

Tax Alert

SINGAPORE

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In this issue, KPMG Tax Services highlights the enhancements made to the Financial Sector Incentive (FSI) scheme, as detailed in the Monetary Authority of Singapore (MAS) circulars issued on 12 May 2009 and 28 May 2009. These circulars were issued following the Singapore Budget 2009 announcement by the Minister for Finance on 22 January 2009.



Changes to the FSI scheme

Financial Sector Incentive-Credit Facilities Syndication (FSI-CFS) scheme

As part of its policy to refine the FSI scheme and make it more relevant to the changing business environment, the Singapore Government has decided to enhance the FSI-CFS scheme to address certain practical issues pertaining to its application.

Commodity Derivatives Trading (CDT) scheme

Capitalising on a well-received incentive scheme since its introduction in 2004, the Government has enhanced the CDT scheme. This is to stimulate interest and growth in the derivatives trading market in Singapore. Amongst the enhancements introduced, the CDT is now subsumed under the Financial Sector Incentive-Derivative Market (FSI-DM) scheme.

Financial Sector Incentive-Headquarters (FSI-HQ) award

Continuing with efforts to promote Singapore as the choice location for headquarter functions of global firms, the Government has also enhanced the FSI-HQ award. This is to position Singapore as an even more attractive location for global firms from which to expand their regional operations.

Details of these enhancements are provided in the MAS circulars dated 12 May 2009 and 28 May 2009. We summarise the salient features of the circulars below.

Enhancements to the FSI-CFS scheme

For any qualifying syndicated offshore credit facilities signed on or after 1 May 2009, the following changes to the FSI-CFS scheme apply:

- **Usage of proceeds from the facility**

Under the existing FSI-CFS scheme, a concessionary tax rate of five percent is granted to income derived by a FSI-CFS company from arranging, underwriting and granting loans under a qualifying syndicated offshore facility. Amongst other qualifying conditions, the loans or funds made available under the facility must be used outside Singapore, before the facility could be regarded as a qualifying syndicated offshore facility. If any portion of the loans or funds is used to settle expenses incurred for services rendered in Singapore, the facility may not be regarded as a qualifying syndicated offshore facility. The concessionary tax rate of five percent would then not apply.

However, it is not uncommon for borrowers to use a small portion of the syndicated facility proceeds onshore for settlement of certain incidental expenses incurred in connection with the facility. The scheme has thus been enhanced to include a facility as a qualifying syndicated offshore credit facility if:

- the proceeds from the facility used in Singapore are solely for the purpose of paying professional fees (such as legal and accounting fees) and the first interest payment; and
- the proceeds used in Singapore for the abovementioned purposes are not more than 10 percent of the total proceeds from the facility.

Notwithstanding this, only the portion of qualifying income arising from the proceeds used offshore would be accorded the five percent concessionary tax rate.

- **Credit facility not syndicated at the outset**

Amongst other qualifying conditions, a facility must be underwritten and syndicated at the outset in order to be regarded as a qualifying syndicated offshore credit facility. However, in certain instances, due to commercial constraints and difficulties, the syndicate may not be formed in time even though all the parties may have indicated their intention at the outset to participate in the facility. Consequently, the income derived by the FSI-CFS company would not qualify for the five percent concessionary tax rate.

The FSI-CFS scheme has therefore been refined to include a credit facility which is not syndicated at the outset, but that the arranger, underwriter or the agent bank has a clear intention to syndicate the facility within six months from the date of signing of the initial loan agreement. To qualify, the agent bank or Singapore arrangers are required to submit a declaration within one month from the date of signing of the initial loan agreement of their intent to syndicate the facility within six months from that date.

KPMG Comments

- Whilst the enhancements introduced are generally positive measures, more details concerning the enhancements would need be provided for greater clarity concerning their applications:
 - Apart from citing legal and accounting fee as an example, there are no clear definitions or guidelines on what constitutes professional fees. This would give rise to uncertainties and possibly additional administrative burdens on the FSI-CFS company to gather the relevant information to substantiate the usage of the proceeds.
 - There may be greater varieties and flexibilities in the price structuring of syndicated loans. This is because of the increasing level of diversity and sophistication in the way loan arrangements are being packaged in the current financial market. One example is where the borrower could be levied with an upfront 'bullet interest payment' (i.e. first interest payment) followed by lower interest payments for the remainder of the loan tenure. Under such circumstances, where the "bullet interest payment" is substantial and deducted upfront from the proceeds of the facility, the 10 percent threshold on onshore usage may be breached for the qualifying syndicated offshore credit facility;.
 - Increasingly, the costs of borrowing are no longer confined to just interest expenses. Other borrowing costs such as guarantee fees, option fees, discounts or premiums and front end fees are now features commonly found in loan facilities. It is therefore critical for MAS to consider whether such borrowing costs would be regarded as akin to interest costs for the purposes of meeting the usage criteria under the FSI-CFS scheme. It would appear to be somewhat restrictive if only interest costs are allowed.
- As only income arising from the proceeds used offshore would qualify for the five percent concessionary tax rate, there is a need for FSI-CFS companies to apportion their income derived from proceeds used onshore and offshore:
 - This requirement is administratively cumbersome and may appear unjustifiable as it is generally perceived that the test should be on the purpose for which the syndicated loans are to be used. Further, the reasons why part of the proceeds are used in Singapore are purely to facilitate the loan arrangements. An administrative concession should be extended to include the proceeds used for the settlement of such initial expenses pertaining to the loans to be offshore usage instead. This would demonstrate the Singapore Government's support for developing the local debt market and promoting simplicity.
 - MAS may wish to consider relaxing the rule where the suggestion for an administrative concession in the preceding paragraph is not feasible, by allowing all income derived from the syndicated loans - whether arising from proceeds used onshore or offshore, to qualify for the five percent concessionary tax rate.

Enhancements to the CDT scheme

Under the existing CDT scheme, a five percent concessionary tax rate is granted to an approved company on its income derived from:

- **trading with or providing services as an intermediary** for qualifying counterparties in over-the-counter (OTC) and exchange traded commodity derivatives
- **trading on or after 24th May 2007 with any person in OTC commodity derivatives**, where the trade is cleared on or after that date through the SGX AsiaClear Facility of the Singapore Exchange Derivatives Clearing Limited
- **incidental physical trading with qualifying counterparties** if such physical trades are not more than 15 percent of total trades.

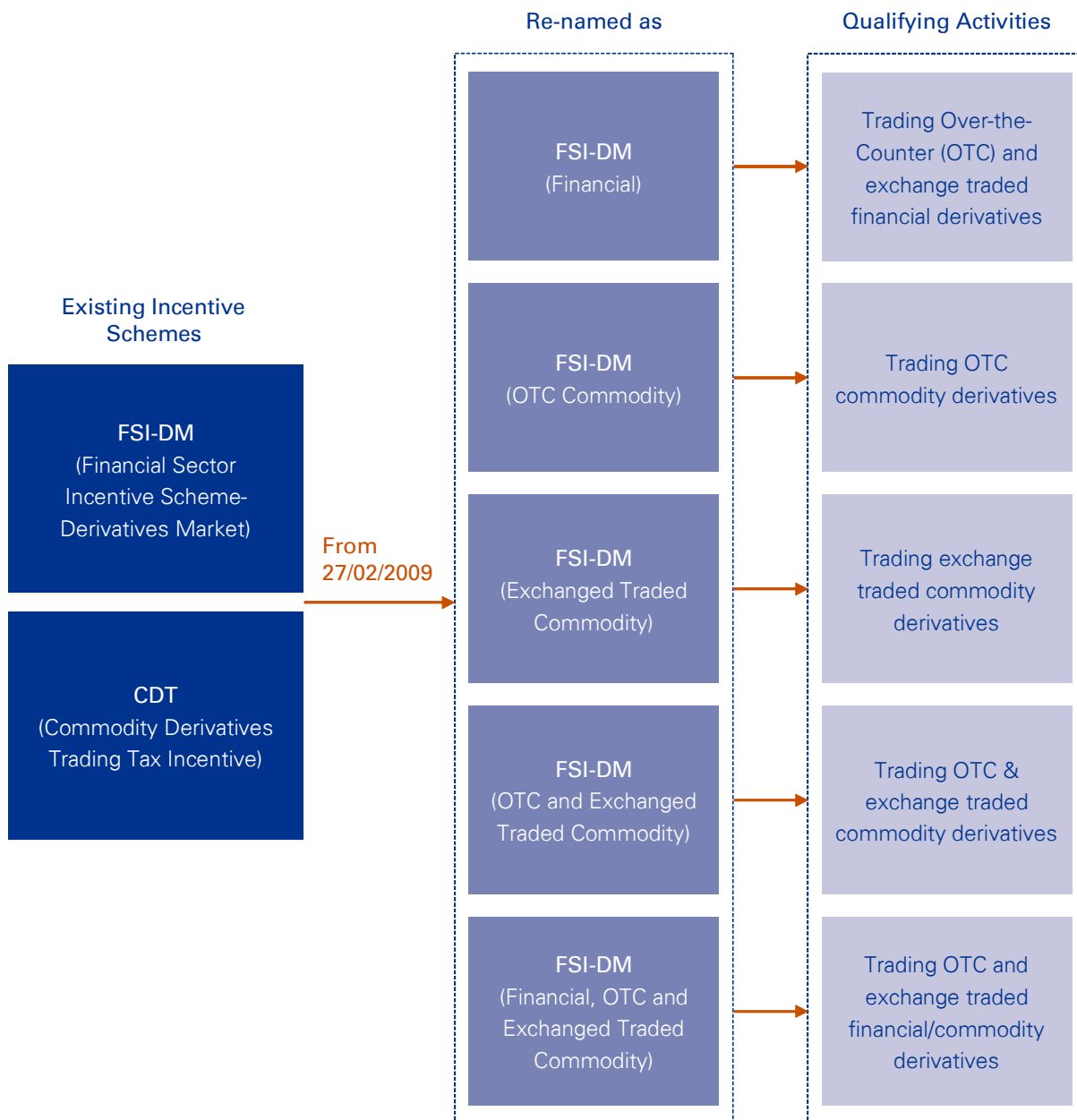
Apart from extending the CDT scheme from 27 February 2009 to 31 December 2013, the following enhancements have been introduced with effect from 27 February 2009:

- **The five percent concessionary tax rate has been extended** to an approved company that:
 - trades in exchange traded commodity derivatives where that approved company is a member of a qualifying exchange¹
 - provides services as an intermediary in connection with transactions relating to exchange traded commodity derivatives between qualifying persons and a qualifying exchange.
- **The scope of commodity derivatives covered** under the CDT scheme has been extended to include emission derivatives.
- **The qualifying conditions for new applicants** carrying out qualifying activities in relation to exchange traded commodity derivatives only have been aligned with those carrying out OTC commodity derivative trades only.
- **The CDT scheme has been subsumed under the FSI-DM scheme** and with that, the FSI-DM scheme has been expanded to five sub-categories as follows:

¹ A qualifying exchange refers to a corporation which has been:

- a. approved as an approved exchange;
- b. recognised as a recognised market operator; or
- c. exempted from being an approved exchange or a recognised market operator under the Securities and Futures Act

We append below diagrammatically the changes to the administration of the FSI-DM and CDT tax incentive schemes:



KPMG Comments

- **The enhancements to the CDT schemes would simplify** the administration and should encourage more commodity derivatives trading activities in Singapore. In particular, the extension to an approved company which is either a member of a qualifying exchange or provide services as an intermediary between qualifying persons and a qualifying exchange as well as the alignments of qualifying conditions for new applicants.

- **The inclusion of emission derivatives** such as carbon credits as commodity derivatives covered under the CDT scheme is appropriate and consistent with the growing business trend. Despite it being less common in this part of the world, carbon credits trading has become a billion dollar market globally.

As companies and investors became more aware of sustainable development and the need to mitigate the effects of climate change, there is a huge growth potential in such emission derivatives trading market. Complemented by the recent introduction of Singapore's third derivatives bourse, the Singapore Mercantile Exchange provides a platform for investors in Singapore to trade in carbon credits. This enhancement is timely and serves to complement Singapore's bid to become a comprehensive commodities trading centre and reinforce the stature of Singapore as a global financial centre.

- **The introduction of five sub-categories under the FSI-DM scheme allows greater** flexibility to the applicants. Applicants who only intend to engage in the trading of either financial or commodity derivative would find it easier to qualify for the FSI-DM scheme as the qualifying criteria is less stringent in comparison to those who intend to trade in both financial and commodity derivatives.

Clarification on Financial Sector Incentive-Standard Tier (FSI-ST) scheme

The MAS has also taken this opportunity to clarify its position on the following:

- **Income derived from the sale of foreign equity securities**

Prior to the implementation of the FSI scheme on 1 January 2004, the income derived by an approved Equity Capital Market Intermediary (ECMI) company from the sale of qualifying foreign stocks, shares and other securities to qualifying counterparties was taxed at the concessionary tax rate of 10 percent.

The MAS has now clarified that pursuant to the implementation of the FSI scheme, similar income derived by a FSI-ST company would continue to enjoy the concessionary tax rate of 10 percent under the FSI scheme.

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- **Under the FSI Regulations, only income derived by a FSI-ST company** from the arranging, managing, underwriting, selling or providing other services (including services as a broker, nominee or custodian) in respect of foreign equity securities would qualify for the concessionary tax rate of 10 percent.

In this connection, the MAS has previously stated in a circular that selling generally refers to acting as selling agent while trading means proprietary buy and selling. This resulted in a disparity as an ECMI company which engages in the trading of foreign equity securities would no longer enjoy the 10 percent concessionary tax rate when it transits into the FSI scheme. The latest clarification would align the tax treatment for income arising from trading of foreign equity securities under the ECMI scheme to the FSI-ST scheme.

Enhancements to the FSI-HQ award

The existing qualifying criteria for the FSI-HQ award prior to the enhancements are relatively restrictive. This is despite the success of the FSI-HQ incentive (and other previous headquarter services related incentives) in attracting financial institutions to manage and control their regional and global operations from Singapore. With the changing landscape of the financial services sector, the FSI-HQ award has now been enhanced in the following manner:

- **Change in eligibility conditions for FSI-HQ award**

Prior to the enhancements made, a company would generally not qualify as a FSI-HQ company if:

- it is not licensed by the MAS or is exempted from such licensing/approval under any Act; and
- it provides treasury, investment or financial services in Singapore to any of its offices or associated companies.

These conditions have now been refined and would include a company which apply for or renew the FSI-HQ award from 22 January 2009 to 31 December 2013 and that is:

- wholly owned, directly or indirectly by, or wholly owns directly or indirectly, a company that is licensed or approved by the MAS or by the financial supervisory authority in its home country; and
- provides treasury, investment or financial services in Singapore for any of its offices or its associated companies.

- **Withholding tax exemption for qualifying loans**

Under Singapore income tax rules, companies (including FSI-HQ companies) are required to withhold tax on interest payments made on loans from non-resident lenders. With the latest enhancement, FSI-HQ companies may now apply for withholding tax to be exempted on interest payments on qualifying loans. The exemption is subject to approval on a case-by-case basis.

The exemption would be available on interest for qualifying loans where the loan agreements take effect between 22 January 2009 to 31 December 2013, and as long as the debtor remains a FSI-HQ company.

For the purpose of the exemption, a qualifying loan is defined as:

- a loan that is denominated in currencies other than Singapore dollar
- the loan is from:
 - any of the FSI-HQ company's qualifying overseas associated companies or offices
 - any bank outside Singapore
 - any non-bank financial institution outside Singapore which is not the FSI-HQ company's associated company office; and
- the funds obtained from the loan are used for the FSI-HQ company's qualifying services.

- **Inclusion of Singapore-based associated companies and offices of a FSI-HQ company**

Before 22 January 2009, where an FSI-HQ company provides headquarter services to its offices or associated companies in Singapore, the income derived by the FSI-HQ company from the provision of such headquarter services is subject to tax at the prevailing normal corporate tax rate.

With the enhancements, income derived by a FSI-HQ company on, or after 22 January 2009 from the provision of qualifying headquarter services to Singapore based associated companies and offices (collectively known as local network companies), is now to be taxed at the concessionary tax rate of 10 percent under the FSI-HQ award.

Notwithstanding, the inclusion of local network companies are subject to the MAS' approval. The tax concession is also on the condition that the total annual revenue of the local network companies does not exceed 10 percent of the group's total annual revenue (revenue ratio).

- **Merger of tax incentive scheme for qualifying processing company (QPC) with the FSI-HQ award**

As part of the enhancements to the FSI-HQ award, the QPC scheme is subsumed under the FSI-HQ award with effect from 22 January 2009.

Pursuant to the above, prescribed processing services provided by a FSI-HQ company would be considered as a qualifying service for the purpose of the FSI-HQ award. All income derived from the provision of prescribed processing services is now taxed at the concessionary tax rate of 10 percent under the FSI-HQ award instead of five percent under the old QPC scheme.

With effect from 22 January 2009, income derived by FSI-HQ companies in the provision of prescribed processing services to any financial institution or other FSI-HQ company is also subject to tax at the concessionary tax rate of 10 percent.

Notwithstanding this, all companies approved under the existing QPC scheme on or before 26 February 2009 continue to enjoy the benefits of the QPC scheme until the expiry of their respective tenures. Thereafter, they may reapply for renewal under the FSI-HQ award.

KPMG Comments

- **The enhancements to the FSI-HQ award on a whole are positive measures** taken by the Singapore Government to enhance the attractiveness of Singapore to foreign investments. However, the introduction of 10 percent revenue ratio restriction may create uncertainties to whether the tax incentive would apply year after year. This is so as the revenue ratio may be drastically affected by any local business expansion, or down-sizing of overseas network companies' operations as a result of adverse business conditions. To provide greater certainty to the tax incentive scheme in a bid to attract more headquarters activities to Singapore, it may appear that the 10 percent revenue ratio is a bit too low. This is given that Singapore may be one of the major revenue generating centre for the group operations as it is one of the major financial centres in the region.
- **With the merger of the QPC scheme and FSI-HQ award**, existing QPC companies would no longer be able to enjoy the concessionary tax rate of five percent going forward when their existing tenure expires. Given the Government's emphasis of developing Singapore as a premier centre for headquarter activities, the tax incentive for QPC companies would now appear less attractive. Having a five percent concessionary tax rate for the merged FSI-HQ scheme could possibly be more appealing for investors.
- **The withholding tax exemption for qualifying loans is definitely a welcomed move** as it would enable FSI-HQ companies to take on a more proactive and effective role in regional funding arrangements within the group. However, the exemption is still subject to a case-by-case approval by the relevant authority upon application of each loan arrangement. To provide more certainty on the withholding tax exemption and enable FSI-HQ companies to react swiftly to business requirements, it may be appropriate to consider waiving the approval process and instead, having a blanket withholding tax exemption on qualifying loans subject to a set of conditions.

Conclusion

The enhancements to the FSI scheme as highlighted in this alert are in line with the Singapore Government's ongoing policy to refine and streamline the existing tax incentives applicable to the financial sector.

On the whole, the enhancements are encouraging and positive. This is taking into account the steps taken by the Singapore Government in its effort to enhance the relevance of these incentives to the ever changing landscape of the financial services sector.

Notwithstanding this, it is also important for the Government to keep track of the development in the financial services market and practical issues that may be encountered by market players concerning the application of tax incentives.

It is important that Singapore has a good spread of tax incentive schemes to attract financial institutions to set up regional operations here and it is equally critical that there is clarity in the administration of these incentives.

Contact us

KPMG Tax Services can help

As a committed tax advisor to our clients, we welcome the opportunity to discuss the relevance of the Financial Sector Incentive Scheme to your business and other local and cross-border investment related tax issues.

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