CURRENT ISSUES AND PROBLEMS AFFECTING TAXATION

by

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The concept of ACU and the Asian Dollar has been defined by various speakers and the problems have also been pinpointed with considerable skill. Singapore's position as a competitive market is now being challenged by Hong Kong and perhaps by Manila. In my opinion, the lawyer and the bankers' ingenuity taken together are adequate to overcome high rates of tax and problems of stamp duty, and I refer to those which have now already been dealt with by the legislature. Some genuine problems still remain including those referred to by Dr. Thio in her paper yesterday. Not all contingencies and problems that arise can be provided for in a legislation and if all problems could be dealt with then you would not need either bankers or lawyers — only moneylenders. Certain risks must remain including legislative risks and the final issue in my view is that the legislation itself can change and any amount of tax planning is really tax planning for the present only.

The areas which attract the 10% rate are now fairly clear. Some of us are still not happy and we would like if possible for that rate to be reduced to nil. Tax is never really intended to produce or result in the maximum happiness for the maximum number. It is unlikely that the 10% rate will be reduced or that all of us will be happy even after the 10% is reduced to nil. A 2% spread is normally the maximum that the banks and financial institutions earn on these transactions. On this marginal spread we are talking in terms of a 10% to 15% tax because there is also an allowance for expenses. And when you talk of 10% or 15% of 2% you are talking in terms of a 0.2% or a 0.3%. In terms of the multi-million dollar transactions that normally involve themselves in a problem of this kind, this may be substantial but as I said most of these can be solved. And those that can't be solved one learns to live with anyway. I discussed yesterday in passing (when I was commenting on another paper) the very practical problem of apportioning expenses between the ACU income which is liable at 10% and the non-ACU type of income which is liable at 40%. There is a clear mathematical advantage to the taxpayer if a larger part of his expenses can be shifted over to the 40% liability rather than the 10% liability. It is not easy to do these adjustments and these are the real problems that one has to look at, and appeal to the Revenue to have an understanding position. The telephone call the local manager receives may be partly to do with the ACU business and partly to do with his non-ACU business. How are we going to split the expenses? There are other areas which have similar problems but on the whole I think that they have never given rise to any issues that have had to be decided by a court of law.

The problem of a 40% rate still remains with regard to withholding tax which in my view is a very substantial problem and this 40% is applicable if the interest is paid by a resident and the words used are "directly or indirectly" or by "a permanent establishment in Singapore or are deductible against Singapore tax". "Non resident"

is defined to include and means in a normal case all branches of non-Singapore incorporated banks. This means that if you pay interest to the Hongkong and Shanghai Bank (Singapore Branch), you are supposed to deduct 40% at source. As to how you deduct 40% when all that the banks do is to debit your account of course remains a little bit of a mystery for practical purposes. The Revenue has never sought to apply this particular provision strictly, and understandably so. But this problem which came about after the last amendment has to some extent been relieved by the new Amendment Act. As it stood before if you bought a house in London and your banker in London debited your account with interest you were supposed to withhold 40% and pay this to the Singapore Revenue. That problem has now been circumvented since it relates to physical assets outside Singapore. But the problems remain in other area, *i.e.* that you are supposed to deduct 40% every time you pay interest to a non-resident bank branch in Singapore. The Revenue has made it very clear to both the accounting body and the legal body that that law is not to be strictly enforced and the rationale is that if the non-resident branch is in Singapore and is paying tax on its profits in Singapore then no withholding need apply although strictly required under the letter of the law. The problem which remains is that in each large transaction you would need to be satisfied with the fact that that practice will continue; at least at the time when you are giving an opinion near the end of the transaction. This is rendered more problematical by the fact that Singapore as an international centre is getting used to the type of legal documentation originating from America where each particular statement has to be warranted. The problem is the subject of a warranty. The local solicitor has almost to warrant that either no taxes are applicable or alternatively what taxes are applicable. Strictly speaking under the law you are supposed to withhold. The Revenue's practice is that you need not withhold. How do you give an opinion to the effect that withholding applies? I am saying that because I have this thrown at me a number of times and I take the precaution of going back to the Revenue to obtain the confirmation and I must say that the Revenue has been co-operative in giving that confirmation when necessary. Alternatively you set out the practice in your opinion and leave it at that.

We have discussed the ACU problems at some length and I wish now to touch upon some other problems which really are not, strictly speaking, ACU orientated. Singapore Revenue has now started to assess regional offices performing services for other head offices on the basis of 5% of their total expenses and deeming these to be Singapore source income. The rationale of that is not difficult to see. A number of regional offices combined all over the world must contribute something towards world wide profit of that particular enterprise. Each one of them taken by itself probably produces nothing. Singapore has taken the view that 5% of the expenses is deemed to be Singapore income and 40% of tax ought to apply. The rationale itself cannot be disputed but until the law is amended to make such income liable to Singapore tax I do not think that the 5% basis of taxation of expenses is a legally valid basis of taxation. Usually this problem is dealt with in the Double Taxation Agreements (DTA), and we have double taxation agreement with almost every important country in the world. We are now on the way to having double taxation agreements with the countries around the region. This problem is usually

dealt with in the DTAs. The regional offices, if not engaged in independent economic activity, do not give rise to profit on which tax can be imposed in the country of source.

One of the major areas of incentives which exists in our law and which has no time limit as to its existence is shipping profits. Shipping profit laws like pioneer income or other income dealt with under the Economic Incentives (Relief from Income Tax) Act started off as being very generous. Then as lessons were learnt as to the fact that it was over generous some amendments were made. For instance the Pioneer Ordinance originally allowed for relief for a period of 5 years and then went on to provide that capital allowances could be postponed or were deemed to be postponed to the first day of the post pioneer period. Effectively this meant relief for 8 years and sometimes more. The amending Act allows the Minister to give relief for up to 8 years but now whether you claim capital allowances or not they are deemed to be incurred during the pioneer period and therefore, your profits are almost mandatorily written down to take into account these capital allowances. The same thing is happening in shipping. The first shipping amendment was very generous. It did not require you to claim the capital allowances and things like that. All that is slowly being eroded. But this is probably correct from the Legislature's point of view as the tonnage registered in the Singapore Registry is increasing and the exemption from tax is still a very important exemption which shippers are able to use. We go back of course to the argument touched on yesterday. Do you really give up any tax by, for instance, starting a new branch of exemptions and shipping is one that could be used as an illustration of the fact that Singapore has less than half a million tons of registered shipping on its Registry before the exemptions were introduced and this has now gone up considerably. Is giving up notionally what you would not be able to tax anyway a tax relief?

I would now like to touch upon other possible areas which could be considered for specific legislative treatment for some kind of incentive. The Singapore insurance industry has somehow lagged behind the more glamorous banking industry. The insurance industry has been administratively taken over by the Monetary Authority and the basis of that lagging behind will probably change. Hopefully there will be a resurgence or at least a promotional resurgence of insurance activity in Singapore and with regard to reinsurance at least there could be some legislative support in the form of incentives. This is an integral part of the financial centre status. So far, the only incentive that exists with regard to insurance is found in the Income Tax Act which says that if you insure your life with the company which does not have an insurance office in Singapore then you cannot claim the deduction. But on the basis of existing CPF rates, these usually absorb the whole of the S$4,000 that is available so that the insurance "incentive" is neither here nor there.

As to which value added industries even if they do not fit into the confines of pioneer or export should be considered for some kind of special treatment is not easy to forecast. I refer however in particular to shipbuilding which has been around for a while and therefore is not considered fit for pioneer type relief but the value added to shipping type industry is considerable. The aerospace industry as

such which is still in its pioneer stages is another. But the non-manufacturing aspects of aerospace industries should be considered for some kind of relief. Three or four years ago somebody suggested that we could in order to attract skills consider the concept of a pioneer person. I am not in favour of that kind of amendment. The recent amendments introduced a new definition of permanent establishment. It is not really new since it comes out of the existing section 13 but it is considerably wider in scope. Its existence in section 13 previously was incorrect since the term "permanent establishment" was also referred to in section 13A. The new definition is in section 2 itself, (the definition section) and is wider. Revenue has however made it very clear to the accounting body and the legal body that there is no intention to really extend the scope to deem the permanent establishment to be contributive to income or that it gives rise to deemed income. The fear nevertheless cannot be overcome that this is the opening of a door to a larger ambit of tax based on a permanent establishment or regional offices.

I have touched on interest. Although there is no withholding tax in respect of interest as recently widened, nevertheless, the definition of deemed source in relation to interest has been widened considerably and covers all kinds of financial activity relating to indebtedness. Section 45 itself has not been amended so that withholding is still only on interest and not on other related activity of a financial institution. This means effectively that there is a 40% withholding and this, in my view, is large. Of course it doesn't apply where there is a double taxation agreement but even without a double taxation agreement it is large. In the example used in Mr. James Chia's paper where a Singaporean puts money in Indonesia and Indonesia charge 25% withholding, if the position is reversed and Singapore charged 40% the whole particular investment would immediately become unattractive.

The new section 12(7) was intended to deem the source to accrue in Singapore in respect of royalties and other like payments. Well, royalties and other like payments clearly should be taxed in Singapore if the source is here but this particular section is so broad now it also covers charter fees. The Revenue's rationale on this we are told is that non Singaporeans were using Singapore double taxation agreements as a basis in order to take advantage of such double taxation agreements and these are the kind of people we do not need to attract because it puts us in considerable defensive position when we negotiate double taxation agreements. The problem in my mind is that if a Singaporean or a Singapore resident company operates shipping they are supposed to withhold 40% when the charges here are paid or credited. As far as a non-resident is concerned he is only liable if freight is uplifted in Singapore. This particular amendment originally would have made 40% of any such charter fees as being liable to Singapore tax if the charter was resident. This is not compatible and the extremely wide ambit of this was appreciated almost immediately the amendment was introduced and the Revenue has been very quick to confirm that the full effect of this law would not be applied and the withholding tax that would be imposed will be either 1%, 2% or 3% of the gross payment depending upon where the particular charterer is resident. Of course this again is overridden in some aspects by existing double taxation agreements. The Revenue's

mitigation in respect of the full effect of this particular amendment has brought into the Singapore tax concept the "tax haven" status. If the charterer is resident in tax haven countries (and they are given a list of about 17 countries) then 3% of the gross is deemed to be Singapore tax liability. It is possible that this particular approach may well be that we are on the way to the Australian approach where any transaction with a tax haven country is subject to the scrutiny of the Comptroller or the Department of Foreign Exchange. It is unlikely however we will reach that far because Singapore's foreign exchange regulations are so liberal. But nevertheless the opening up is quite clear.

I would like to end by saying that in as much as we have competition from Hong Kong and Manila the rates are marginal and if tax were the only reason, the tax havens would be the only people in the world who would be doing this kind of business. This 10% and 15% rate is not prohibitive and I do not see Singapore's position as a financial centre being seriously eroded merely by this marginal difference.

REGULATORY ASPECTS OF OFFSHORE LENDING TO INDONESIAN CORPORATE ENTITIES

by

WILLIAM HUI

Representatives of commercial banks and merchant banking houses in an international financial centre often have to concern themselves with the security instruments pertaining to loans made to borrowers in neighbouring countries. They also need to know the laws, regulations and policies pertaining to offshore loans in such countries. I will outline the regulations applicable to offshore loans made to Indonesian corporate entities by Singapore-based banking and financial institutions.

In terms of the applicable regulations two questions may be posed:

(1) Are the funds intended as part of the capitalisation of a *Perseroan Terbatas* (Indonesian limited liability company) organised under the Foreign Investment Laws of Indonesia?

(2) Is the proposed borrower a government-owned enterprise?

The regulatory strictures vary in relative strictness of procedure and enforcement depending upon the answer to each of the above questions.

1. *PRIVATE ENTERPRISES*

(A) Within the Foreign Investment Law

If the funds to be borrowed are for the purposes of direct investment under commitments made within the processes and procedures of the Foreign Investment Law, 1967, a borrower may obtain the approval of the BKPM (*Badan Koordinasi Penanaman Modal*) stating in its application the amount, the term of years, and other particulars