to non-residents in ACU accounts are allowed for deductions. Local companies are not subject to a 40 per cent withholding tax and the interest paid by them is allowed for deduction against the income. Section 45 of the Income Tax Act provides deduction for tax at 40 per cent from interest paid to non-residents only. Where the non-residents can show that a Singapore tax is less than what has been deducted, the excess of the tax collected (this is not withholding tax but is an advance collection which is set-off against the liability of the interest recipients) would be refunded. This happens where double taxation agreements for non-resident relief to the recipients of the contracting states concerned and the actual tax is less than the amount collected under Section 45. The purpose of a financial centre for the region is to garner offshore funds for the use of borrowers in the region. Hence, where Singapore corporations are borrowers of ACU funds no tax concession is given.

INCOME TAX AND STRATEGIES IN THE SINGAPORE ASIANDOLLAR MARKET

by

BRIJ S. SOIN

1. *INTRODUCTION*

Business regards all taxes — income tax, sales tax, import and export taxes etc. — as compulsory contributions to government funds; as costs of production which are similar to the trade costs of manufacture, distribution and selling. Where these tax costs can be included in the selling prices, with the result that the customers bear them and leave a margin of profit for the enterprise, the business will continue and develop. Otherwise its objectives and growth will frustrate.

The domestic taxes in a jurisdiction help to determine the level of prices in that country and transactions are possible at that level. Where the business is punished is where a double claim is made by two taxing authorities on the same income or transaction. This overlapping taxation must be eliminated if international business is to grow and prosper. The way in which overlapping taxation can be removed is simple. All that is needed is an international code. For example, a starting point in this region could be an Asean tax code which provides that each country should tax only that income which arises or the capital which is situated in or the transaction which is effected within its jurisdiction and abstain from taxing other income, capital or transaction.

2. *THE SINGAPORE TAX SCENE*

Income Tax was introduced in Singapore in 1948 in not too pleasant circumstances. The Singapore Income Tax Act does not contain anything particularly difficult or obscure as to who is taxable, on what and at which rate. When compared with taxation legislation of the United Kingdom, India or the United States our Act stands in the simple innocence of its infancy.

2.1. *Income Aspects*

There is no general definition of "income" under the Singapore Income Tax Act. The Act merely charges tax on income which is identified under a number of different sources. These classes of income are grouped under six headings namely,

(i) income from a trade, business profession or vocation;

(ii) income from employment;

(iii) dividends, interest or discounts;

(iv) pension, charge or annuity;

(v) rents, royalties, premiums or any other income from property;

(vi) any other gain or profit of an income nature.

The various kinds of taxable receipts and benefits listed in the Act under Section 10 can be said to collectively define the limits of taxable income. There is however one subsection in Section 10 which was included in 1965 and this threw the cat amongst the pigeons in that it broke up the fundamental structure of taxable income. Section 10(1) (g) is often referred to as the "sweep up subsection" and under this "any gains or profits" which are not included under any of the other preceding subsections (subsection 10(l)(a) to 10(l)(f)), are taxable. Since that Act uses the terms "income", "profits" or "gains" interchangeably, the inclusion of subsection 10(l)(g) appears incongruous within a system of taxation which identifies income by the process of categorisation. The irony is that nowhere in The Act is it provided as to what it is that is to be "swept up".

All classes of taxpayers namely individuals, trading companies, banks and other trading institutions are chargeable to tax in respect of income which is strictly to be computed in accordance with the categorisations (i) to (vi) above.

The identification of the source of any income is an important concept under the Singapore tax code. This is perhaps more so here than in other countries because of the lack of some urgent definitions of terms and the reluctance of the taxing authorities to accept certain general principles evolved by courts outside Singapore. For example, a trade or business begs for a definition in the case of companies carrying on activities involving the investment in land and/or securities and the derivation of rents, dividends and interest. Despite the large number of court decisions which provide pertinent guidance, the attitude of the taxing authorities remains largely unclear and strangely uncontested. The citation of case law to support definitions often proves futile as offshore tax case law is not always acceptable to the authorities as a basis of making decisions.

The approach to taxing statutes was best explained by Lord Blackburn in the *Coltness Iron Company's* case in the following words:

"No tax can be imposed on the subject without words in an Act of Parliament clearly showing an intention to lay a burden on him. But when that intention is sufficiently shown, it is, I think, vain to speculate on what would be the fairest and most equitable mode of levying that tax. The effect of those framing a taxing act is to grant to Her Majesty a revenue; no doubt they would prefer if it were possible to raise that revenue equally from all, and as that cannot be done to raise it from those on whom the tax falls with as little trouble and annoyance, and as equally as can be contrived; and when any enactments for the purpose can bear two interpretations, it is reasonable to put that construction on them which will produce these effects. But the object is to grant a revenue at all events, even though a possible nearer approximation to equality may be sacrificed in order more easily and certainly to raise that revenue; and I think the only safe rule is to look at the words of the enactments, and see what is the intention expressed by those words".

The above words of wisdom were uttered almost a hundred years ago — in 1881.

Concepts such as "income" or "profits or gains" or "trade or business" may not be defined in tax statutes but they are certainly not obscure concepts. Where such words appear it is only reasonable to construe them in a commonsense way.

Income from a trade or business is generally considered to have been earned as reported for accounting purposes. This income is then used as the starting point for determining taxable profits. Various rules for the measurement of taxable income are provided in the tax statutes and to some extent certain rules are distilled from decided cases. There are two essential points that have to be determined. *Firstly,* what are the items that are to be included in the tax base, and *secondly,* how is the tax to be defined so that only these are included.

In Singapore the above points are not difficult of determination. Our territorial concept of taxation clearly provides for inclusion of only those items of income which are derived or accrue within the jurisdictions of Singapore. All other income clearly falls out of the tax net. However, recognition is given to income earned outside our jurisdiction, if such income is remitted here. Where receipts are to be classified under separate sources a quick reference to Section 30 provides the necessary guidelines. The absence of tax on capital gains and unremitted offshore income makes it relatively convenient to define the tax that is to be attached to the balance of "gains or profits".

2.2. *Deduction Aspects*

The deduction aspects of an Income Tax Act are perhaps more important than the incoms aspects as herein lies the key to the computation of taxable profits. The Singapore tax laws allow a deduction for expenses which are wholly and exclusively incurred in the production of income provided the ex-

penditure is not one which is of a capital nature. The question of the allowability of an expense which has been charged in the accounts must be strictly evaluated from the taxpayers' subjective viewpoint. However, it is common practice with revenue officials to make an objective scrutiny of each expense even to the extent of inquiring whether it is warranted. It is submitted that as long as the expense is not patently excessive tests should only be applied where an expense is specifically prohibited or where the transaction giving rise to it is not at arm's length. The broad scheme for the deduction of expenses under the Singapore Income Tax Act is that Section 14 sets out various classes of expenditure which are deductible and Section 15 prohibits the deduction of various classes of expenditure. There are indeed no rules under our Act which lay down affirmatively what amounts are to be treated as expenses in computing taxable profits. And therefore between Section 14 and Section 15 lies a large area of confrontation between the taxpayer and the revenue authorities. There are four other types of deductions which must be mentioned here which, subject to certain specific conditions, rank for deduction when ascertaining taxable income.

There is *firstly* capital allowances which are allowed as a substitution for the depreciation of fixed assets provided in the accounts. The most important category of capital allowance items is plant and machinery and this term has a very wide definition. Industrial buildings also qualify for capital allowances. *Secondly,* we have what can be referred to as incentive deductions which are introduced into the Act to stimulate the economy. One form is that of giving a double deduction and this applies to certain expenses incurred in promoting the export of Singapore manufactured goods. Another form is by way of accelerated capital allowances on plant and machinery and here a taxpayer is permitted to deduct from the profits, the cost of qualifying plant and machinery in three years. This incentive deduction is extended only to taxpayers who can be classified as "industrial enterprises". *Thirdly,* we have deductions which are in the nature of gifts in cash made to institutions of a public character. And *fourthly,* the deductions in respect of carry over losses and capital allowances. Losses and capital allowances, under our laws, can be carried over for an indefinite period provided the "continuity of ownership" test is met. Briefly, this test requires that the changes, if any, in the ownership of a company must not exceed 50 per cent. There are no provisions for losses to be carried backward.

2.3. *Exchange Gains or Losses*

In view of the nature of the subject of this seminar a few words on the treatment of exchange gains in computing profits would not be out of place. Generally, when gains and losses arise from movements in the parity of different currencies, for tax purposes, one has to determine whether the gain or loss arose from capital or revenue transactions. For example, an adverse exchange difference arising from a loan transaction will not be allowed to an ordinary trader but if the loss arose from the purchase and sale of inventory it would be taken into account.

In the case of banks, a loan transaction is considered to be on revenue account and any gains or losses made from exchange differences are accountable for tax.

2.4. *Rate of Corporation Tax*

The rate of company tax in Singapore is a flat 40 per cent on the taxable profits computed in accordance with the provisions of the Income Tax Act. Each company is treated as a separate taxable entity and consolidated tax returns are not required by a group of companies.

2.5. *Best Judgment Assessments*

There are provisions in the Singapore Act for making an arbitrary determination of taxable profits. That is to say, the authorities have the powers to examine and restructure income tax results of transactions on the basis of considerations such as an "artificial and fictitious" transaction, an "assignment of income" from one taxpayer to another and a "profit shifting" transaction. The authorities also have the powers to allocate income and deductions between related parties. Further, in the absence of proper records or where fraud is determined the authorities have the powers to recompute the taxable income to the best of their judgment.

2.6. *Residence*

Residence for exchange control purposes is determined by rules which are different from those applied to residence for tax purposes. It is therefore perfectly possible for someone to be resident for exchange control purposes but not for income tax purposes or vice versa. An individual is resident for tax purposes in Singapore in a fiscal year if he is physically present in Singapore or if he exercises an employment in Singapore for 183 days or more in the preceding calendar year. Residence, it must be remembered, is strictly determined in accordance with the facts in each tax year. It is also well to remember that an individual can be resident in two or more countries or for that matter none. The fact that an individual is treated as a resident of another country does not normally preclude Singapore from treating him as a resident. Where there is a double taxation agreement with the other country of residence, the terms of the agreement will sometimes override domestic law and result in the individual being treated as resident in only one of the two countries.

Where companies are concerned, and this includes financial institutions like banks, insurance companies etc., the test of residence is very simple and clear cut. Residence, in these cases is determined by the location where the management and control of the company is exercised. That is to say the location of the seat of control. Effectively, the control of a company is exercised by its directors and it has been accepted in law and practice that the place where the directors meet to exercise their control and management is the place where the company is resident. As in the case of individuals the place of residence

is determined in accordance with the facts in each tax year. For exchange control purposes, residence is a matter of designation by the Monetary Authority of Singapore. For example, a company operating in Singapore, notwithstanding where it is incorporated or where its seat of control and management is, is deemed to be resident in Singapore. In the case of individuals, Singapore nationals living permanently in Singapore or nationals of countries outside Singapore who have been granted permanent stay in Singapore and who intend to stay permanently here, are deemed to be resident in Singapore.

2.7. *Withholding Taxes*

Whether or not withholding taxes are appropriate depends largely on the situations in which these taxes are imposed. A withholding tax can extend to domestic income, international transactions or income paid to residents of foreign countries. Overall, the existence of a double taxation treaty can affect its limitations and consequences. In the domestic situation the imposition of withholding tax tends to bring revenue into the treasury coffers earlier than if the tax was related to the submission of income tax returns. For example, a withholding tax on interest derived from government bonds or bearer shares would be paid over to the authorities at the time the interest is paid to the taxpayer. In some cases, in the domestic situation, a withholding tax on income paid out can assist in reducing or eliminating tax evasion or tax deferral. There is, however, one distinct disadvantage where a withholding tax is imposed on the domestic scene. Take Singapore as an example. Our rate of withholding tax is 40 per cent on the interest arising from certain loans. This rate can be high in a situation where the recipients personal rate of tax averages around, say, 20 per cent. The result is that a claim for the refund of tax has to be made and this, more often than not, is a cumbersome process.

In the international scene, the withholding of taxes from income paid to persons not resident in the country of the payer is an important fiscal issue and this is particularly so in the case of capital importing countries like Singapore. Under the tax laws of many countries, international income would be taxed first in the country in which it is earned, and then in the country in which it is received. In cases where withholding taxes are imposed, the tax burden of the recipients of foreign income can be greater than that of income which was earned and received in the home country. Take the case of a resident of Singapore who is not taxed here on his foreign income unless it is remitted here. Now if there is a foreign withholding tax on his income this can be a disadvantage to him particularly if his effective tax rate in Singapore is lower than the foreign withholding tax. Where the foreign income, which has suffered withholding tax, is remitted into Singapore this can also be disadvantageous if Singapore does not grant a foreign tax credit here. The result can be double taxation.

The withholding taxes issue can be important to those countries which are developing. Such countries, in relation to capital exporting countries, are sometimes referred to as host countries.

One of the rather important tax inducements provided by the host country is a reduction or complete elimination of withholding taxes from certain classes of income. Although this can conflict with the objectives of the tax policy in the host country, the ultimate aim is to provide a balance between the need for revenue and the encouragement of foreign investment and economic growth. In Singapore withholding taxes are imposed on interest, royalties, management fees and rents. There are no withholding taxes on dividends.

2.7.1. *Interest*

This perhaps is the most important source of income on which withholding tax is imposed in circumstances where a person carrying on a business in Singapore pays interest to a person who is not resident in Singapore. The tax is on gross interest and here lies that most serious problem for both investors or for developing countries as it can make capital expensive. Take the case of a bank loan which is obtained at 9 per cent interest; the bank pays to its depositors 6 per cent and its own costs amounts to 2 per cent. This leaves a net income of 1 per cent. If the source country, say Singapore, imposes a 10 per cent tax on the gross interest, this equals 90 per cent on the net amount. To avoid this situation tax treaties provide for exemption from withholding taxes in the source country and for exclusive taxation in the residence country where the net interest income is assessed. The most frequent withholding tax rates under various national laws and treaty arrangements lie between 10 per cent and 40 per cent.

2.7.2. *Royalties*

In the country where the user is resident, tax on royalties can be imposed either by way of an assessment on net income or by withholding. Generally, the withholding tax method is used. The question is to what extent does the royalty constitute income or a refund of expenditure. The answer depends largely on the right for which the royalty is paid. For example, there is a clear distinction between royalties paid for patents and those paid for know-how. Where the royalty includes a cost element, the tax position becomes similar to that illustrated earlier in the case of interest. Some countries impose tax only on a part of the royalty paid thus providing an exemption to that part which represents the cost element. In Singapore royalties paid to non-resident persons are generally subject to a withholding tax on the gross payments and this leaves the recipient to claim the Singapore tax either as an expense in the home country or as treaty relief. Where tax treaties exist, generally royalties are exempt — that is to say they are not subject to tax in the user country. If there is a withholding tax in the user country the rate varies from 15 per cent upwards.

2.7.3. Withholding taxes are also imposed in Singapore on management fees and rents.

3. *THE ASIANDOLLAR*

So much has been written on this subject that I feel I may well be repeating and boring you. I believe on a subject such as this, like a mini skirt, it should be up-to-date, short and cover the essentials. I hope therefore you will forgive me to some degree if in trying to be brief I get selective in the choice of some facets of this topic.

3.1. *The Concept of the Asiandollar*

The term "Asian dollars" has been adequately defined. It is linked up with the term A.C.U. meaning Asian Currency Unit. In very simple terms, where an American dollar is placed with a bank outside the United States and this bank happens to be in Asia, the deposit will be referred to as an Asiandollar deposit. When the dollar is moved back to the United States the prefix "Asian" is removed and the dollar becomes an ordinary US dollar. The prefix "Asian" can sometimes be misleading in that it can imply that the dollars in question are deposited in Asia. This need not necessarily be so. The Asiandollar can be found outside Asia e.g. in Canada, Chile etc. In Europe, bankers refer to their dollar as the Eurodollar. One can safely say, therefore, that the dollar gets a prefix attached to it depending on who describes it and where it is housed. For example, in 1975 there was a Euro-Asian dollar bond issue made by the European Investment Bank.

3.2. *The Asian Currency Unit*

Asian Currency Units are entities set up within a bank specifically to do Asiandollar business. They operate under licences issued by the Monetary Authority of Singapore under certain terms and conditions.

3.3. *The Asiandollar Market*

The expansion of the Asiandollar market which first saw the light of day in 1968 has been phenomenal. The latest figures released by the Monetary Authority show that at the end of 31 March 1977 the gross size of the market stood at US$17.6 billion. This was from a meager US$100 million in 1969. In comparison the Eurodollar market stands at around US$300 billion. In 1976 the rate of growth in Singapore is stated to be 38 per cent and it is reported that this was largely due to interbank activity and the large inflow of funds from the United Kingdom and France. Interbank lending is believed to represent 75 per cent of the total Asiandollar market in Singapore. The balance of the funds are used by non-bank borrowers mainly in the form of syndicated bank loans. Hardly any funds are channelled into the domestic market. The high proportion of inter-bank lending has often been questioned by leading bankers — some have referred to it as an unhealthy state particularly where all that is happening is that a whole lot of banks are sorting out their own short term positions. Be that as it may, the Asiandollar market has not only come to stay but as an offshoot of the Eurodollar market, however small, it forms an integral part of the world's monetary systems.

The Asiandollar market is not a market in the normal sense. That is to say there is no location or place where borrowers and lenders assemble to discuss and transact business. Unlike the stock exchange it does not have an indication board which displays interest rates and movements in them. Most of the deals irrespective of size, are concluded by phone calls or telexes. Quick decisions, a good name and a profitable rate of interest and a deal is stuck. This, simply, is all that happens and millions of dollars change hands. Trading in the Asiandollar market is not confined to the Asiandollar. Most of the freely convertible currencies of the world find their way into this region and A.C.Us often handle transactions in these. The more common ones, besides the US dollar are the Deutsche mark, Japanese yen, Swiss franc and the Dutch guilder.

3.4. *Asiandollar Growth Factors*

Some of the more important factors that have led to the continuous growth of this market in Singapore are:

- favourable yields;
- low borrowing rates;
- absence of exchange controls;
- efficiently trained personnel;
- well equipped and efficient lines of communication;
- absence of red tape;
- speed and ease of working;
- generous taxation incentives.

It is with the last factor that I will deal with now in some detail.

3.5. *Income Tax Incentives*

Income tax incentives have been one of the most potent fertilisers to the growth of the Asiandollar market. These incentives are extensive and stretch out to all income derived from offshore transactions except exchange profits and income derived by domestic A.C.Us from transactions with residents in Singapore. Offshore income can arise from transactions,

(a) where the lender and the borrower are cited in different countries;

(b) where both are cited in a country or countries other than the one in which the loan is made or negotiated;

(c) which are in a currency foreign to the site of the transaction.

3.6. *What is Offshore Income*

Some of the types of income which is included in the definition of "offshore" income are:

- interest on loans and deposits;
- dealings in and holdings of foreign currencies;

- dealings in negotiable certificates of deposits — more commonly referred to as NCDs;
- foreign currency bankers' acceptances;
- dealing, holding, floating and underwriting of Asiandollar bonds;
- broking;
- front end fees, management fees, commitment fees, commissions etc.;
- fees, commissions or interest from advising or confirming offshore letters of credit from transactions in bills drawn on such letters of credit;
- any other consideration which forms an integral part of an offshore A.C.U. transaction.

3.7. *Rate of Income Tax on Offshore Income*

The rate of income tax charged on offshore income is 10 per cent and this compares favourably with the normal corporate rate which presently is 40 per cent. Singapore has an edge over Hong Kong, its present closest rival, in this respect as the latter makes a charge of 15 per cent on such income. However, a new contender in the Asiandollar market is showing its teeth by providing a tax rate of 5 per cent on offshore income. This is Manila.

3.8. *Other Incentives*

There are further tax incentives provided which, although do not directly effect the computation of offshore income of an A.C.U. help to boost the Asiandollar market. These are,

- there is no withholding tax on interest paid to a non-resident person who places deposits in A.C.Us in Singapore. In other words, the depositor receives his interest free of tax.
- non-residents who invest in Asiandollar bonds are not subject to estate duties on such holdings. Thus, a non-resident can havenise his savings by moving them to Singapore.
- residents of Singapore are permitted to place deposits with A.C.Us up to the following limits:

Individuals:	S$500,000
Companies:	S$5 million
Pension and Provident Funds:	S$5 million
Approved unit trusts, Mutual funds and investment trusts:	S$5 million or 15% of their funds outstanding at any one time whichever is the lesser.

- no tax is charged on the income derived from the above investments provided of course the income is not remitted into Singapore.

- stamp duties are classed as taxes on transactions. They are an important levy in the context of international trade and funding and can directly influence the raising of capital by the creation of shares, floating of loans and bonds and the transfer of property. The bulk of international funding is done by legally incorporated bodies and the impact of stamp duties on the functioning and viability of such companies requires attention.
- at present there are no stamp duties in Singapore on bills of exchange, negotiable certificates of deposits and promissory notes to which a bank is a party.
- in the case of A.C.U. offshore loan agreements a limit of ½ per cent ad valorem stamp duty is levied to a maximum S$500. This is to encourage the signing of such loan documents in Singapore.

4. *PLANNING TAX STRATEGIES IN THE ASIAN DOLLAR MARKET*

Planning tax strategies and tactics is like playing cowboys and Indians but with real bullets. And putting an auditor to do tax planning is like getting him drowned in a river with a depth of one foot. Nevertheless planning and lawful tax avoidance are meaningful concepts. There is an Indian proverb which suggests that he keeps wealth who plans before tax.

Now how does one approach this subject?

The first and most vital task would be to familiarise oneself, in depth, with the structure of domestic and international banking institutions and their various operations and methods of doing business. The second task would be to identify where and how their profit elements are exposed to tax. In this task it is important to identify the location where the operations are conducted or where they may be conducted. One should then move on to familiarise oneself with the business itself and its immediate and future plans in the domestic and international fields.

Having collected and absorbed the background information one should then move on to consider the type of animal the Asiandollar is and what is involved in dealing in it. The approach to tax planning can be different if one is dealing with a domestic bank as compared with dealing with an international bank. For example, if it is an international bank there will be a greater scope for taxplanning in that movement of funds, facilities for updated and immediate information, knowledge of the domestic financial market in each location etc. are readily available for bargain assessments and closing deals. Timely information being the essence in clinching deals, there is less red tape and greater speed where international banks are concerned as compared with banks whose operations are limited to the domestic or to the immediate regional markets. Further, the facilities of what is often referred to in tax planning as: "playing off one jurisdiction against another" are greater in the case of banks which have international activities. "Playing off one jurisdiction against another" merely means obtaining the best advantages of differences in circumstances,

differences in rates of yield and differences in rates of taxation. And finally you lend money only when you have it. And international banks have more than domestic banks.

Having established that an international operation has distinct advantage let us now move on to use a "captive" bank. The concept of a "captive" bank is relatively new and such banks are normally located in tax havens where restrictions are minimal or do not exist. For example, a captive bank housed in the New Hebrides or Liechstenstein or Jersey.

What happens in the case of such a "captive bank" is that it enables a company or a group of companies with multinational operations to pool funds in a tax haven. These "captive banks" then make loans to affiliates, finance the export and import transactions of related companies and in some cases factor their book debts. Now the concept of a "captive bank" need not be confined to multinational trading companies. Banking institutions also can conveniently use this media to engage in multi-country underwriting or to pay tax-free interest on deposits made by their foreign customers. The "captive bank" concept has not yet found favour with banks in Singapore but the virus may spread in the near future.

Singapore does not appear to be a suitable place for the housing of a "captive bank" because of the presence of tax on interest, restrictions on dividend distributions and generally the strict controls over the operations of banking institutions.

I would summarise the tax planning aspects of the Asiandollar market under three distinct headings.

First, The FACTS. They would cover the structure and operations of the bank, its objectives and its problems.

Secondly, The TAX FACTOR. Here a comprehensive study is necessary of the domestic internal tax systems of the countries which are involved in the planning exercise. Factors such as rates of tax, withholding taxes, stamp duties, distributions to shareholders, tax incentives, double taxation treaties etc. would be relevant.

Thirdly, The NON TAX FACTORS. These can be of considerable importance and would relate to banking regulations, currency and exchange controls, political and economic stability, professional services, communications and the position of foreigners.

5. *TAXING AUTHORITIES AND THE MONETARY AUTHORITY OF SINGAPORE*

As a tax adviser I cannot but help touching on attitudes of the Tax Authorities in Singapore in relation to the tax structure. These I must say affect the viability of any tax plan geared by financial institutions or investors who wish to move into the Asiandollar market.

Three basic elements of a good tax structure for the Asiandollar market would be durability, understandability and flexibility.

In the beginning, and even in some cases now, the interpretation and implementation of the government policy in relation to Singapore's position as a financial centre have not been really satisfactory. The distinctions between onshore and offshore income, between financial and non-financial institutions, the allocation of expenses to offshore and onshore income, the production of acceptable evidence to support offshore income claims, all these and many more have created such complexities, inflexibilities and inequities that one wondered at the tax motivated decisions made to implement a perfectly good policy supported by a set of regulations. The banks and his advisers have both been under severe strain. One of the possible reasons for this state of affairs is the passive role played by the M.A.S. As a representative of the banking community in Singapore it has often been found wanting in its attempts to bridge the "communication gap" between the taxing authorities and the banking institutions.

The radical reforms of tax on offshore income, arising from the Asiandollar transactions, announced by the Minister in his last Budget Speech, have provided the much needed silver lining. But one cannot tread without caution in such matters because what happens in the minds of theoreticians who are seeking the conceptually clear tax system as an aim in itself may not be the same as that which happens in the real world of the taxing authorities. We may well continue to hear from them (the taxing authorities) that the "system" will not let them do what they want. It is therefore unreasonable and clearly impracticable to bind investors, present and future, by initiating tax systems which have rigid requirements and implementations.

The tax system applicable to the Asiandollar market and offshore income must be objective — that is to say it must bear a clear relationship to national objectives. Like any instrument, it must not only be designed for a particular purpose but must be used with understanding and flexibility so that it can help achieve the objectives. To my mind there are three basic defects in the approach of the taxing authorities. First, there is excessive emphasis on detailed investigations into the nature of the income and in the qualification and allocation of expenses. Secondly, there is insufficient recognition of the relationship of taxation to the national objectives in terms of impact on the financial institutions. And thirdly, there is that lack of realisation that the only source of real growth and lasting improvement in the well being of a financial centre and its components comes from high productivity economic growth. Here, I feel that the M.A.S. must directly and effectively participate, both in dialogue and directives, so that "the means to the end" are appreciated in their proper perspectives.

The role of the M.A.S. is to strengthen confidence in the financial market here and this responsibility is being discharged admirably. In the same token the role of the tax authorities is to strengthen public confidence in the tax system by fair application of the tax laws. I am sure a combined effort by both M.A.S. and the Revenue will provide the positive approach to the tax problems that face financial institutions in Singapore.

For the ambitious ones like me I would like to see the luxury of a tax system that does away with tax on all offshore income gener-

ated by Asian Currency Units. This type of tax structure package will drastically change the scene in Singapore and will inevitably increase the flexibility of response that international financial institutions need in a period of accelerating change like the present.

Chairman: Thank you Mr. Soin. I will now call upon Ms. Loke to deliver the last paper.

U.S. TAX PROBLEMS CONNECTED WITH INVESTMENTS IN SINGAPORE

by

LOKE KIT CHOY

Introduction

I should preface my discussion of U.S. tax problems connected with investments and loans made in Singapore by stating that there are no specific provisions in the Internal Revenue Code ("IRC") which bear upon Singapore only. Prior to the Tax Reform Act of 1976, there were provisions which favoured investment in less developed countries ("LDCs"), including Singapore. Unfortunately, these advantages are being phased out and will be completely terminated by 1979. In the light of the brevity of this paper, I will only touch briefly on these LDC tax advantages to illustrate how the investment climate in Singapore will be affected by the new tax legislation. The main focus will be on the tax problems facing a U.S. investor with foreign-source income. Where I am able to interface Singapore and U.S. tax laws, I will attempt to highlight the problem.

Brief Analysis of US. Taxation

The basic scheme of taxation is as follows: a U.S. person is taxed on his worldwide income but a foreign person is taxed only on U.S.-source income. A U.S. person holding shares in a foreign company is taxed on such dividends as are received in that fiscal year, unless the foreign company is a CFC and the income is Subpart F income. In the case of a CFC with Subpart F income the U.S. shareholders are deemed to have received their pro rata share of the CFC's Subpart F income even though no dividends are distributed. As will be apparent, any U.S. subsidiary operating in Singapore will have to seek ways of circumventing Subpart F of the IRC to minimize its tax burden.

CFC and Subpart F Income

One of the ways of circumventing Subpart F's application would be to ensure that the Singapore subsidiary is not a CFC. Since a CFC is defined as a foreign company where more than 50% of the voting power is held by U.S. persons owning at least 10% of the voting power each, planning the distribution of voting control becomes significant. A Singapore subsidiary fully owned by 11 unrelated U.S. shareholders each holding equal voting power will not be a CFC. Similarly, in the case where a U.S. corporation holds 50% of the total