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

voting power of the Singapore subsidiary, the other 50% being held by an unrelated non-U.S. person, the Singapore subsidiary will not be a CFC. Care must be taken to ensure that indirect ownership through the attribution rules will not apply so as to increase the voting control of a U.S. person.

Another way of avoiding Subpart F income is to ensure that the Singapore subsidiary, a CFC, does not engage in activities which may make the income foreign base company income or income derived from the insurance of U.S. risks. A CFC incorporated in Singapore, engaged solely in manufacture and sale of goods in Singapore, would not have any Subpart F income. If the CFC Singapore subsidiary engages in the import of goods for sale to countries outside of Singapore, the income from the import-export sales will fall within Subpart F. Where the CFC Singapore subsidiary imports parts and materials from which it manufactures or constructs products, income from the sale of such products is not Subpart F income.

Foreign Tax Credit

To avoid double taxation of foreign income, the IRC provides a foreign tax credit to U.S. persons receiving income from foreign sources. The new rules require the U.S. taxpayer to "gross up" all dividends received from LDC corporations ("LDCC") by the amount of deemed paid foreign taxes when computing his income and foreign tax credit. (The old rules had allowed LDC shareholders to include net dividends as income which had the impact of reducing the overall effective tax rate on the earnings of the LDCC.)[1] In addition, all taxpayers (with minor exceptions) must use the overall limitation in

[1] *Example.* P, a U.S. company, has a wholly owned subsidiary F in Singapore. For 1975, F had pre-tax earnings of $1000. F paid $400 in taxes to Singapore and distributed the remaining $600 to P as a dividend. The net U.S. tax payable by P on the dividend is $48 and the overall effective tax rate on the earnings of F is 44.8% computed as follows:

Gross U.S. tax (48%) on dividends	$288
Credit ($\frac{600}{1000}$ X400)	$240
Net U.S. tax (288—240)	$ 48
Total U.S. and foreign tax (400+48)	$448
Overall effective tax rate $\frac{448}{1000}$	44.8%

Under the new rules, with exactly the same facts and figures, the net U.S. tax payable by P on the dividend is $80 and the overall effective tax rate on F's earnings is 48%, computed as follows:

Gross U.S. tax (48%) on dividend	$480
Credit ($\frac{1000}{1000}$X400)	$400
Net U.S. tax (480—400)	$ 80
Total U.S. and foreign tax (400+80)	$480
Overall effective tax rate $\frac{480}{1000}$	48%

All things being equal, the old rules provided an incentive for U.S. business to invest in LDCC with tax rates of less than 48%. The new rules will erase this advantage and in so doing would make LDCC with tax rates above 48% more attractive than in the past.

computing their foreign tax credit rather than elect to use the "per country" limitation previously allowed under the IRC.[2]

With the new foreign tax credit limitation, the chances of foreign losses offsetting U.S. tax on U.S. income is reduced since these losses are used to offset foreign income from other countries first. Foreign losses will reduce U.S. tax on U.S. income only in cases where foreign losses exceed foreign income from all foreign countries for the taxable year and, in these cases, will be subjected to recapture.

Special mention should perhaps be made of foreign oil related income in the light of Singapore's refining industry. "Foreign oil related income" is defined to include income from the processing of crude oil into their primary products and the transportation, sale and distribution of such minerals or primary products. For taxable year ending after 1975, all corporations must use a separate overall limitation when computing the foreign tax credit on foreign oil related income. In addition, the recapture rules will apply. The amount that is recaptured represents a loss that in a prior taxable year, reduced the U.S. tax on income from U.S. sources. This is done by "deeming" a portion of the foreign income earned in subsequent years to be domestic U.S. income. The amount of such "deemed" income is limited to the amount of the loss.

2 Under the old law, a taxpayer may elect to use the overall limitation or the per-country limitation in computing its income and foreign tax credits. The per-country limitation had the effect of giving the taxpayer full credit for taxes paid to any country with an effective income tax rate of 48% or less. However, it also had the disadvantage of not allowing "excess credits" from sources in countries having an effective rate greater than 48%, from being applied against the U.S. tax on income from countries with rates lower than 48%. This may result in a less favourable foreign tax credit position than under the overall limitation.

Example 1

	Country			
	A	*B*	*C*	*Total*
Taxable income	100	100	100	300
Foreign tax	40	60	48	148
Per-Country Limitation	48	48	48	
Overall Limitation				144
Per-Country Credit	40	48	48	136
Overall Credit				144

The main strength of the per-country limitation is in those cases where the U.S. taxpayer sustains losses in some countries and profits in others. The losses will not reduce the foreign tax credit of those sources generating profit. It is this feature in the overall limitation which makes it less advantageous than the per-country limitation.

Example 2

	Country			
	A	*B*	*C*	*Total*
Taxable income (loss)	100	100	(100)	100
Foreign tax	40	60		100
Per-Country Limitation	48	48	—	
Overall Limitation			—	48
Per-Country Credit	40	48		88
Overall Credit				48

In the application of the foreign tax credit, it should be noted that foreign income exempted from tax in the source state, e.g. exemption in Singapore under the tax sparing provisions of the Economic Investments and Incentives Act, does not give the U.S. recipient of such income any advantage as no foreign tax credit may be claimed by the recipient. The unwillingness of the U.S.A. to grant a "tax sparing" provision in their double taxation treaties has prevented many LDCs, including Singapore, from concluding any tax agreement.

Conclusion

On an overall perspective and from a long range point of view, U.S. tax of foreign income is unlikely to change in favour of investments abroad. The Carter Administration has suggested that the taxation of foreign income be subject to the same terms as domestic income, with the termination of deferral completely. If such legislation should be enacted, there is good reason to believe that U.S. investments abroad will be affected to the extent that companies abroad will be encouraged to repatriate their earnings rather than reinvest in foreign business.

GLOSSARY

1. *US. Person* Any individual who is a citizen or resident of the U.S., a domestic company or partnership and a trust or estate other than a foreign trust or a foreign estate.

2. *US. Shareholder* ("US Sh") A U.S. person owning at least 10% of the voting control of the company.

3. *Controlled Foreign Corporation* ("CFC") Any foreign corporation of which the voting control is vested in US Shs for one or more days during the taxable year, (with certain exceptions not otherwise relevant to our discussion.)

4. *Voting Control* The vesting in the hands of US Shs of more than 50% of the total combined voting power of all classes of stock entitled to vote.

5. *Subpart F Income* Income derived from the insurance of U.S. risks (applicable to insurance companies), foreign base company income (excluding all income effectively connected with the conduct of a U.S. business) with certain exceptions, international boycott related income and foreign bribe-produced income.

6. *Foreign Base Company Income* This is divided into 4 subparts,
   a) foreign personal holding company income
   b) foreign base company sales income
   c) foreign base company service income
   d) foreign base company shipping income.

7. *Foreign Personal Holding Company Income* includes (i) dividends (ii) interest on loans (including imputed interest) (iii) royalties from intangibles (patents, copyrights, trade secrets etc.) and exploitation of minerals, oil and gas deposits (iv) stock, securities

and commodities transactions (except in the case of dealers) (v) annuities (vi) gains from the sale of an interest in a trust or estate (vii) income from the performance of a personal services' contract where the other party to the contract has the right to designate the employee of the CFC who is to perform the services.

S. Khattar (Commentator): On the whole the problems that face the tax adviser with regard to international tax planning are not different from those faced by any other lawyers. It is the specific problems that may give rise to the problems that have to be resolved in each country according to the domestic tax law and the prevailing policy. And prevailing policy can sometimes evade a tax planner. One specific problem which I think has been discussed or raised by some of you is in relation to ACU income tax at 10%. One of the biggest problems is the difficulty of apportioning expenses. It is fairly clear now as to what area of income of the ACU unit becomes liable to 10% but the expenses that are attributable to that income can give rise to problems because you get different mathematical results and therefore different amount of tax payable if a larger part of these expenses is attributable to income that is liable to 40% and the income which is liable to 10%. Now both speakers also touched on in their papers that we are facing strong competition from the Philippines which has introduced a 5% rate and Hong Kong which my colleague in the Revenue said offers considerably greater advantages but in Mr. Brij Soin's paper he said that they tax at 15%. As I see it Hong Kong offers considerable advantages but that does not really solve the issue. In my view tax by itself does not really decide the matter one way or the other.

The third category of other known tax factors referred to in Mr. Soin's paper is very often relevant especially if the comparison is between 10% and 15% or, 10% and 0%. Of course if the comparison is between 0% and 40% then you have virtually no choice and the known tax factors are usually outweighed by the 40% marginal difference. In the examples given by Mr. Chia, it is clearly easy for a back to back transaction being used to sidestep the tax that may result in Singapore if such a transaction was not done in that form. But if the realisation is that it is so easy to sidestep the high rate of tax in Singapore are there really problems? To channel most of the tax planning in this form combined with the reduced rate of stamp duty or the new rate of stamp duty applicable to promissory notes a lot of tax planning can be done on this basis. Of course there are still problems. And there seems to be a penalty on the domestic borrower who borrows from abroad, who has to pay a withholding tax of 40% and this withholding tax is the one that really causes confusion and considerable financial loss in a normal case where the borrower is not a bank but an individual. In going through Mr. Chia's paper I saw a $500.00 limit on stamp duty with regard to loan agreements even where the loan agreement is primary security. It caused me some confusion and I went to the stamp office to confirm it. There is such an exemption except that it applies only to loan transactions of the ACU type and the definition goes back to s. 43(a) of the Income Tax Act. My client was a Singapore company borrowing money on the ACU market. So he was not entitled to the particular exemption. Well the answer which again is referred to in Mr. Chia's paper is that they got round by issuing promissory notes and the whole document is now liable for $1.00 stamp duty. There is a clear need to be

competitive for Singapore but as I have said if we can keep our laws simple the 5%, 10% or 15% margin may well be outweighed by other non tax factors. It is in my view almost wishful thinking to expect that a zero rate will apply and the rationale for that is itself impossible to reconcile with the conflicting views that must come forward from a promotional agency as against the taxing authority. I still think that the abolition of tax will not come about simply because it seems the easiest way out. The persons who have to promote Singapore as a financial centre will have to promote it even without the zero rate of tax and so far, we have done very well even with the limitations we have had.

I wish to refer only to the last comments of Mr. Brij Soin where he said, in commenting on the taxing authorities, that the basic elements of a good tax structure for the Asian Dollar Market would be durability, understandability and flexibility. My own view is that generally, tax law (there is no exception in ACU) can never be flexible. If it is flexible the chances are there will be no certainty. In as much as it will allow the Revenue to decide or take an opinion in your favour it will also, if it is flexible, allow them to take a position against you. Tax law therefore in my view, cannot always be flexible. On durability — the fact that it is a tax legislation means that it is not durable because it is going to be changed in view of the circumstances that will arise from year to year and based upon transactions which happen over a period of time. The Revenue usually allows some aspects to go on seemingly unnoticed until such time when they snowball large enough to require legislative treatment. The community of specialists who deal with this problem is a very small core and if the Revenue has a relationship with the professional bodies which is a healthy one, then Singapore, I venture to say with this understanding, perhaps even without so much flexibility and durability, will continue to be a financial centre of some standing. Thank you.

DISCUSSION

Charles Stevens: *One aspect of US income taxation which is of particular relevance in Singapore is the fact that our income tax system now is only a preventive form against corruption of foreign government officials. I think Singapore's position as a regional centre makes that very interesting. Your model of not having corruption in Singapore is commendable. To the extent that this city is used as a regional centre for other countries in the region — presumably some American company officials have now used Singapore as a base for corrupt practices in those areas. This last year our income tax auditors using general auditing powers issued what were called the "11 questions" to American companies of a certain size. The 11 questions are directed at the top officers of the companies in a very broad net and under our law, they have to be answered by the officers as individuals. Any incorrect or untruthful answers is punishable by imprisonment. As far as I know those 11 questions have not yet been submitted to American residents abroad or resident in regional centres such as Singapore but that aspect of our tax law I think will have impact in a place like Singapore in the future, especially if President Carter's package against foreign corruption is not passed by the Congress. The second comment I have is really a question which can be perhaps*

addressed later at an appropriate time, that is, the illustrations of Mr. Chia's paper or those endorsed by Mr. Soin. In our law we would have a section 482 which would prevent this sort of bargaining related between entities and which would give the income tax authorities power to restructure the transactions to give them reality. I think that may have been implied by Mr. Khattar when he was talking about expenses. But my question is, don't you have something similar in Singapore that would allow this sort of officiality to be undone to the detriment of all our clients?

James Chia: *I think we do not have the equivalent of the very elaborate section 482 of the United States Tax Code. We have a very simplified provision in Singapore with the artificial transaction provision but the difficulty is in its application. If the transactions are in Singapore then it is easy to apply. You would be able to obtain the evidence. But if you get a case where it involves several jurisdictions then difficulties arise.*

Andrew Ang: *Perhaps 1 might ask Mr. Chia a question again related to this. Assuming that the foreign subsidiary of the Singapore company is proven to be a subsidiary, does the fact that it is related by being parent subsidiary put it within section 33 of our Act?*

James Chia: *I would certainly say there would be and see what counsel on the other side has to prove.*

S. Khattar: *Well I don't think I agree with that. The second example in your paper refers to a deposit by a Singapore parent with a wholly owned subsidiary outside Singapore. Now there is no artificial or fictitious transaction there. That particular wholly owned subsidiary deposits the money with a Singapore ACU. That income is exempt from income tax under section 13(1)(t). The Singapore ACU bank can lend. Otherwise it will do this, that is, via its own parent bank in Singapore it will lend money to the Singapore company. Now that by itself is a very clear ordinary business day transaction. It is not appreciated where the artificiality will come in. There have been some precedents, unfortunately not too many, in this part of the world. We have some precedents. I think there were 2 cases in the whole of Singapore where this "artificial" and "fictitious" value was discussed. But please don't get me wrong on that. We started tax in 1948 so it is not too long. But fictitious is usually equated with a sham transaction. This particular arrangement would be difficult in my view to categorise as an artificial transaction, because you look at all the transactions. I do not think one would be able to categorise or predicate it as an artificial transaction only.*

Chairman: *On the question of artificiality — the bank in Singapore lends money to a foreign subsidiary of the eventual borrower. Foreign subsidiary deposits that same sum of money at the same interest rate back with the bank. By the definition of artificiality which, as you have stated, is found in precedents, I think there is no commercial reason to dictate such a transaction except tax avoidance. My view is that such a transaction is artificial.*

Brij Soin: *Is tax avoidance legal?*

Chairman: *No there is nothing illegal about this. But we are not drawing a distinction between tax avoidance and tax evasion. We are saying that although it is tax avoidance the transactions here were dictated only by that and nothing else. In fact there is no commercial reason for it except to save the taxes. You might consider tax evasion a commercial reason. In a manner of speaking it is. But if every tax scheme were to be defended on that ground, there would be no room for section 33 of the Income Tax Act. Such an interpretation of "artificial" in section 33 would in effect render the section meaningless.*

Chairman: *This morning we were on the topic of administrative discretion — the exercise of administrative discretion, within the Income Tax Department and the point was made by Mrs. Annie Wee that although ministerial statements for example or even laws are passed with the intention of boosting Singapore's attractiveness as a financial centre, yet in the interpretation of those laws and sometimes in the exercise of discretion within the Income Tax Department, the intention of the legislature has often been negated or cut down. I don't know whether that is a fair comment. Mr. Chia didn't really have an opportunity to defend the position of the Income Tax Department.*

James Chia: *As pointed out by Dr. Thio this morning, policy makers say one thing, administrators go off tangent to do something else. In most of these cases authorities are dealing with corporations. Corporations have thought of ways of manoeuvring round the provisions thus giving rise to the problem. When policy makers provide for a certain incentive it is done with good intention to create a certain advantage or certain growth to the economy of Singapore. But when you get a way out of an existing provision and go to another area where there is a tax advantage you should not turn around and say administrators ought to have thought about this. As I have mentioned earlier, the government is conservative and cautious in its policies. It has a certain objective, it has a certain purpose. The administrators have guidelines to go by. In some instances the authorities try to be flexible to accommodate the interest of the corporation if it is to be the interest of Singapore. But I don't believe any of my friends in the business sector would agree with that. Now the MAS I believe have been on very cordial dialogue with the banking sector. The Association of Banks have also been in very cordial dialogue with the Revenue Authority. The Singapore International Chamber of Commerce and the Singapore Society of Accountants have got out of most their problems through these channels. So I would not say that the administrators have gone off tangent from the policies.*

Charles Stevens: *Singapore I know, likes to try to avoid any implication that it is a tax haven. What about the use of Singapore offshore companies? Why were they allowed to be created? Are they intended as a means of government policy to encourage the use of Singapore as a corporation centre? That is a question. I don't know if anybody wants to answer that.*

S. Khattar: *Under the Singapore Income Tax Act first of all foreign income is not even taxed at all unless remitted. So by that fact alone a certain leeway has been part of our law since 1948.*

An offshore company is basically one that is incorporated here but is managed and controlled from outside. Simply by the definition of the fact that a resident company in Singapore is that which is managed and controlled in Singapore and this particular company is incorporated in Singapore and is managed and controlled outside, it is therefore non-resident and being a non-resident it is not liable to Singapore tax except for income which is accrued from or derived in Singapore. There is no specific government policy in relation to it. It comes within our Tax Act because we do not believe in charging any tax merely on the basis of the fact that it is incorporated in Singapore. So there is, as far as I know, no marked or deliberate government policy to encourage offshore company to be based here. The problem arises when you come to dividends and things like that. But that again applies only to a resident company. Incorporation is an irrelevant criterion for Singapore tax purposes.

Thio Su Mien: *In this connection when you talk in terms of offshore companies, I think you are only talking in terms of the Income Tax Act. Because in terms of their legal entity they are either a branch of a foreign company or a locally incorporated company.*

S. Khattar: *Yes, you can have a non-resident company for tax purposes but which is resident for the purposes of the Companies Act; and also resident for the purpose of the foreign exchange regulations.*

Annie Wee: *I am interested in statistics and that is, what kind of revenue we would lose if we were to make it tax exempt — the question of debentures. I have always wondered, how much it is that we are talking about? Why are we making it so difficult for both borrowers and lenders to do businesses? It is very exhorbitant — this ad valorem method of stamp fees.*

S. Khattar: *Are you seriously saying that there will be more debentures if there is no stamp duty? I mean banks will lend on the basis that they want a debenture.*

Annie Wee: *No, there will be more debentures, there will be more business, there will be more receivables discounting. There will be factoring.*

S. Khattar: *Will there be more debentures just because the stamp duty is not ad valorem? I don't think so.*

Annie Wee: *Yes. Very often it is very prohibitive. There could easily be the kind of transactions like the huge aircraft loan example that Su Mien gave this morning. Because when you begin to think of ad valorem against the amount of the loan and when you begin to think of the Euro Dollar type of loan it is huge. It is not just the loan agreement. I am talking of debentures. I am talking of receivables discounting and factoring. At the moment assignment or chose in action attract ad valorem duty.*

James Chia: *Strictly the transaction is purely internal among the parties here. I don't think there should be any encouragement for this sort of business activity and the instances given by Dr. Thio I*

thought may be isolated. I don't know how many aircrafts are going to be sold within a year. So just a provision for that particular transaction is not the intention of Government. As to statistics I am not too sure, I don't think there are any at this point. I would like to know about that myself.

S. Khattar: *On stamp duty we are slowly following London, and the stamp duty is being imposed on fewer businesses. 1 think it is coming to that but regarding the purely domestic items I don't see government giving up tax just like that. But if a case can be made out like shipping income, it will be considered. I think the stance of the Revenue was, "why should we exempt where it is a loss." But the argument against a normal promotional exercise justifying exemption would be, "well, you get nothing in the first place so why can't you agree to give up what you are not getting in the first place." Until exemption is given and there is some experience and you have figures to back the growth because of exemption, then the arguments are not really capable of proof in putting forward a particular case. A certain amount of risk is involved in terms of revenue. But if London is any example to go by it is a risk worth taking. London has virtually abolished stamp duty on almost everything. This is in keeping with the financial centre status. We are slowly moving in the same direction. A lot of things including promissory notes issued by or in favour of local bank are now exempt. There is hope for more but 1 am not sure debenture is one area for that. The debenture you take here will be in relation to local assets. Therefore it is a domestic transaction and that is the kind of thing in respect of which the legislature may not want to give up revenue on.*

Thio Su Mien: *In this particular situation, the assets belong to an offshore borrower but because it is an aircraft it comes in and out of the country so it is local and it is not local. But if you are talking in terms of policy that generally you want to encourage this kind of financing at the international level then in terms of policy it is consistent to abolish stamp fees for this kind of transactions. It is a matter of policy. Do you want to encourage this kind of activity or do you not want to. And if you wish to, then you must take the necessary steps and if it is undesirable, of course you don't bother.*

Patrick Teo: *On the domestic level it is only a very small point and it only involves a few hundred dollars. If you were to compare hire purchase where stamp duty is a dollar on the hire purchase contract, and a recent innovation, that is, leasing which attracts stamp duty at the rate of $5.00 per thousand on the face value of the lease, you have an anomaly; it is unfortunate since leasing and hire purchase are, to the user of the equipment, ultimately similar because it often ends up with him owning the equipment. In terms of policy, one should put leasing on par with hire purchase if it is the objective to promote greater financial activity of a variety of types in Singapore.*

Lai Kew Chai: *I think this morning Su Mien mentioned about an anomalous situation. Ship financing mortgages are exempt from stamp duty. But when you want to finance the construction of a ship you have to take an assignment of shipbuilding. In a particular case there was an ACU loan of US$20 million to a Singapore company to finance the construction of two specialised vessels. I think to be*

fair to the Government and to the Ministry of Finance they readily and I think without any fuss granted remission so that the assignment of the shipbuilding contract could be done and no stamp duty was payable. So I think in situations like that it is the role of the lawyer to get hold of the facts and present them and say, this is a nascent ship which is still being built, instalments are being released in stages. In the meantime, we are taking an assignment with a mortgage in escrow and seek remission of the stamp duty. So in ad hoc situations like the aircraft, you know, I would have thought ministerial remission should not be too difficult to obtain. And I don't hold a brief for the government, please.

S. Khattar: *But in the same example you could also, if you were not able to get or not inclined to apply for remission, use a promissory note to cover the assignment and you won't even need an assignment which in any event would be collateral security and therefore, requires stamping with nominal stamp.*

James Chia: *Yes it has been done.*

Ong Ai Boon: *I would like to ask Ms. Loke Kit Choy a question. You mentioned this US tax deferral and preferential tax on investments on LCDs and Subpart F income. Does this apply to banks in the States setting up branches in Singapore for instance and how can they prove to the Inland Revenue Department that their operations overseas are not of a tax haven nature?*

Loke Kit Choy: *It is all a question of fact. Of course, it comes down to the IRS as to whether you are operating in a tax haven country. So you will have to examine the facts of every case and this is the kind of situation where a bank would probably seek a ruling before advancing into the country to conduct the kind of activities that they want to do. That is the answer to your last question. The answer to your first question. Banks are taxed in very much the same way as any other corporation is taxed although there are some provisions in the Code which would apply specifically to banks. I think your question was directed to the foreign tax credit?*

Ong Ai Boon: *Both. No, not the foreign tax. I was talking about tax deferral and the preferential tax rate on investment — LCDs.*

Loke Kit Choy: *If the US bank were to operate a branch in Singapore for instance, then under most circumstances, the income produced in Singapore would be deemed to be a part of the total world income of the US parent and there would be no deferral because this is a branch operation, which you are talking about.*

Ong Ai Boon: *I am talking about subsidiaries. Merchant banks for instance.*

Loke Kit Choy: *If you have a subsidiary then you are pretty much in the same situation as any other subsidiary would be and unless there is a remission of the money back into the US the income would not be subject to tax. So banks do I think accumulate a lot of the income in foreign countries utilising them for purposes of development of further subsidiaries in foreign countries.*

S.Y. Lee: *Just to continue your point. Because of the US tax law you find that some subsidiaries which gain money overseas would not remit back the money to USA. Instead they would deposit into Euro Dollar Market or Asian Dollar Market. The correspondent bank lends the money to the parent company. This is to avoid tax. How does the USA plug this loophole?*

Loke Kit Choy: *Under the 1976 Act for instance what used to be foreign trusts, which is what you are talking about, the company would create or individuals would create a foreign trust which would then hold the money and utilise it outside of the US. The taxation of foreign trust now has been changed such that not only would the grand total be taxed when the money gets back but I think there are now provisions which would make it possible for the Government to tax second- and third-tier persons in this trust structure, such that the income may very well be taxed under the present statute to the holder of the trust or the beneficiary of the trust. That is one way. The Tax Treasury Department in the United States is fully aware of this system. They do not want to discourage I think, total investment in foreign countries but they do see a need to have some of the US dollars brought back into the country and subject to tax simply from the point of view of balance of payment or whatever it is that they are concerned with. And one of the schemes where US persons use to keep money abroad and re-invest it and then utilise it when it is abroad is to set up this trust scheme and the government has taken measures to take care of it.*

S.Y. Lee: *Relating to your problem would it be what you call the Investment Equalisation Tax (1ET).*

Loke Kit Choy: *It is no longer.*

S.Y. Lee: *Before its abolition in 1975, USA tried to discourage foreign investment by means of this tax of 15%. However, with the improvement of the situation it was abolished. What is the impact on the US companies? Would they be encouraged to invest abroad?*

Loke Kit Choy: *I cannot see any US investments now being encouraged to go abroad simply by virtue of the fact that it has been abolished.*

S.Y. Lee: *Relaxation of the control so that funds can flow out more easily from USA to other countries.*

Loke Kit Choy: *That may be true. But the tax laws in other aspects were tightened such that they would seem to be no longer necessary to have the Interest Equalisation Tax which is seen as a very complex matter and unweildy in its application.*

S.Y. Lee: *Looking at the problem from a different angle, from the developing countries' angle, it is commonly said that transnational companies can shift their profit to a country where the tax is low. What is your view?*

Loke Kit Choy: *If the Carter administration passes its proposed legislation that deferral be completely done away with this would*

mean, I think, that companies will no longer find it important to consider the high or low tax rate that is applied in a foreign country. The proposal is only in terms of a dialogue that has been carried on I think by the Treasury Department.

William Hui: *Mr. Chairman. I think Professor Lee's question relates to transfer pricing rather than Ms. Lake's response to the question.*

S.Y. Lee: *I would like to say a few words on the shifting of profits to countries where the taxation is low. One way is to make, use of accounting prices. When a subsidiary sends goods to a country where its parent company or one of its other subsidiaries is, the accounting price can be manipulated. For example, Shell in the Middle East sends crude oil to its subsidiary in Japan for refining. The accounting price in Japan can be fixed at the discretion of Shell. Shell then sells some of the equipment to its Middle East oilfields at another accounting price. This is one way it can shift its profits and tax liabilities. Likewise, if a transnational company anticipates a currency appreciation or depreciation, it can take advantage of the situation by manipulating the receipts and payments in foreign exchange.*

Loke Kit Choy: *I think the US Treasury is aware of it and most countries are aware of it. This is effectively a large part of the problem in accounting. How would you allow a company to represent in its account what the particular figures are and what the particular figures represent. There is a proposal that has been considered for some time now which says that a US foreign corporation should not be treated any different from an American domestic corporation. Now the American domestic corporation could very easily have its books examined and the figures rearranged by the US Treasury if it is found that the particular activity does not correspond to the true facts and the tax accounting would then be taken into consideration. If this is true, all the foreign US corporation then would be taken care of. But this does not help the developing country. One possible solution to that would be the tax treaty. A number of tax treaties have made such provisions to allow for governments to help each other in terms of the audit of books. Information which may be obtained by one government in relation to particular corporations may be utilised or passed on to another government interested in the same corporation in the same kind of transaction. That is one way I think the problem could be solved. Mr. James Chia perhaps might be able to tell you some other ways which the Tax Department is considering.*

James Chia: *Well Professor Lee has just posed a theoretical problem but I believe in practice it is more difficult than what it is going to be. Transfer pricing is a major problem which is still being considered by the United Nations and after 12 sittings they have not arrived at any formula. Now the other aspect about shifting. You can shift to certain limits. You can't keep on shifting around the world until you find a perfect state.*