Professional Level – Options Module

Advanced Taxation (Singapore)

Monday 6 June 2011

Paper P6 (SGP)

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–4

Do NOT open this paper until instructed by the supervisor.
During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.
This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

The Institute of Certified Public Accountants of Singapore

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below for the year of assessment 2011 will continue to apply for the foreseeable future.
2. All apportionments should be made to the nearest month.
3. Calculations and workings need to be made to the nearest $.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

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

Corporate income tax

Rate of tax		
Year of assessment 2009	18%	
Years of assessment 2010 and 2011	17%	
Partial corporate tax regime		
First $10,000 of chargeable income is 75% exempt		$7,500
Next $290,000 of chargeable income is 50% exempt		$145,000
		$152,500
Full tax exemption for new start-up companies		
First $100,000 of chargeable income is 100% exempt		$100,000
Next $200,000 of chargeable income is 50% exempt		$100,000
		$200,000

Voluntary Central Provident Fund (CPF)

Contributions of the self employed. Year of assessment 2011

Capped at $26,775 or 35% of s.10(1)(a) assessable income, whichever is lower.

Central Provident Fund (CPF)

Contributions for individuals below the age of 50 years and earning more than $1,500 per month

	Employee	Employer
Rates of contribution		
– 1 July 2007 to 31 August 2010	20%	14·5%
– 1 September 2010 to 28 February 2011	20%	15·0%
– from 1 March 2011	20%	15·5%
Maximum annual ordinary wages (OW) attracting CPF	$54,000	
Maximum annual additional wages attracting CPF	$76,500 less OW subject to CPF	

Personal income tax rates for resident individuals for the years of assessment 2011

	Chargeable income $	Tax rate %	Tax $
On the first	20,000	0	0
On the next	10,000	3·5	350
On the first	30,000		350
On the next	10,000	5·5	550
On the first	40,000		900
On the next	40,000	8·5	3,400
On the first	80,000		4,300
On the next	80,000	14·0	11,200
On the first	160,000		15,500
On the next	160,000	17·0	27,200
On the first	320,000		42,700
Above	320,000	20·0	

Personal income tax reliefs for the year of assessment 2011

Earned income	**Normal (max)**	**Handicapped (max)**
Age		
Below 55 years	$1,000	$2,000
55 to 59 years	$3,000	$5,000
60 years and above	$4,000	$6,000

Spouse relief	$2,000 (max)
Qualifying child relief (per child)	$4,000
Handicapped child relief	$5,500
Working mother's child relief	
	(% of mother's earned income)
First child	15%
Second child	20%
Third child	25%
Fourth child and subsequent child	25%
Maximum relief per child	$50,000
Cumulative % for working mother's child relief	100%
Life assurance relief	$5,000 (max)

Nsman relief

For Non-key appointment holder [Non-KAH] and Key appointment holder [KAH]

	Non-KAH	**KAH**
Active Nsman	$3,000	$5,000
Non-active Nsman	$1,500	$3,500
Wife/widow	$750	$750

Course fees	$5,500 (max)
Foreign maid levy	$6,360

Goods and services tax (GST)

Standard rate	7%

Stamp duty

Purchase or transfer of immovable property	Duty payable
Purchase price or market value	
Every $100 or part thereof of the first $180,000	$1
Every $100 or part thereof of the next $180,000	$2
Thereafter, every $100 or part thereof	$3

Transfer of shares	
Purchase price or net asset value	
Every $100 or part thereof	$0·20

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Question 1 begins on page 6.

Section A – BOTH questions are compulsory and MUST be attempted

1 WindTech Pte Ltd (WindTech), a Singapore registered company and a tax resident of Singapore, is in the business of designing, fabricating and installing wind turbines in the Asian region. Its business operations are located in Singapore. The company is also a registered trader for Goods and Services Tax purposes.

To upgrade the skills of its workforce, WindTech's management has started an in-house training programme that qualifies for the Productivity and Innovation Credit (PIC) scheme. Experts in advanced wind turbine technology have been engaged to conduct the training. The training programme is an accredited Workforce Skills Qualification (WSQ) training course and the trainers are approved as WSQ in-house training providers. The programme will take two years to complete. The expenditure incurred and expected to be incurred by WindTech in conducting the training programme in Singapore is as follows:

Financial year ended 31 December	**2010**	**2011**
Nature of expenses	**$**	**$**
Salaries of trainers	270,000	310,000
Rental of external premises	10,000	10,000
Costs of training materials	10,000	10,000
Accommodation for trainers	30,000	70,000
Administrative support costs	40,000	40,000
Total	360,000	440,000

The above salaries for trainers are solely attributable to the delivery of the training courses. In addition, to help defray the salaries of the trainers, WindTech will receive a cash grant of $20,000 per year from the Singapore Government and $50,000 per year from a non-Government agency.

Because of the expenses (as above) to be incurred for the financial years ending 31 December 2010 and 2011, WindTech expects to return losses for both these financial periods.

Required:

(a) In relation to the Productivity and Innovation Credit scheme, describe:

(i) the overall nature of the incentive provided;
(ii) the time frame;
(iii) ANY FOUR of the categories of qualifying activities;
(iv) the limits to the relief available; and
(v) the approval process. (8 marks)

(b) Draft a memorandum for the directors of WindTech Pte Ltd, setting out the Singapore income tax implications of the expenditure incurred and to be incurred by WindTech Pte Ltd in conducting the in-house training programme in the financial years ended 31 December 2010 and 2011. (17 marks)

Professional marks will be awarded in part (b) for the appropriateness of the format and presentation of the memorandum and the effectiveness with which the information is communicated. (2 marks)

(c) Windtech also proposes to engage, under contracts for service, two foreign scientists (both non-tax residents of Singapore) who are renowned in the field of wind turbine technology, to speak at a one-day public seminar in Singapore to be organised by Windtech. In consideration, Windtech will pay a fixed fee of $50,000 to each of the scientists for their work in Singapore and bear their travelling and hotel accommodation costs in Singapore, estimated to be $10,000 for each scientist. The scientists have agreed to bear any Singapore tax due themselves.

Windtech will charge a registration fee of $450 per person for the seminar which will be held at Hotel Shangri-La Singapore. The seminar is likely to incur a loss to Windtech.

Required:

Explain the Singapore income tax, goods and services tax and withholding tax implications for Windtech Pte Ltd of the proposed seminar and calculate the amounts of withholding tax to be withheld from each of the scientists.

Note: comments on payment dates and mechanisms to account for taxes are not required. (8 marks)

(35 marks)

2 A company in India is in the business of processing coconuts into value added products in India. It intends to embark on a mega project aimed at modernising and expanding the existing coconut processing units in India. For this reason, it has invited tender applications for the various scopes of work described, one of which is project management.

CoNut Development Pte Ltd (CND), a company registered and tax resident in Singapore, intends to apply for the project management work. It is considering registering a branch in India. The Indian branch of CND will tender for the project management work and, if successful, the branch will undertake most of the work in India. To ensure a profitable return for the project management work, CND is considering the following:

(1) The Singapore Head Office (SHO) is looking to fund the Indian branch's operations using one of the following options:

Option A
The Indian branch will obtain a loan from a bank in India to fund its working capital requirements in India. Interest on the loan at the flat rate of 1·5% per annum will be charged by the bank.

Option B
The SHO will, out of its own surplus funds, provide a loan to the Indian branch. The SHO will impose an arm's length interest rate of 2% per annum for the use of these funds.

(2) The SHO will second some staff to the Indian branch. The salaries, accommodation and travelling expenses incurred by the seconded staff will be paid by the Indian branch. However, CND's management has not decided whether the Indian branch or the SHO should bear these costs. For the secondment arrangement, the SHO will charge the Indian branch a fee of $10,000 per year.

(3) The chief accountant has estimated that the following other costs will also be incurred but CND's management has not decided whether the SHO or the Indian branch should bear these costs.

Pre-commencement and pre-operating expenses including:

- tender costs of $30,000;
- travelling and accommodation costs of $15,000; and
- marketing costs of $20,000.

(4) The SHO will engage Mr Nathan from Malaysia to assist in the project management work. Prior to this engagement, Mr Nathan was a Malaysia tax resident and has been working in Malaysia in the area of coconut processing. To fulfil his responsibilities, he will spend part of his time in Singapore and the rest of his time in India. Under the terms of his contract with the SHO, Mr Nathan will be paid an annual salary of $100,000 plus allowances and some benefits-in-kind.

The following information has been obtained by CND about the Indian tax system:

- Trading profits sourced in India are taxed at the corporate income tax rate of 42%.
- There will be no Indian withholding tax on either the loan interest payable by the Indian branch to the lending bank in India or on the interest payable by the Indian branch on the funds extended to the branch by the SHO.

Required:

As the tax adviser to CoNut Developments Pte Ltd (CND), write a letter to the company's CEO setting out the following:

(i) The after tax cash flow implications of the two options (A and B) for funding the Indian branch, together with details of the assumptions made; (7 marks)

(ii) The Singapore tax implications for CND with regard to the Indian branch profits and the various items detailed in (2) to (4) above; (11 marks)

(iii) The Singapore personal income tax treatment of Mr Nathan's employment income and any special scheme(s) that might reduce his tax liabilities. (7 marks)

Professional marks will be awarded in question 2 for the appropriateness of the format and presentation of the letter and the effectiveness with which the information is communicated. (2 marks)

(27 marks)

Section B – TWO questions ONLY to be attempted

3 Since he was young, Mr KG Man has been in the business of collecting second-hand goods and used items, including old newspapers, for resale to a central distributor that will on-sell them to a recycling plant. In 2009, he was presented with the opportunity to be the central distributor of such goods and on 1 June 2009, Mr KG Man, his daughter [Mdm Aggie Tan] and his son [Mr Tony Man] registered a limited partnership, called KGMan LP, to undertake this new distributorship business.

Under the KGMan LP structure, Mr KG Man will be the general partner whilst his daughter and son are to be the limited partners. They have agreed to share the profit/loss as follows: Mr KG Man, 70%; Mdm Aggie Tan, 20%; and Mr Tony Man, 10%. The partnership's financial year-end is 31 December.

Other significant events and relevant information for the period 1 June 2009 to 31 December 2010 are as follows:

2009

On 3 July 2009, KGMan LP signed a long-term lease for a new storage place and recruited staff.

On 4 August 2009, the first batch of collectors came with their second-hand goods and used items for sale to KGMan LP.

On 7 August 2009, KGMan LP delivered the first batch of second-hand goods and used items to the recycling plant and issued its first sales invoice.

For the financial period ended 31 December 2009, KGMan LP generated distributable trading profits of $100,000 and distributed all of its accounting profits to the partners.

2010

KGMan LP won and collected the top prize of $3m under the Singapore sweepstake betting system. This sum was all distributed to the partners.

Due to a severe slump in the second-hand goods and used items market, KGMan LP made an unexpected distributable trade loss of $300,000 for the financial year ended 31 December 2010.

As at 31 December 2010, the amounts of capital contributed by each partner were as follows:

	$
Mr KG Man	170,000
Mdm Aggie Tan	20,000
Mr Tony Man	10,000

In 2011 the partners decided to use the proceeds from the sweepstake win to venture into a small recycling paper plant in Singapore. This new business will require substantial investment in plant and machinery. However, the partners have not decided whether to house the new recycling plant business under the existing partnership, KGMan LP, or to incorporate a new private limited company, limited by shares, for this purpose. Based on the initial studies done, the partners expect that in the initial years the new recycling plant business may generate losses or, at best, generate only small profits.

Required:

(a) Explain the Singapore income tax treatment of the limited partnership, KGMan LP, for the years of assessment 2010 and 2011. Your answer should include both details of the general principles of taxation applied to limited partnerships and the specific effect of the above transactions. (13 marks)

(b) State the main differences between a limited liability partnership and a limited partnership from a Singapore income tax perspective. (2 marks)

(c) Explain the benefits of using a new company structure rather than the existing KGMan LP structure to house the new recycling plant business. (4 marks)

(19 marks)

4 Mr Thawerat, a Thai citizen and tax resident in Thailand incorporated a company in Singapore called Tai Seng Property Pte Ltd (TSP) on 31 October 2008. Mr Thawerat owns all of the shares of TSP, whose financial year end is 31 December. Upon incorporation, TSP was immediately registered as a trader for GST purposes.

In 2008 and 2009, the following events took place:

(1) On 10 November 2008, TSP purchased an industrial property in Paya Lebar for $30m. At the time of purchase, the property was mostly tenanted. The property was purchased with the intention to hold it as a long-term investment. Accordingly it was treated as a fixed asset in the balance sheet of the company as at 31 December 2008.

(2) TSP's profit and loss account for the financial period ended 31 December 2008 showed a profit before tax of $400,000.

(3) The purchase of the industrial property in 2008 was funded by a loan of $30m from the Singapore branch of The Bangkok Bank which is a tax resident of Thailand for Singapore tax purposes. A flat interest rate of 2·5% is charged on the five-year bank loan. As security for the $30m loan on the property, the lending bank insisted on a guarantee, valued at $5m, to be issued by The Siam National Bank. Mr Thawerat maintains a fixed deposit account with a balance of $5m with The Siam National Bank, which operates in Thailand and is a tax resident of Thailand for Singapore tax purposes. In consideration for issuing the banker's guarantee in favour of the Singapore branch of The Bangkok Bank, The Siam National Bank charged TSP an annual fee of $10,000.

(4) At incorporation, Mr Thawerat and Mr KK Boon were appointed the directors of TSP. However, on 31 May 2009, the company terminated the services of Mr KK Boon over some alleged defamatory remarks about the company's performance and accordingly paid Mr KK Boon a termination payment of $200,000. The provisions in the service contract that Mr KK Boon signed with TSP cover premature termination.

Later, relying on further internal investigation of Mr KK Boon's conduct within the company, TSP sued Mr KK Boon for mishandling certain rental contracts of the units in the industrial property owned by the company. On 23 November 2009, the court cleared Mr KK Boon of any wrongdoing and accordingly awarded him damages of $150,000 and legal costs of $15,000. These amounts were accrued in TSP's 2009 financial accounts.

(5) On 1 July 2009, TSP decided to change its intention in respect of the industrial property to one of holding it for property development purposes and not as a long-term investment. This change of intention is primarily based on a feasibility study carried out on the prospects and trends of commercial properties in Singapore in the face of the current economic climate. Documentations, including minutes of board meetings, were prepared and maintained to support this change of intention. On the balance sheet as at 31 December 2009, the industrial property was recorded as a current asset of the company.

(6) As at 31 December 2009, TSP accrued director's fees of $250,000 for Mr Thawerat. This amount was not paid to him until May 2010.

(7) TSP's profit and loss account for the financial year ended 31 December 2009 showed a profit before tax of $2·5m.

Required:

(a) Explain the Singapore tax implications, including the withholding tax implications, of the above transactions of Tai Seng Property Pte Ltd for the financial periods ending 31 December 2008 and 2009. (15 marks)

(b) Explain the Singapore tax implications for Mr KK Boon in respect of the termination payment, damages and legal costs due to him from Tai Seng Property Pte Ltd. (4 marks)

(19 marks)

5 ZCars Pte Ltd (ZCars) is in the business of distributing luxurious cars. Due to the poor economic situation and the losses suffered in the past two years, the current shareholders of ZCars have decided to sell their shares in the company to two senior managers of ZCars for $3m. The target date of transfer is 1 July 2011.

As at the proposed date of share transfer, ZCars has a loan principal of $10m due to the Singapore branch of Citibank, a tax resident of the United States of America for Singapore tax purposes. The original loan amount extended by the bank to ZCars in 2005 was $20m. The funds were used to finance the working capital of ZCars. Under the loan mandate, interest at 4·5% per annum was chargeable. In addition, the bank loan is redeemable in 2015 and upon early redemption, compensation computed at 1% of the outstanding principal amount would be payable to the lending bank.

To structure the share deal, the two senior managers registered a new company called NuCar Holdings Pte Ltd (NuCar) to act as a holding company for ZCars. NuCar will be equally owned by the two managers. As the managers do not have sufficient funds to finance the acquisition, they consulted a financial advisor. The advisor, after conducting a full due diligence, proposed the following financial arrangements:

Step I
NuCar will apply to UOB Singapore for a short-term loan of $3m. The funds will be used to acquire the shares of ZCars. UOB Singapore will require NuCar to repay the bank loan within 18 months and the interest rate payable thereon will be 2·8% per annum, calculated on a straight-line basis.

The managers are confident that the luxury car market is optimistic in 2011 and that ZCars will generate sufficient profits and revenue reserves by the end of 2011 to distribute one-tier tax exempt dividends of $3m in 2012 to its holding company, NuCar, which will in turn use the proceeds to repay the short-term bank loan extended by UOB Singapore. Alternatively, ZCars could use the expected profits to provide an interest-free loan of $3m to its holding company, NuCar, in 2012 to enable NuCar to repay the short-term bank loan.

Step II
After the share acquisition, ZCars would raise funds of $13m using one of the following alternative methods:

Option I
Issue warrants to selected high net worth individuals. Every two warrants would entitle the holder to exchange during a pre-determined period, for one ordinary share of ZCars at a pre-determined exercise price. The exercise price will be fixed at 70 cents per ordinary share and this represents a discount of 30%. The professional fees associated with this exercise are estimated to be $150,000 and will have to be paid upfront.

Option II
Issue bonds to selected high net worth individual investors. The investors will be both tax residents and non-tax residents of Singapore. The coupon rate will be 2% per annum calculated on a straight-line basis. The professional fees to be incurred for this exercise are estimated to be $100,000 and will have to be paid upfront.

Option III
Obtain a bank loan from UOB secured on the trading stocks of ZCars. UOB will charge interest on the loan at a fixed rate of 2·5% per annum calculated on a straight-line basis. The professional fees involved would be minimal; however, the lending bank will charge an upfront guarantee fee, calculated at 0·1% of the principal borrowed.

The purpose of the above financial proposals is to take advantage of the high liquidity and low interest rate regime currently prevailing in the financial market. The funds raised of $13m will be used to repay the outstanding loan of $10m due to the Singapore branch of Citibank and the balance will be used to provide working capital for ZCars.

Required:

Explain the Singapore tax implications arising from the proposed transactions in Step I and Step II to be undertaken by ZCars Pte Ltd and NuCar Holdings Pte Ltd under the new ownership.

(19 marks)

End of Question Paper