Companies Ordinance (Cap. 174).

35. Control and checking may be carried out more easily upon such companies. Furthermore, branch offices are normally regarded as part of the head office, with the result that the operations of such branches are caught in the tax net of the country within which the head office is resident, especially if the tax is imposed on a world-wide basis, as is the case in many countries. Singapore does not see why profits derived in and from Singapore should be used to increase other countries' revenues.

It should be noted, however, that this may still be the major effect of tax exemption in those cases where the relief results in greater profits which are remitted to shareholders abroad who incur an increased tax liability to their own government as a consequence. This is particularly important where the shareholder is a resident or citizen of, or otherwise subject to tax liability to, a government which provides a direct or indirect tax credit for taxes paid to a foreign government, i.e., to the Singapore government. Thus, for instance, increased profits remitted to the United States because of tax exemption or relief under any of the provisions of the Act only increase the shareholder's tax liability to the United States government. Although the American foreign tax credit system is somewhat complicated, it is sufficient here to note that the U.S. shareholder is able to credit against his U.S. tax liability those taxes paid to a foreign government which would have been subject to U.S. income, excess profits, or war tax laws. As a result, whenever tax exempt profits are remitted from the Singapore Corporation to a person subject to U.S. tax liability on such remissions, the effect of the tax relief schemes is to shift revenue from the Singapore government to that of the United States. See United States Internal Revenue Code of 1954, ss. 901-905. For a comprehensive discussion of the operation of the foreign tax credit system, see Downs, Elizabeth A., *The Foreign Tax Credit* (1961), Harvard Law School International Programme in Taxation.

b. *The pioneer enterprise*

The Minister may by order declare any industry to be a pioneer industry, and any specific product thereof to be a pioneer product.[36] Prior to making such declaration, he must give notice of his intention to do so in the Government Gazette, setting out the proposed order. Any person who might object to the declaration being made has thirty days within which to lodge his objection with the Minister, together with his grounds for so objecting. The Minister is then obliged to consider the objection(s), and may then make the declaration if he sees fit.[37] Under the Ordinance, the Minister was empowered, after considering such objection (s), to make the proposed declaration with variations, conditions and restrictions, if any.[38] Apparently, this is now deemed to be an unnecessary recital of a power assumed to be implicit in the Minister. In any case, the Minister has for years been making the declaration exactly as it had been set out in the Gazette notification. The persons who may object are conceivably established manufacturers in the proposed pioneer industry, alarmed at the prospect of competition from newcomers operating under a tax advantage. The Minister's over-riding power to reject all objections to the making of the order is evidence of the Government's intention to maintain full control over the direction in which the country's industrial programme develops, and to select the particular sectors of product-manufacture in which investment should be encouraged. The Minister also has the power to revoke any order made under S. 4 of the Act.[39] Presumably, this is exercised when a pioneer industry is felt to be occupied to the present limit of Singapore's domestic and export needs; there is the appropriate reservation of the benefit to those still enjoying pioneer status on the basis of the order at the time of its revocation.

After an industry has been declared to be a pioneer industry and a product thereof to be a pioneer product, any company which intends to engage in the manufacture of such product may apply to the Minister for approval as a pioneer enterprise, and for the granting of a pioneer

36. Section 4(1). In the corresponding pioneer scheme found in the Investment Incentives Act, 1968, of Malaysia, it would appear from the wording of s. 3 thereof that the Minister may only make such declarations upon the representation of interested persons, and on no other occasion. If this is really the case, it is inadvisable restriction upon the powers of the Minister. Contrast the import of s. 3 of the Malaysian Act, and the procedure set out therein, with the wide latitude and discretion given to the Minister by s. 4(1) of the Singapore Act.

37. Section 4(2)(a), (b).

38. The Ordinance, s. 5(3).

39. Section 4(4). This is a sort of safeguard; the power reserved to the Minister is in contemplation of changes that render the carrying on of a particular pioneer industry uneconomical. At the time of writing, however, the power has not been exercised.

certificate.[40] The company has to supply extensive information when it makes its application. The Minister, in deciding whether or not to grant the certificate, is to have regard to the production or anticipated production of the pioneer product from *all* sources of production in Singapore.[41] The present limitation of this benefit of the scheme to companies alone has already been noted. The Minister may specify in the certificate, when and if it is issued, such conditions as he thinks fit.[42] Among such conditions is commonly found the stipulation that the pioneer enterprise should purchase and use first-hand equipment wherever possible.

The certificate is also to specify the production day, which is defined as the day on, or before which it is expected that the company will commence to produce the pioneer product in marketable quantities, and the rate of production of such product expected to be attained on or before that day.[43] This day is usually determined by the Economic Development Board project officers and application-processing staff — not the applicant company. They have regard to such factors as the size of the company and the capital investment.[44] Such a provision is to the advantage of the manufacturer, because the tax relief period does not begin to run until the production day. Thus, he has time to get the company off the ground and achieve a reasonable production level before the tax relief period begins. This suspension of the relief period is also an incentive for him to make profits as soon as possible. Specification of the production day has another effect, and that is to prevent laxity on the part of the company in reaching the stipulated level of production by that date; failure to do so means that the certificate may be revoked. Under the Ordinance, there was a set procedure to be followed in the event of the enterprise failing to achieve the specified rate of production — the Minister was given powers of inquiry, and an ultimate power of revocation of the certificate if certain things were not done.[46] These provisions are missing from Part II of the Act, under which the Minister is simply given the discretion to amend the certificate in respect of the production day, and change such day to an earlier or later date.[47] It is submitted that this is a beneficial change — it eliminates cloying formality. The production day is, after all, not to be estimated so easily, and failure to reach the estimated level of production by that day could well be due to perfectly valid, *bona fide* reasons. On the other hand, of course, no serious attempt

40. Section 5(1). In practice, all the work of processing the applications is done by the Economic Development Board, which decides whether the applicant is worthy of exemption. The Minister, of course, is kept fully acquainted with the situation in respect of each applicant, since he may wish to impose conditions, etc. If the Revenue Department is consulted at all, it is with regard to matters such as the sort of accounts the applicant should keep as a pioneer enterprise. Officially, the Board and the Revenue Department do not often agree; the Comptroller must surely be concerned over the terrific sacrifice in revenues that the peioneer scheme has cost, and is still costing, Singapore.

41. Section 5(2).

42. *Ibid.*

43. Section 5(3).

44. According to an E.D.B. application-processing officer.

45. Section 6(1).

46. The Ordinance, ss. 6 and 7.

47. Section 5(4).

may have been made to get the pioneer company on its feet. The broad implication in the generality of S. 5(4) is that persuasion, help or pressure, as the particular case may warrant, can be brought to bear upon the company that fails to meet its production day specifications — a desirable improvement in administrative flexibility.

If the desired result is still not achieved, there is the ultimate "big stick" to be found in S.46 of the Act, which gives the Minister power to revoke *any* certificate issued under the Act (including pioneer certificates) for any breach of terms or conditions imposed in such certificate, or for any contravention or non-compliance with the Act's provisions or rules made thereunder. The old Ordinance did not contain, such a comprehensive power of revocation; the pioneer certificate could then only be revoked for failure to attain the agreed level of production on production day.[48] This was an obvious shortcoming, and is now remedied by the power under S.46, which is exercisable if the Minister is satisfied that, "having regard to all the circumstances of the case, it is expedient to do so" — all power to him, in the making of a decision which probably cannot be questioned successfully even in a court of law.

The contents of a company's application for pioneer status, and of its certificate shall not be revealed except at the company's own instance; but the name of an enterprise which has had a pioneer certificate granted or revoked shall be published in the Gazette.[49]

Under the Ordinance, the tax relief period was originally a blanket five years, which was awarded the moment *any* enterprise obtained a pioneer certificate.[50] While Singapore was in Malaysia, this was amended,[51] so that the relief period would vary depending upon the amount of fixed capital expenditure invested by the pioneer enterprise. The revised periods were as follows:

Fixed Capital Expenditure *	Relief Period
less than $250,000	2 years
more than $250,000 — but less than $500,000	3 years
more than $500,000 — but less than $1,000,000	4 years
more than $1,000,000	5 years

* In Singapore dollars. All monetary figures used hereafter are in Singapore dollars unless otherwise indicated.

48. The Ordinance, s. 7(4).

49. Section 45.

50. The Ordinance, s. 9.

51. By the Pioneer Industries (Relief from Tax) (Variation) Act, 1965; extended throughout Malaysia; s. 2(b), Second Schedule, paragraph 5, amending s. 9 of the Ordinance.

Part II of the Act contains a similar pattern.[52] "Fixed capital expenditure" is defined as capital expenditure incurred by the pioneer enterprise on its factory in Singapore, and on any plant or machinery used in Singapore in connection with its pioneer product.[53] The author submits that the rationale behind this newly hedged benefit is two-fold; firstly the smaller the company, the more quickly it is able to recover its capital cost and begin making profits — hence the shorter tax holiday for such companies; secondly, and more importantly, development policy favours investment in Singapore in a big way. High initial capital investment is viewed as a manifestation of an intention to get well and truly grounded in Singapore and to persevere therein.

The Minister may also extend this tax relief period of a pioneer enterprise, from the minimum period of two years up to the five-year maximum, depending upon how much further capital expenditure the enterprise incurs before the end of its relief period.[54] It might be interesting to note in passing that under the corresponding Malaysian pioneer industries incentive scheme, the rates of fixed capital expenditure governing the relief period are identical, but the extension provision is more generous, in that the new qualifying capital expenditure may be incurred up to one year *after* the end of the initial tax relief period;[55] the pioneer enterprise may also win further periods of relief up to a maximum of eight years.[56]

The Act provides for a notional separation in the life of a pioneer enterprise, for the purpose of its accounts-keeping and the Income Tax Ordinance,[57] into two parts — an old trade or business which is deemed to have ceased at the end of the tax relief period, and a new trade or business which is deemed to begin on the day following the end of such period.[58] The company is required to make up yearly accounts in respect of its old trade or business, and has to begin a new set of accounts for its new trade or business, taking, as the opening figures for such new accounts, the closing figures of the last accounting period in respect of its old trade or business.[59] These requirements are to facilitate the application of the complex commencement and cessation provisions of the Income Tax Ordinance,[60] which will operate upon the cessation of the pioneer enterprise's old trade or business and the commencement of its new trade or business as a non-pioneer enterprise. Normally, a company is taxed upon the income earned in any one year in the next year, called the year of assessment; thus every dollar of the income earned

52. Section 6(1).

53. Section 6(3).

54. Section 6(2), (4), (5).

55. Investment Incentives Act, 1968 (No. 13 of 1968, Malaysia), s. 13.

56. *Ibid.,* s. 14. One year each is added if the pioneer enterprise (a) has a factory in a "development area"; (b) produces priority products; and (c) uses specified local content.

57. Cap. 135, 1970 Rev. Ed.

58. Section 7(a), (b).

59. Section 7(c), (d).

60. Cap. 166 (1955 Rev. Ed.). No longer applicable, see now Cap. 141, 1970 Rev. Ed.

by a company is ordinarily taxed only once.[61] Under the commencement and cessation provisions, however, when a trade or business is ceased to be carried on, a company is taxed, in respect of the two years of assessment which immediately precede and include the year in which the cessation of business took place, upon the income earned over certain periods which overlap one another.[62] This of course means that parts of the company's income are taxed twice over. A pioneer enterprise does not come under this liability because all the income earned in the old trade or business, i.e. during the tax relief period, is exempt from tax. But when a company commences a new trade or business (and a pioneer enterprise is deemed so to do when it emerges from its tax relief period), it is taxed, in respect of the three years of assessment beginning with the year in which the new trade or business is commenced, upon the income earned over certain periods, which also overlap.[63] An ex-pioneer enterprise is liable to pay tax in respect of these years of assessment, and S.7 has added to the complexity by making the date on which the relief period ends as the focal point for both cessation and commencement of a trade or business. Add to this the ever-present possibility under the Act, of an enterprise holding certificates in respect of more than one incentive scheme, with the result that it may emerge from one relief period only to embark immediately upon another, or enjoy two relief periods which may or may not coincide in terms of commencement and duration; and we have a fairly complex problem of keeping correct accounts for the purposes of the various exemption schemes. This difficulty has to be borne by both the enterprise and the Revenue Department, and the keeping of accounts and taking of figures as stipulated in S.7 will perhaps make the administration of the pioneer scheme, as well as of the Act generally, slightly easier.

The provisions of S.9[64] of the Act have been inserted to prevent the abuse of the period of tax exemptions. The income of a pioneer enterprise should be computed according to ordinary principles of commercial accounting — that is, incomings and outgoings, actual and anticipated, that occupy their normal places in the company's accounts inside or outside any one accounting period. Because all profits shown in a pioneer enterprise's accounts for its income tax relief period are totally exempt from income tax, income should not be manipulated so that an abnormal proportion thereof flows during the tax relief period. This seeks to prevent a pioneer enterprise from bringing into the tax exempt accounting periods income which would normally fall outside thereof; and, similarly, to prevent expenditure which might ordinarily fall to be accounted for during the relief period from being pushed out of that period. The net result in both cases would be that profits for the relief period be increased unnaturally and therefore be tax exempt. In anticipation of such activity, the Comptroller of Income Tax is given power to issue directions in order to correct such manipulations, so that the profit figures are normalised. The power given to the Comptroller also brings out another possible reason why the sole proprietor and the partnership have

61. *Ibid.,* s. 35(1).

62. *Ibid.,* s. 35(5).

63. *Ibid.,* s. 35(3).

64. There was a similar provision under the Ordinance, s. 13 thereof.

been dropped from the compass of the scheme; in their cases there is an even greater advantage in juggling their profits in the way described, because by reducing the non-relief period profits, they can escape the progressively heavier taxes imposed upon individuals — unlike the flat rate of 40% payable by companies.

During its tax relief period, a pioneer enterprise shall not carry on any trade or business other than the trade or business relating to its pioneer product(s), unless the Minister has given his permission in writing therefor.[65] The Ordinance contained a similar stipulation,[66] but because of the then existing limitation on the power of revocation of the pioneer certificate, it was largely unenforceable. Experience showed that the businessman, especially the sole proprietor and the partner, will not limit himself to the manufacture of the pioneer product if other equally or more lucrative opportunities present themselves. For example, an enterprise milling flour, and holding a pioneer certificate for that purpose, may carry on the business of selling wheat grain on the side. It is much more difficult for an incorporated or registered company to carry on such clandestine activities undiscovered. Sometimes, of course, these activities were disclosed, but then only when accounts were submitted to the Inland Revenue Department, the requirement of the Minister's permission having been flatly neglected. Since there was no effective way in which these activities could be policed and curbed, the Revenue authorities usually made such enterprises formalise their position by getting the Minister's written permission to carry on such separate trade, and then imposed conditions to ensure that the tax-exempt trade did not suffer.

Two reasons can be found for this limitation upon a pioneer enterprise's activities. First, the beginning of a side-line is often also the beginning of a lack of enthusiasm for the manufacture of the pioneer product. It may well be that such manufacture is not producing hoped-for profits, or that the side-line is more profitable — but it is development policy that the manufacture of the pioneer product is desirable and should be developed. After all, that is the whole idea of declaring an industry and a product thereof to be a pioneer industry and pioneer product respectively. The pioneer enterprise's difficulties may be due to its own inefficiency rather than an inherent unprofitability in the particular industry, in which case the Minister would anyway revoke the order declaring such industry to be a pioneer industry. The authorities would like to see all the investor's energies devoted to the pioneer activity. Second, the existence of a non-exempt activity side by side with an exempt activity is a standing invitation to engage in manipulations of accounts — to put as much as possible into the books of the exempt trade, thus maximising exempt profits and minimising taxable profits. It is toward the curtailment of such manipulations that the rest of S.8 is directed.

Where the carrying on of a separate trade or business has been permitted, certain conditions are imposed upon the pioneer enterprise. First, it must keep separate accounts in respect of the non-pioneer trade or business; the accounting periods must be identical to those used for

65. Section 8(1).

66. The Ordinance, s. 12.

the pioneer trade's accounts.[67] This side-by-side accounting assists the tax authorities in keeping the profits arising out of the two activities identifiable and separate for the purposes of comparison and control. Second, where the non-pioneer activity results in a loss in any accounting period, such loss will be set off against the income arising out of the pioneer activity over the same period, thus reducing that income.[68] This, presumably, is meant as a measure, either to make sure that the enterprise will be constrained to make its non-pioneer activity a profitable one, or to discourage the setting up of such an activity in the first place. Third, if the non-pioneer profit does not amount to at least 5% of the total turnover of the non-pioneer trade, it is made up to 5% by carrying over profits from the pioneer trade and taxed accordingly,[69] also abating the pioneer profits thereby. Where, however, the Comptroller is satisfied that the carrying on of the separate trade is subordinate or incidental to the carrying on of the pioneer trade, the income or losses of the former shall be deemed to form part of the income or losses of the latter.[70] A good example of such a situation would be where a company manufacturing wire mesh under a pioneer certificate also engaged in manufacturing drawn wire, from which the mesh would be cut and welded.

It may be wondered why non-pioneer activities, under the abovementioned conditions, are still permitted by the Act. The only conceivable reason why they should be prohibited is because they might draw the company's energies and resources away from the manufacture of the pioneer product. If everyone were allowed to engage in such activities as they thought fit, the pioneer industries scheme and the industrial development programme generally could degenerate into chaos. Hence the conditions in S.8 are imposed, to make sure that the pioneer activity does not suffer even while non-pioneer activities are carried on. Other than that, the government should be keen to see as much industrial activity as possible, with the income and the job opportunities thereby created. It is therefore submitted that S.8 is a very necessary provision, especially since most companies today are quite able to carry on two separate trades without disadvantage to either.

A pioneer enterprise is obliged[71] to make returns of income in respect of its old trade or business as if such income were chargeable to tax under the Income Tax Act.[72] Such income is computed, for each accounting period within the tax holiday, in accordance with the provisions of the Income Tax Ordinance,[73] except that none of the capital allowances ordinarily deductible shall be made.[74] The Comptroller shall then issue to the pioneer enterprise a statement showing the income for each accounting period, and the enterprise shall be entitled to appeal[75]

67. Section 8(2).
68. Section 8(4).
69. Section 8(5).
70. Section 8(6).
71. Section 11.
72. Cap. 141, 1970 Rev. Ed.
73. *Ibid.*
74. Sections 10(1), 12(1).
75. Section 10(2).

against the figure so shown, as if the statement were an ordinary notice of assessment made under the Income Tax Act.[76] To date, however, not a single pioneer enterprise has appealed, even as far as the Income Tax Board of Review; presumably they do not wish to run the risk of incurring expenses thereby. Where the Comptroller's statement has become final and conclusive, the amount of income shown thereon shall not form part of the statutory income of the pioneer enterprise for any year of assessment, and shall be exempt from tax.[77]

Normally, a company, in computing its income for any one year, is entitled to make various deductions, as laid down in SS.16-22 of the Income Tax Act.[78] These are depreciation allowances in respect of industrial buildings and structures, wear and tear allowances on plant and machinery, and accelerated allowances on such plant and machinery. But when a company is enjoying a tax holiday upon 100% of its profits, it naturally does not want to reduce these profits in any way — contrary to the position in non-relief circumstances when it is interested in as low a taxable income as possible, and consequently eager to deduct as many allowances as may be permitted. As will be seen, all exempt income is distributable tax free to company shareholders; if such sums were distributed not as part of the final figure as shown in the Comptroller's statement,[79] but merely as sums available because of capital allowances, they would be liable to tax in the shareholders' hands.

The Act provides that no deductions of the above-mentioned allowances shall be made in computing the income of the pioneer enterprise for any accounting period in its tax holiday.[80] No such deductions are made at any time during the relief period, i.e., the pioneer enterprise's benefits are maximised, to the extent of being able to pay tax-free dividends out of the unreduced amounts of income. But the benefit does not stop there. When the pioneer enterprise emerges from its tax relief period, all capital expenditure incurred by it within such period shall be deemed to have been newly incurred on the day immediately following the end of the relief period.[81] In other words, the old capital assets acquired within the relief period, though by this time possibly worth very little, are treated as having been newly acquired on the first day of the company's new trade or business, and they accordingly qualify for the large initial allowance granted under the Income Tax Act.[82] These amount, for instance, to 10% upon buildings, and 20% for plant and machinery. In 1966, the Minister was given discretion to increase such initial allowances, which now may go up to 27½% on heavy plant, and 40% for trucks and lorries. Then there are the accelerated allowances

76. Cap 141, 1970 Rev. Ed.; except, of course, that the enterprise would be endeavouring to raise such figure, instead of lowering it as would be the case in ordinary circumstances.

77. Section 13.

78. Cap. 141, 1970 Rev. Ed.

79. Under s. 13.

80. Section 10(1).

81. Section 10(2); provided that the assets acquired by such capital expenditure are used for the purposes of the new trade or business.

82. Cap. 141, 1970 Rev. Ed., ss. 16-22.

available under S.19A.[83] The practical result is that the allowances deductible from the income of the ex-pioneer enterprise in respect of its new trade or business may amount to such a substantial sum that all profits during the first year or more of the ex-pioneer firm's new trade or business may also be tax exempt.

The same deferment of capital allowances applies to industrial buildings, plant and machinery used for the purposes of both a non-pioneer trade permitted under S.8 and the pioneer trade.[84] These assets, since they are being used partly for a non-pioneer activity, should, in the ordinary course, entitle the enterprise to the usual allowances or a portion thereof even during the pioneer relief period. But when such period ends and the deferred allowances are made, there would be duplication; and apparently it has been thought not worthwhile to draw up some special formula for computing allowances in such cases. Presumably also, it is thought that the taxable income of the non-pioneer trade should not be reduced further, especially if it is in the region of the 5% minimum.

A further refinement is made in the proviso to S.10(2) ; where a pioneer enterprise holds two pioneer certificates running over different periods of time, and has incurred capital expenditure on any industrial building, plant or machinery which is then jointly used in carrying on both pioneer trades. Capital allowances, under S.10(2), shall not be made in respect of such expenditure until both relief periods have ended. Having one part of the company's activity exempt while the other part is no longer exempt while the same equipment is being used for both parts makes it cumbersome to notionally dissect such equipment for the purposes of allowing deductions.

Not only is the income of a pioneer enterprise exempt from tax in its hands, but any dividends which are paid out therefrom to shareholders are also exempt from tax in the hands of the shareholders. Such a benefit was conferred in the old Ordinance,[85] which was amended in 1965,[86] to extend the exemption to dividends paid, by a company holding shares in the pioneer enterprise, out of the exempt dividends received by the former from the latter. The shareholders of such a company would hold these "second generation" dividends free from tax also, provided that the company (1) held the beneficial interest in all the issued shares of the pioneer enterprise or such proportion thereof as the Minister might agree, and (2) held such interest throughout the pioneer enterprise's tax relief period. In other words, the company had to be a holding company, the idea being that the exemption under the scheme should attach to and follow the income of the pioneer enterprise — at least up to this point. This extension is again provided in the Act,[87] and applies to dividends paid on or after 1 January 1968. To ensure that only the income arriving originally out of the pioneer enterprise's trade or business is exempted

83. *Ibid.*

84. Sections 8(3); 10(1), (2).

85. The Ordinance, s. 18.

86. Pioneer Industries (Relief from Tax) (Variation) Act, 1965, extended throughout Malaysia, s. 2(b), Second Schedule, paragraph 6, amending s. 18.

87. Section 14(9).

from tax, controls are imposed in the form of a special account which has to be kept constantly up to date, by which means the movement of exempt income out of the hands of the pioneer enterprise and into the hands of the shareholder may be kept track of.[88] Such account must be made available for checking by the Comptroller of Income Tax at any time.[89]

There is an important power reserved to the Comptroller, to the effect that where he discovers that any portion of income of a pioneer enterprise ought not to have been exempted as income of that enterprise or as dividends paid out therefrom, by reason either of a direction he had made under S.9, or the revocation of the enterprise's pioneer certificate, he may, within twelve years of such disentitling occurrence, make the necessary adjustment either by raising an additional assessment or debiting the account kept under S.14(l), as the case may warrant.[90] The pioneer enterprise shall be entitled to appeal against such action on the part of the Comptroller, through the channels available to aggrieved ordinary taxpayers.[91] It would appear, however, that the Comptroller has no power to take such action other than in the events mentioned in sub-section 6 of S.14; e.g., he would not be able to make an additional assessment upon the pioneer enterprise on the ground that the figure shown in his statement issued under S.12(2) was computed and passed wrongly by an inadvertent member of his staff. If this is so, it is a significant curtailment of his powers under S.73 of the Income Tax Ordinance[92] to make additional assessments for any reason from which he concludes that the initial assessment was less than it should have been. Perhaps it was felt that a pioneer enterprise should not be too much bothered by the reopening of accounts by revenue authorities; that it should devote its full energies to making its activities profitable, with an ultimate view to Singapore's benefit. This may be a material non-fiscal incentive for some investors.

Lastly, if the pioneer enterprise has incurred an over-all loss in respect of its old trade or business, such loss may be treated as having been incurred in its new trade or business in the year in which such new trade or business is deemed to have commenced. Such loss may then be set off against the statutory income of the company for the purpose of ascertaining its taxable income for any year of assessment.[93]

88. Section 14(1)-(4).

89. Section 14(5).

90. Section 14(6).

91. Section 14(7).

92. Cap. 141, 1970 Rev. Ed.

93. Section 15. The Investment Incentives Act of Malaysia, No. 13 of 1968, contains a refinement not evident in s. 15. When a pioneer enterprise in Singapore has incurred an over-all loss in respect of its old trade or business, it is able to write it off, completely or partially, by (1) setting it off against the income earned in the new trade or business, and (2) reducing such taxable income earned in the new trade or business by deducting therefrom initial allowance under the provisions of s. 10(2). Under s. 18(3) of the Malaysian Act, a company in such a position may alleviate its loss even further, by deducting, from its taxable income in respect of its new trade or business, annual allowances which would normally have been made in respect of the years spent as a pioneer company if the company had not held such pioneer status.

c. *Some observations upon the pioneer industries incentive scheme*

In terms of exemption from income tax, the scheme is as generous as anyone could ask; once granted, the exemption is complete, and extends all the way down to "second generation" dividends paid out from the exempt income. An enormous amount of capital allowances may be deducted immediately after the pioneer enterprise comes to the end of its tax relief period, and this sometimes has the practical effect of extending non-payment of tax for another year at least. An over-all loss in respect of the pioneer activity may be set off against the income earned after the pioneer period. The only complaint seems to be that the relief period, even at its maximum five years, is too short. The author concedes that this may be so in some cases, but feels that the Republic cannot afford, in terms of revenue loss, to continue giving blanket tax exemption beyond such period. The cost of providing the industrial infrastructure has to be met, and regard must be had to the accumulation of sufficient reserves to finance future economic development. In addition, though some companies may well have difficulty making a profit during the first four or five years after their "production date," the author has talked with many businessmen who claim that they, and others, have obtained profits sufficient to gain a complete return of their initial capital investment after one to four years of operation. These investors clearly need no extension of the tax exemption period. Indeed, it would appear that their operations are sufficiently profitable so that tax exemption for pioneer status is probably only marginal, at most, in affecting their initial investment decisions. In such cases the primary effect of the tax exemption is to reduce government revenues with little or no effect on investment.[94]

A pioneer enterprise's activities are strictly limited to those specified by the pioneer certificate (s) it holds. As already observed, this makes sense enough. Considerable controls are placed upon the enterprise's account-keeping, but these are necessary mechanics to facilitate the administration of the tax exemption scheme; there is no interference otherwise with the enterprise's autonomy as to how it should conduct its operations and make its profits. The supervisory provisions in Part II are in the main directed towards the prevention of abuse of the tax relief period. Furthermore, the enterprise need not be molested by revenue authorities once a figure of income has been agreed upon as final and conclusive.

Applications for pioneer certificates are processed with all possible speed — the Economic Development Board tries to keep red tape down to a minimum, which is one of the reasons why its officials feel that the Republic has a slight edge over Taiwan and other countries in the region in respect of over-all attractiveness to the investor.

94. See *post,* pp. 25-29, for a further discussion of the effectiveness of tax exemption as an incentive to investment. What does suggest itself at this point is that one of the considerations to which the government should pay close attention in declaring particular industries and products to be pioneer is whether or not tax exemption will be an important factor in the potential investors' decision-making. If it is not, that is, if the manufacturing or processing activity is expected to be so profitable that the investor will invest regardless of whether he obtains tax exemption, then such industry and product should not be declared to be pioneer.

The administration of the scheme has been generally smooth and trouble-free. None of the companies interviewed had any complaints as to their dealings with the Revenue Department; they said that their returns and accounts were approved and returned in due course without appreciable delay. Bickering with tax officials is generally in respect of what can or cannot be deducted in the computation of statutory income; a pioneer enterprise need not concern itself with such things during its tax relief period; and the Board of Review has never heard an appeal from a pioneer enterprise. The Inland Revenue Department has not been unduly extended in the administration of the scheme; the administrative discretion necessary under the scheme, as to whether or not any particular company should be granted pioneer status, is vested in the Economic Development Board, which is, however, sometimes unfortunately more concerned with the number of new investors than it is with the question as to whether or not the enterprise is worthy of a tax exemption period. The Revenue Department is solely concerned with the computation of the enterprise's tax exempt profits, and the policing of their activities to prevent tax evasion, etc.; over the years spent in operating the scheme, the Department has worked out formulae to cover almost every possible situation in which a pioneer enterprise may find itself — together with old files and records, administration of the scheme has become more or less a mechanical matter.[95]

It is common knowledge that prior to 1966, many investors came in, acquiring pioneer status along the way, in contemplation of the greatly enlarged domestic sales region that Singapore industry would have in the much-vaunted Malaysian common market. The author verified this with the companies he interviewed. It is also common knowledge (by now, at least) that with the separation, many of these investors surrendered their pioneer certificates and left amidst dire predictions of downfall and ruin. And the pioneer scheme for a while looked as if it were coming to nought.[96] But today, it is operating in full swing again; the investors now flowing into Singapore are a different breed altogether — they accept the fact of separation, and are mainly export-oriented in their outlook. It is to the external markets that they look for their profits, and being seasoned operators, are fully appreciative of every year of tax exemption which they enjoy under the pioneer scheme.

The government today relies heavily upon Singapore's commercial sector for proposals as to new areas of industry that might be declared pioneer. The scheme is therefore operated in an atmosphere of consultation and readiness to give heed to another's views, and the author feels that it is proving to be a useful and fairly attractive device to attract investment in Singapore. For several years it will probably continue to be the most widely claimed incentive offered.[97] Administra-

95. According to an official in the Inland Revenue Department.

96. See *post,* pp. 39-41, for further discussion on this point.

97. At the time of writing, the only Gazette notifications, being made are still with respect to pioneer industries and pioneer products. There are no notifications in respect to the other schemes under the Act as yet; although see the Economic Expansion Incentives (Relief from Income Tax) Regulations of 1968, No. S.254, which were issued on 16 August 1968 with regard to implementation of the export incentives under Part IV of the Act. See *post,* pp. 52-53.

tive control under the scheme is at such a level as to preserve the essential element of free enterprise; the only two restrictions that are of a non-tax-mechanism-type are the production day stipulations, and the qualified curb upon non-pioneer trading activities.

d. *The pioneer scheme as an incentive to investment*

This is the only tax incentive scheme that has had a chance of operation in Singapore over a period of years. The author originally entertained the hope that some sort of evaluation from hard data could be made as to the incentive's effectiveness in carrying out its avowed purpose, that is, to attract the investor to set up industry in Singapore.

Evaluation of a tax incentive scheme has various aspects. One might be concerned with the actual fiscal benefits that the pioneer enterprise has derived from its tax holiday; that would be a matter of computation from accounts, production costs, and innumerable other statistics. One might also be concerned with the wide-angle benefits which the pioneer scheme has brought Singapore, in terms of job opportunities, subsidiary activities generated thereby,[98] etc. But this would be the job for a full-scale research team, which would have to range far and wide, and which would run up against the problem of when to attribute such benefits directly to the operation of the pioneer scheme. The Economic Development Board keeps voluminous sets of statistics, but no attempt has been made by E.D.B. to collate them with this purpose in mind, though an attempt is presently being made to classify such information into some kind of order from which they may be manipulated for purposes of analysis and evaluation.

One might, however, be interested in finding out just how important a part the pioneer scheme played in persuading the investor to make his initial decision to come into Singapore. One does not simply point to the increasing number[99] of pioneer firms in Singapore over the years, as an infallible indication of the tax incentive's effectiveness in this respect; one speaks to the pioneer companies themselves — whereupon the problems begin. An interviewer never asks: did you decide to invest in Singapore because of the pioneer scheme? That never happens. The proper question would be: of what weight and consideration was this tax incentive scheme to you, in your deliberations as to whether or not to invest in Singapore? The answers that the interviewer obtained in reply to this question went like this: "oh yes, it was important;" or, "well, we considered it with other things;" or, "yes, of course it did play a part." Yes, but what part? These are highly imprecise answers for any kind of analysis.

It has to be borne constantly in mind, that the adoption of tax incentives for the purpose of encouraging industrial investment rests

98. For example, the construction industry, the machine shops which engage in the manufacture of components, etc., for the large pioneer enterprises, or other examples of industrial linkage.

99. There were 245 pioneer enterprises in Singapore as of 1 August 1968, holding 269 pioneer certificates. This figure is given in a report published by the Economic Development Board listing such companies by name and pioneer certificate numbers.

essentially on one premise — that the conferment of tax benefits will induce domestic or foreign investors either to initiate activities which they would not otherwise have undertaken, or to increase their investment in already existing enterprises. This is the whole object of the exercise. The validity of this premise, under the existing conditions in any country under consideration, in turn rests largely upon two assumptions:[1]

1. Tax considerations are highly important in decisions to invest, and taxes as such frequently operate as an impediment to investment. The removal or minimisation of tax obstacles will therefore encourage investments that would not otherwise be made. Similarly, tax incentives make otherwise unpromising investments attractive because they permit a rapid recovery of capital and a higher rate of return. Finally, they encourage re-investment by making available to the taxpayer funds that would not otherwise be at his disposal for this purpose.

2. Tax incentives are valuable as an indirect stimulus to investment because they publicize and enhance the country's investment climate. In addition to their advertising value in calling the country to the attention of the foreign investor as a desirable location for investment, incentives improve that intangible frame of mind called the investment climate for both domestic and foreign investors by indicating the favourable disposition of the government toward private investment. Also, in so far as the country is competing with others for scarce capital, failure to offer the same advantages as do other countries might result in a serious diversion of capital to those countries.

In view of the widespread adoption of tax incentives, it might be expected that there would be a correspondingly widespread interest in a study of these assumptions. Unfortunately, interest though there may be, the mere enumeration of the above somewhat rudimentary premises appears, nearly everywhere, to be the extent of the analysis. Though these premises have the strength of a common-sense appeal, there are substantial obstacles to further and more critical examination thereof. Even general estimates of the cost to the government of various incentives require extremely complex and difficult computations for which the requisite statistical information is probably lacking in many countries; in others, diverting the energies of trained accountants and statisticians to this task and away from other pressing assignments may not be a wise allocation of scarce technical personnel. Also, the development of useful economic models, for evaluating the significance of tax incentive experience in one country for use in another country, may be impossible.

Where tax incentives are intended to induce new, or increase, investment, the more serious difficulties in designing satisfactory models or guides for the design and/or evaluation of tax incentive schemes arise from the fact that any analysis of the probable impact of such schemes requires that the relationship between taxes and investment decisions be understood, and, in fact, be reducible to relatively simple mathematical formulae or description. While the value of a particular incentive pro-

1. Heller and Kauffmann, *op. cit.,* at p. 4.

vision rests upon its capacity for stimulating investment, investment decisions are, at best, only dimly understood. As psychological phenomena, they embody a wide range of rational and irrational components, which vary over time, and among investors and countries. Consequently, investment decisions are difficult to reduce to such mathematical explanation or simple description. Among the factors that bear upon the attractiveness of a prospective investment are the investor's judgments about the present and potential market; the adequacy of credit, raw material, labour, power, transportation-distribution facilities, skilled technicians and managerial personnel; and the possibility of monetary or political instability. All these may vary widely in importance from the point of view of any one individual investor. One thing is certain, however: since all these factors, amongst others, play a part in investment decisions, the role of the tax factor is highly indeterminant. This is so regardless of whether taxes are high or low. The existence of high taxes does not invariably lead to the conclusion that profits will be low — U.S. corporation taxes are amongst the highest in the world, yet profits are still made. Conversely, low taxes do not by any means indicate that profits will be high; the compass and state of efficiency of the industrial infrastructure to a very large extent determine whether profits may be maximised or minimised.

Since it is probably impossible to design an analytical framework for assigning correct weight to all the above-mentioned factors, and for isolating the tax factor in the broad spectrum of considerations balanced by prospective investors, it is impossible to predict accurately what the impact of a change in tax burdens will be for any particular investor.

In spite of these difficulties, however, can any kind of informal inference be drawn, more to provide information rather than for an analytically accurate framework with which to make predictions as to investment trends resulting from tax incentives? The author selected as wide a sector of Singapore industry as time would permit, and interviewed at least one major enterprise engaged in each such industry. He found that the pioneer scheme had played a part in almost all the decisions made to invest in Singapore, but was struck by the off-handedness with which the interviewees referred to the tax incentive. Whether this was due to the feeling that it was unimportant compared to, e.g., the export market situation, or to a taken-for-granted attitude, the author was unable to perceive. But he was given the over-all impression that his questions more or less forced the tax incentive upon the investor's mind for perhaps the first time in years.

Consider the case of a company A with a capital investment of over $1 million, carrying on in Jurong the pioneer manufacture of drawn wire and selling the bulk of its output to an associate company B which is situated next door and engaged in the manufacture of welded wire mesh. At one time company B, an established concern, imported drawn wire from outside of Singapore, and it was found that production costs could be cut if the company set up a separate department to draw its own wire — i.e., to take its production process one stage back. There would also be other advantages, e.g., quality control, and an ability to draw wire over wider ranges of diameter and gauge. Company B would have embarked upon this extension of its activity, tax incentives or no tax incentives. The question was whether a self-contained department or

a separate associate company should be set up — there were matters of comparative costs and so on. The board of directors of company B were mulling over this choice when the Singapore government announced the pioneer industry scheme for the first time, in 1959. And of course the decision of company B was then automatic; a new company could get tax exemption and recoup incorporation costs more quickly, with profit to spare besides. Company A was therefore set up, and it has recently emerged from its tax relief period with no complaints whatsoever, having made profits from the very start (which was of course to be expected, in view of its biggest buyer being assured and situated next door).

This is one example of a decision to invest in Singapore before tax incentive considerations even enter the picture. The decision stemmed from a cost appraisal; another factor which figured was the fact that setting up the investment at Jurong could enable 700 tons of wire rod to be unloaded from the Estate's deep water wharves and taken delivery of in three days, as compared with the two weeks that would be required for a similar quantity to be cleared from the Port of Singapore Authority wharves; transport and demurrage charges would also thereby be cut, not to mention the saving in time. What is evident from this case-study is that there are factors which figure in the investor's mind that may be peculiar to his position.

The present investment climate in Singapore is vigorous and optimistic. There is a continuing gigantic governmental effort to transform the economy, from one which has been traditionally entrepot in nature to one which rests upon industry; the results are an industrial infrastructure evident anywhere the investor chooses to look in Singapore. The population is fully investment-conscious, thanks to the bludgeon-like publicity accorded to State's industrialization programme. It responds instantly to offers for private capital subscription to new industry; it is sympathetic to the foreign investor and does not generally regard him as an exploiter. The government is placing increasingly heavy emphasis upon a qualified labour force and is accordingly expanding its technical education programme in an effort to emulate the dynamism behind the Japanese post-war economic miracle. The government and its associated agencies are to a large extent responsible for the stage of industrialization one sees today, and they continue to extend themselves in securing contacts and favourable terms of trade for the manufacturer. The Economic Development Board has expanded its activities to the extent that it now has to delegate specific functions to town corporations and a development bank. The economy exudes an atmosphere of confidence; political stability, in the sense of continued peaceful government, appears to be assured for a long time yet. Legislation as to terms of employment, settlement of investment disputes, and monetary stability is a further factor impressing itself upon the potential investor's consciousness. Singapore even has had extra-territorial help with her investment promotion programme — upheavals in Hong Kong during the second half of the 1960's persuaded many investors to decide upon Singapore as their base for operations; perhaps the same can be said of the riots in Western Malaysia in May and June of 1969.

It is against such a perspective that the more direct investment incentives, like the lifting of import and licensing restrictions in respect

of raw materials and equipment destined for Singapore industry, governmental preferential buying and protectionism, *and* tax incentives, have to be viewed; and one might be forgiven for concluding that tax incentives cannot figure greatly in the potential investor's decision in the face of all these other considerations. And on the other hand, investment promotion division officers of the Economic Development Board have assured the author that almost the first thing that the potential foreign investor asks about, when he walks into the Board's office for some information, is the variety and extent of the tax concessions Singapore has to offer. But then, of course, the investor wants to know what Singapore has to offer, in its entirety. The question remains unanswered, viz., will the investor come in even without the tax incentive? If he will, there is no reason to put up with such a terrific sacrifice of revenue.[2]

4. EXPANSION OF ESTABLISHED INDUSTRIES

a. *Introduction*

Part III of the Act introduces a new scheme of tax incentives into Singapore's investment promotion programme. It is intended to encourage established manufacturers to engage in production expansion, either by increasing productive capacity, or by increasing profitability.[3] Such increase is anticipated to be the result of the acquisition of new capital assets, which is why the scheme is based partially upon the incurring, by the manufacturer, of new capital expenditure. It is a tax exemption which may operate in conjunction with the capital allowances available to any manufacturer under the Income Tax Act.[4] The benefit offered is in the form of tax exemption upon a certain computed portion of income; in this sense it is similar to the abortive Industrial Expansion (Relief from Income Tax) Ordinance, 1959[5] which was also aimed at encouraging capital investment. Since the benefit is extended to established industries, the provisions of this Part are couched in terms that proceed upon the assumption that the applicant company has already been in full operation for at least a year.

b. *The expanding enterprise*

Where the Minister feels that the increased manufacture of the product of any industry would be of economic benefit to Singapore, he may, by order, declare such industry to be an approved industry and the product thereof to be an approved product.[6] The procedure laid out for the making of the order, the giving of notice prior thereto, the consideration of objections and the wide powers of decision notwithstanding,

2. See *post,* pp. 69-77, for additional discussion on this point, from a slightly different perspective, and some conclusions and suggestions.
3. Although nothing in the Act stipulates that Part III is available only to established enterprises, this is clearly the intention of the government. It is expected that new enterprises will avail themselves of Part II.
4. Cap. 141, 1970 Rev. Ed., ss. 16-22. These are capital allowances in respect of plant and machinery.
5. No. 2 of 1959, explained *ante,* pp. 6-8.
6. Section 16(1).

are very similar to the comparable provisions in respect of the pioneer industries scheme laid out in Part II.[7] There is also a similar power of revocation of any order so made, vested in the Minister, with again the appropriate reservations, of the scheme's benefit to those enterprises enjoying the benefit of the scheme by virtue of such order at the time when it is revoked.[8] At the time of writing, no declaration under these provisions has been made.[8] A company (note again the limitation of eligibility to the legal person incorporated or registered in accordance with Singapore law) intending to incur new capital expenditure for purposes of the manufacture or increased manufacture of an approved product may apply to the Minister for approval as an expanding enterprise.[10] Extensive information must again be supplied in the application form. "New capital expenditure" is defined as expenditure incurred in the purchase of productive equipment intended to increase production or profitability.[11] "Productive equipment" is in turn defined[12] as machinery or plant[13] that would normally qualify for capital allowances under the Income Tax Act.[14] The applicant company, to qualify for the benefit of the scheme, must contemplate new capital expenditure exceeding $1 million.[15] If such expenditure is anticipated to be less than $1 million but exceeds $100,000, the company will still qualify under the scheme if the expenditure will result in at least a 30% increase in value, at original cost, of all the company's existing productive equipment.[16] There is also a proviso to the effect that that expenditure incurred in the purchase of secondhand productive equipment shall not be considered new capital expenditure for the purposes of qualification under the scheme, unless the Minister is satisfied both that the purchase of such equipment is economically justifiable and that the purchase price represents a fair open market value of such equipment.[17] The purpose behind these limitations is two-fold: first, to prevent the enterprise from wasting time and money upon equipment which in all probability has seen the greater part of its useful working life; and second, where the purchase of second-hand equipment is justified, to prevent the "palming off" upon the enterprise of equipment at inflated prices just so to meet the requirements of S.17(l). It is therefore submitted that this is a necessary limitation.

The expansion certificate when issued may contain such conditions as the Minister sees fit to impose;[18] it shall specify the date on or before

7. Section 16(1), (2), (3), as compared with s. 4(1), (2), (3).
8. Section 16(4).
9. According to Economic Development Board Projects Division officials.
10. Section 17(1).
11. Section 17(3).
12. Section 3(1).
13. Examples of which would be heavy assemblages, boilers, or lathes.
14. Cap. 141,1970 Rev. Ed., vol. 4, ss. 19-22; note that allowances on land and buildings are excluded.
15. Section 17(1) (a).
16. Section 17(1)(b).
17. Proviso to s. 17(3).
18. Section 17(2).

which the new productive equipment shall be put into operation — this date shall be the expansion day for the purposes of the scheme.[19] The Minister is given discretion to amend the certificate in respect of the expansion day and substitute therefor an earlier or later date.[20] The contemplation is that the Economic Development Board shall determine the expansion day.[21] At the time of writing, no company has yet made an application for a certificate under this scheme.[22]

It will be noted that the procedural and administrative framework under Part III bears a striking similarity to the pioneer industries scheme. The author expects that this should regularise and ease the administration of the two schemes in conjunction with one another; the same tax officials should be able to handle both with equal facility.

The length of the tax relief period again depends upon the amount of new capital expenditure incurred — three years where the expenditure is below $250,000 — and five years where it exceeds that sum.[23] Provision is made for extension of the period from three years to five years, where in those three years the enterprise has acquired more assets to bring its total expenditure upon productive equipment to a figure above the initial $250,000.[24]

The purpose of the expansion day is to mark the time from which the expanding enterprise begins to enjoy its tax relief period. The exemption will begin as from the accounting period commencing on or after expansion day. The enterprise has, however, the option of choosing its exemption period as beginning from the accounting period in which the expansion day falls — i.e. backdate the day upon which exemption begins.[25] This is to enable the enterprise to select that accounting period the income of which gives the most advantage under the computations provided in S.19 as the first accounting period of its tax holiday. It should be noted that the start-off point for its relief period is not the enterprise's expansion day; unlike the position under the Pioneer Industries Scheme whereunder the relief period begins from the production day. Since the tax exemption is based upon the excess of income of one accounting period over that of another accounting period, the expanding enterprise's accounting periods have to be taken as the measuring rods from which one may quantify profits and then determine whether income has increased or not; thus the necessity to measure out the tax holiday by means of the enterprise's accounting periods.

The extent of the relief from income tax is calculated as follows: the amount of exempt income is the quantitative increase in income resulting from the expansion of capital, but is limited so as not to exceed

19. Section 17(4).

20. Section 17(5).

21. According to Economic Development Board application-processing staff.

22. According to an Economic Development Board Projects Division official.

23. Section 18(1) (a), (b).

24. Section 18(2).

25. Section 18(1).

the proportionate increase in the value of plant and machinery resulting from such expansion. The income of the expanding enterprise in respect of the approved product is computed in accordance with the provisions of the Income Tax Act for any accounting period within its tax holiday.[26] However, capital allowances which would normally fall to be deducted in respect of the new capital expenditure under ordinary tax computations of statutory income shall not be so deducted;[27] such non-deduction is for the purposes of ascertaining the true picture — how much income the enterprise has earned. Making capital deductions would distort this picture, because such initial allowances are very substantial indeed.

Thus the income of the enterprise is determined, for any accounting period within the tax holiday; this is called the *expansion income* for that particular accounting period in respect of which it was calculated.[28] Let us symbolize this *expansion income* as A. Using the same method of computation as used for calculating A, the income for the accounting period immediately preceding the tax holiday is ascertained. This is called the *pre-relief income,*[29] which we shall symbolize as B.[30]

Then, for any accounting period during the tax holiday when A is equal to or is less than B, no relief whatever shall be given.[31] If, however, for any such accounting period A exceeds B, the amount of such excess, that is, (A-B), shall be allowed as a deduction from the *expansion income* of that accounting period and shall be free from tax.[32] Thus, the taxable portion of the expansion income at this stage is A-(A-B).

As appears from the above, the amount of deduction from the figure of taxable income is the excess of the *expansion income* over the *pre-relief income,* i.e., (A-B). But there is a limitation, to the effect that such deduction shall not exceed a certain sum, which we represent by X. This sum X bears the same proportion to the *expansion income A,* as the new capital expenditure (which we shall call C) bears to the total of such new capital expenditure and the value, at original cost, of the productive equipment owned and used by the enterprise prior to its expansion,[33] whose total we shall call D. The result is that the very maximum deduction allowable is the amount of income increase which is proportionate to the capital increase.

26. Section 19(2).

27. *Ibid.*

28. *Ibid.*

29. Section 19(5).

30. Note that in computing both the *expansion income* and the *pre-relief income,* no capital allowances have been deducted, in pursuance of the direction under s. 19(2). This facilitates the comparison of these two true figures of income earned over the two periods, to determine whether or not there has been an increase in income.

31. Section 19(5) (a).

32. Section 19(5) (b).

33. *Ibid.*

Two worked examples will illustrate this limitation:

Assume the case of an expanding enterprise which has been granted an expansion certificate for five years, having incurred new capital expenditure amounting to $600,000. Its old plant and machinery, at original cost, was valued at $1,000,000

It acquires new plant and machinery, worth $ 600,000 i.e., C.

The total value, at original cost, is therefore $1,600,000 i.e., D.

Assume now that the enterprise's accounting period immediately preceding the relief period is 1969, and that its relief period therefore begins in 1970.

Assume then that its income for the accounting period, 1969, is $100,000, i.e., its *pre-relief income* is $100,000 i.e., B.

Take 2 examples:

I. Where the *expansion income* for 1970 is $135,000 i.e., A.

II. Where the *expansion income* for 1970 is $170,000 i.e., A1.

I. Excess of A over B is (A-B) i.e., $135,000–$100,000=$35,000. *Prima facie* this is the deduction allowable, provided it does not exceed X.

To determine X, we are given the formula $\frac{X}{A} = \frac{C}{D}$

$$\text{i.e. } \frac{X}{\$135{,}000} = \frac{\$\ 600{,}000}{\$1{,}600{,}000}$$

$$\text{Therefore} \quad X = \frac{\$135{,}000 \times \$600{,}000}{\$1{,}600{,}000}$$

$$= \$50{,}625.$$

(A-B) does not exceed X. The maximum deduction therefore=(A-B) =$35,000

II. Excess of A1 over B is (A1-B) i.e., $170,000–$100,000=$70,000. *Prima facie* this is the deduction allowable, provided it does not exceed X.

To determine X, we are given the formula $\frac{X}{A1} = \frac{C}{D}$

$$\text{i.e. } \frac{X}{\$170{,}000} = \frac{\$\ 600{,}000}{\$1{,}600{,}000}$$

$$\text{Therefore} \quad X = \frac{\$170{,}000 \times \$600{,}000}{\$1{,}600{,}000}$$

$$= \$63{,}750.$$

(A1-B) does exceed X, and the deduction allowable is only $63,750.

As is seen from the above, an enterprise qualifying as an expansion enterprise under Part III will entail certain capital expenditures. Where it can show an increase in income, as a result of the capital expenditure,

a portion of its statutory income will be exempt from taxation under S.19(5)(b). In addition, though there is no provision in the Act so stating, it seems clear that the enterprise will be able to deduct all the capital allowances in relation to such capital expenditure to which it is entitled under the Income Tax Act.[34] Assume that the total of these allowances is E. The expanding enterprise will only have to pay tax on that portion of its income that remains after the deduction of (1) the excess of *expansion income* over *pre-relief income,* and (2) the total of such allowances; that is, only [A-(A-B)-E] is taxable. This formula obviously applies for any accounting period within the tax holiday, with the result that the enterprise's taxable income for any such accounting period may be very substantially reduced, especially if the new capital expenditure has been incurred in such accounting period, bringing the large initial allowances into E.

Where the expanding enterprise carries on trading activities other than those to which its expansion certificate relates, the expansion income shall be ascertained in such manner as appears to the Comptroller to be reasonable in the circumstances.[35] This is because the expansion income is the income derived from the manufacture of the approved product only, and there is no provision in Part III for the keeping of separate accounts as there is under Part II. Presumably it is felt that the separation of the expansion income from the rest of the income earned by the enterprise is not a matter of too great difficulty; but it is submitted that separate accounts should have been stipulated for by the Act, since S.19 (3) makes possible what might seem like arbitrariness on the part of the Comptroller. There is also a provision that if the Comptroller should opine that the carrying on of such separate trading activities is subordinate or incidental to the carrying on of the manufacture of the approved product, the income arising therefrom shall be deemed to form part of the expansion income.[36] As has been mentioned earlier, an expanding enterprise may also be enjoying tax exemption at the same time as either a pioneer enterprise or an export enterprise; in such a case, it is provided that the income exempt under either or both of the latter schemes shall be included in the computation of the expansion income. There is, however, one important restriction; and that is that the deduction allowable under Part III shall be limited so that the total of such deduction and the exempt income under the latter two schemes do not exceed 100% of the expansion income.[37] One point must be made here: the provision appears to suggest that an enterprise can enjoy exemption under Parts II, III and IV simultaneously. This is incorrect; the company cannot enjoy exemption under Part IV until it concludes its tax holiday under Part II.[38] That being so, the restriction should read thus: the deduction allowable under Part III shall be limited

34. Cap. 141, 1970 Rev. Ed., ss. 19-22. This view is strengthened by the apparent intention that such claims for capital allowances will be accepted by the Revenue Department when the scheme is in operation.

35. Section 19 (3).

36. Section 19 (4).

37. Section 19 (6).

38. See s. 23 (1) (b).

so that the total of the exempted income under *either* of the schemes under Parts II and IV together with such deduction under Part III does not exceed 100% of the expansion income.

To see how this could happen in the case of an expanding enterprise which is also a pioneer enterprise, consider the example of the company in Example I.[39] Its expansion income is $135,000, with an allowable deduction, under Part III, of $35,000. It could also, however, be entitled as a pioneer enterprise to an exemption in respect of the whole $135,000 under Part II. The practical result would be that an exemption of $170,000 would have been gained — an exemption greater than the actual income earned in that accounting period, i.e., 1970. Section 19 (6) is directed to remedy such situations by limiting the deduction so that, together with the income exempt under the pioneer scheme, it shall not exceed the expansion income. Where the expanding enterprise is also an export enterprise, however, such an event is much less likely to arise. This is because exemption under the export enterprise scheme (Part IV) is not upon the whole amount of income earned, but a portion thereof. Thus, in our example, while the expansion income might be $135,000, with an allowable deduction of $35,000 under Part III, the income exempt under Part IV may amount to perhaps only $10,000 due to the restrictive delimitations under the latter Part. In such a case, the full amount of the Part III deduction — $35,000 — is deductible, together with the exempt income under Part IV — $10,000 — as it does not exceed 100% of the expansion income i.e., $135,000.

This slight complication is due to the possibility that an enterprise's income may be derived in respect of a product which is at one and the same time a pioneer product,[40] an approved product[41] and an export product.[42]

Finally, Part III provides that where, for the purposes of computing the deduction allowable to the expanding enterprise, it is necessary to compare the income of different accounting periods, and any such period is greater or less than 12 months, the income of such period shall be adjusted on a time-basis, to determine the notional income for a period of 12 months.[43]

It should be noted that the deducted portion of the expansion income is tax-free in the company's hands, but not in the shareholders' should it be distributed as dividends — unlike the situation under the pioneer scheme. The obvious intent is that the company should plough back such exempt income into its activities.

39. *Ante,* p. 33.

40. Under Part II of the Act.

41. Under Part III of the Act.

42. Under Part IV of the Act.

43. Section 19(7). A company which intends to take advantage of any of the benefits under the Act would be well advised to keep accounting periods on a yearly basis, and preferably in accordance with the calendar year as well. Such accounts are easiest to manipulate for the purposes of computing incomes and exempt portions thereof under the Act.

c. *Some observations upon Part III*

A point might be made to the effect that a tax incentive based on the increase in income resulting from increased productive capacity is (1) too limited, and/or (2) rather unpredictable. It might be pointed out that in some countries, the tax exemption is immediately given in the form of an allowance based on a percentage of the new capital expenditure; the expanding enterprise does not have to wait and see whether it will be able to increase its income so as to gain exemption; such certainty aids investment planning on the part of the company.

As has been pointed out earlier, the Singapore government is not giving anything away free. The Minister apparently feels sheer capital investment in Singapore should not entitle a company to any tax exemption at all; it must show that by such investment it is capable of raising its output *and* its profits — that is, tax exemption is only for the efficient enterprise. Perhaps the government can afford to be less generous under Part III, for the reason that the expanding enterprise is established, and would, if it was doing well, have expanded in any case. It is not as if the enterprise were a new company, needing time and generous tax measures to get through the uncertain first few years of operation. After all, if the expanding enterprise is established, it has been paying tax upon its income earned all along before Part III was introduced; there would seem to be no good reason to suddenly lift tax upon such income except in respect of that portion which shows an improvement and increase from past years. Further, the ordinary capital allowances available to the expanding enterprise before, during and after its tax relief period, as they stand at the moment, can alone reduce its taxable income by enormous amounts, what with free-style initial allowancing at the Minister's discretion and accelerated allowances under S.19A of the Income Tax Act.

At the time of writing, no formal applications for approval as an expanding enterprise have been received by Economic Development Board Projects Division officers. The reasons for this inactivity are not evident; but the author expects applications to come in soon, having encountered a few firms who were embarking upon expansion and preparing their applications under the scheme. One manufacturer of veneer and plywood products contemplated a $3 million plant expansion. A manufacturer of rubber products noted that the Minister has not gazetted any approved products as yet, so that what expansion would qualify under Part III could not be spelt out immediately. He also observed that expansion in order to benefit under Part III would be difficult — for example, land is surely necessary, but expenditure thereon does not qualify as new capital expenditure under the scheme. A cement manufacturer had made tentative inquiries with the government as to expansions; the cement industry's position is peculiar — the companies are under rigid governmental controls should they attempt to export their cement; a local price ceiling has been fixed for them, and in such a situation expansion plans have to be proceeded with very cautiously.

The author feels that Part III makes a fair offer to the established manufacturer. There are few loose Ministerial discretions present — no accounting controls; the only substantial restriction is upon buying of second-hand productive equipment, which is justifiable.

5. Production for Export

a. *Introduction*

Since the present Singapore leadership came to power in 1959, the underlying reason for its industrialization policy has remained constant; i.e., to reduce the heavy reliance of the country upon the entrepot trade sector of the economy by developing an alternative form of economic activity which could create employment and income. During the first four years the foundation was developed for later growth. The Pioneer Industries Ordinance of 1959[44] was enacted to provide fiscal incentives for industrial investment in Singapore. Work has begun on the development of industrial estates, most notably the Jurong Industrial Estate, which included government built factories if desired, transportation facilities, and a cheap supply of power and water needed for industrial activity. The education system was greatly expanded, in large part to increase the skill level of the labour force — although it was not until 1968 that there was a significant shift to technical education. And the Economic Development Board was established to centralize and increase development efforts. In 1965 the framework in which industrialization policy operated changed when Singapore joined the Federation of Malaya, Sabah, and Sarawak to form a single political entity, Malaysia, with the intention of creating a single common market. The expectation of the common market, with a population of twelve million people, rich agriculture, mineral, and timber resources, and an excellent harbour and reasonably highly skilled labour force in Singapore, provided the foundation for the Island's industrialization policy. However, significant changes have occured since 1963, and these changes provide the key to understanding the history of the development of Part IV of the Act, and its implementation, or the lack thereof.

In August 1965 Singapore was expelled from Malaysia, and the hope of a common market was, at least for the foreseeable future, destroyed. The industrialization policy had to be developed on a domestic market of only two million. Indeed, foreign investors who had come to Singapore in the expectation of producing for a domestic market growing from a base of twelve million expressed considerable disappointment — several giving up their pioneer certificates. The picture was clear. A domestic market of two million people was insufficient to produce efficiently, or to provide the employment necessary to cope with the increasing problems of unemployment.[45]

44. No. 1 of 1959; see *ante,* pp. 6-8.

45. By 1968 there were officially 65,000 unemployed, about 14% of the labour force. As in most cases, official figures tend to understate the problem. They do not include those who have not registered as seeking employment, nor do they take into account the amount of under-employment in the economy. While less than in many developing countries, this group is still substantial in Singapore. In addition to those who are unemployed or under-employed, economic planners must contend with the fact that there are 20,000 school leavers entering the labour force each year.

In addition, the Confrontation between Malaysia[46] and Indonesia had seriously affected Singapore's traditional source of income and employment — the entrepot sector of her economy. Official statistics indicate that the level of exports and imports dropped by 25% from pre-Confrontation levels.[47] This compelled a serious retrenchment of labour in the trading sector. The immediate problem was acute, but the long range implications also stood out as a sharp reality. The entrepot sector would always be subject to developments in Singapore's external relations with her neighbours. Even if these relations were maintained at a friendly and positive level, the ability of the entrepot sector to contribute to the growth and development of the economy was likely to decline as Singapore's neighbours developed the ability to trade directly with their trading partners.

It was in this context that the development of Part IV took place. The need for industrialization was even sharper than it had been when the programme began in 1959. Yet the domestic market alone was woefully insufficient for substantial industrialization. In addition, the fact that Singapore is almost totally lacking in natural resources, except for its harbour and the industriousness of its people, meant that industrialization would have to rely heavily on imports, with the foreign exchange problems inherrent in such a situation. It was clear that a significant portion of the industry needed to generate employment and income would have to be heavily export oriented. But realizing the need for export-oriented industry, and accomplishing it are two different things. Singapore's neighbours are engaged in their own industrialization programmes and frequently are attempting to attract the same foreign investors which Singapore is seeking, or are protecting, with tariffs and/or quotas, production of the same products which Singapore might hope to export. While Singapore might be able to develop minimal markets in the developed countries, substantial imports from Singapore are likely to arouse protectionist sentiments compelling the governments of those countries to take measures which would seriously jeopardize Singapore exports.[48] In addition to access to world markets, the establishment of export markets requires expertise in international marketing. Both factors meant that Singapore would have to attract foreign investors if its export-oriented industrialization policy was to succeed. This meant that Singapore would have to compete with Taiwan and Hong Kong, both of

46. Even though Singapore was expelled from Malaysia in August 1965 Indonesia continued to apply *Konfrontasi* policies against Singapore in the same manner as against her neighbour to the north. Though politically separated, Singapore and Malaysia continued to form, to some extent, a common economic bloc.

47. See Official Trade Statistics, published by the Singapore Government.

48. The concern of the Singapore government in this regard was indicated by the then Minister of Finance, Mr. Lim Kim San, in a speech to the South East Asian Economic Conference, Tokyo, 6 April 1966:

> With a limited home market, we are forced to seek export outlets only to find that our neighbours are in the same position as ourselves. The next step is to seek entries into markets of the developed countries where they may just be tolerated. But the moment a foothold is gained, vested interests object vociferously and a clampdown is enforced.

For a copy of the speech, see *The Mirror,* Vol. 2, No. 18.

whom had industrial sectors more advanced than that of Singapore, and could offer low labour costs and substantial fiscal incentives.[49]

The problems involved were indicated by the then Minister of Finance, Mr. Lim Kim San, in his budget speech to Parliament on 5 December 1966:

> The solution to the unemployment problem lies in a crash programme for the development of export-oriented industries. The majority of our existing industries still depend to a large part on the domestic market... We must now move to a new phase of the industrial programme, namely the development of export-oriented industries. In order to achieve full employment and to ensure long term economic stability and growth, we need specifically to encourage manufacturers with established markets.[50]
>
> . .. We have therefore to attract the type of export industries which buy raw materials and sell their products on a world wide basis and which can make full use of the high quality of our labour forces, our geographical advantage and our efficient infrastructures. International manufactruers of this type have more or less free choice in selecting their plant location. Singapore, therefore, has to compete with other countries in all parts of the world for such enterprises.
>
> This means that our fiscal incentives must be as attractive as, if not more than those offered by other countries.[51]

In the same speech the Minister spelled out the policy implications, giving the first indication of what could be expected when the Government introduced the expected "Economic Expansion Incentives Bill" before Parliament. More specifically concerning exports, the incentives indicated were:

> Profits on export of manufactured goods for both existing and new manufacturers and deep sea fisheries will be taxed at the equivalent of one tenth of the normal company tax rates. This concessionary rate (4%), applies to all limited companies where the profit derived from the exports are at least 20% of their total profits and export sales (fob) amount to not less than $100,000 per year. Qualifying firms with pioneer status will be granted this concessionary rate for a period of not less than ten years from the date of expiry of their pioneer status and the concessionary period for non-pioneer firms will not be less than fifteen years.[52]

This first look at what was intended in the Government's new export promotion programme was extremely attractive: a reduction of company tax from 40% to 4% on all profits derived from exports; and, given a minimum export level, the concessionary rate seemed to be intended to be available to all.[53]

49. The tax rate, 15%, on company profits in Hong Kong is particularly important. Though the Colony offers no special incentives, this low rate of taxation is extremely attractive because of its implications for long-range profits.
50. *Singapore Parliamentary Debates,* Vol. 25, Col. 454.
51. *Ibid.,* Col. 456.
52. *Ibid.,* Col. 457.
53. Even as late as November 1967 it appeared that the benefits of the scheme would be widely available. A Ministry of Finance statement on 14 November read:

    > This in effect means that nearly all the industries established since 1961 will qualify for the full benefits of the incentive scheme as will most of the new industries of the future.
    >
    > It is the intention of the government to approve all products except for a limited number, including oil products now being refined, entrepot trade and such like items.

However, before the bill was enacted into law, Ministerial portfolios changed.[54] In addition, the economic situation in Singapore had begun to change, as had the government's revenue needs. The contrast in the economic picture can be shown by a brief look at economic factors in 1966 and 1967. In 1966 only twenty-one pioneer certificates were issued. Nine certificates were surrendered due to the loss of the common market possibility, making a net gain of only twelve. The number of pioneer firms which were in the implementation stage or in operation by the end of the year was only 137, providing employment for only 607 more people than in the previous year.[55] The unemployment problem was agravated by the set-back in the textile industries when import quotas were imposed by the developed countries resulting in the retrenchment of 1700 workers in pioneer firms alone.

In 1967, however, a quite different picture emerges. The number of pioneer firms in the implementation stage or in production increased to 234, and employment in such firms increased by more than five thousand. The disturbances in Hong Kong resulted in several Hong Kong industrialists moving their operations to Singapore. In addition, they affected Hong Kong's attractiveness to foreign investors as a site for industrial operations, thus improving the competitive position of Singapore. 1967 saw a rapid increase in tourists coming to Singapore. This resulted in expanded construction and economic activity in the tourist industry, and provided a boost to the country's foreign exchange position. In that year, also, Confrontation with Indonesia formally ended, and resumed trade relations resulted in an improved position of exports.

While these developments in 1967 removed the immediate need for a crash programme in industrial development in the export sector, the long range picture was not substantially changed. Perhaps the most important factor, then, is related to the change in ministerial portfolios. The new Minister of Finance had been, before the change, the Minister of Interior and Defense. In that capacity he had been responsible for beginning the development of a major defense programme on the part of the Singapore Government. He must clearly have been aware of the tremendous cost that such a programme would entail, and the very substantial government revenues that would be needed to meet the cost of the programme. A flat reduction of the company tax from 40% to 4% on virtually all export profits would mean a very substantial loss of government revenue. This might be justified in the long run, even with the immediate revenue needs that the government faced, if the tax incentive is critical to potential investor's decision-making. But 1967 also began to show that many of the investors which Singapore was attracting without legislation regarding the tax incentives for exports, were already export oriented. This might well mean that the export incentives, if maintained at the liberal level which seemed to be intended when they

54. Dr. Goh Keng Swee was moved from Minister of Interior and Defense to become the Finance Minister, and Mr. Lim Kim San became the Minister of Interior and Defense.

55. The figures used here, and the figures below for 1967, are taken from the "Report of the 1968 Joint Annual Survey of Industries," prepared by the Economic Research Division of the Economic Development Board, published in June 1969. See Table III (a) therein.

were first announced, might be little more than a windfall to a large number of investors, unnecessarily reducing government revenues by a substantial amount.

For whatever reason, the export incentive as enacted in Part IV of the Act substantially limits the benefits thereunder. Just how much the incentive has been restricted will be seen after a complete discussion of Part IV.

b. *The export enterprise*

Part IV of the Act provides that the Minister may, if he considers it expedient in the public interest to do so, approve any product manufactured in Singapore or the produce of deep-sea fisheries as an export product or export produce.[56] No notification of "intention to approve" is stipulated as a necessary precondition to the approval, and it is curious to note that the preceding two schemes dealt with stipulate such procedures.[57] In addition to not providing for notification of "intention to approve," or for consultations and representations in this regard, Part IV also fails to require that approved products or produce be gazetted. While the former departure from the provisions of Part II and III probably makes little practical difference, the latter departure may be of substantial importance. Although the reasons behind the departure are unclear, its effect is readily apparent. If the government does not make public those products which have been approved as "export products" or "export produce," and this appears to be the intention, it will be extremely difficult for manufacturers to know whether they are eligible for the relief offered under Part IV. This, in turn, makes the provisions therein less useful as a tool by which the Government can guide and influence the decision-making process of investors. Each manufacturer or potential investor will have to seek out the Government to determine whether the products which he manufactures or wishes to manufacture have been or will be approved. Even without looking at the substantive tax relief provisions it is clear immediately that, with regard to the export incentives, the Government intends to "keep its cards close to its chest."

One other point is interesting to note. The benefit is to be open to the manufacturer or processer of goods, but interestingly, it is also made available to those who intend to harvest the produce of the sea. Presumably this is an attempt to promote an industry engaged in full-scale operations, with modern equipment and techniques, in a place where no difficulty of finding fishing grounds is envisaged. This activity is only to be encouraged for export, since Singapore's domestic needs are, for the moment, met by the local small fishermen.

56. Section 20.

57. Unlike ss. 4 and 16, with regard to pioneer industries and products, and expansion industries and products, s. 20 provides no opportunities for objection to the Minister's approval by established manufacturers or otherwise interested parties. Perhaps it is felt that the established exporter is sufficiently protected under the scheme itself so that no objections are anticipated.

If, and as, products are accordingly approved, companies upon application may be granted export enterprise status if they are already manufacturing or intend to manufacture such products, either wholly or partly for export.[58] An export enterprise certificate is thereupon issued, subject to such conditions as the Minister thinks fit.[59] Two things are worthy of note: the scheme's benefit is again limited to companies, and is available to such companies already manufacturing products which turn out later to be declared as export products.

The starting point for the operation of this particular incentive scheme is an accounting period called the export year which is specified in the certificate. This export year is that accounting period in which it is expected that the export sales of the export product will exceed a certain level quantitatively and percentage-wise.[60] "Export sales" is defined to mean export sales (f.o.b.) made directly by the export enterprise or through an agent or independent contractor.[61] Export sales by a retailer to whom the enterprise has sold the export product do not qualify; this is to enable the Revenue Department to have direct contact throughout with the company claiming exemption for the purpose of administering and policing the scheme. The certificate may be amended by the Minister with respect to the export year specified therein.[62] The period over which the tax relief shall extend will be fifteen years, commencing from, and inclusive of, the enterprise's export year.[63] If the enterprise is or was also a pioneer enterprise, there is no difference except when the export year falls within the pioneer tax holiday, i.e., certificates under the two schemes are held at the same time and the export year occurs while the company is still enjoying pioneer tax exemption. If such is the case, the relief period under Part IV will begin immediately after the end of the pioneer relief period, i.e., from the commencement of the enterprise's new trade or business, and shall extend over a period which together with the pioneer tax holiday will aggregate fifteen years.[64] The Minister may extend the relief period of any individual export enterprise beyond fifteen years.[65] Some complex computations may be necessitated due to the superimposition of the Income Tax Act's commencement provisions[66] upon the calculations, under SS. 28-30 of the Act, of the export enterprise's income in respect of its first two or three years of relief as such as enterprise. This is possibly one of the many reasons why moves are afoot to repeal the troublesome commencement provisions of the Income Tax Act (These provisions have been repealed. See now Cap 141, 1970 Rev. Ed.). In the meantime, the Comptroller's

58. Section 21(1).

59. *Ibid.*

60. Section 21 (3) (a), (b). The export sales in the export year (1) must not be less than 20% of the value of the company's total sales, and (2) must not be less than $100,000.

61. Section 21(4).

62. Section 22.

63. Section 23(1) (a).

64. Section 23(1)(b).

65. Section 23(2).

66. Cap. 141, 1970 Rev. Ed., s. 35(3) thereof. See *ante,* pp. 16-17.

power to give directions under S. 9 of this Act, for the purpose of ascertaining true figures of income earned, is reiterated as inherent in the administration of Part IV.[67]

The export enterprise is under an obligation to submit returns annually[68] as if the whole of its income in respect of its export profits were chargeable to tax under the Income Tax Act.[69] Each such return shall be accompanied by a statement showing the quantity and value, at f.o.b. prices, of its export product(s) exported during that accounting period in respect of which the return is furnished.[70]

For the purposes of granting relief, the Comptroller may accept that an export product has been duly exported where such export has been made under and in accordance with current export and customs legislation or regulations thereunder.[71] All export of export products must be in accordance with regulations laid down and conditions prescribed by the Comptroller.[72]

Before income of an export enterprise will be subject to the tax relief provisions of Part IV, one further set of conditions must be met. The concept of the "export years" has already been mentioned.[73] The export year is that year when the fifteen year tax relief period begins to run. It is determined at the time the export certificate is issued, and thus is based upon an estimate as to when export sales of the export product will exceed a certain amount[74] and comprise a specified percentage of total sales.[75] It is not necessarily the year in which tax relief is first given, nor will relief necessarily be given in all of the remaining years of the tax relief period. Section 29 provides that before relief will be granted, the export enterprise must have exported, in the accounting year to which such relief is applicable, the export product in quantities not less than 20% of its total sales, and not less than $100,000 in value.[76] If the value requirement is met, but the proportion requirement is not,

67. Section 24.

68. Section 25(1).

69. Cap. 141, 1970 Rev. Ed.

70. Section 25(2).

71. Section 26. The statutes are (1) the Registration of Imports and Exports Ordinance (Cap. 261), 1955 Rev. Ed.; (2) the Control of Imports and Exports Act (Cap. 240), 1970 Rev. Ed.; and (3) the Customs Act (Cap. 133), 1970 Rev. Ed. In addition, s. 55 gives power to issue regulations governing the export products or produce by an export enterprise to the Comptroller, or, if delegated by him, to the Controller of Customs and Excise. In 1968 such regulations were issued: The Economic Expansion Incentives (Relief from Income Tax) Regulations, 1968, No. S.254. For discussions, see *post,* pp. 52-53.

72. Section 27.

73. *Ante,* p. 42.

74. $100,000; s.21(3)(b).

75. 20%; s. 21(3)(a).

76. Section 29(1)(a).

the Minister may nevertheless direct that the relief under the scheme shall apply in respect of such export year, or any accounting period subsequent thereto during the enterprise's tax relief period.[77] Where the conditions as to value and proportion have been met, or where the Minister has made a direction as indicated above, the export sales for subsequent accounting periods during the tax relief period must amount to not less than $100,000 before relief will be granted in such subsequent accounting periods.[78] It is readily apparent that it is not sufficient to have been approved as an export enterprise. Upon receiving such approval an enterprise must also meet conditions as to value and proportion with regard to the exports of its export product. The conditions will tend to exclude small manufacturers from the relief scheme.[79] Presumably the government feels that the cost of administrative manpower and time which would be required to process and supervise the records and accounts of enterprises which are unable to meet the conditions would exceed the value of the exports of such firms which the scheme might encourage. This is probably correct, for as we have seen, and will see when we turn to the formulae involved in calculating the amount of relief, the scheme is extremely complicated and will cast a heavy burden on those responsible for administrating it.

c. *Calculating the relief*

Once the enterprise has met the conditions set out above, the formulae by which one arrives at the enterprise's export profits that will qualify for exemption in any one accounting period during the relief period are best explained in a series of steps.

I. The income of an export enterprise in respect of the export sales of its export product shall be ascertained, for any accounting period within its tax relief period, in accordance with the provisions of the Income Tax Act, without making any deductions normally allowable under SS. 16-22 thereof.[80] Let us call this amount of income "i profits," a certain portion of which will proceed toward the next hurdle in an attempt to qualify for exemption. That portion is calculated in accordance with the procedures set out in step II.

II. Work out the proportion borne by the total value of the company's export sales (f.o.b.)[81] of its export product to the total value of its total sales, which includes such export sales, export sales of *other*

77. Section 29(2). The assumption is that these conditions as to value and proportion will be met, or a Ministerial direction will be given, in the export year. If this is not the case, then s. 29(1) (c) provides that relief will not be granted until such accounting year in which such conditions are met, or such direction is made.

78. Section 29(1)(b).

79. However, it is possible that a small enterprise manufacturing a single product may satisfy the conditions.

80. Section 28(1).

81. Note that the term is "sales", and *not* profits.

non-export products, domestic sales of all manufactured products (at ex-factory prices), and all other sales and provisions of service. Thus such proportion is:

$$\frac{\text{total value of export sales of export product}}{\text{total value of total sales of all products and services}} = \frac{e}{t},$$

and taking i as computed in Step I

$$\frac{x}{i} = \frac{e}{t} \text{ or, } x = i \text{ times } \frac{e}{t}$$

where x = the *total export profits* for any one accounting period within the tax relief period.

It will be seen that the portion of the enterprise's profits in respect of export product that will qualify for exemption is determined by the proportion borne by the enterprise's export product activities to its over-all activities.

III. It is convenient at this point to consider two definitions.

(a) *"Established export market"* means a country to which an export product has been exported by any Singapore manufacturer continuously and in such value as the Minister may determine for a minimum period of five years immediately preceding 1 January 1966.[82]

(b) *"Average annual export profits"* which is a sum:

(i) equal to 1/5 of the export enterprise's total export profits, arising from the export of its export product to an estab-

82. Section 28(5) (b). Note how wide is the definition of "established market." The definition is concerned with a volume of exports, as determined by the Minister, of *any* export product, made by *any* Singapore manufacturer. Thus if a manufacturer of bicycles wishes to export to a given market, that market may be an established market if printed cotton textiles (assuming printed cotton textiles has been approved as an export product) have been exported there in sufficient quantities during the five years preceding 1 January 1966. There seems to be little logic to support this position, since surely bicycles will not compete with printed cotton textiles and it would appear that the intention of the government is to protect established exporters from Singapore competitors who might be benefiting from the tax relief under the scheme. Indeed, one official of the Economic Development Board has suggested to the author that this intention should be read into the provision. According to his reading, each export product and each export produce would have its own established markets — those markets where the appropriate volume of exports of the particular export product or produce was reached during the five years preceding 1 January 1966. This reading cannot, in any way, be drawn from the wording of s. 28(5) (b), which uses the phrase "any product or produce, approved under section 20 of this Act as an export product or export produce...."

To date the Minister has not designated any such markets. Indeed, there may be no intention of such designation. Such information may only be available upon persistant inquiry at the Economic Development Board; or the Minister may designate the volume of exports involved, and then the manufacturer will have to determine which markets are "established" by measuring the volume of exports of export products or produce to the markets in which he is exporting. But this will also be extremely difficult, since, as seen earlier, (see *ante,* p. 41), the Minister is not compelled to announce publicly which products or produce have been approved under s. 20.

lished export market, for the five year period ending 31 December 1965. The total export profits for these five years is computed in accordance with the formula laid down in S. 28(2), dealt with in steps I and II above;[83] or,

(ii) calculated as follows, if the export enterprise has been exporting its export product, possibly on and off, to an established export market for a total period of less than five years prior to 31 December 1965: the total export profits for such period are computed in accordance with the formula in S. 28(2), and set out in steps I and II above, and then divided by the number of months in which such export has been carried on. The resultant is multiplied by twelve to give a notional average annual export profit.[84]

There is a proviso to the effect that where the company was a pioneer interprise, the fact that it is deemed to have commenced a new trade or business at the end of its pioneer tax holiday shall be immaterial for the purpose of (b) (i) and (ii) above.[85]

IV. (a) Now, where the export enterprise in its tax relief period exports its export product to a country which is not an established export market as defined in step III (a),[86] the whole of its *total export profits* (x), for any one accounting period within its tax relief period as computed in steps I and II, qualifies for relief.[87] Steps III and IV (b) are of no concern to such an enterprise which manages to find new markets; since there is no interference with established Singapore exporters, the whole of its *total export profits* will be subject to relief under S. 30 thus enabling it to sell more competitively in such new markets.

(b) However, where the enterprise, in its tax relief period, exports its export product to a country which is an established export market within the definition set out in step III (a),[88] then only a portion of its *total export profits* will qualify for relief, and even then there is a trichotomy:

(i) Where the company has previously exported the export product or produce to the established market over at least a continuous five year period ending 31 December 1965, the portion of its *total export profits* which will qualify for relief will be the excess of those *total export profits* over the *average annual export profit* as computed in step III(b)(i).[89]

83. Section 28(5) (a).
84. Section 28(5) (a) (ii).
85. Section 28(3), proviso.
86. Section 28(5) (b).
87. Section 28(4).
88. Section 28(5) (b).
89. Section 28(5) (a).

(ii) Where the company has previously exported the export product or produce to the established market, but for a period of less than five years prior to 31 December 1965, the portion of its *total export profits* which will qualify for relief will be the excess of those *total export profits* over the *average annual export profit* as computed in step III(b)(ii).[90]

(iii) Where the company has never previously exported the export product or produce to the established market prior to 31 December 1965, the portion of its *total export profits* which will qualify for relief will be the excess of those *total export profits* over a fixed sum to be determined by the Minister. In determining the fixed sum the Minister shall have regard to the total sales of such company, as defined in S. 28(2), and the percentage of the total sales of other major export enterprises which are exported to the established market.[91]

Thus it is not the whole of the export income derived from exports of the export product or produce which qualifies for relief under the scheme. At best it is only that part which bears the same proportion to such export income as export sales of the export product bears to the enterprise's total sales. Part IV makes a distinction between exports of the export product to an established market and to a new market. In the former case, a still smaller amount will qualify; only that which exceeds the *average annual export profit,* or, if the enterprise has not exported to the market, then a figure set by the Minister. This distinction is important. In addition to substantially affecting the amount of income which will be eligible for relief, the distinction makes it necessary for an enterprise, where it is exporting to both new and established markets, to keep separate accounts with regard to the two kinds of markets. As seen earlier,[92] there is considerable difficulty at present in determining which markets fall into the two categories.

A hypothetical example may show more clearly some of the problems involved, i.e., the complexities in determining the amount of relief, and the difference in the relief available under the Act from that which was expected following the first statements in December 1966, by the then Minister of Finance, Mr. Lim Kim San. Let us assume that Company X has total sales of $2,000,000.[93] Of this amount, $400,000 is derived from sales of the export product in new markets, and $400,000 from sales of the export product in established markets. In both cases the income[94] derived from such sales is $100,000. Using these hypothetical figures

90. Section 28(5) (a) (ii).

91. Section 28 (3) (b).

92. *Ante,* p. 45, footnote 82.

93. Section 28(2)(a)-(d): its domestic sales of manufactured products or produce at ex-factory prices; its export sales (f.o.b.) of its export product and export produce; its export sales (f.o.b.) of other products; and all other sales and provisions of services. This figure is symbolised by the letter "t" in the formula on page 48.

94. See *ante,* p. 44, step I.

we can begin the process of determining the amount of income which qualifies for the relief granted under the Act.[95] In the case of income derived from sales of the export product in new markets the amount of income qualifying has the same proportion to the total income from such sales as the sales of the export product in new markets bears to total sales.[96] This can be shown by the following equation:

$$\frac{x}{i} = \frac{e}{t} \text{ or, } x = i \text{ times } \frac{e}{t} \text{ or, } x = \$100{,}000 \text{ times } \frac{\$400{,}000}{\$2{,}000{,}000}$$

$$\text{or, } x = \$20{,}000.$$

For sales of the export product in new markets, then, the amount of income which qualifies for relief under Part IV is $20,000.[97] With regard to sales of the export product in established markets, one additional step is required. Since the figures for sales and income are the same as those used above, the first step will give us the same figure — $20,000 as the export profits. But in this case only that amount of export profits which exceeds the *average annual export profit,* or the fixed sum set by the Minister, will qualify for relief. Let us assume that the *average annual export profit* is $15,000.[98] The qualifying income from the sale of the export product in established markets, then, is $20,000 less $15,000, or $5,000. The total amount of Company X's income which is subject to relief under Part IV is $20,000, from sales in new markets, plus $5,000, from sales in established markets, or $25,000.

If we now recall what was expected from the first references of the Government to its new export incentives, we can see the very substantial difference between that expected and what, in fact, is available under the Act. The Minister of Finance, in December 1966, seemed clearly to indicate that the whole of profits derived from exports would be subject to relief under the new scheme. There was, at that time, no mention of export products or produce; all export profits seemed to qualify. But aside from that difference, if we assume that Company X, in our example above, only exported the export product and thus its total export sales include those mentioned above — $400,000 to new markets, and $400,000 to established markets — the difference is still very substantial. Under the scheme as it appeared when first announced, Company X could have expected income amounting to $200,000[99] to qualify for relief. As we have seen in the above calculations, under Part IV as enacted, only $25,000 qualifies for relief.

Thus far we have only discussed how that amount of an enterprise's income which is qualified for relief is determined. The actual amount of relief is determined by application of S. 30. The complexities already

95. It should be noted that the amounts to be so determined are not exempt from tax. They only qualify for relief. Further calculations are necessary to determine the amount of relief, or the amount of income which is tax exempt.

96. Section 28(2). See also the formula on p. 45, *ante.*

97. Section 28(2).

98. The figure is purely hypothetical. For the manner of actual determination of such figure, see s. 28(5) (a); also *ante,* p. 46, step IV(b).

99. See *ante,* p. 39, at footnotes 52 and 53.

discussed regarding Part IV are further compounded by the fact that S. 30 is possible of three distinct readings. One reading suggests that after computation of the export enterprise's qualifying portion of its income, capital allowances under SS. 16-22 of the Income Tax Act[1] shall be deducted therefrom,[2] though such deductions are not made for the purposes of ascertaining the enterprise's *total export profits.*[3] The Comptroller shall then "issue to the export enterprise a statement showing the *balance of the export profits"* for the year of assessment in question.[4] An amount equal to 90% "of this balance of such export profit shall not form part of the statutory income of the export enterprise for that year of assessment but shall be exempt from tax."[5]

Let us return to the hypothetical example given above,[6] adding some additional figures, to see how this reading would apply in a particular situation. Assume that Company X has incurred capital expenses for which allowances are available under SS. 16-22 of the Income Tax Act. Assume further, that the proportion of income to total sales is the same as it was to export sales to new and established markets. This will giver us the following figures:

Export sales of export product to new and established markets	$ 800,000
Income from export sales of export product ..	$ 200,000
Total sales	$2,000,000
Income from total sales	$ 500,000
Export profits qualifying for relief ..	$ 25,000
Capital allowances under SS. 16-22	$ 20,000

It will be noticed that except for Part IV, Company X's taxable income would be the income from total sales less capital allowances, or $480,000. Using the above reading of S. 30 a slightly lower figure is determined as the taxable income. The capital allowances are deducted from the qualifying export profits. Ninety percent of the balance is then tax exempt. This tax exempt figure and the capital allowances are then deducted from the total income from all sales. The following figures result:

$25,000 less $20,000 = $5,000. 90% of $5,000 = $4,500.
tax exempt profits = $4,500.

$500,000 less ($20,000 + $4,500) = $475,500 taxable income.

1. Cap. 141, 1970 Rev. Ed.
2. Section 30(1). The provision stipulates that where any export profits qualify under ss. 28 and 29, the capital allowance deductions "shall be made". It is not clear from what they shall be deducted.
3. Section 28(1); see *ante,* pp. 44-45, steps I and II.
4. Section 30(2); emphasis added.
5. Section 30(3).
6. *Ante*, p. 47.

One implication of applying the 90% figure to the balance remaining after deducting the capital allowances from the qualifying export profits is clear: the amount of exempt income is further reduced. This reduction has a second effect. As in the case of the pioneer industries scheme,[7] dividends distributed from exempt profits are also exempt from taxes in the hands of shareholders.[8] The amount of tax exempt dividends in the hands of shareholders of export enterprises will also be reduced.

The wording of S. 30(2)[9] does support the above reading, but at least three factors suggest that the reading may be incorrect. It is entirely possible that an export enterprise may have incurred substantial capital expenditures in order to improve efficiency and expand its export profits qualifying for relief. In such a situation the capital allowances available under SS. 16-22 of the Income Tax Act[10] may well exceed the amount of export profits qualifying for relief. The above reading would then mean that there was no relief at all as there would be a negative balance remaining after the deduction of allowances from the export profits. The second factor is that the relief is already very meager. Further reduction tends to make the legislative exercise, and the amount of time spent by the enterprise and revenue officials in computing the enterprise's income, rather absurd. Finally, the capital expenditures for which allowances are available will undoubtedly be related to the creation of income other than that related to the export product or the export profits. Where this is so it seems unusual, at best, to deduct the whole of the capital allowances from the export profits, especially those allowances which are totally unrelated.

This raises the second possible reading of S. 30, which is identical to the reading above, except that only that portion of capital allowances which bears the same proportion to total capital allowances as income from the export sales of the export product bears to total income is deducted from the qualifying export profits. In the hypothetical example this would mean that only $8,000 of the capital allowances[11] would be deducted from the qualifying export profits, i.e., $25,000. This would leave a balance of $17,000 and, when applied to the 90% figure in S.30(3), $15,300 as tax exempt. The total taxable income would then be $464,700. Although this reading appears to be more logical than the first reading, and it was suggested by an official in the Revenue Department,[12] there is absolutely nothing in S. 30, or elsewhere in the Act, to suggest that the capital allowances be divided.

7. Section 31(9).

8. Section 31.

9. Section 30(1) refers to making deductions for capital allowances. S. 30(2) then says that "the Comptroller shall issue to the export enterprise a statement showing the balance of the export profits for the year of assessment...." It is not impossible to read this as meaning the balance remaining after the deduction of capital allowances have been made from the qualifying export profits.

10. Cap. 141, 1970 Rev. Ed.

11. This figure is determined in the following manner:

$$\frac{X}{\$20,000} = \frac{\$800,000}{\$2,000,000} \quad \text{or,} \quad X = \$8,000.$$

12. Since no guidelines have been indicated in this regard, the official wishes to remain unnamed.

The author feels that the only way in which the ambiguity can be resolved is to determine from what are the capital allowances mentioned in S. 30(1) to be deducted, and what is the balance referred to in S. 30(1) and (2). The author contends that S. 30(1) assumes that the enterprise, or the tax authorities, are starting from the total income from all sources. The capital allowances are then deducted from this amount, and not from the qualifying export profits. No reference, other than in S. 30(1), is made to deducting capital allowances from total income before determining the enterprise's tax liability. After this figure is determined, S. 30(2) and (3) are applied. The "balance of the export profits" refers to the balance remaining after the calculations of S. 28 which determine the amount of qualifying export profits. Ninety percent of this figure is then tax exempt. The effect of this reading is to reduce the amount of taxable income from what it would be without Part IV by 90% of the export profits. Again, referring to the hypothetical example, the following figures emerge:

$500,000 less $20,000 = $480,000 taxable income prior to deduction of tax exempt income under Part IV.

$480,000 less (90% X $25,000) = $457,500 taxable income.

This last reading of S. 30 is consistant with the section's wording; it is logical and it is the least complicated of the three readings suggested. While the author contends that it is the preferred reading, this does not lessen the fact that the section is ambiguous, and until clear guidelines are issued by the Revenue Department it will be extremely difficult, if for no other reason, for enterprises to know what are the exact benefits available under the export scheme.

As mentioned above,[13] Part IV also provides for extension of the relief to "second generation" dividends distributed by a company which is the holding company of the export enterprise — a benefit similar to that under the pioneer scheme.

A company qualifying for relief under Part IV shall not be entitled to relief under S. 14B of the Income Tax Ordinance, even though the expenditures for which deductions are therein allowed may be totally unrelated to the company's sales of export products or produce.[14] Presumably the government does not want to provide "double relief" for what it considers to be the same activity, or activity on the part of the enterprise which is directed at the same objective — increasing exports.

Sections 32-35, the remaining provisions in Part IV, recite powers possessed by tax and customs authorities, of entry, search, seizure, and arrest. The purpose is to ensure that relief under the scheme is based

13. *Ante*, p. 50. See s. 31.

14. Section 29(1)(d). S. 14B of the Income Tax Act deals with deductions for expenditures such as advertising, samples, travel, etc., incurred for the purposes of securing export sales. As seen from the above discussion and calculations, such expenditures could easily exceed the amount of income which will ultimately be tax exempt under Part IV. Now repealed by Act 23/1969. See *ante*, p. 7, footnote 10.

upon genuine exports of export products or produce, and not upon goods set out from Singapore and later re-landed in secrecy or upon goods which are not export products or produce.

d. *Regulations governing procedures for export*

The above discussion sets out Part IV of the Act, explains the provisions found therein, and notes the effect of the changes which have occurred from the time the export incentive scheme was first mentioned until it was finally enacted. But the discussion will not be complete without at least a brief reference to the Regulations promulgated under S. 55(4) of the Act related to procedures for export. These regulations are the "Economic Expansion (Relief from Income Tax) Regulations, 1968.[15] The object of the regulations is two-fold: first, to ensure that only export products or produce are exported in a consignment for which tax relief is later claimed; and second, to ensure that the products or produce are in fact exported to the destination designated, and not to some other destination, or returned to the warehouse, or re-landed somewhere else in Singapore to be re-exported or locally consumed at a later date.

The Regulations give substantial power to the customs officials to supervise export operations. As and when required by the Comptroller of Customs and Excise, the export enterprise must provide, at the export warehouse, (i) separate storage space for finished export products or export produce which is ready for export, (ii) a separate office for the customs officers, and (iii) such other requirements as are deemed necessary by a senior customs officer.[16] The Comptroller may require any export enterprise wishing to pack any export product or produce at its export warehouse, to give twenty-four hours notice of such intention to a senior customs officer.[17] He may further require the enterprise to submit the export product or produce to a senior customs officer for him to examine, take samples of, and weigh.[18] The enterprise may be required to pack the export product or produce only under the supervision of a senior customs officer.[19] The Comptroller may require that the enterprise allow a senior customs officer to lock, mark, seal, or otherwise secure the export product or produce,[20] and, further, that no export product or produce so secured shall be exported except with such locks, marks, seals, or other safeguards intact.[21] Provision is made for control by senior customs officials in the removal of any export product or produce from the enterprise's export warehouse.[22] The Comptroller has the power to prohibit the export of export products or produce by means of vessels

15. The Economic Expansion Incentives (Relief from Income Tax) Regulations 1968, issued on 16 August 1968, No. S. 254. Hereafter referred to as the Regulations.

16. *Ibid.*, s. 4.

17. *Ibid.*, s. 5(a).

18. *Ibid.*, s. 5(b).

19. *Ibid.*, s. 5(c).

20. *Ibid.*, s. 5(d).

21. *Ibid.*, s. 6.

22. *Ibid.*, ss. 8 and 9.

below seventy-five net registered tons, and to prescribe other conditions for such export.[23] The export enterprise may be required to provide proof that the export consignment containing export products or produce has been landed at the prescribed destination. No tax relief shall be allowed for any consignment for which such proof is required and cannot be furnished by the enterprise.[24] The Regulations further provide for the hours during which export operations may be undertaken, and for reimbursement by the enterprise for any overtime incurred by customs officials.[25] Any senior customs officer may require that packing and stacking of export products or produce be carried out in the fashion which he indicates,[26] and he may direct that any package already packed be opened for his examination.[27]

For the most part the Regulations do not actually prescribe procedures; rather they give the power to prescribe. But the power given in this regard is extensive, and, depending upon the actual requirements of the Comptroller and other customs officials, may require substantial expenditures of time and money on the part of the export enterprise. As we have seen previously, the benefits under Part IV will seldom be substantial. One Singapore manufacturer has estimated that the costs which may be incurred as a result of the Regulations will surely offset any benefits which might be derived under the export scheme. Actual outlays may be required to provide separate space in the export warehouse, an office for customs officials, and in paying overtime to such officials. Further costs will undoubtedly be incurred as a result of the restrictions on the enterprises export operations. Again, however, it should be noted that these problems may not arise, depending upon how the Regulations are implemented by the Comptroller and other customs officers. It is hoped that the limited benefits under the scheme will not be further eroded by the requirement of procedures which are unnecessarily onerous on the enterprises.

e. *Some observations upon Part IV*

Since its first discussion by the then Minister of Finance, Mr. Lim Kim San, the export incentive has been substantially restricted. This has been accomplished in two ways: first, at the most the portion of export profits which will be subject to relief is that which holds the same relationship to total export profits as export sales of the export product or produce holds to total sales; and second, by the introduction of the concept of the "established market", and the requirement of increased profits from exports to such markets before relief will be given. Two observations can be made regarding the limitation. The original pattern indicated by the Government would undoubtedly have been over-generous. No attempt has been made to estimate the revenue loss that would have resulted, nor is such an estimate really possible, but it certainly would

23. *Ibid.*, s. 10.

24. *Ibid.*, s. 11.

25. *Ibid.*, ss. 12, 14, 15 and 16.

26. *Ibid.*, s. 17.

27. *Ibid.*, s. 20.

have been large. Such a loss in revenue could have been justified only if, and perhaps not even then, the tax relief was a critical factor in inducing substantial volumes of export which would otherwise not have occurred. But as noted earlier,[28] by 1967 it was clear that many of the enterprises that would have reaped the benefits of such a scheme were export oriented anyway. In addition, many of the enterprises which could, or would, obtain benefits under the scheme as originally outlined, or as enacted, are foreign owned. An unnecessary loss of revenue to such enterprises increases the amount of benefits derived from investment which may be appropriated by foreign interests, and thus reduces the benefit accruing to domestic sources.

The second observation is related to the introduction of the concept of the "established market." There is some value in such a notion. Surely Singapore, or any other country, is interested in more than simply increasing its exports. It must also seek to increase the diversity of those exports, and the diversity of the markets to which it is exporting. To the extent to which this can be accomplished, its economy will be strengthened as it will be less dependent upon world prices for any particular product, or the developments in any particular market. Thus the exporters should be encouraged to find new markets.

But it is the author's contention that the over-all effect of the limitations introduced, and the complicated calculations therein required, totally eliminate the scheme as a useful device in attracting investment, or in guiding investment into desired industries or economic activity. In order to affect investment decisions, either initial decisions or those made after the enterprise is in operation, the investor must be able to calculate with some degree of certainty the amount of benefit which he will derive by making those decisions in conformity with the provisions of the intended incentive. Because there is no requirement that the approval of products or produce be made public,[29] and because what constitutes an "established market" is so unclear,[30] it is difficult to determine what, in fact, must be done to conform with the requirements of the Act in order to qualify for the benefits therein. But even if an enterprise does qualify, it is impossible to tell, with any certainty, the magnitude of the relief which might be expected, if any.[31] Even at best, the relief provided will be limited, and the Regulations issued with regard to the scheme[32] suggest that whatever benefits might accrue may be offset by the additional cost which will be incurred to satisfy the procedural requirements thereunder.

At the time of writing, the Government has been unwilling to state definitively whether any enterprises have been approved as export enterprises. The author has heard different figures in this regard, none higher

28. See *ante,* p. 41.

29. *Ibid.*

30. See *ante,* p. 45, and footnote 82.

31. See *ante, pp.* 44-47. The calculations involve so many variables that it is impossible to determine before hand what the outcome will be. Notice also the ambiguity in s. 30 regarding how the actual relief is determined; *ante*, pp. 48-51.

32. See *ante,* pp. 52-53.

than six.[33] However, a number of businessmen have indicated their irritation with the Government for its reluctance to implement Part IV, even in its restricted form, and approve applications which they have made thereunder.[34] In each case, however, the reason for the Government's unwillingness to approve applications is readily apparent: they have all represented enterprises which are exclusively, or almost exclusively, export oriented. Such enterprises will export to their capacity, regardless of whether they obtain benefits under the scheme.

It can be argued, of course, that if they know they will obtain tax relief they will then be able to reduce prices as a result of the consequent reduction in costs, and increase their export sales. But this would be true only if they could calculate at the time of any particular sale negotiation, the amount of tax relief they would enjoy. As noted earlier, the limitations imposed in order to reduce the amount of revenue loss to the Government have been accomplished in such a manner so that it is impossible to determine just what relief will be obtained. Thus the scheme is not useful to increase exports of existing enterprises. Nor will it be instrumental in affecting initial investment decisions. It can, in most cases, only provide windfall benefits to the private sector, and since the Government rightfully is not interested in such an exercise, the scheme is, for the most part, unused, and unworkable.[35]

6. Foreign Loans for Productive Equipment

This scheme, under Part V of the Act, is introduced to assist the local enterpreneur in getting foreign loans on favourable terms; if certain conditions are fulfilled the tax which is payable by the creditor upon the interest on such loans is lifted.[36] Unlike the preceding three schemes, this is not an incentive in the form of tax exemption on profits earned by the Singapore enterprise, and it is available to any company engaged in any industry; there is no provision for certain industries and/or products to be declared as having a special status. Presumably the scheme should operate in conjunction with Part III, which offers incentives for the expansion of established industries, in that the foreign loans must also be in respect of productive equipment.

33. The sources include officials at the Economic Development Board and businessmen. For obvious reasons, none wishes to have his name disclosed.

34. Some have even suggested that the government's unwillingness to approve applications, when noted alongside its widespread publicity of "export incentives to a tax free rate of 4% on export profits," amounts to fraud.

35. It is the author's belief that in order to preserve some semblance of the original proposal, and still reduce the amount of revenue loss, the government, either purposefully or as a result of lack of care, emasculated the scheme so severely that it now should be considered a "dead letter." Yet the need for Singapore's industrialization to be heavily export oriented remains. In the concluding portions of this article the author will suggest possible alternatives to the present system which might usefully be employed.

36. Such interest is deemed to have been derived from or accrued in Singapore; it is therefore chargeable to tax under s. 10(1)(d) of the Income Tax Act. The mechanism for collection of such tax is laid down in s. 45 of the same Act.

The Singapore Government is prepared to sacrifice some of the revenue arising from the 40% tax which is normally payable upon interest on foreign loans.[37] The loan must not be less than $200,000, unless the Minister allows otherwise.[38] The reference in Part V to a loan from a non-resident person or the foreign lender, as he is called, arises from the fact that most capital equipment used in Singapore for industrial purposes is imported, having been manufactured in foreign countries. Singapore does not have a sophisticated machine tools industry. Equipment has therefore to be purchased from foreign manufacturers, who ordinarily finance the transactions by granting credit under financial agreements. Such transactions may also be financed by foreign merchant bankers. The scheme is meant to relieve the foreign lender of paying tax on the loan interest, so that he makes more than he otherwise would; it is hoped that this will in turn prompt or enable him to pass on all or some of the benefit to the local buyer, by granting the latter more favourable purchase terms.

Application may be made by a company which is eligible in accordance with the above mentioned pre-conditions; a copy of the financial agreement is to accompany the application.[39] Approval means the issuance of a certificate approving the particular loan specified as an approved foreign loan.[40] One other condition is set down in the Act, and that is that productive equipment purchased or financed from an approved foreign loan shall not be sold, transferred or otherwise disposed of, without the prior written permission of the Minister.[41] The intention is that entrepreneurs should not obtain approved foreign loans for the sake of loans; the certificate holder should be a genuine buyer of machinery for his own use, not to engage in purchase-resale operations on the side and make use of this exemption to enlarge his profits therefrom. This restriction shall apply until the loan has been repaid in full, i.e., when no more interest is payable by the local company.[42] Until then, the equipment is tied; economically expedient or *bona fides* sales may not be possible as it may take too long for the Minister's permission to be secured. Local manufacturers should therefore think twice before they choose to apply for exemption under the scheme.

The interest, normally taxable at a rate of 40%,[43] is completely exempted from such tax under the scheme.[44] This is subject to a very important proviso; the Comptroller must be satisfied that such exemption will not visit upon the foreign lender an increased tax liability in his own country of residence.[45] The intention is to avoid sacrificing Singa-

37. Cap. 141, 1970 Rev. Ed., s. 45.

38. Section 36(1).

39. Section 36(2).

40. Section 36(3).

41. Section 37.

42. *Ibid.*

43. But see Cap. 141, (1970) Rev. Ed., s. 45, proviso (1), which gives the Comptroller the authority to require payment at either a higher or lower rate than 40%. No indication is given as to when or why the Comptroller might exercise this power.

44. Section 38(1).

45. *Ibid.*

pore's own revenue merely to the benefit of a foreign treasury.[46] In many countries some kind of relief, usually in the form of a tax credit, is provided by the regular tax laws for foreign taxes paid. Without reciprocal relief arrangements, or double taxation agreements containing tax sparing provisions, the less a foreign taxpayer is taxed upon his income derived in Singapore, the more he has to pay to his own tax authorities in his country of residence.

The mechanism by which exemption under Part V is effected is as follows: where the company holding an approved foreign loan certificate fulfills all the conditions as enumerated above, upon paying such exempt interest, it shall not deduct therefrom the tax which it would otherwise have been obliged to deduct[47] under S. 45 of the Income Tax Act.[48] A statement of such amount that but for the scheme would have been deductible must be submitted immediately to the Comptroller.[49] Where the company contravenes S. 37 of the Act, i.e., sells the loan-financed productive equipment without the Minister's permission, or any of the conditions imposed upon its certificate,[50] such amount shall be deemed to have been deducted from the payable interest, and shall be a debt from such Singapore company to the Government;[51] provided, however, that the Comptroller cannot proceed to recover such debt without the Minister's prior sanction.[52] This is an instant sanction by which means the exemption gained may be disallowed, and the tax must be paid out of the Singapore company's own income rather than being deducted from that of the foreign lender. The exemption shall apply to additional interest which becomes payable by reason of an extension of the period within which the approved foreign loan must be repaid.[53]

Statutory bodies such as the Public Utilities Board have shown interest in the exemption under this Part of the Act, as they frequently embark upon very large projects, at times using equipment purchased from abroad whose value runs into millions of dollars. Such equipment is purchased through credit arrangements with overseas sellers. The problem, however, is that such bodies are neither companies nor are they engaged in manufacturing, and thus they are not eligible under the provisions of Part V.

It may be argued that the intention of Part V, easing the burdens upon the import of modern capital equipment, is contrary to the need to reduce the problems arrising from unemployment. It is submitted that this is not the case. It is seldom that capital-intensive industries are directly competitive with labour-intensive industries. Where they are, the problems can be reduced or avoided through the appropriate

46. For further discussion of this point, see *ante,* p. 12, footnote 35, and post, p. 74, at footnote 20.

47. Section 38(2).

48. Cap. 141, 1970 Rev. Ed.

49. Section 38(2).

50. Under s. 36(4).

51. Section 38(3).

52. Section 38(4).

53. Section 39(1).

administrative discretion to approve or deny the application for approved status. If Singapore is going to enjoy sustained economic growth and development, it must move beyond the stage of relying solely on labour-intensive production methods. It must begin to produce and export sophisticated products of uniformly high standards. Capital-intensive industries are more likely to achieve this than are those which are labour-intensive.

In general the provision is admirable. It wisely includes the limitation that the exemption will only be granted when the relief does not result in an increased tax liability, for the party receiving the interest payments, to a foreign government. Indeed, some thought should be given to including such a provision in other exemption schemes found in the Act. It should be noted, however, that in many cases the exemption may only marginally affect the interest rates payable on the loan, or, in even more cases, affect the ability of the Singapore company to import the equipment in question. Thus the wide discretion available to the Minister is appropriate. The exemption should be allowed when it will significantly affect the transaction. The Minister should be particularly careful to note the relation of the parties involved, and the terms of the loan and interest payments. Particularly when the Singapore company is a subsidiary of a foreign company, the party granting the loan may be the parent company or one that is otherwise affiliated. In such cases the loan may be, in part, a device used to transfer funds from the Singapore company to the parent or affiliate without paying Singapore taxes. Of course this is not always the case, and there are a number of factors regarding the terms of the loan which should be examined: whether or not the interest rates are consistent with those which would be paid if the transaction were between unaffiliated parties operating at "arms-length;" whether or not the loan has a fixed repayment period; whether or not the debt created by the loan is subordinated to unaffiliated creditors; and whether or not the loan and/or interest can be converted into equity holdings in the company. If the answer to any of these issues is affirmative, the Minister should be very careful before approving the application.

There is one more factor which should be borne in mind. The repayment of principal will require use of Singapore's foreign exchange. This presents no unusual problems as the purchase of any equipment from abroad will require the use of foreign exchange. But the purchase through foreign loans adds the use of foreign exchange for the payment of interest. While Singapore's foreign exchange position is, at the moment, healthy, this is largely the result of an enormous inflow of foreign equity capital which has not yet created a reverse flow of capital in the form of dividends. As enterprises with foreign held shares reach the maximum of their capacity, and profits remitted abroad increase, the foreign exchange position may become more important. The added debt burden created by substantial foreign loans may then become a critical drain on foreign exchange. For this reason, the Minister should look carefully at the expected results of the purchase involved: will it increase foreign exchange through increase productions of exports, or decrease the amount of imports. Again, however, the provision wisely

grants ample administrative discretion to the Minister to avoid these problems. If that discretion is properly used, the tax exemption provided under Part V of the Act could be of significant value in important, but limited, situations.

7. ROYALTIES, FEES, AND DEVELOPMENT CONTRIBUTIONS

Part VI of the Act is similar in its objective to Part V — that is, to assist Singapore industry to assemble a large pool of machinery and skill in order to speed up the Republic's economic development. Part V is concerned with enabling the local entrepreneur to obtain loans from foreign traders under better terms in transaction for the purchase of foreign made equipment. Part VI is directed towards enabling the same Singapore company to derive the benefit of foreign industrial technology upon more favourable terms.

The relief is extended to royalties, technical assistance fees, and contributions to research and development costs paid by the local company to non-resident persons. Royalties and technical assistance fees are paid in respect of copyrights, patents, designs, plans, secret processes or formulae, trade-marks, and other like property or rights. Also included are information concerning industrial or scientific knowledge, experience or skill. A full definition may be found in S. 3(1) of the Act, from which it is evident that the tax benefit is in respect of the intangibles which are as much a part of any manufacturing process as are raw materials or the machines themselves.[54] Development contributions are

54. It is not entirely clear from s. 3(1), or from elsewhere in the Act, whether fees paid as a result of a management contract entered into by a Singapore and a foreign enterprise will qualify for exemption under the provisions of Part VI. It would appear at first reading that the benefits are restricted to fees paid to obtain technology, technological skills, patents, processes, designs, or what otherwise might be included in the term "intellectual property." Although this term is far from free of ambiguities, it would appear that it does not include managerial skills or management know-how. The benefits acquired may or may not fit within the phrase "information concerning industrial, commercial or scientific know-how, experience or skill," which is used in the definition contained in s. 3(1). The question which will confront the Minister is whether the definition in s. 3(1), and the provisions of Part VI, should include payments made under management contracts.

In many cases it may be difficult to separate the two kinds of payments, as the same agreement may cover the transfer of management and technological skills and know-how, with little, or no, indication of what payment is for what service. Since they are both frequently dealt with under the same agreement it may be appropriate for the government to treat them both in the same manner. If this is the case, it will be important not to distinguish between payments made under agreements which only provide for the transfer of management services, and those which provide for both management and technological services. There are clearly policy reasons supporting the inclusion of payments made for the transfer of management skills. Technology is certainly important to any industrial operation. But equally important is obtaining the ability to organize that technology in combination with human endeavours to increase productivity and profitability. This latter aspect may be identified as management know-how, and the same benefits applied to the acquisition of technology, etc. should be accorded to the acquisition of management know-how, skills, or services.

In this article, the author assumes that Part VI of the Act applies to all such payments, but wishes to note, in accordance with the above, that whether the provisions therein will, in fact, be applied to payments for management know-how is not clearly established.

fees or sums paid to research organizations so that they will make available their findings. The idea behind the scheme again is to relieve the non-resident person who provides these items from a percentage of the tax he ordinarily has to pay under Singapore tax law; so that he may be persuaded to make available technology, technical skills, etc., or, if he has already so decided, to pass on the benefit of the tax relief to the Singapore buyer.

The passport to the exemption under the scheme is, as usual, a certificate issued upon application by a company engaged in industry, which is desirous of entering into an agreement with a non-resident person whereby the former has to pay the latter royalties, fees, or contributions.[55] The certificate may be granted subject to such conditions as the Minister might think fit to impose,[56] and the company issued with such a certificate may not amend or otherwise vary the terms of the agreement without the Minister's prior permission.[57] Permission is not necessary where the amount of payment is reduced, or where the payments cease to be payable before expiry of the period set out in the agreement; in both cases notice has to be given to the Minister within thirty days.[58]

Ordinarily such royalties, fees, or contributions are taxable, under S. 43 (b) of the Income Tax Act,[59] in the hands of the foreign recipient at a flat rate of 40%. Under the scheme such tax payable is reduced to 20%, or lifted altogether if the Minister should so decide.[60] If the non-resident does not withdraw payments taxed at 20% from Singapore, but instead invests it, or a part thereof, in shares of the paying company, such amounts or part thereof shall not be liable to tax at all.[61]

There is again the important condition that the Comptroller must first be satisfied that the exemption will not render the non-resident person liable to increased tax in his country of residence because of the tax relief offered by Singapore.[62]

Quite apart from the provisions of Part VI, the author anticipates that there may arise complications as to whether the royalties, fees, or contributions are liable to tax under S. 43 of the Income Tax Act[63] at all. The charging section of that Act, S. 10, imposes a tax upon "the income of any person accruing in or derived from Singapore," and this includes the non-resident person contemplated by Part VI. The question, therefore, is as to when the royalties, etc., accrue in, or are derived from, Singapore. The place of payment and the place of residence of the payer are not conclusive. For example, royalties upon a secret process

55. Section 40(1).
56. Section 40(3).
57. Section 41(2).
58. Section 41(1), (2).
59. Cap. 141, 1970 Rev. Ed.
60. Section 43.
61. Section 44.
62. Section 42.
63. Cap. 141, 1970 Rev. Ed.

may be paid on the basis of the number of articles produced under such process. Ordinarily this is a good case of accrual in Singapore and such payments normally attract tax; the income accrues only when and where the goods are actually produced, and that is in Singapore. However, payment may be upon the basis of the actual work or information the non-resident person — who may be a scientific corporation or a consultant engineer — has performed or provided. If such services are not rendered *in* Singapore by such person, the income he derives is not taxable, not having accrued in Singapore. The non-resident consultant may be working in a research station outside Singapore, making available discoveries concerning manufacturing processes, or moving in and out of Singapore giving advice, ironing out production snags, etc. When may the Revenue Department say that such persons have received income accrued in Singapore? Even before Part VI was introduced such non-resident persons were entitled to certain relief and exemptions under the Income Tax Act.[64] If these provisions, together with Part VI, are administered by the Revenue Department too severely and restrictively, there may well result a disservice to Singapore. Such non-resident consultants and experts benefit Singapore greatly, and they could be discouraged and disgruntled if made to pay heavy taxes. Many are probably not exempt or given relief at home in the absence of double taxation agreements. Experts coming to Singapore under the aegis of the United Nations enjoy the same status as diplomatic personnel; one of the privileges appurtenant thereto being that they are not liable to tax in Singapore. But experts from foreign private enterprises assisting Singapore enterprises in the transfer of technology and technical skills do not enjoy such benefits.

While Part VI indicates that the Government recognizes the importance of transfers to Singapore of technology, technical know-how, and skills through enterprise-to-enterprise agreements, problems remain. In order to focus on such problems, it will be helpful to (i) determine who is likely to benefit from the operation of the scheme in the context of the present economic-commercial situation in Singapore, and (ii) determine whether Part VI is sufficient to maximise the benefits which could accrue to Singapore from the transfer of technology, etc., through the mechanism of enterprise-to-enterprise agreements.

At the present time a substantial number of enterprises incorporated in Singapore are paying fees to foreign corporations for the transfer of managerial skills, technology, and related skills.[65] Almost all such payments are made by a wholly owned subsidiary to the foreign parent corporation, or by a joint venture to the foreign corporate partner of that joint venture.[66] In such cases the transfer of managerial skills and/or technology, etc., is almost certainly part of the investment package under-

64. *Ibid;* one example is s. 40A, which provided relief in respect of moneys held on deposit in approved banks, and which has been amended recently to give total exemption of tax thereon. Such depositors are also now not liable to have their accounts scrutinised by tax authorities. Section 40C, which provides relief for non-resident employees, is another example.

65. No complete list is available, but the author estimates that there were at least fifty such agreements as of 31 December 1969.

66. One notable exception is the agreement between Sembawang Shipyard (Pte.) Ltd., a wholly government owned ship building and repair firm, and Swan Hunter, a British firm supplying management and technological services.

taken by the foreign enterprise. The important point to note is that the transfer will take place regardless of the presence of the tax relief offered under Part VI. In those cases where the payment is made by a wholly foreign-owned subsidiary, for all practical purposes it is the foreign enterprise which determines the cost to the local enterprise of such transfer. If it is in the interest of the foreign corporation to lower the price of such transfer it will and can do so, regardless of any relief being granted under Part VI. A lower price for such transfers will, presumably, lower the cost of production for the local enterprise, and thereby increase its profits. If the increased profits are remitted to the parent, the lower price merely allows the foreign corporation to recover the cost of the managerial or technology transfer through dividend remission rather than through direct payment of fees. Where the Singapore subsidiary is a pioneer enterprise, and is enjoying tax exempt status, the foreign parent will undoubtedly chose to recover the cost of the transfer through profit remission.[67] This is because such profits are exempt from taxes,[68] and dividends from such profits are tax free in the hands of the shareholder;[69] while the relief under Part VI normally will only reduce the tax rate from 40% to 20%.[70] Where the Singapore subsidiary is not enjoying tax exempt status as a pioneer enterprise, the parent corporation may wish to transfer the cost of the managerial skill or technology by way of direct fees, if it can obtain relief under Part VI.[71] But in neither case is Part VI likely to affect the amount or value of managerial skills or technology transferred, or its cost.

There would appear to be only one situation when the Singapore subsidiary, and the parent corporation, would want to take advantage of the provisions of Part VI. This is when the parent corporation wishes to reinvest its earnings[72] and the Singapore subsidiary is not enjoying tax exempt status as a pioneer enterprise. In such a situation the profits of the subsidiary will be taxed at the corporate tax rate of 40%, while fees approved under S. 40(3) of the Act, if invested in the company,

67. There are possible exceptions to this. Even though there may be no tax liability to the Singapore government on the part of the Singapore subsidiary for its profits or on the part of the foreign corporation for dividends received from the Singapore subsidiary, the foreign corporation may incur a tax liability to its government for profits received in the form of dividends. The foreign government may, however, have entered into a "double taxation agreement" with Singapore which includes a tax sparing provision with regard to taxes not paid as a result of the operation of Part VI. In such a case, the foreign corporation may prefer to receive payment in the form of fees which will be exempt from taxes in both Singapore and the country of the parent corporation, rather than profit remission. This will be the case, for instance, where the parent corporation is located in Australia. See, The Income Tax (Singapore-Australia) (Avoidance of Double Taxation) Order, 1969, No. S. 33, at Article 18(3).

68. Section 13; see *ante,* p. 20.

69. Section 14; see *ante,* pp. 21-22.

70. Section 43(1). The Minister is given the authority under s. 43(2) to completely exempt such payments from Singapore tax, but the normal procedure will provide only a reduction in the tax rate to 20%.

71. Note that Part VI is available only if the relief granted thereunder will not increase the tax liability of the person receiving the payments to its government; s. 42; see also *ante,* p. 60, and *post,* pp. 63-64.

72. Note that under s. 44 the earnings must be reinvested in the Singapore corporation making the payment, and not in any other enterprise in Singapore.

will be tax free.[73] The affect of this, however, is to encourage the parent corporation, and the Singapore subsidiary, to charge high fees for the transfer of managerial skills and/or technology in order to increase the amount of earnings for which there will be tax relief, and reduce the Singapore subsidiary's taxable profits.[74] In such a situation it is possible that the provisions of Part VI will increase the transfer of managerial skills and/or technology. But even here the size of the transfer, or its value to Singapore, will be primarily determined by the needs and dynamics of the broader corporate system of which the Singapore subsidiary is but a single unit. Part VI is likely to be marginal, at best, in affecting the transfer.

Where the transfer is made to a joint venture by the foreign partner to that venture, the impact of Part VI will be little different than that described above, despite the fact that the Singapore corporation will have local shareholders. The transfer of managerial skills and/or technology will undoubtedly be part of the foreign partner's investment. Even where the Singapore partner is the majority shareholder, the existence of a managerial contract, or a technology agreement, gives the foreign partner an important tool of control over the operations and decisions of the Singapore subsidiary, and thus the cost of such transfers and the form in which the payments are to be made. The presence of Singapore shareholders does mean that payment for the transfer is likely to take the form of direct payment of fees, rather than through profit remission.[75] Government measures, such as the relief provided in Part VI, to reduce the cost to the foreign supplier may increase the appropriation by Singapore sources[76] if it increases the Singapore corporation's profits. Where this occurs as a result of tax relief under Part VI, the provisions therein will have served a useful purpose. But Part VI will probably have little effect in the determination of the size or utility of the transfer. This will, again, depend largely on the interest and needs of the foreign partner in the joint venture.

As noted previously,[77] there are few managerial or technology agreements between Singapore corporations which are entirely locally owned and foreign enterprises. The relief available under Part VI of the Act has not been, nor is it likely to be, a significant factor in stimulating

73. Section 44.

74. If the Singapore corporation is not enjoying tax exempt status, its profits will be taxed at the 40% rate, thus reducing the amount available for reinvestment. Consequently the parent corporation, and the Singapore corporation (if the decision-making of the two can be separated), will want to increase the size of the payments for management skills and technology in order to increase the tax exempt earning which can be reinvested. Admittedly control of such practices can be maintained through the Minister's grant of approval.

75. Payment, however, can be in the form of shares in the Singapore corporation. That is, the foreign partner who is to supply managerial skills or technology may be allocated shares above what his capital contribution would indicate. In such a situation, the joint venture agreement, and/or the management contract or technology agreement may set the level of payment for transfers under such agreements at a figure which is lower than would otherwise apply.

76. To the extent that the relief results in increased profits to the Singapore corporation, a larger proportion of the benefits accruing as a result of the transfer can be appropriated by Singapore shareholders through the issuance of dividends.

77. *Ante,* p. 61.

transfers which would result from such agreements. In part this may be because of the form in which the relief is offered. The only direct and certain beneficiary of the relief will be the foreign supplier, as it is the tax on its income which is reduced. The presumption is that the foreign supplier will provide the technology or services at a lower price since, as a result of the tax relief on payments made, its after-tax income will be increased. But such a benefit to the Singapore corporation is indirect at best, and may not accrue at all, even though the foreign supplier is benefiting from the tax relief.

It should be further noted that the tax relief will not be available in the case of *all* payments made for transfers of managerial skills and/or technology. Where the relief will result in an increased tax liability on the part of the foreign supplier to its own government, the scheme under Part VI is not applicable. In such cases there is no benefit or assistance at all to the Singapore corporation. The reason for this limitation has been noted previously,[78] and, within the context of the present scheme where the direct beneficiary is the foreign supplier, the limitation is not only justifiable, but also wise. But the affect of the limitation is to prevent any benefit at all in the cases where the Singapore corporation might seek a transfer of skills and technology from an enterprise that owes its principal tax liability to any government which, for example, grants a tax credit for foreign taxes.[79] This excludes all payments for such transfers made to foreign suppliers located in the United States, perhaps the biggest potential source of managerial skills, technology, and technical know how.

The value of the scheme, then, is extremely limited. This may be justifiable if the potential value to Singapore resulting from such transfers is also limited. But it is the author's contention that benefits accruing as a result of the transfer of managerial skills and technology are the greatest that foreign investment has to offer Singapore. Singapore has shown a remarkable ability to mobilize local capital, either public or private.[80] What she cannot mobilize from local sources is technology and related skills, and managerial know how, including marketing skills. Indeed, Singapore officials have increasingly recognized this in their public statements regarding the need for foreign investment, and in the shift to attracting investment in industries which require high technology inputs. This being the case, the incentives provided under Part VI are simply insufficient to achieve the objective — to attract a high rate of transfer of foreign managerial skills and technology through enterprise-to-enterprise agreements.

As noted above,[81] one part of the difficulty is that the direct benefit is to the foreign supplier enterprise, with only a potential, indirect benefit

78. *Ante,* pp. 56-57, 60.

79. In such a situation the foreign supplier would be able to credit against his tax liability to its own government any taxes paid to the Singapore government. A reduction of the taxes paid to the Singapore government will consequently only result in a direct increase in the supplier's tax liability to its government.

80. For a discussion of the increasing availability of privately held capital for industrial investment in Singapore, see Hughes, H. and You, P.S., *Foreign Investment and Industrialization in Singapore* (1969).

81. *Ante,* p. 63.

to the Singapore corporation. In most cases the foreign enterprise will not need the incentive, as its decision regarding the transfer is tied to its interest in a wholly-owned subsidiary, or a joint venture in which it is at least one of the foreign partners. What is needed is a direct benefit to the Singapore corporation.

Under the Income Tax Act the Singapore corporation may, for the purpose of determining its taxable income, deduct payments made for the transfer of such technology and services.[82] One means of providing an incentive to local corporations to enter into enterprise-to-enterprise agreements for the transfer of managerial and technical skills, etc., is to increase the amount of the deduction allowed under S. 14 of the Act. Where, for instance, approval from the Minister has been obtained,[83] the transferee, or Singapore corporation, could be allowed to deduct a sum equal to 100% of the payment made in addition to that allowed under S. 14. The benefit will thus flow directly to the Singapore corporation, and serve as an incentive for it to enter into the desired agreements with foreign enterprises. The amount of the benefit will be immediately ascertainable. The requirement of Ministerial approval will ensure that foreign supplier corporations who are also parents of a wholly foreign owned subsidiary, or the foreign partner to a local joint venture, do not use the benefits accruing to such subsidiary or joint venture under the scheme to merely increase the payments made to them. In addition, since the benefits would flow directly to the Singapore corporation and only indirectly, if at all, to the foreign enterprise, there is less need to be concerned about the reduction in revenue accruing to the Singapore Government by merely being transferred to a foreign government treasury.[84]

Although the above proposed incentive scheme would probably substantially increase the amount of managerial skills, technology and related skills which would be transferred to Singapore,[85] it will not be sufficient by itself. The Singapore Government should play a much more active role in seeing that the benefits of such transfers to the Singapore economy and society are maximized. The Minister should require, before giving his approval, that any agreement between the local and the foreign enterprises provide for the following:

1. that the local enterprise will have immediate access to all new patents or other technology and technical know-how which is related to that in the original transfer;

82. Cap. 141, 1970 Rev. Ed., vol. 4, s. 14. Such payments are not specifically enumerated therein, but are certainly included in the phrase "all outgoings and expenses wholly and exclusively incurred during that period by such person in the production of the income...."

83. Section 40(3). See *ante,* p. 60.

84. Since no tax relief will be given to the foreign supplier who is receiving payments, such payments will be taxed by the Singapore government at the rate of 40%.

85. The proposed scheme would be of direct, and immediate, interest to Singapore corporations who are wholly locally owned. It is this group which needs to be encouraged to enter into such agreements; as we have seen, Singapore corporations with foreign equity holdings readily enter into such agreements as a result of the interests of the foreign parent, or partner.

2. that the foreign enterprise will provide substantial assistance to the local enterprise in ensuring that appropriate modifications are made to suit the technology involved to local production needs, or to the demands of the market served by the local manufacturer;

3. that the agreement does not impose unnecessary or unjustifiable restrictions upon the market accessibility of the local enterprise in its use of the technology transferred;

4. that the foreign enterprise will undertake to train local personnel in the technical skills involved in the technology transfer, both in Singapore, and, if necessary or feasible, at the supplier's home plant, or the plant of an affiliate of the supplier;

5. where the agreement is a managerial contract, that the foreign enterprise will undertake to provide management training to local personnel, either in Singapore or abroad; and

6. that the cost to the local enterprise is not excessive.

Indeed, thought should be given to requiring government approval for all such agreements, whether or not tax relief is given by the Government; approval being given only when the above listed requirements are satisfied. Such a requirement could be of substantial assistance to the local enterprise in its negotiations with the foreign supplier, particularly where the local enterprise is wholly locally owned or a joint venture. If such a policy is implemented, care will have to be taken that the result is not a decrease in the amount of management skills and technology transferred.

An alternative to requiring government approval for all such agreements is to require approval only where tax relief is given to the Singapore corporation, and/or where the foreign supplier has an equity interest in the Singapore corporation. In the latter case, such requirement is unlikely to deter the amount of the transfer as this will, for the most part, be determined by the interest which the foreign enterprise has in the Singapore corporation. The requirement of government approval may, however, decrease the cost of the transfer, and increase the benefits which will flow to the Singapore corporation and the economy as a whole.

8. MISCELLANEOUS PROVISIONS UNDER THE ACT

Part VII of the Act contains provisions relating to the general administration of the incentive schemes. The Minister's power of revocation of a certificate issued under any such scheme upon the breach of a provision of the Act, or a regulation thereunder, has been noted,[86] so also the prohibition upon the publication of the contents of any application made by, or of any certificate issued to, any company under the Act.[87]

A company enjoying the benefit of any scheme under the Act shall remain under the obligations imposed by the Income Tax Act[88] for the

86. Section 46.

87. Section 45.

88. Cap. 141, 1970 Rev. Ed.

purpose of establishing its tax liability, except in so far as such obligations are varied by the Act itself.[89]

Section 48 provides for offences and penalties under the Act. These mainly arise out of the anticipated operation of Part IV. Contravention of the regulations and conditions, with respect to the export of export products or produce, laid down by the Comptroller under S. 47 is an offence severely punishable;[90] so also is the re-landing of export products in Singapore after they have been exported.[91] It is an offence under the Act for any person to (1) obstruct or hinder a customs officer in the discharge of his duty under the Act;[92] (2) fail to produce to such officer such export documents as he may require;[93] (3) refuse to give such information as he is able to give to such officer making inquiry, or give false information.[94] whether or not he knew it to be false.[95] However, no person should be obliged to furnish information that would tend to expose him to criminal charge, penalty or forfeiture.[96] Attempts and abetments with respect to offences under the Act incur the same penalties as those for actual commissions thereof.[97] A senior customs officer or an officer authorised by the Comptroller of Income Tax may conduct prosecutions in respect of any offence under the Act.[98] Such offences may be compounded;[99] or, if not compounded, any District Court or Magistrate's Court has jurisdiction to try such offences.[1] If an offence has been committed by a company, any person who at the time of commission of the offence was a director, secretary or other similar officer of the company shall be deemed guilty of that offence unless he exonerates himself in accordance with the provisions of S. 53(1). Nothing done by a government officer in the course of his duties shall be deemed to be an offence under the Act.[2]

From the above it is evident that comprehensive provision is made for due compliance with the stipulations set out in Part IV and other Parts of the Act, by means of heavy penal sanctions. In addition, however, the Minister has power to make regulations under the Act for the due administration thereof.[3]

89. Section 47.
90. Section 48(1); the penalty is a maximum fine of $10,000 and/or two years imprisonment.
91. Section 48(1).
92. Section 48(2) (a).
93. Section 48(2) (b).
94. Section 48(3) (a).
95. Section 48(3) (b).
96. Section 48(3) (c).
97. Section 49.
98. Section 50.
99. Section 51.
1. Section 52.
2. Section 54.
3. Section 55.

9. THE ACT IN PERSPECTIVE

a. *Administration of the Act*

Analysis of tax incentive legislation currently operative in may developing countries in the world suggests that they may be classified into two statutory patterns: first, provisions substantively and administratively integrated into already existing tax structures; and, second, provisions enacted as independent pieces of legislation to be implemented, at least to some extent, outside the regular tax administration on a case-by-case basis.

Singapore's Economic Expansion Incentives Act is an obvious example of the second category. Although the Act is to be "construed as one with the Income Tax Act,"[4] and although there are frequent references to the Income Tax Act in the Act, it sets out a selective fiscal policy which is substantially separate from the Act. There is substantial administrative discretion, conferred on the Minister of Finance, in determining which sectors of the economy should receive incentives, and which enterprises should obtain benefits allowable under the Act. This determination of the conferment of benefits is lodged in a unit of the government distinct from that which is responsible for general tax collection and administration.

The greatest advantage of this type of tax incentive legislation is its inherent flexibility, which makes it a potentially effective instrument for directing industrial growth in accordance with development policy. The price which has to be paid for such flexibility is, of course, the increased burden of administration. This has two aspects: first, the selection of those sectors of industry that should be encouraged and developed, and the conferment of benefits to the individual investor; and, second, the day-to-day operation of tax administration under the incentive schemes. The first aspect is the responsibility of the Ministry of Finance — in particular, the Economic Planning Division thereof — and the Economic Development Board. From them come the decisions as to which industries, and also which present and potential manufacturers within those industries, shall come under the incentive schemes. The decision as to who is to benefit is made there; and it may be noted that the power to decide is very wide indeed. Specific policy objectives are legislatively defined in extremely broad terms.[5] Companies desiring the benefits under the schemes have their applications considered individually, with discretion completely in the hands of the Minister as to whether they will receive tax relief even though they may be producing a product designated under the various schemes and meet all the requirements set out in the Act. There is infinite flexibility here, and the granting of such discretion presumes a very high level of competence on the part of the Republic's development planners. The evidence indicates that such discretion has been well placed, and, with the exception of the difficulties involved in the implementation of the export incentives under Part IV of the Act, few complaints can be made with regard to the execution of the discretion provided. Even with Part IV the problem

4. Section 2.

5. See, for example, ss. 4(1), 5(2), and 16(1).

is not so much with the discretion allowed, but with the substance of the incentive itself. It is remarkable that the burden which such flexibility involves has not resulted in substantial "red tape" and lengthy negotiations between potential investors and government officials. Indeed, one of the positive factors which Singapore has to offer foreign investors is that the investor who has his project clearly in mind can obtain quick action on the part of the government in determining whether or not he will be able to obtain benefits under the schemes.[6]

Once past this stage, however, the flexibility largely comes to an end. The second aspect mentioned above is the concern of the Inland Revenue Department, and, in the case of the export incentives, the customs officials. Once an enterprise is selected to receive benefits under the Act, the amount of benefits received is determined according to formulae set out in the Act, and, secondarily, in the Income Tax Act. A determination of the quantum of benefit in respect of each enterprise obtaining relief is largely a mechanical exercise, which is a burden only in terms of working hours. Except where the statutory formulae are subject to ambiguities,[7] the benefit which will accrue is as certain as the investor could desire, at least in the sense that it is largely up to him to determine the amount of income which will be subject to relief. The few discretions left at this stage are vested in the Comptroller, and they relate generally to the mechanics of income computation.[8]

For the most part the administration of the Act, and the incentive schemes contained therein, has been smooth and efficient. There have been few complaints regarding administration from investors, local or foreign. While it might be said that the Minister, in the early years of the Act, or its predecessor, did not exercise sufficient discretion or discrimination in determining which industries and which enterprises should receive benefits, this seems to have changed with the Government taking a much more careful approach to the conferment of benefits. Even the early approach may well have been justified as it was necessary for the government to firmly establish Singapore as an attractive place for industrial investment of both foreign and local capital.

b. *The substance of the Act*

The substance of the Act and the incentive schemes contained therein have been set out above. In addition, some comments and suggestions have been made regarding most of the schemes. It remains to comment in more detail upon two schemes included in the Act: the pioneer industry scheme under Part II; and the export incentive scheme under Part IV.

6. Businessmen have frequently expressed to the author their suprise at the speed with which the Economic Development Board and other government agencies act on applications for tax relief — with the exception of those pursuant to Part IV. The importance of this should not be minimized. Many businessmen prefer a speedy negative response to an application for benefits under the Act rather than several months of negotiations and waiting, even if the ultimate answer might be affirmative.

7. See particularly s. 30. See *ante,* pp. 48-51.

8. In practice the Comptroller does not appear to have acted arbitrarily; at least not a single pioneer enterprise has appealed against his action.

The pioneer industry scheme provides for the selection of industries and products which are important to the Singapore economy, either for domestic consumption or for export. Once an industry and product thereof have been declared to be pioneer, a company producing such product, or contemplating such production, may apply for approval as a pioneer enterprise. Such status will mean that the profits of the enterprise derived from the production of the pioneer product will be exempt from tax for a period of two to five years, depending upon the amount of capital expenditure, starting from the enterprise's production day. Such exempt income will also be exempt in the hands of shareholders when distributed as dividends.[9] In addition, allowances available under the Income Tax Act, SS. 16-22, are postponed until after the exemption period.[10]

One question which is difficult to avoid is whether the maximum period of relief offered under the Act — five years for fixed capital expenditures in excess of $1,000,000 — is appropriate, too short, or too long. The issue is frequently raised by businessmen, who naturally have their own profit interests at stake. It is of continual concern to economic planners and revenue officials who must continually seek the best package of incentives which will attract investment and yet not unnecessarily forego needed revenue for the government. As discussed above,[11] the question is difficult to answer, or even to assess, as assessment requires that the frequently conflicting and imprecise interests of each of these groups be taken into account.

Any attempt at assessment invariably leads one back to the original purposes of the tax relief period: to affect the investor's decision-making as to whether or not he should invest in Singapore. With regard to foreign investors this frequently means whether to invest in Singapore as opposed to somewhere else. With regard to domestic investors it usually means whether or not to invest at all, or, at least, whether or not to invest in a sector of the economy to which the tax relief benefits of Part II of the Act are extended.

Assuming that tax relief of any sort may affect the decisions of a foreign investor, an assumption which can be made only with significant qualifications and reservations, it may then be important to look at the practice of other countries. It has already been noted that a pioneer enterprise in Malaysia can obtain a maximum of eight years of tax exemption.[12] The Philippines grants its pioneer firms tax exemption for five years, as counted from the day of commencement of their Investment Incentives Act of 1967;[13] but continues to grant partial exemption, at diminishing percentages, for another nine years thereafter up to 1981. At the time of writing Indonesia had a tax exemption for five years, with a possible extension in the case of major investment projects which are considered vital to the development of the country. However the Government has just introduced before Parliament amendments to the

9. Section 14. See *ante,* p. 21.

10. Section 10. See *ante,* pp. 20-21.

11. See *ante,* pp. 25-29.

12. See *ante,* p. 16.

13. Republic Act No. 5186.

Foreign Investment Law[14] and the Corporation Tax Law[15] which will significantly alter the situation. The maximum tax exempt period will be extended to six years. The laws will also provide for an investment allowance of twenty percent for investments incurred after the tax exempt period, and provide for the indefinite carry forward of losses incurred during the first six years of operation. Taiwan and Thailand offer relief periods to investors which are comparable to those offered by Singapore. Hongkong does not offer a pioneer scheme, but has very low rates of corporation tax. In terms of length it can be seen that Singapore does not compare too well, but as discussed earlier,[16] the attractiveness of such an exemption does not depend entirely upon its longevity, nor is its operation an isolated factor in the potential investor's decision-making process.

Focusing briefly once again, and from a slightly different perspective, on factors other than the length of the tax exempt period, it is important to remember that the investor is interested in long-range profit expectations. In addition, the value of the tax exemption is a combination of the length of time for which it is extended, and the level of profits which can be earned during this time. Both of these factors are related to the level of the infrastructure necessary to support industrial activity, the productivity of labour, the efficiency of governmental administrative operations, etc. These factors, in turn, depend, at least in part, on the amount of government expenditures on the development and maintenance of transportation and communications facilities, the development and maintenance of industrial estates, the level of education, and the development of a skilled labour force. In all of these areas Singapore fares extremely well. Extended periods of tax exemption, particularly where it is granted to enterprises which would have made similar investment regardless of the exemption, operate to reduce the amount of revenue available to the government. This may hinder the government in its attempts to provide those services which are demanded by business, and which are, as pointed out above, critical in encouraging investment in the first place. It must be remembered also that the more economic, particularly industrial, activity there is in the country, the greater will be the social and infrastructure overhead costs which must be borne by the government.

Although the above comments have been directed to the question of whether or not the foreign investor will invest in Singapore as opposed to somewhere else, the same kinds of considerations are relevant when considering the position of domestic investors. Particularly in Singapore where domestic capital tended to flow to commercial and trade sectors of the economy where there is a rapid return on investment, it was essential to convince the potential industrial investor that he could obtain a rapid return on his investment. This depends more on the level of profits in the first years of operation than it does on the length of the tax exemption period.

14. Law No. 1 of 1967.

15. Corporation Tax Law 1925. For an English translation see *Indonesia Tax Laws* (1969), prepared by Sycip, Corres, Velayo & Utomo (Certified Public Accountants), Djakarta.

16. See *ante,* pp. 25-29.

Given this kind of initial analysis, there is considerable evidence to support the conclusion that Singapore's tax exempt period is at least not too short. Despite the fact that Malaysia, for example, has a maximum tax exemption period which is three years longer than that offered by Singapore, and despite the fact that the population of Malaysia is five times greater than that of Singapore, therefore offering a larger potential domestic market,[17] the flow of investment into the industrial sectors of the economy, from both foreign and domestic sources, has been much greater in Singapore than in Malaysia. Interviews with a number of businessmen who are now, or have been, enjoying pioneer status pointed to the same conclusion.[18] A textile and garment manufacturing company, struggling together with the rest of the industry to break even in the face of domestic competition from Communist Chinese textiles and quotas in international trade, is understandably not too concerned with the pioneer scheme or the tax holiday which it is enjoying thereunder. In fact, the company expressed a preference to surrender the pioneer certificate in order to be free of the controls and limitations under the scheme so as to be able to embark upon other activities which promise greater profitability. This example represents one extreme; where the profits are either non-existent or too small for tax exemption to be of any importance. A company manufacturing drawn wire has consistently made high profits from the outset, in large part because it sells the bulk of its product to an affiliated company which is just next door. Although satisfied with the tax exemption under the pioneer scheme, the company expressed the view that the exempt period should be longer, particularly for enterprises with enormous initial capital expenditures. An enterprise manufacturing tires and rubber products, having an investment of $20 million in its factory at Jurong Industrial Estate, has somehow managed to obtain a complete return on its capital investment within four years — three years ahead of its original estimate. This is possibly due to the fact that parent company in Japan has extensive markets in Asia and may well have made room therein for its Singapore subsidiary. A plywood and veneer company, with a $3 million capital expenditure, has recovered its initial capital investment after two years of operation, thanks to an unlimited world market, comparatively low production costs, and the tax exemption it is granted as a pioneer industry. Both of the last two companies felt that the maximum tax exemption period should be longer than five years. This is a natural position for businessmen to take; they would like to see no taxes at all if the government can provide the services and facilities which they demand. But the critical point about each of the last three companies mentioned is that they made the decision to invest knowing that the tax exemption period would be only five years. In fact the evidence seems to indicate that they may well have made essentially the same investment decisions with a shorter

17. As noted earlier, *ante,* p. 37. Malaysia's population is five times greater than that of Singapore. The reader should be cautioned, however, about using population sizes as the sole variable in comparing market sizes. Per capita income is frequently more important, and in this respect, Singapore has an edge over Malaysia, Yet in the long run the Malaysian market must be considered to be more attractive than that of Singapore.

18. See Cheong Yue Kuan, *An Analysis of the Economic Expansion Incentives (Relief from Income Tax) Act, 1967* (1969), an unpublished paper written for the Faculty of Law, University of Singapore.

exemption period, or even with no exemption at all. Looking at the question from the perspective of the tax exemption's affect on investment decisions a longer period of tax exemption would only have amounted to an unnecessary loss of revenue to the government. Arguably, the tax exemption period granted under Singapore's pioneer industry scheme is too long, particularly given the fact that the maximum period is available to investors who have only to invest $1 million.

But there are at least two other views from which tax exemption should be examined. The first relates the "defensive nature" of tax exemption schemes, and the psychological importance they may play in the investor's, especially the foreign investor's, decision-making. It is now common practice for developing countries to include various forms of tax exemption schemes in their development packages intended to lure investment within their boundaries. Once the foreign investor has made the decision to invest abroad, he then has to decide the best place for that investment. He will, of course, attempt to make that judgment on the basis of the estimated return on the investment, selecting the country where he can expect to maximize his long run profits. But unless there is something about the industry which makes a particular country the logical choice,[19] or unless the investor has a history of working within the region, estimates as to expected profits over the long run are frequently educated guesses at best. In such a situation where corporate calculations indicate that two or more countries can be expected to offer roughly equal returns on investment, the country offering the longest tax exemption period may have the advantage. Those people in the corporate hierarchy who make the initial decision as to where to invest may feel the need of opting for the "longest tax exemption," in case profits do not materialize as expected and the Board of Directors or shareholders begin to ask questions. In this respect the length of the tax exemption period may be of significant psychological importance in the investor's decisions. At least it suggests that any given country's tax exemption scheme should not be too far out of line with those of countries with which it expects to compete in attempting to attract foreign investment.

The second view is less related to the affect of the tax exemption period on the initial investment decision than it is to the country's policy regarding the most appropriate means of providing the mechanism to finance continued growth of existing enterprises or new ventures altogether. It is arguable, particularly with regard to foreign investment, that tax exemption which contributes substantially to increased profits provides a substantial contribution to the financing of increased industrial activity. The increased profits resulting from the tax exemption may be remitted abroad in the form of dividends to shareholders, or they may be kept as retained earnings, or be reinvested to expand production capacity.

19. Corporations in the extractive industries will, for instance, invest in countries where the mineral resources they require are found. This is particularly true when the industry is concentrated in the hands of a few, highly vertically integrated corporations. Frequently such corporations, or corporate systems, must invest even in a country which has only a potential resource in order to protect its position in the world market. There are, of course, other examples, but this should be sufficient to illustrate the point.

There are two distinct factors which push in the direction of re-investment rather than remission in the form of dividends. Particularly when foreign investors are moving into a new territory, or a new market, they tend to keep their initial investment as small as possible. It will be just large enough to adequately test and explore the market and to meet the problems inherent in any new investment venture, but small enough to minimize the risk of loss. In addition, as is the case at present, it may be difficult or expensive to raise the capital in the investor's own country or capital market. Once the venture is on its feet, and the investment secure, there is a tendency for the investor to expand his productive capacity, and to expand into new products altogether. He usually attempts to raise as much capital as possible in the country where the subsidiary is located, using early profits for this purpose.

The second factor varies, depending on the tax regime of the capital exporting country. Most economically developed countries tax on a world-wide basis; that is, a taxpayer in the country in question incurs a tax liability on income earned, no matter what is its source. In the ordinary course of events the income of a parent corporation in, for instance, the United States, earned by its subsidiary in Singapore, would be taxed by the United States tax authorities at the time it is earned. If such income is also taxed by Singapore then the same income will be taxed twice, once by Singapore, and once by the United States.[20] In order to mitigate such double taxation problems, a number of developed countries allow for tax deferment. This may be accomplished in several ways, but the most frequently employed is to defer tax liability until such time as the income is remitted to the parent company in the form of dividends.[21] So long as the profits of the subsidiary are retained — not dispersed in the form of dividends — no tax liability arises to the government of the parent company. Where the capital importing country exempts the profits of the subsidiary from taxation, no tax liability accrues at all so long as the subsidiary retains such profits. Not wishing to lose the advantages offered by the tax exemption, the Singapore subsidiary will

20. A simple example will illustrate this point. Assume Corporation P is the sole shareholder of a Singapore Corporation S. Assume further that S has, in any given tax year, $100,000 taxable profits. The Singapore tax on such profits will be 40% x $100,000, or $40,000. Because such profits are also income of P, the government to whom P owes its tax liability will also wish to tax them. Depending on its tax regime, this tax may be levied on either the whole of the profits of S, or on that portion which remains after the Singapore tax has been paid. In the first instance, assuming the effective tax rate is 50%, the tax will be $50,000, making a total tax of $90,000. If the tax is only on that portion which remains after payment of the Singapore tax, the tax will be 50% x $60,000, or $30,000, making a total tax payment of $70,000. If Singapore has unilaterally exempted the profits of S from taxation, under a tax exemption scheme, e.g., Part II of the Act, then the parent will still have to pay the tax on the full amount of the profits earned by S — 50% x $100,000, or $50,000.

21. Two countries, in addition to the United States, that provide such tax deferment, and which are important investors in Singapore, are The Federal Republic of Germany and the United Kingdom. See, respectively, Harvard Law School International Programme in Taxation, *World Tax Services: Taxation in The Federal Republic of Germany* (1963); and Harvard Law School International Programme in Taxation, *World Tax Services: Taxation in the United Kingdom* (1957). Other countries modify this system slightly, by either taxing foreign source income at a lower rate, or by allowing the parent corporation to deduct from the income of its subsidiary, the taxes paid to the tax authority of the subsidiary. The effect of this latter alternative was demonstrated in footnote 20, above.

tend to retain its earned profits. This, along with the first factor mentioned above, acts as a very strong force encouraging the investor to reinvest his profits which have increased as a result of the tax exemption.[22]

The almost immediate reaction to this view, assuming that corporate reinvestment of profits is a positive economic factor, is that tax exemption, no matter what its affect is on initial investment decision-making, should be encouraged, and perhaps even prolonged. But the assumption that corporate reinvestment is a positive economic factor should not be too hastily made. Whether or not it is a positive factor depends on the quality of the reinvestment, that is, whether it is made in sectors which are determined to be important or vital to the economy of the country. It also depends on the value of alternative investment which might be undertaken by the government as a result of increased revenue transferred to it by way of taxation.

Three examples may illustrate this more clearly. The number of enterprises which may have established themselves producing a pioneer product may be such that the government feels that increased production is no longer needed, or production of the product is not of significant value to the economic development of the country. The latter may frequently be the case in Singapore, since until recently the government granted pioneer status to enterprises with little concern for their significance to economic development. If such an enterprise uses its increased profits, resulting from the tax exemption, for reinvestment to increase production of the product in question, the economic consequences are marginal at best.

In such a situation the return on the investment, as viewed from the needs of the economy as a whole, may be higher if it is carried out by the government. This is particularly the case if the government investment which would result from increased tax revenues is in sectors which have a high social and economic return; the maintenance and development of communication and transportation facilities, and other

22. Where the tax regime of the parent corporation offers a tax credit for foreign taxes paid, there is an even stronger psychological pressure for the Singapore subsidiary to retain tax exempt earnings. Where the subsidiary remits tax exempt profits, and where the recipient country offers a tax credit, the value of the tax exemption is almost totally lost, particularly in those cases where Singapore's tax rate is lower than, or equal to, that of the recipient country. See *ante,* p. 12, footnote 35. In such a situation there will be strong psychological pressures to retain the earnings rather than remit them to the parent corporation where they will be taxed. If the intention of the government is to encourage reinvestment, this psychological pressure can be changed into an economic incentive by a limitation on the tax exemption on dividends paid out of tax exempt corporate profits. Instead of automatically exempting all dividends paid out of exempt profits (see *ante,* p. 21), s. 14 might be changed to provide tax exemption only in those cases where such exemption will not increase the tax liability of the recipient of the dividend to its government. This would employ the device used in s. 38 (1) and s. 42 regarding tax relief for interest payments on foreign loans and payments for the transfer of technology, etc. Such a provision would only affect foreign investors whose governments provide a tax credit for Singapore taxes paid. It would not increase the amount of tax liability accruing to the foreign investor, and thus would not affect his initial investment decision. It will, however, encourage the reinvestment of profits, as opposed to their remission in the form of dividends. It will also minimize an unnecessary loss of government revenue which will otherwise merely be transferred to the treasury of the recipient country.

industrial facilities; increasing the training of skilled labour; improving the general quality and level of education and housing; or in direct investment in productive activity through such institutions as the Development Bank of Singapore and INTRACO. In this regard Singapore has an extremely good record. Since the present government came to power in 1959, a very substantial portion of government revenue has been expended in the areas mentioned above;[23] few people will argue that the results have not substantially contributed to the productivity and tremendous growth of the Singapore economy.

Granting this to be the case, recent developments in Singapore give rise to the third example which is indicative of government investment which may have a very low economic return. Particularly at present, it is quite possible that a substantial amount of such additional tax revenues may be used for military expenditures. Although the current Singapore National Service Programme undoubtedly assists in increasing the capacity of Singapore's youth to handle technical skills, there are other, and more productive, ways of accomplishing this than through military expenditures. Aside from the indirect economic effects of such training, and the notion that military expenditure has indirect economic effects by increasing political stability (a notion which is at best only arguable), military spending is generally not economically productive. This is particularly the case in Singapore where defence spending does not include the development of sophisticated technology which might have a high spin-off value for the productive sectors of the economy.

On the whole, however, the evidence of the last ten years indicates that Singapore government expenditure has had a very high social and economic value. This record casts serious doubt on the proposition that the Singapore government ought to, in effect, subsidize corporate expansion through substantial tax exemption programmes.[24]

23. During the period 1961-65, the Singapore Government incurred actual expenses of $920,870,000. Out of this total, the following expenditures were made:

Industry and Commerce	$405,320,000	44%
Transportation and Communications	137,300,000	15%
Social Development	325,400,000	35.5%

This indicates that an amazingly high percentage of government revenues was spent in areas directly related to economic and social development — 94.5%. For complete figures with a more detailed breakdown, see, Hughes, Helen, and You Poh Seng (editors), *Foreign Investment & Industrialization in Singapore* (1969), pp. 22-23.

24. Any exemption from the normal tax regime of a country amounts to a subsidy to the beneficiary of the exemption. The government, in effect, is allowing the "taxpayer" to retain funds which would normally accrue to the government. The question is whether such funds would obtain a higher social and economic return if they were invested by the government rather than by the "taxpayer." In addition to the problems related to the value of the reinvestment as compared to the alternative investment by the government, other difficulties arise regarding the use of tax exemption schemes as a mechanism for financing industrial expansion. Obviously those who benefit the most from tax exemption are those who make the greatest profits. As noted earlier, additional investment in such industries may not represent the greatest value to the economy as a whole. In addition, however, those corporations making large profits are precisely the corporations who will best be able to find the necessary financing for expansion programmes other than out of tax exempt profits. Where profits are large, the Singapore tax rate — 40% — will still leave substantial earnings to be reinvested. More important, however, such corporations will almost certainly be able to obtain capital from banks or from capital markets in Singapore and abroad.

Before moving on to any conclusions regarding the length of Singapore's tax exemption period, one additional comment should be made regarding the above analysis that there are strong forces supporting reinvestment by foreign investors. One of the factors involved herein is the nature of the tax regime of the foreign investor. As noted above,[25] many economically developed countries provide a tax deferment for income derived from developing countries, but once the profits are remitted, they will be subject to taxation. For domestic shareholders, however, the situation is quite different. Indeed, the Act provides that dividends paid out of exempt profits are also tax exempt in the hands of the shareholders, and, further, where that shareholder is a holding company its dividends paid from this sum will also be tax exempt.[26] Since such dividends will not be subject to any tax liability in the hands of Singapore shareholders, they may well desire to take advantage of these provisions of the Act, and may urge the pioneer company to distribute its profits rather than reinvest them. It should be noted, however, that the pioneer enterprise's profits which are tax exempt under S. 13 are credited to an account, and it is dividends which are paid out of such account which will be tax exempt in the hands of the shareholder. It does not appear that such dividends must be paid out prior to the end of the tax exemption period in order to retain their tax exempt status. Nonetheless, S. 14 will undoubtedly have the effect of increasing the amount of profits of domestically owned pioneer enterprises which will be paid out as dividends rather than reinvested. A second factor, and one which is independent of the Act, which will undoubtedly increase the desire of Singapore shareholders to receive immediate dividends, is that the equity holding of a local investor usually represents a much greater share, when compared to foreign investors, of his total resources. He may frequently have borrowed a part of the capital necessary for the initial investment, and thus will need the profits more urgently than a foreign investor. As a result of these factors, longer tax exemption periods are not likely to serve as a mechanism for internal corporate financing of industrial expansion where Singapore shareholders own the majority of the pioneer enterprise's shares.[27]

Given the above analysis of the two principal views of the length of tax exemption periods, it is the author's view that the maximum five year period offered under the pioneer industry scheme is certainly not too short. Indeed, many investors have undoubtedly received the benefits of tax exemption when they would have made substantially the same investments without such exemption benefits. As indicated earlier,[28] tax exemption should not be conferred on those industries, and those enterprises, where the profit margin is already expected to be high. These enterprises can be expected to invest without tax exemption. If benefits

25. See *ante,* p. 74.

26. Section 14. See *also,* ante, p. 21.

27. In cases of joint ventures this may provide one of the principal conflicts between the Singapore partner (s) and the foreign partner (s). Since the dividends paid by the joint venture will be tax exempt in the hands of the local shareholders, they may wish to distribute profits as quickly as possible. However, since profit distribution may result in the foreign partner incurring a tax liability on such profits to his government, the foreign partner is likely to seek reinvestment of the profits.

28. See *ante,* p. 23, footnote 94.

are needed, they should be conferred through the operation of Part III of the Act,[29] rather than Part II. At this point in Singapore's economic development, Part II should be used to attract investment in industries which provide substantial external economic benefits, particularly those having a high linkage effect with other industries in Singapore, either because they supply products and services used by such other industries, or because they will, in their own production, use the products and services of other Singapore industries. In either case there is substantial possibility that any loss of revenue due to tax exemption will be offset by increased production, profits and employment in other industries, and the the increased revenue which will result therefrom. Finally, as will be discussed in the following portion of this article, tax exemption under Part II of the Act should be used as one of the principal incentives to attract investment in export-oriented industries.

We have already examined the export incentive scheme under Part IV in some detail, noticing that only a portion of export profits qualifies for benefits under the provisions thereof, and, if the exports of the export product or produce are to an established market, the export enterprise must increase its profits derived therefrom before receiving any tax relief.[30] In addition, the 1968 Regulations suggest that any enterprise seeking benefits under the scheme may have to incur substantial costs to meet the requirements therein imposed.[31] Because of the complexity of the formulae involved, the uncertainty as to how the concept of "established market"[32] will be implemented, the ambiguity found in S. 30,[33] and the expectation of additional costs which the enterprise will have to bear under the Regulations, the author does not believe that the scheme has been, or will be, useful in increasing the flow of capital into export-oriented industries. To be sure, a number of enterprises would like to be approved as export enterprises and reap the benefits which might accrue under the provisions of Part IV. But these are overwhelmingly foreign-owned enterprises which have decided to invest in Singapore quite apart from the provisions of Part IV, and which are already export oriented.

If the author is correct in this contention, and if, as discussed above,[34] Singapore must continue to attract and stimulate investment in the export sector of its economy, it may be of value to examine briefly some alternative devices which might be employed to obtain such results. It should be noted that the need to attract investment in the export sector is not to relieve a present strain on balance of payments.[35] Rather it is because

29. See *ante,* pp. 29-36.

30. Section 28. See *ante,* pp. 46-47.

31. See *ante,* p. 52, footnote 15, and text at pp. 52-53.

32. Section 28 (5) (b). See *ante,* p. 45, footnote 82 and accompanying text.

33. See *ante,* pp. 48-51.

34. See *ante,* pp. 37-41.

35. As noted above, *ante,* p. 58, Singapore's external balance is presently in a healthy position. However, this may change if the foreign capital inflow drops, or does not increase to match the reverse flow resulting from remission of profits to foreign shareholders. If this becomes a problem, steps taken now to increase export production will serve as a counter-balance to maintain a healthy external balance.

the size of the domestic market is too small to attract or accommodate sufficient investment to meet Singapore's employment needs, or to absorb the amount of increased production that it needed to meet the Republic's growing income demands. In order to compete in the world market, Singapore's export industries must be sufficiently large to take advantage of economies of scale. In addition to being able to produce efficiently, enterprises wishing to export must have marketing expertise and be able to gain access to foreign markets. Although the entrepot sector of Singapore's economy contains substantial market expertise, it is largely limited, at least with regard to the markets in economically developed countries, to those primary commodities which have traditionally been exported from Southeast Asia. With regard to manufactured commodities, such expertise may well have to be drawn from foreign enterprises. This, along with the need for large amounts of capital required to achieve economies of scale, suggests that it is foreign investment which Singapore must rely on if it is to develop the export sector of its economy. If this is the case, it will have to compete with other countries in Asia, particularly Hong Kong and Taiwan, in its efforts to attract foreign investment.

Competition between developing countries for the attraction of foreign investment frequently focuses on tax incentives and other fiscal policies. But as pointed out frequently in this article, tax incentives are less important to the investor than is frequently supposed. A generous tax incentive, conferred with the intention of increasing the investors' profits and thereby the return on their capital investment, may be offset by high production costs, the unavailability of credit, or high shipping costs. Tax incentives by way of exemptions from taxation, may, and frequently do, result in greater costs to the government than the benefits which accrue as their result. However, improvement in the other areas mentioned will undoubtedly increase production in all areas of the economy, not just the export sector. Singapore's efforts to compete with other countries, then, should not be limited to the provision of generous tax incentives.

With this in mind, let us examine some of the policies and devices which Singapore might explore in its efforts to increase the amount and rate of investment in the export sector. A significant number of efforts towards this end are already underway. Singapore's airport is being enlarged, and its ability to handle air cargo is being increased. Already Singapore ranks fourth in the world in terms of the amount of cargo entering and leaving its harbour.[36] Additional work is being undertaken to increase the efficiency and capacity of its port.[37] Incentives have been offered to encourage ship owners to register their ships in Singapore, and substantial capital has been invested in the ship-building and repairing industries by the government and by private investors. In addition to such efforts to improve the country's transportation facilities, the govern-

36. It should be noted, however, that this is determined on the basis of tonnage of freight moving through the harbour, not the amount actually imported into and exported from Singapore. A substantial amount of the freight included does not leave the ship in which it originally enters the harbour.

37. In late 1968 the Singapore Port Authority began a third labour shift. The loading and unloading process increasingly relies on mechanization. In addition, the Port Authority is in the process of creating the capacity to deal with containerization and to handle ships in excess of 200,000 tons.

merit has joined with private investment to form a state trading agency — INTRACO — which will, *inter alia,* promote Singapore manufactured products abroad, secure export contracts for Singapore goods, help in financing export production, and purchase raw materials in bulk quantities to assist in lowering the production costs of Singapore manufacturers.[38] Such steps have aided substantially in improving the attractiveness of Singapore to investors, domestic as well as foreign, who are looking for locations in Asia to establish export-oriented operations. But more can be done.

Before anything else, the government must clearly know which industries it wishes to attract and support. It should determine in which industries there will a growing world demand over the next ten to fifteen years.[39] These are the industries which Singapore should seek, and the industries into which domestic capital, government and private, should be encouraged to flow. The government should, for the most part, refrain from conferring benefits to any industry which cannot be expected to find an increasing world demand for its products.[40]

Once the appropriate industries are determined, what kinds of devices should be employed to attract or encourage them? The author has already suggested that the pioneer industry scheme under Part II of the Act should be used as a major incentive to attract such industries.[41] When enterprises fitting into this category are declared to be pioneer, the Minister should be cautious with regard to the kinds of conditions imposed in the pioneer certificate,[42] particularly regarding the amount of labour which such enterprises must employ. Despite the fact that one of Singapore's pressing economic problems is unemployment, the government should be careful about pressing too hard for labour-intensive production methods in the export sector. Many industries, and the enterprises therein, must be capital-intensive in order to be competitive in the world market. The imposition of high labour requirements on enterprises may well result in increased production costs. Even where the enterprise may employ either capital or labour-intensive production methods with approximately equal production costs, the capital-intensive method may be preferred, particularly where production is for export. Obtaining and increasing export markets requires that the products in

38. See Chia, Jennifer, "The legal position and functions of INTRACO and its relation to export promotion", *Singapore Law Review* (1970), vol. 2, p. 126.

39. This may seem like an obvious step, but few countries have actually attempted to determine the industries in which world demand can be expected to grow significantly, and then consciously set out to develop the industrial capacity to meet such a demand. Japan is one country which has done so, and to a substantial extent its present economic, particularly export, strength is the result. See *The Economist* (3-9 July 1967), "The Risen Sun" in the special survey on Japan.

40. There are, of course, exceptions to this. Where the product in question will have significant external economic benefits, for example. But where the enterprise will not be able to produce efficiently except by exporting, and where the world demand is expected to remain the same, or to only increase slightly, the costs involved in supporting such enterprise are not likely to be offset by the benefits accuring to the economy.

41. See *ante,* p. 78.

42. Section 5(2).

question be of uniform quality with an uninterrupted production flow. Frequently capital-intensive production methods are better able to achieve these results.

In 1968 the Singapore government established the Development Bank of Singapore, combining both government and private capital.[43] The Bank took over the earlier functions of the Economic Development Board to provide medium and long term industrial loan financing and direct government equity participation in industrial activity. Obviously the Bank could direct government equity and loan capital into export-oriented industries having an expected high world demand over the next decade. However, what may be more important than the Bank's policy regarding the priorities for such loan capital, is the interest rates at which such loans are extended. Most D.B.S. loans, depending on the source of the loan capital, already carry interest rates lower than those available from commercial banks. The suggestion here is that in particular cases loans be granted, for the purposes of establishing or expanding an enterprise, at even lower rates, perhaps 1-3%. If such a policy were undertaken, the loan capital for the loans would have to be made available from the government, as the owners of private capital available to the Bank would undoubtedly not make such capital available with interest rates this low. The question, then, is whether the benefits to the economy would offset the cost to the government. The minimum costs to the government are easy to determine; they are the difference between the return on such loans and the returns which would be available if the funds were loaned at the normal rate attached to D.B.S. loans. There is, however, an alternative in addition to using such capital for loans at the prevailing Bank interest rate — direct equity investment in the proposed venture — which may provide an even greater return on the government's capital. The potential investor may be interested in equity investment by the government. It will, certainly, reduce the amount of capital which the private investor will need to find for the investment. But it will not reduce the cost of his capital, or increase the return which can be expected from his investment. Our assumption has been that what is necessary to encourage investment is to improve production, market, and transportation facilities, and/or reduce the cost of production, increasing thereby the level of return on the investor's capital. Long term loans at low interest rates will achieve this objective; government equity participation will do so only indirectly, if at all.

When compared with a scheme providing tax exemption, a policy of providing low interest loans has several advantages. As a rule the extension of loans can be much more selective than can be the conferment of tax exemption benefits, even where the tax exemption scheme provides the utmost flexibility, as do those under the Act. The government need not provide all the loan capital which is needed by the investor, but can tailor the amount to the interests of the government, and to its-determination as to what will be needed in each case to induce the investment. The government will be able to determine more easily the costs involved; and the investor will know immediately how much he is benefiting, when

43. Although only 49% of the Bank's capital is from the government, the remainder from the private sector, it is accurate to say that the Bank was established by the government, and that it serves as an instrument of government economic policy.

compared to an investment elsewhere or in some other industry where loan capital is not available on such favourable terms. Thus the provision of low interest loan capital is likely to be a more decisive factor in influencing the investment decision.[44] It can confer a substantial benefit on an investor regardless of his profit expectation, unlike the tax exemption which confers a greater benefit to those who make the highest profits, i.e., those for whom the benefit is the least critical in making the investment decision. In addition, it may be possible to alter such a policy after it has been implemented more easily than it is to alter, or end, a tax exemption scheme once it has been undertaken. A policy decision to provide low interest loans to selected investors is amenable to an unlimited number of variations. It can, and probably should, favour the investor seeking to establish an enterprise over an existing manufacturer.[45] The actual interest rates can be adjusted to meet the test of experience. Where a substantial loan is granted, the Bank can require that the enterprise meet certain conditions regarding the use of the funds, and can require, as it does with its present loan programme, that a nominee of the Bank be placed on the Board of Directors of the borrowing enterprise.

Credit availability is important in a manner different than that suggested above, which focused on the use of long term loans at low interest rates to induce the establishment or expansion of export-oriented industries. The second factor related to credit policy is to utilize devices and institutions which can assist manufacturers to obtain export contracts and to finance export production. Particularly where Singapore exporters desire to compete with exports from economically developed countries, the decisive factor may be the manufacturer's ability to provide the purchaser with credit, rather than the price of the commodities in question. The purchaser may require ninety to one hundred and eighty days, or more, credit before he can buy. If the manufacturer must provide such credit out of his own capital this will undoubtedly impose a squeeze on his working capital, and thus affect his ability for further production. Most Singapore export transactions are based on a cash, letter of credit, or sight draft basis. Seldom is credit on thirty days or more provided; as most manufacturers are working on a minimal amount of working capital. The resulting inability to provide credit terms competitive with those available for export from other countries, including an increasing number of developing countries, places the Singapore exporter at a considerable disadvantage.

Several countries, including both developed and developing countries, have adopted measures to insure against export credit risks.[46] Such export credit insurance schemes commonly insure against political risks, and those commercial risks which will not be covered by normal com-

44. Such a policy has been effectively used by both the Republic of Korea and Taiwan. See "Problems involved in implementing export promotion," Conference for Economic Planners, ECAFE, E/CN. 11/CAEP. 3/L. 4, 13 October 1967.

45. The government's major concern should be to attract the investor here in the first place. The existing manufacturer may well be able to finance its expansion out of accumulated profits or from other sources. At the time when an enterprise begins to think about expansion it is usually well on its feet, and should not have to rely upon benefits conferred by the government.

46. See *Export Credits and Development Finance* (1968), United Nations publication.

mercial insurance institutions. Normally the insured must underwrite part of the financial risk involved; that is, the scheme will only cover 60-90% of the possible loss. Frequently he may obtain such coverage on either a contract basis, or only upon a shipment basis. In all cases the government has been involved in the scheme to cover the political risks, but frequently the schemes have also involved banks and insurance companies to cover all or part of the commercial risks.

The operation of such schemes do not immediately make available the capital which may be necessary if the manufacturer is to extend credit to the purchaser, but it does make it possible for him to obtain credit from commercial banks on the basis of the insured export contract or sale. Such credit will provide him with the necessary working capital to continue his manufacturing operations without receiving immediate payment for the goods sold.

The attractiveness of such a device is enhanced by the fact that the cost to the government is minimal or non-existent. The scheme is entirely self-financing, with operating capital and payments for insured losses covered by insurance premiums. Singapore has, with the assistance of the United Nations, undertaken a feasibility study for such a programme. It could be instituted by either INTRACO or the Development Bank of Singapore in conjunction with private banks and insurance companies. Such a programme would provide substantial assistance to Singapore manufacturers, particularly local manufacturers who are working with only small operating capital margins, to obtain export markets and sales.

A number of countries have successfully employed exchange rate policies or export bonus schemes to increase the export of manufactured goods.[47] There are, however, a number of difficulties involved with using such devices in Singapore. Those countries which have been successful in using multiple exchange rates or bonus export schemes[48] have employed such devices to shift investment from traditional export sectors, usually primary commodities, to the manufacturing sector. Singapore, however, does not produce primary commodities, at least not in significant amounts. Its traditional exports are from other countries through its entrepot trade. It is not, and should not be, the policy of the Singapore government to hinder this sector. Rather it should develop an industrial sector to balance the entrepot sector. In addition, Singapore's exchange rates cannot be freely manipulated as a result of the currency agreement between Singapore, Malaysia, and Brunei.

47. Particularly Pakistan, but also Taiwan, The Republic of Korea, and Thailand; see *ante,* p. 82, footnote 44.

48. Bonus export schemes, particularly that employed by Pakistan, are equivalent to a multiple exchange rate. Exporters of selected commodities receive export bonus certificates which are, in turn, required for the import of certain commodities. The exporter who has export bonus certificates can sell them in the market to importers who require them. The result is that the price, or exchange rate, for both the selected imports and the selected exports is increased. The intention of such a scheme is to decrease the amount of imports of those commodities for which the certificates are required, and to increase the profitability of exporting the selected manufactured export commodities. The latter result causes a shift of investment from traditional primary commodity sectors to the selected manufacturing industries.

Fiscal incentives such as those found in Part IV of the Act, or in the Malaysian Investment Incentives Act,[49] are likely to either be excessively costly to the government, or be extremely difficult to frame and implement in a manner that will make them a decisive factor in the investor's decision-making process. There are, however, other fiscal devices which can be employed to assist the exporter. Singapore already provides a "drawback" system whereby manufacturers may recover import duties paid on commodities which are then processed or manufactured and exported. Such a system is relatively unimportant where the country's tariffs on imports are selective or marginal, as has been the case with Singapore in the past. An increasing number of commodities manufactured in Singapore, however, are protected by tariffs. The "drawback" system will assist in offsetting some adverse affects of a pattern of tariff protection, but it will not overcome the general thrust of inefficiency which it necessitates and is the result of such a pattern. It is, of course, theoretically possible to tread the narrow line of providing tariff protection for those industries which are producing for the local market without affecting the efficiency of those which are export-oriented. In practice it is less easy, particularly as the industrial sector of the economy becomes more sophisticated and industries oriented to the local market begin, in fact, supplying industries which hope to export. Even before this stage of development, a policy which freely provides protection for industries oriented to the domestic market tends to attract investable capital, particularly local capital, into such protected sectors. This can result, eventually, in a reduction in the flow of capital into the export sector.

It should be clear from the above that the author does not believe that any single policy or device can be critically decisive in attracting export-oriented investment. The ability of the government to attract such investment will depend on its general economic policy, and its ability to stimulate general economic growth and activity. The government has had substantial success in this regard. The author has attempted to suggest, and discuss briefly, some additional policies and devices which could be usefully employed. The government should first determine which industries it wishes to attract and support. Such determination should be based on a determination of which industries can expect a high world growth demand over the next ten to fifteen years, and to which industries can Singapore offer production-cost-factor advantages. Once this has been determined, a series of fiscal and monetary incentives should be employed: the present pioneer industry scheme under Part II of the Act; low interest (1-3%) medium and long term loans to selected export-oriented enterprises; a pattern of no tariffs, and a continued use of the drawback system where needed. In addition, the government

49. Malaysian Investment Incentives Act, No. 13 of 1968, s. 29. The Malaysian Act confers a tax exemption on a portion of export profits. The formula used in determining the amount of relief is nearly as complex as that found in the Act. Different requirements, however, are applicable. The amount of relief is dependent on the amount of Malaysian materials used, and the amount of wages paid by taxpayer to employees earning less than $500 per month. Aside from the complexities involved, the "Malaysian content" concept is attractive. However, tying the amount of relief to low wage employment may be counter-productive. As we have seen, export industries may need to be capital-intensive, which means that low skill (low wage) employment may be minimal.

should institute an export credit insurance scheme to assist export manufacturers in providing credit to purchasers of Singapore manufactured goods. Such a combination of devices should replace the present export incentive scheme found in Part IV of the Act. Implementation of the present scheme to make it a decisive factor in investment decisions would be far too costly to the government. In order to reduce the cost, the Government has found it necessary to make it ineffective with regard to the investor's decision-making.

10. THE ECONOMIC EXPANSION INCENTIVES (RELIEF FROM INCOME TAX) (AMENDMENT) ACT OF 1970

a. *Introduction*

On 22 July 1970 Parliament enacted the Economic Expansion Incentives (Relief From Income Tax) (Amendment) Act of 1970.[50] Of the five incentive schemes incorporated in the Act, the Amendment affects four — Royalties, Fees, and Development Contributions (Part VI), Pioneer Industries (Part II); Expansion Industries (Part III), and Export Industries (Part IV). The last three are significantly changed. In sum, the Amendment represents an extraordinary change in Singapore's economic policy regarding foreign and domestic investment. The impact will most readily be seen in the changes wrought in the Pioneer Industries' scheme, primarily because it has been the major device thus far used by the Government to attract investment in desired industries.

The author has been in Singapore only briefly since the Amendment was enacted, and has had no opportunity to interview Government officials or businessmen. Consequently the following discussion cannot be as detailed or complete as the preceding material. The intention here is to discuss each of the changes introduced by the Amendment, attempting at the same time to show the relationship of the changes to the Act as discussed in the preceding pages.

b. *Royalties, fees, and development contributions*

The incentive scheme contained in Part VI of the Act is designed to relieve the non-Singapore resident from a percentage of the Singapore tax payable on income received for "royalties" on technical fees or contributions to research and development costs.[51] The mechanism by which the tax relief shall be determined has not been changed. However, S. 3 of the Amendment does alter the types of income which are eligible for tax relief under the scheme. Paragraph (a) of S. 3 (1) of the Act is deleted. In its place a new definition of royalties and technical assistance fees is inserted:

> (a) any royalties, rentals or other amounts paid as consideration for the use of, or the right to use, copyrights, scientific works, patents, designs, plans, secret processes, formulae, trademarks, licenses or other like property rights.

50. No. 31 of 1970, hereafter referred to as the Amendment. The Amendment was assented to by the President of the Republic on 27 July 1970.

51. Sections 40, 43 and 44. See also *ante,* pp. 59-61.

The Amendment removes all references to artistic works, motion picture films, films or tapes for radio or television broadcasting. More importantly, sub-paragraph (ii) of paragraph (a), referring to "information concerning industrial, commercial or scientific knowledge, experience or skill," is removed. This latter effect of the Amendment is unfortunate, as it was precisely this language which would have allowed the incentive scheme to be applied to management contracts and thus encouraged Singapore corporations to enter enterprise-to-enterprise agreements for the "import" of management skills — a commodity which is equally important to the "import" of technical skills or other industrial property rights.[52]

As discussed above,[53] the problem with the scheme contained in Part VI is not the definition of "royalties and technical assistance fees." Rather it is in the tax relief mechanism set out therein. The present incentive device acts only indirectly at best as an incentive to the Singapore corporation (particularly a locally-owned corporation) to "import" technical skills and other such know-how. In order to encourage Singapore corporations to utilize enterprise-to-enterprise agreements to achieve an increase in the transfer of technical know-how and managerial skills, the incentive must flow directly to such corporation. As noted above, this could be achieved by increasing the corporation's allowable deduction under S. 14 of the Income Tax Act for payments of fees, etc., approved by the Minister.[54]

c. *Pioneer industries*

The most significant developments resulting from the Amendment are the changes in the pioneer industries scheme. The varied period of tax relief — two to five years, depending on the size of fixed capital investment[55] — has been replaced by a fixed five year tax relief period.[56] This change is accompanied by an increase in the minimum amount of fixed capital expenditure necessary to qualify for tax relief under the scheme to $1,000,000.[57] This is the same amount required under S. 6 of the Act to obtain the maximum five year tax relief period. The effect of the Amendment, then, is to remove from the incentive scheme those enterprises having a fixed capital investment of less than $1,000,000. Under the Act a holder of an enterprise manufacturing a pioneer product was eligible to receive a pioneer certificate, and such a pioneer enterprise automatically received a two year tax exemption even if its fixed capital expenditure was less than $250,000.[58]

This represents a specific policy decision on the part of the Singapore Government to remove the tax incentive to small investors — those with a fixed capital expenditure of less than $1,000,000. Three factors

52. See *ante,* p. 59, footnote 54.
53. See *ante,* pp. 61-66.
54. *Ibid.*
55. See s. 6, and *ante,* p. 15.
56. The Amendment, s. 5.
57. *Ibid*, s.4(a).
58. Sections 5 and 6(1).

stand out clearly as supporting this decision. First, the administrative load associated with processing applications for pioneer status, enforcing the provisions of the scheme as set out in the Act[59] and processing tax returns for enterprises with small investments is not supported by a corresponding benefit provided by such enterprises to the Singapore economy. Second, enterprises with a small fixed capital expenditure investment are unlikely to add any technological advances to the Singapore economy. With neighbouring countries, particularly Indonesia, having larger and cheaper labour forces, Singapore must place its emphasis on increasing the technological input related to industrial production.[60] Third, and perhaps most important, small enterprises are unlikely to have economies of scale sufficient to allow them to compete in the world market, thus they will not be able to export their production. As noted earlier,[61] the pioneer industries scheme should be used to attract export-oriented industries and enterprises. The Amendment limiting the incentive scheme to enterprises investing not less than $1,000,000 in fixed capital expenditures removes from the scheme a substantial number of investments which almost surely will not contribute to the export sector of the economy. This alone is useful, but it will not substitute for ministerial care in determining products and industries to be pioneer only if they have a high growth potential in the world market.[62]

The Amendment tightens the definition of "fixed capital expenditure."[63] Expenditures on land are specifically excluded, as are expenditures on second-hand plant or machinery except when approved by the Minister.[64] This latter change is valuable, as it allows the Government to insure that incentives, and thus costs to the Government in terms of reduced tax revenues, are not granted when the plant and machinery are obsolete or will not advance Singapore's ability to compete in international markets. In addition, the Government will be able to control the assessed value of such plant or machinery on the books of the corporation, and thus its cost to Singapore shareholders.

Perhaps the most important change, other than the removal from the incentive scheme of enterprises with a fixed capital expenditure of less than $1,000,000 is the method of calculating exempt income during the enterprise's "old trade or business." Under the former provision[65] a pioneer enterprise enjoying a tax holiday does not deduct capital allowances available under SS. 16, 17, 18, 19, 19A, 20, 21 and 22 of the Income

59. Particularly those associated with carrying on a separate trade or business. See s. 8, and *ante,* pp. 18-20.

60. Although I have not seen any statistics or studies supporting the assumption made, arguably a far higher percentage of enterprises with a fixed capital expenditure in excess of $1,000,000 have a higher technological input than those with fixed capital expenditures below this figure.

61. *Ante,* pp. 78-80.

62. *Ante,* p. 80.

63. See *ante,* p. 16, footnote 53.

64. The Amendment, s. 4(b). The amendment excluding expenditures on land is merely a legislative confirmation of administrative policy.

65. Section 10 (1). See also *ante*, pp. 20-21.

Tax Act during the old trade or business, i.e., during the tax holiday period. Further, the Act provides that when the pioneer enterprise emerges from its tax holiday period all capital expenditures which have been incurred will be deemed to have been incurred on the day immediately following the end of such period, i.e., on the first day of the enterprise's new trade or business.[66] The effect of these two provisions was two-fold. First, not making any deductions during the tax holiday period for capital allowances available under SS. 16-22 of the Income Tax Act substantially increased the amount of tax exempt income which could be distributed in the form of dividends and also be tax exempt in the hands of shareholders.[67] Second, treating all capital expenditures as if they occurred during the first day of the enterprise's new trade or business, and thus allowing the capital allowances on such expenditures to accumulate and be deducted during the first taxable year after the relief period, effectively extended the tax exempt period for one or more years. The first of these effects, maximizing the income which is tax exempt in the hands of the shareholders, encouraged the distribution of profits rather than their reinvestment, particularly when a majority of the enterprise's shareholders are residents or citizens of Singapore.[68]

This system has been substantially changed by the Amendment. Hereafter the capital allowances available under SS. 16, 17, 18, 19, 20, 21 and 22 of the Income Tax Act will be "taken into account notwithstanding that no claim for such allowances has been made."[69] The obvious effect of this change is to reduce the amount of the pioneer enterprise's income which can be distributed without being taxable in the hands of the shareholders. In addition, the new provision[70] provides that where the allowances available under SS. 16, 17, 18, 19, 20, 21 and 22 cannot be given full effect because they exceed the enterprise's income, the excess of such allowances will be carried forward to the following year to form part of the allowances available for deduction in such following year.

66. Section 10 (2). See also *ante,* p. 20.

67. *Ibid*., s. 14, with the proviso added to subsection (3) therein that "where the dividend is paid on any share of a preferential nature," it shall not be exempt in the hands of the shareholder — the Amendment, s. 9 (a). Where the first generation shareholder is a "holding company," the dividends of such "holding company" were exempt in the hands of its shareholders (second generation shareholders) to the extent they could be traced to the exempt distributed income of the pioneer enterprise — S. 14 (9). Note that the requirements for qualifying as a "holding company" have been relaxed under the Amendment — s. 9 (b).

68. See *ante,* p. 77.

69. The Amendment, s. 7. Notice that deductions for accelerated depreciation under S. 19A of the Income Tax Act will not be made. Further, s. 7 of the Amendment makes no change where fixed capital expenditure in the pioneer enterprise amounts to at least $1,000,000,000, or where it amounts to $150,000,00 and (1) more than 50% of the paid-up capital is owned by persons permanently resident in Singapore, and (2) where the Minister is of the opinion that the pioneer enterprise will enhance the economic or technological development of Singapore — s. 10 (2) as amended by s. 7 of the Amendment. Presumably the last of these criteria will be easily met, otherwise the enterprise is unlikely to have been declared pioneer. However, instances where fixed capital expenditure amounts to $1,000,000,000, or where it amounts to $150,000,000 and over 50% of paid-up capital is owned by permanent residents of Singapore will be relatively rare.

70. Section 10 (1) as amended by s. 7 of the Amendment.

The second effect of this change is to reduce the capital allowances available for deduction from income during the first year of assessment following the tax relief period, thus increasing the taxes which will be payable after the formal five year tax holiday.

Finally, the Amendment changes the treatment of losses incurred by the pioneer industry during its tax holiday period, and the carry-forward of such losses. Under the Act losses incurred were significant only if the total losses exceeded the total of all income for accounting periods in which losses were not incurred. In such cases the balance of such losses were treated as if they occurred in the first year following the tax holiday period.[71]

The Amendment provides that a loss for any year during the tax holiday period of any pioneer enterprise will be available as a deduction in the same manner that it is to a non-pioneer enterprise under Subs. (2) of S. 37 of the Income Tax Act, except that such loss shall be deductible only from the income of the pioneer industry from its pioneer products.[72] Section 37 (2) (a) of the Income Tax Act provides that in order to be available the deduction must be claimed in writing within one year after the end of the year of assessment in which such loss occurred. Any losses which have occurred during the tax holiday period and are carried forward to the new trade or business will be available as deduction when the enterprise is subject to taxation.[73]

The principal effect of this change is to compel the enterprises to claim their deduction within one year of the end of the year of assessment in which the loss occurred. Doing so may allow the enterprise to carry forward losses to the new trade or business, but will reduce the amount of income which can be distributed tax free in the hands of its shareholders for any year of assessment in which income exceeds losses carried forward from prior years. An example may help to illustrate this. Assume an enterprise has the following losses and profits, or assessable income:

Year 1. — $60,000 tax holiday
Year 2.— $40,000 tax holiday
Year 3. —$20,000 tax holiday
Year 4. + $10,000 tax holiday
Year 5. + $30,000 tax holiday
Year 6. + $80,000 no tax holiday

The enterprise can carry its losses in years one through three until they are offset by assessable income in ensuing years. In the above example the enterprise carried $80,000 of losses forward to the sixth year when its income is taxable. This is offset against its assessable income of $80,000 during the sixth year, resulting in no taxable income. This result would avail both prior and after the Amendment. The difference

71. Section 15.

72. The Amendment, s. 10.

73. *Ibid.*

arises in that under the Act as amended, the enterprise, in order to carry forward its losses to the post-tax holiday period (the sixth year) must offset losses against the income earned during the fourth and fifth year, thus leaving no tax exempt income which may be distributed during such years to be tax-free in the hands of its shareholders. This restriction is valuable as it reduces the incentive for the enterprise to sustain "book losses" during one or more of its tax holiday years solely in order to reap advantage during the post-holiday period.

However, the new scheme will be more advantageous to the enterprise where it incurs losses at the end of its tax holiday period rather than at its beginning. In the above example, had the enterprise incurred profits during its first three years amounting to $120,000, and losses amounting to $40,000 during the fourth and fifth year, no losses would have been available during the new trade or business under the original provisions of the Act as losses would not have exceeded profits. Under the provisions of the Amendment, however, the losses of the fourth and fifth year may be carried forward to the post-tax holiday period. Arguably this is more equitable than the earlier provision. It is not likely to encourage "book losses" (as opposed to real losses) as few enterprises are likely to incur losses in the last years of the tax holiday period.

The change is not significant, however, as it can be expected that very few enterprises will incur losses under the more restricted application of the pioneer enterprise scheme. To the extent losses have occurred in the past, they have been incurred most frequently by small enterprises who will no longer meet the fixed capital expenditure requirements of the Act.

The principal effects of the changes in the pioneer industry scheme are two-fold. First, the scheme is limited to enterprises with a fixed capital expenditure of at least $1,000,000. Second, the application of the capital allowances under SS. 16, 17, 18, 19, 20, 21 and 22 of the Income Tax Act will (1) reduce the amount of tax exempt income which may be distributed tax-free to first generation shareholders and, where the first shareholder is a qualified "holding company," second generation shareholders, and (2) reduce the capital allowance tax deductions available in the post-tax holiday period. Both changes have substantial merit. The second limits overly-generous pre-existing tax benefits and will encourage reinvestment of profits, at least those profits which cannot be distributed tax-free in the hands of the enterprise's shareholders. The first change limits the enterprises which will qualify for a tax holiday under the scheme.

It should be noted, however, that exclusion of enterprises with fixed capital expenditures of less than $1,000,000 will affect primarily domestic capital, or, put differently, national entrepreneurs.[74] To some extent the scheme is, as a result of the Amendment, more heavily oriented to attracting foreign investment in either wholly foreign owned enterprises or joint-ventures with substantial foreign capital. Although this shift may present political difficulties, there are five strong economic policy

74. Although the author knows of no completed studies or data which are publicly available, he is confident that the vast preponderance of pioneer enterprises having fixed capital expenditures of less than $1,000,000 are wholly domestically owned.

considerations supporting the change. Three have already been mentioned — administrative cost factors involved with small enterprises; small enterprises are unlikely to add significant technological advances to the Singapore economy; and economies of scale arguments favour larger, rather than smaller, enterprises being able to compete in world markets.[75]

The fourth economic policy consideration is related to the above three, though it focuses on the optimal utilization of Singapore's scarce resources. With a population of slightly more than 2,000,000 people, Singapore has a limited supply of labour, particularly skilled labour. During the last one and a half years the Singapore government has found it necessary to undertake an extensive campaign to recruit skilled labour with high technology capacities from neighbouring countries in order to meet the needs of its burgeoning economy. The effect of this is to increase the benefits from Singapore production which are sent abroad. The difficulty is familiar when seen as profits being remitted abroad in the form of dividends to foreign shareholders, or interest to foreign lenders. The same difficulties may arise when an increasing percentage of the labour force repatriates a portion of its wages to support families who have remained abroad. This suggests that Singapore must marshall its scarce skilled labour resources to ensure that the benefits derived therefrom are maximized. As noted frequently above, this maximization will best occur where production is export-oriented and is capital-or-technologically-intensive. Put differently, a high fixed capital expenditure is more apt to maximize the use of skilled labour and the economic benefits to Singapore.

A related scarce resource in Singapore is land. With only two hundred and twenty-five square miles of land, economic considerations suggest that land must be used to maximize its economic return. As noted above, small enterprises are not likely to add to the technological development of the economy or its export competitiveness, yet they may take up the same amount of land as an enterprise with high fixed capital costs which will add technology and strengthen the export sector.[76] While the Singapore Government probably should not prohibit the use of scarce labour and land resources to profitable, but low priority production investment, it should not "subsidize" such use through tax holiday incentives.

The fifth economic policy consideration supporting the shift in economic policy to encourage only high "fixed capital expenditure" investment, even if this shift tends to favour foreign capital instead of domestic capital, is related both to the proper function of tax incentive legislation and the success of the Singapore Government's economic policies over

75. See *ante,* pp. 86-87, and footnotes 59-61 at p. 87. See also *ante* p. 79 for discussion of the need to rely on foreign investment to attract technology, gain access to export markets, and capital in sufficient quantities to be able to reap the advantages of economies of scale necessary to be competitive in international markets.

76. Notice that land is not included in "fixed capital expenditure," thus removing any fiscal incentive to incur land costs in excess of those which are actually necessary. The Amendment, s. 4(b), amending s. 5 of the Act by adding a new subsection (5).

the past ten years. The Government has largely succeeded in changing the investment attitudes of Singapore capital owners from one oriented to trade or commercial investment to an overwhelming orientation to long term production investment.[77] Generous tax incentives were necessary and useful in achieving this shift in attitude. As a result of this achievement, tax incentives are, arguably, no longer needed to entice Singapore capital owners to invest in profitable production operations. Tax incentive legislation is theoretically based on the notion that investment — more particularly, desired investment — will not occur without the tax benefit. Where it will occur without a tax benefit, in this case a tax holiday, the benefit operated only as a windfall to the investor and a cost, without any corresponding benefit, to the Government and the economy.[78] If the above assumption that Singapore investors are now oriented to investment in profitable production ventures with or without a tax holiday is correct, then granting such tax benefits is an unnecessary cost which the Government is wise to avoid.[79]

Although Singapore capital investments are likely to continue in enterprises having a fixed capital expenditure of less than $1,000,000, the new requirements will encourage Singapore capitalists to combine their capital, or to raise additional capital through the public sale of shares, loans, sale of debentures, etc., in order to meet the $1,000,000 fixed capital expenditure requirements.

d. *Expansion of established industries*

Four major changes are introduced to the expansion industries scheme. Under the Amendment the scheme is limited to companies intending to incur new capital expenditure, in relation to an approved product, of not less than $10,000,000.[80] This simplifies the determination of which companies are eligible for relief under the scheme. It does so, however, by severely limiting the scheme's application. The language of the Amendment suggests, and perhaps requires, that the minimum capital expenditure of $10,000,000 must be in relation to a single approved product. Thus if a company manufactures two or more products and intends to incur $10,000,000 in capital costs for expanded production of at least two products, it will not qualify even if both products are approved.

77. See *ante,* pp. 28 and 71.

78. For discussion of a second basis supporting tax incentive legislation — allowing maximization of early profits and speeding recovery of the initial capital investment for reinvestment purposes — see *ante,* pp. 74-76.

79. This line of reasoning is less valid regarding foreign investment even though Singapore has established itself as an attractive place for foreign capital. To the extent that tax incentives are important to foreign investors — for discussion of reservations as to this assumption, see *ante,* pp. 25-27 and 70-76 — Singapore must continue to compete with other developing countries, particularly in Southeast Asia. See *ante,* pp. 70-71.

80. The Amendment, s. 11, amending subsection (1) of section 17 of the Act. Under the former provision the scheme was available to companies intending to incur $1,000,000, or where such expenditure is less than $1,000,000 but more than $100,000, and will result in an increase of at least 30% in value, at original cost, of the company's existing productive equipment — see *ante,* p. 30. The Minister must continue to approve the company as an expanding enterprise.

The second major change in the scheme abolishes the fixed periods of tax relief by giving the Minister discretion to set the tax relief period to a maximum of five years.[81] This change does away with the arbitrary periods of the earlier provision. In light of the capital expenditure requirements, however, the scheme is unlikely to be decisive in investment decisions unless the Minister approves the maximum five year period, and perhaps not even then.

The Amendment provides in fashion similar to the change under the pioneer industries scheme, that capital allowances available under SS. 16, 17, 18, 19, 19A, 20, 21 and 22 of the Income Tax Act shall be taken in computing expansion income of the enterprise.[82] The amount of the expansion income so computed which exceeds the "pre-relief income" shall not form part of the statutory income of the enterprise for any year of assessment during the tax relief period.[83] The effect of this change is to reduce the amount of exempt income by first taking into account the capital allowances. It has no effect on the taxes payable by the company as these are frozen, during the tax relief period, to those payable on the pre-relief income.[84]

The reduction of exempt income is meaningful only in the context of the fourth change. The Amendment provides that an amount equal to the exempt income shall be credited to an account to be kept by the expansion enterprises. Dividends paid from this account will be tax exempt in the hands of first generation shareholders, and, where the first generation shareholder is a qualified "holding company," second generation shareholders.[85] The Amendment thus introduces to the expansion enterprise incentive scheme a new benefit identical to that existing in pioneer industry scheme.[86] Thus the tax relief benefits conferred on the expanding enterprise are passed on to its shareholders.

81. The Amendment, s. 12, repealing section 18 of the Act, and enacting a new section 18. The former provision established a two year tax relief period where the capital expenditure did not exceed $250,000, and five years for capital expenditures in excess of that amount. See *ante,* p. 31.

82. The Amendment, s. 14, amending section 19 (2) of the Act. Notice, however, that the capital allowances available under section 19A of the Income Tax Act are not taken under the amended pioneer industries scheme. See the Amendment, s. 7, and *ante,* p. 88.

83. The same proviso found in the earlier provision is maintained, establishing the maximum exempt income as that which bears the same proportion to expansion income as the capital expenditure on productive equipment bears to the total productive equipment. See *ante,* pp. 33-34.

84. This assumes the tax rate will continue at 40% and statutory income will be at least equal to that prior to the expansion. Note, however, that the latter assumption may not always be fulfilled. After the expansion the company will have substantial allowances to deduct from its income in determining statutory income. Particularly in the initial years of the tax relief period, before the full impact of the expansion is felt on increased income and when initial allowances and accelerated depreciation allowances of sections 16 and 19A of the Income Tax Act are greatest, statutory income may be reduced below that of the pre-relief period.

85. The Amendment, s. 15, adding a new section 19A to the Act.

86. Section 14, as amended by section 9 of the Amendment. See also *ante,* p. 21 and footnote 67 at p. 88.

The increased capital expenditure requirements to qualify for benefits under the scheme again reflect an economic policy decision on the part of the Government to encourage capital-intensive enterprises which will add technology to the economy. In theory this change is sound. Whether or not the passing of tax relief benefits on to the shareholders will make it sufficiently attractive to affect investment decisions, and thus encourage large, capital-intensive investment, is questionable, though admittedly untested.

e. *Export enterprises*

The final incentive scheme changed by the Amendment is that to encourage exports. Two major changes are introduced. The method of determining the length of the tax relief period has been altered. In order to obtain a fifteen year tax relief period, an export enterprise must have incurred, or intend to incur fixed capital expenditures of (a) not less than $1,000,000,000, or (b) not less than $150,000,000 but less than $1,000,000,000, and, in the latter case, meet two additional requirements: more than fifty percent of the paid-up capital must be owned by permanent residents of Singapore; and the Minister must be of the opinion that the enterprise will add to the country's economic or technological development.[87] Where these capital expenditure requirements are not met the tax relief period will be five years for non-pioneer enterprises; and for pioneer enterprises the relief period will, together with its tax holiday period as a pioneer enterprise, total eight years.[88] In all cases the relief period commences from the enterprise's export year, as determined under S. 21(3) of the Act.[89] The effect of this change is obvious. For almost all companies in Singapore the tax relief period will be greatly reduced. In order to obtain the same tax relief period obtaining under the former provision the enterprise must have very high fixed capital expenditures.

The second major change is in the method of calculating the tax benefit available to a company approved as an export enterprise. The export profits of such enterprise are determined in the same manner as under the Act prior to its amendment.[90] The amount of income which qualifies for relief is the amount by which export profits, as determined under Subs. (2) of S. 28, exceed a fixed sum. Where the company has previously exported the export product or produce the fixed sum shall be the "average annual export profit," which shall be one-third of the total export profits of the company[91] for the three years preceding the date on which the company made application to be approved as an export

87. The Amendment, s. 16, substituting a new section 23 of the Act, of which this provision is s. 23(2). As under the former provision where the export enterprise is also a pioneer enterprise the pioneer and export tax relief period together total 15 years. Note also that this benefit of a longer relief period (fifteen years as opposed to five or eight years) requires fulfilment of conditions identical to those contained in the pioneer industries scheme to increase tax exempt income by not taking capital allowances under sections 16, 17, 18, 19, 20, 21 and 22 of the Income Tax Act. See the Amendment, s. 7, and *ante*, p. 88, footnote 69.

88. The Amendment, s. 16, amending section 23(1) of the Act.

89. See *ante,* pp. 42-43.

90. Section 28(2). See a*nte*, pp. 44-45.

91. Ascertained in the manner provided in subsection (2) of section 28 of the Act.

enterprise.[92] Where the company has not exported the export product or produce for three years prior to its application, the fixed sum shall be an amount determined by the Minister. In so determining the fixed sum the Minister shall consider the total sales of the export enterprise, and export performance of other major export enterprises exporting similar articles.[93]

The effect of this change is to delete any distinction between established markets and new markets.[94] Under the former provision all export profits resulting from exports to new markets qualified for relief.[95] The amendment treats all export profits in a manner similar to those from the sale of export products or produce to established markets by qualifying for relief only that portion of export profits which exceeds a fixed sum.[96] Under the former provision the export enterprise could maximize the portion of its income qualifying for relief by concentrating its sales of its export product or produce in new markets. That is no longer possible as all export profits are treated alike regardless of the destination of the export.[97]

Two additional changes are made in the export scheme. Section 29 is amended by deleting paragraph (d) of Subs. (1) therein, since Section 14 (b) of the Income Tax Ordinance referred to in such paragraph had been repealed by prior legislation.[98] In addition dividends from income which is exempt under the scheme will not be tax exempt in the hands of a shareholder where the dividend is paid on a share of a preferential nature.[99] This change conforms the export scheme to the pioneer industries and expansion industries schemes as amended.[1]

The changes in the export incentives scheme are useful if the Government is intent on employing this type of device to afford a tax benefit to export-oriented enterprises.[2] For most enterprises the tax relief period is reduced so that the Government can afford to approve companies as export enterprises without fear of losing too much tax revenue. The

92. This is the apparent meaning of the Amendment, s. 17, amending subsections (3) (a) and (4) of section 28 of the Act. The drafting of paragraph (a) would be clearer if the word "which" had been inserted after "company" and before "shall be ascertained...."

93. The Amendment, s. 17, amending subsection (3) (b) of section 28 of the Act.

94. Section 28(3)-(5). See also *ante,* pp. 45-48.

95. Section 28(4).

96. Notice, however, that under the former provision the annual export average was determined over the *five year* period preceding 31 December 1965; s. 28(5) (a).

97. Although this change theoretically reduces the amount of the benefit, it is unlikely that a desire to do so was the primary motivation for the change. The former system was largely unworkable as it required the Minister, in effect, to determine which markets were "established" and which were new. See s. 28(5) (b), and *ante,* p. 54 at footnote 30, and also footnote 82 at p. 45.

98. See *ante,* p. 51 at footnote 14.

99. The Amendment, s. 19, amending subsection (3) of section 31 of the Act.

1. See *ante,* footnote 67 at p. 88 and p. 93.

2. See *ante,* pp. 78-85 for discussion of the author's belief that the type of incentive device used here is essentially unworkable, and for discussion of alternative incentive devices.

superficially attractive, but unworkable distinction between new and established markets is deleted from the scheme.

The principal difficulty with the scheme as a whole is that it is too uncertain in the actual tax relief it proffers to have any impact on investment decisions. Relief is tied to export profits exceeding a fixed sum. That sum itself is uncertain where it is to be determined by the Minister.[3] More importantly export sales, and thus export profits, are always somewhat uncertain. They depend heavily upon conditions external to the company and even to Singapore, i.e., the American balance-of-payments position and economic policies pursuant thereto, the political and economic stability of Singapore's neighbours (particularly Malaysia and Indonesia), and developments within the European Economic Community.[4] Two formulae with substantial variables, are needed even to determine the amount of income which qualifies of relief. Perhaps the biggest drawback is that even after the amount of income qualifying for relief is determined, the amount of actual tax benefits are, under the scheme, uncertain. The Amendment does nothing to clarify the language and meaning of S. 30, which is the actual benefit-conferring provision, and, as discussed above,[5] is possible of three distinct readings.

This is not to conclude that there will not be interest in the scheme. I suspect that a large number of companies will seek approval as export enterprises. But they will do so quite apart from investment decisions they make. In all too many cases application of the scheme will operate as conferring an "award" to enterprises which meet its requirements rather than to induce investment decisions desirable to Singapore's economy. It is the latter purpose which tax incentive legislation should be intended to achieve. As noted elsewhere, when the tax incentive device employed fails to affect investment decisions it merely grants a windfall benefit to the enterprise and results in an unnecessary loss of tax revenue to the Government.

f. CONCLUSION

The most important aspects of the Amendment are the economic policy decisions which it reflects. Although tax incentive legislation is but a single reflector of economic policy, the changes introduced here strongly indicate that the Government intends to focus on large, capital-intensive enterprises. These are the enterprises which can be expected to maximize scarce resources (land and skilled labour), introduce significant technological development to Singapore, and reap the benefits of economies of scale necessary to compete in world markets.

3. Where the company has not exported the export product or produce for a period of three years prior to its application to be approved as an export enterprise.

4. External economic factors are somewhat less controlling where a foreign corporation establishes a Singapore subsidiary to export to the established market of the parent corporation. However, all too freequently in such situations the particular tax incentive scheme employed by Singapore will have no real effect on the parent corporation's decision to invest in Singapore, and once the investment is made the Singapore subsidiary will export whether or not there is a tax benefit.

5. See *ante,* pp. 48-51.

The changes introduced in the pioneer industries scheme are valuable, and appropriate to accomplish the economic policy changes which they reflect. Small enterprises, which will not be useful in achieving the policy objectives, will no longer qualify for the tax benefits of the scheme. Only enterprises having very high capital expenditures will obtain the same benefits which were available under the former provisions.

The changes introduced to the expansion industries and export schemes reflect the same policy objective. Unfortunately these two schemes continue to be sufficiently uncertain and complex that they are unlikely to be useful devices to affect investment decisions. Consequently they cannot be expected to provide significant aid in achieving economic policy objectives. The failure to clarify the very obvious ambiguities in S. 30, the benefit-conferring section of the export scheme is particularly disappointing.

In addition, the Government needs to focus more attention on devices to encourage enterprise-to-enterprise agreements for the transfer of technological and managerial know-how. The latter type of "investment" may well have been excluded from the legislation altogether by the changes in the definition of "royalties and technical assistance fees."[6] The entire scheme contained in Part VI is unlikely to encourage domestically-owned enterprises to enter such enterprise-to-enterprise agreements, and these are precisely the enterprises which need the encouragement.[7]

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6. See *ante,* p. 86.

7. See *ante,* pp. 61-66 and p. 86.

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