



2006 SINGAPORE BUDGET COMMENTARY

INTRODUCTION

The Prime Minister and Minister for Finance (“the Minister”) Mr Lee Hsien Loong delivered his 2006 Budget Statement on 17 February 2006. To support the Government’s continuous effort to upgrade and restructure our economy, various tax and other initiatives were announced in the Budget.

CORPORATE AND BUSINESS TAX

Corporate Tax Rate

The current corporate tax rate remains at 20%.

The partial tax exemption on the chargeable income of \$100,000 is still applicable. New companies that meet certain qualifying conditions will still enjoy exemption of up to \$100,000 of their chargeable income (excluding Singapore dividends) for the first 3 consecutive Years of Assessment (“YA”) which fall within YA 2005 to YA 2009.

Foreign-Sourced Income Tax Exemption

Currently, under the foreign-sourced income tax exemption (“FSIE”), foreign-sourced dividend, foreign branch profits and foreign-sourced service income received in Singapore by a company resident in Singapore are exempt from tax provided the following conditions are met:

- i The income is subject to tax in the territory from which the income is received (“subject to tax condition”);
- ii At the time the income is received in Singapore, the headline tax of the territory from which the income received is at least 15%; and
- iii The Comptroller is satisfied that the tax exemption would be beneficial to the person resident in Singapore.

As a concession, the “subject to tax condition” is met where the income received in Singapore on or after 30 July 2004 is exempted from foreign tax as a direct consequence of a tax incentive for carrying out substantive business activities in the foreign country.



The Minister has proposed to grant tax exemption on foreign-sourced income that does not meet the conditions under the FSIE rule, if such income is remitted under specified scenarios or circumstances.

Details will be released by the Inland Revenue Authority of Singapore (“IRAS”).

Proposed Effective Date: To be announced

Writing Down Allowances for Intellectual Property Rights

Currently, a company carrying on a trade or business in Singapore is granted Writing Down Allowances (“WDA”) over a period of 5 years for capital expenditure in acquiring intellectual property rights (“IPR”). To qualify for the WDA, the company must have acquired the legal and economic ownership of the IPR. The WDA applies to IPR acquired from 1 November 2003 to 31 October 2008.

The Minister has proposed to remove the legal ownership requirement. Applications for approval are administered by the EDB.

Details will be released by the EDB.

Proposed Effective Date: IPR acquired on or after 17 February 2006

Writing Down Allowances for Cost Sharing Agreements for Research and Development Activities

Currently, where a person carrying on a trade or business has incurred expenditure under an approved cost sharing agreement in respect of research and development activities, WDA may be granted to him over 5 years period or such shorter period as may be approved.

The Minister has proposed to accelerate the write down period from 5 years to 1 year for all expenditure incurred on approved cost sharing agreements entered into and approved on or after 17 February 2006. Applications for approval are administered by the EDB.

Proposed Effective Date: 17 February 2006



Industrial Building Allowances

Previously, the claim of Initial Allowances (“IA”) and Annual Allowances (“AA”) for Industrial Building Allowances (“IBA”) are subject to some limitations.

The Minister has proposed the following changes to the IBA claim:

- i To grant IBA - IA and IBA - AA to purchases of new industrial buildings even where the leasehold interest is less than 25 years.
- ii To remove the requirement that a used building purchased must be previously used as an industrial building or structure before IBA - AA can be granted. IBA – AA will be granted based on current use of the building as a qualifying industrial building.
- iii To compute the IBA – AA based on purchase price for both new and used building rather than the cost of construction.
- iv To compute the IBA – IA based on purchase price for new building rather than cost of construction.
- v To remove the 50-year restriction for claiming AA. The restriction is now based on the amount of expenditure incurred.

**Proposed Effective Date: Buildings purchased on or after
1 January 2006**

Tax Deduction for Shared-based Compensation Payments

Currently, there is no specific provision for tax deduction in respect of cost incurred by companies in relation to employee shared-based compensation.

The Minister has proposed to grant a tax deduction to companies that have incurred actual outlay for shared-based compensation granted through treasury shares.

Details will be released by the IRAS.

Proposed Effective Date: Year of Assessment 2007

Approved Holding Companies

The Minister has announced that gains by approved holding companies (“AHC”) on the disposal of shares in approved subsidiaries will be exempt from tax, if they owned at least 50% of the shares for a period of not less than 18 months continuously.

The scheme will be administered by the EDB. The AHC status may be granted from 17 February 2006 to 16 February 2011. This concession provides tax certainty for 5 years from the date of the AHC status.



Tax Incentives

Limited Liability Partnerships

The Minister has proposed to allow tax incentives to be granted to partnerships, including Limited Liability Partnerships on a scheme-by-scheme basis. A broader-based implementation will be considered after further study.

Proposed Effective Date: This will start on a scheme-by-scheme basis

Maritime Finance Incentive

Currently, there is no tax incentive for ship financing activities. The Minister has proposed the Maritime Finance Incentive ("MFI) as follows:

- i The ship investment vehicle (e.g. a ship leasing company, a shipping fund or a shipping trust) will be able to enjoy tax exemption on its qualifying income; and
- ii The ship investment manager (e.g. a fund management company or a trustee manager) will be able to enjoy a 10% concessionary tax rate on its qualifying income.

The MFI status will be granted from 1 March 2006 to 28 February 2011 for a period not exceeding 10 years.

Details will be announced by the Maritime and Port Authority of Singapore ("MPA").

Proposed Effective Date: Year of Assessment 2007

Approved International Shipping Enterprise Incentive

The Minister has announced that the Approved International Shipping Enterprise Incentive ("AISE") status may be extended for another 10 years after the second 10-year period, thereby extending the maximum period of incentive from 20 years to 30 years. Applications for the AISE are administered by the MPA.

Proposed Effective Date: Year of Assessment 2007

Global Trader Programme

The Minister has proposed to remove the requirement for companies enjoying the concessionary tax rate of 10% under the Global Trader Programme to show that the income from over-the-counter ("OTC") derivative trades are in connection with or incidental to any physical trading before such income can qualify for concessionary tax rates.

Proposed Effective Date: Year of Assessment 2007



Promoting Financial Services

To enhance Singapore's status as a global financial centre, various incentives were proposed as follows:

Designated Unit Trust Scheme

Proposed Effective Date

The Minister has proposed to extend the Designated Unit Trust ("DUT") Scheme to certain other types of unit trusts. Specified income derived by such unit trusts granted the DUT status will be exempt from tax at the trust level. Individual will be exempt from tax on distributions out of specified income from unit trusts that are Restricted Authorised Schemes under the SFA.

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Details will be released by the MAS.

Qualifying Domestic Trusts

To enhance growth in the asset and wealth management industries qualifying domestic trusts and their underlying holding companies will be granted tax exemption on their local sourced investment income earned on or after 17 February 2006 and foreign sourced income received in Singapore on or after 17 February 2006. Any distribution made by the qualifying domestic trusts to their beneficiaries out of above income will also be tax exempt in the hands of the beneficiaries.

17 February 2006

Qualifying Foreign Trusts

The scope of the approved trustee company and the exemption for qualifying foreign trusts will be enhanced.

17 February 2006

Details will be released by the MAS.

Funds Domiciled in Singapore

To encourage fund domiciliation in Singapore, a new tax incentive will be introduced. Tax exemption will be granted on specific income from designated investments derived by funds set up in the form of companies which are resident in Singapore but "substantially owned" by foreign investors, subject to certain conditions. The window period for approval to be granted under this incentive will be from 17 February 2006 to 16 February 2011.

17 February 2006

Details will be released by the MAS.



Real Estate Investment Trusts

The scope of tax exemption granted to Singapore – Listed Real Estate Investment Trust (“REITs”) will be expanded to include foreign-sourced interest and distributions by foreign trusts paid out of income or gains related to ownership of foreign properties subject to satisfying certain qualifying conditions.

17 February 2006

Details will be released by the IRAS.

Qualifying Debt Securities Scheme

To encourage the development of short-term debt market, the Qualifying Debt Securities (“QDS”) Scheme will be expanded to include discount debt securities with tenures of more than one year.

QDS issued from
17 February 2006 to
31 December 2008

Finance and Treasury Centre

To further encourage development of Singapore capital market and treasury functions, the scope of Finance and Treasury Centre (“FTC”) will be enhanced. The list of FTC qualifying activities and services will be expanded to include trading and arranging of derivatives provided that such transactions are carried out with specified counterparties.

17 February 2006

Over-the-Counter Derivatives Clearing Facilities

To promote OTC derivatives clearing activities, a new tax incentive will be introduced. Qualifying income derived from the provision of clearing services in Singapore by approved clearing members of a Singapore OTC derivatives clearing facility would be taxed at 5% concessionary tax rate. The tax incentive period is 5 years. The window period for clearing members to qualify for this concessionary tax rate will be from 17 February 2006 to 16 February 2011.

17 February 2006

Details will be released by MAS.

Tax Treatment of Islamic Financial Products

The tax treatment of four Shariah - compliant financial products will be aligned with conventional products. Specific tax rules will be prescribed for products structured under the three Islamic financial arrangements.

17 February 2006



Tax Exemption for Approved Captive Insurance Companies

Approved captive insurance companies will be granted tax exemption on the following income:

17 February 2006

- a. Income derived from accepting insurance covering offshore risks;
- b. Dividends and interest derived from outside Singapore, the gains or profit realised from the sale of offshore investments, and interest from ACU deposits derived from:
 - i the investment of its insurance fund for offshore captive insurance business; and
 - ii the investment of its shareholders' funds used to support the offshore captive insurance business.

The tax incentive period is 10 years. The window approval period for captive insurance companies to be approved for the proposed tax exemption will be from 17 February 2006 to 16 February 2011.

PERSONAL TAX

Personal Income Tax Rates

The reduction of the top tax rates for personal income tax for years of Assessment 2006 and 2007 has been announced last year.

The personal tax rate tables for Years of Assessment 2006 and 2007 are attached in Appendix A.

Additional Tax Relief for National Servicemen

The Minister has proposed to grant National Servicemen ("NSmen") who are key appointment holders an additional tax relief of \$2,000 over and above the normal NSmen tax relief. The relief will be granted on preceding work year basis (i.e. from 1 April to 31 March).

Proposed Effective Date: Year of Assessment 2007



Income Tax concession for Industrial Design, Interactive and Digital Media Talents

To encourage creative talents, industrial design and interactive and digital media will be included as new fields qualifying for the existing tax concession that exempt 90% of the royalties earned by creative individuals. This concession is also extended to include a company in which the inventor/author beneficially owns all the issued shares. The inventions or innovations must be approved by the EDB or The Ministry of Information, Communications and The Arts to qualify for tax concession.

Proposed Effective Date: To be announced

GOODS AND SERVICES TAX (“GST”)

GST recovery for Singapore-listed REIT

Currently, where a REIT uses Special Purpose Companies (“SPCs”) to hold overseas non-residential property, any GST incurred is not recoverable.

The Minister has proposed that REITS listed in the Singapore Exchange will be able to recover the GST they incur in relation to the structuring and set-up of SPCs.

IRAS E-tax guide can be accessed at www.iras.gov.sg.

Proposed Effective Date: GST incurred from 17 February 2006 to 17 February 2010

Zero rating of Tools Supplied to Contract Manufacturers

The Ministers proposed to allow the supply of tools used in the manufacture of goods for export to be zero-rated for GST.

IRAS E-tax guide can be accessed at www.iras.gov.sg.

Proposed Effective Date: 1 April 2006

Waiver of GST on Goods Removed from Zero GST Warehouses

The Minister has decided to automatically allow GST suspension for goods removed from Zero GST Warehouses by companies who qualify under the Major Exporter Scheme or the Approved Third Party Logistics Company Scheme

Proposed Effective Date: 1 July 2006



GST Treatment of Islamic Financial Products

If a loan is used to finance the purchase of non-residential property, any increase in the selling price by the bank to the customer will be exempt from GST. Any GST that the bank incurs on the purchase of non-residential property from vendor will be recoverable in full.

Proposed Effective Date: To be announced

GST on Insurance Services

The Minister has proposed that general insurers will be allowed to claim GST as input tax as follows:

- i Cash indemnities paid to non-GST registered policy holders under insurance contracts that are subject to GST, and
- ii Expenses incurred on motor car repair services.

Proposed Effective Date: Insurance policies entered into or after 1 January 2007

OTHERS

Record-Keeping Period

The Minister has proposed to reduce the record-keeping period generally to 5 years in 17 statutes.

Proposed Effective Date: To be announced

Transfer Pricing

IRAS E-tax guide on transfer pricing can be accessed at www.iras.gov.sg.

Important Note:

As the Budget proposals are yet to be legislated, this commentary should be used only as a guide. This commentary is prepared for clients and staff of MHC Tax Services Pte. Ltd. It is not intended to be comprehensive. Whilst every effort has been made to ensure the accuracy of information contained in the commentary, no responsibility can be accepted for any errors or omissions. Readers are advised that the contents of this article should not be relied on or acted upon without professional advice. No liability can be accepted for any action taken as a result of reading this article without prior consultation with regard to all relevant factors.

**Rates of Income Tax for Resident Individuals
YA 2006 and YA 2007**

	Chargeable Income \$	YA 2006		YA 2007	
		Tax Rate	Tax	Tax Rate	Tax
		%	\$	%	\$
On the first	20,000	0.00	0	0.00	0
On the next	<u>10,000</u>	3.75	<u>375</u>	3.50	<u>350</u>
On the first	30,000		375		350
On the next	<u>10,000</u>	5.75	<u>575</u>	5.50	<u>550</u>
On the first	40,000		950		900
On the next	<u>40,000</u>	8.75	<u>3,500</u>	8.50	<u>3,400</u>
On the first	80,000		4,450		4,300
On the next	<u>80,000</u>	14.50	<u>11,600</u>	14.00	<u>11,200</u>
On the first	160,000		16,050		15,500
On the next	<u>160,000</u>	18.00	<u>28,800</u>	17.00	<u>27,200</u>
On the first	320,000		44,850		42,700
Excess over	<u>320,000</u>	21.00		20.00	