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Group Taxation: IFA Singapore Branch Report

Cecil Duncan MACRAE

Singapore Management University, cdmacrae@smu.edu.sg

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Group Taxation: IFA Singapore Branch Report

Branch Reporter: C. Duncan MacRae*

1. Introduction

Under the income tax system of the Republic of Singapore (Singapore), each company is considered a separate legal entity and taxed independently. Until recently there was no direct method for corporate groups to offset loss items of one company against the taxable profits of another company within the same group. Effective with year of assessment (Y/A) 2003, however, a loss-transfer system of group relief was introduced in Singapore to reduce the effective tax rate for corporate groups and encourage more risk-taking and enterprise.[1] Under this group relief system, a company which is a member of a group may transfer its current year unutilized loss items to another company in the group with the same accounting year end. An objective of this report is to examine this direct method for offsetting loss items of a corporate group against profits of the group. Not all groups of companies subject to Singapore income tax are eligible to use the group relief system. An additional objective is to examine the tax implications of certain indirect methods to offset loss items of a group against income of the group.

2. Groups of companies

It is not unusual for firms doing business in Singapore to be organized into groups of companies to reflect the management of their business and to limit liabilities. In some cases holding structures must be formed for regulatory reasons. For example, a separate company must be set up for each residential development project undertaken by a project developer.[2]

The Government of Singapore (Government) is not unfriendly to corporate combination. Singapore does not currently have a broad based anti-trust law. Regulation of competition is limited to the telecommunications, media, and electricity sectors. However, the Government is committed to having a generic competition law by 2005.[3]

The Government welcomes multinational enterprises carrying out operations in Singapore. Singapore is home to over 6,000 multinational corporations. The Government is keen on having multinational enterprises maintain their regional headquarters in Singapore. Of the multinationals in Singapore, 60% have regional responsibilities and headquarters functions.[4]

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* Practice Associate Professor of Law, Singapore Management University

[1] Minister of Finance, *Budget Statement 2002 – A Budget for a Different World.*

[2] *Ibid.*

[3] *United States-Singapore Free Trade Agreement.*

[4] Economic Development Board, *Media Release*, 13 August 2003.

3. Basics of company income taxation

This section provides essentials of company income taxation under the Income Tax Act (ITA)[5] necessary to examine the group taxation regime in later sections. This branch report does not consider the taxation of specialized businesses under the ITA, or the investment incentives provided under the Economic Expansion Incentives (Relief from Income Tax) Act (EEIA).[6] This report also does not consider transition provisions in the ITA, particularly with regard to the phasing out of the imputation system of company taxation.[7] All section references are to the ITA unless otherwise stated. All money measures are in Singapore dollars.

3.1. Basic concepts

The income tax system of Singapore employs a territoriality principle of taxation. Under section 10(1), income tax is payable on the income of any person accruing in or derived from Singapore (Singapore income) or received in Singapore from outside Singapore. Thus, if income is sourced outside of Singapore (overseas income), it is not charged with tax until it is received in Singapore. The taxation of overseas income is briefly discussed in 6.1.

Under section 2, the term "person" includes a "company," which means "any company incorporated or registered under any law in force in Singapore or elsewhere." The residence of a company is based, not on where the company is incorporated, but where the management and control of the company is exercised. Thus, a resident company is a company whose management and control is exercised in Singapore. In general, a non-resident company is given the same tax treatment as a resident company. Differences in tax treatment are briefly described in 6.2.

Income earned in a year is assessed to tax in the next Y/A. Thus, the group relief system only became effective with income earned in 2002. Under section 43(1), the prevailing corporate tax rate for Y/A 2003 is 22%. The base on which this rate is applied is referred to as "normal chargeable income." The Government has indicated it will reduce the corporate tax rate to 20% by Y/A 2005.[8]

3.2. Income

Singapore does not have a capital gains tax. Only revenue receipts, and not capital receipts, are subject to tax. In general, receipts from the sale of fixed assets of a business are capital receipts. However, receipts from the sale of trading stock are revenue receipts.[9] Under the income tax, trade income is distinguished from non-trade income. Certain "badges of trade" are taken into account in determining whether a person is carrying on a trade.[10] Dividends are distributions of a company's profits to its shareholders. Proceeds from liquidation are capital receipts. Dividends are Singapore

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[5] Chapter 134, 2001 revised edition.
[6] Chapter 86, 2001 revised edition.
[7] *See* M. Khaw, *Corporate tax rate and tax base: Singapore*, International Fiscal Association, 2003 Sydney Congress, for an examination of the imputation system in Singapore.
[8] Minister of Finance, *Budget Statement 2003 – Seizing Opportunity in Uncertainty*
[9] Sum Y. L, *Singapore Tax Workbook*, 6th edition 2003, ¶ 301.
[10] *Ibid.* ¶ 303.

income if they are made by resident companies.[11] Under section 13(1), dividends paid under the one-tier system by resident companies are exempt from income tax. Under section 13, certain other income is also exempt from tax.

3.3. Deductions

The income tax system in Singapore employs a source principle of taxation. Income is determined after deducting the allowable expenses incurred in producing that income. Under section 14(1) an expense is deductible only if the expense is wholly and exclusively incurred in the production of income. Interest expense incurred in financing a non-income producing asset is not deductible. Under section 15, a capital expense is not deductible. Depreciation is not deductible. Certain other expenses are not allowed.

The statutory income of the company is the total of the company's income from all sources (net of deductible expenses).[12]

3.4. Capital allowances

While depreciation is not an allowed expense, capital allowances can be claimed in respect of certain fixed assets of a business under Part VI of the ITA. Under sections 16 and 19, initial allowances upon the incurrence of cost cannot be deferred, but need not be claimed. Annual allowances over the life of the asset may be deferred. Under section 19A, accelerated allowances can be deferred, but once claimed must continue to be claimed. Under sections 17 and 20, there may be balancing allowances or charges upon the sale or cessation of use of a fixed asset upon which capital allowances have been claimed.

3.5. Taxation of business

Under section 37, capital allowances and trade losses brought forward (b/f) and current year allowances and losses can be set off against the statutory income of the company. While donations are not allowable as expenses of the company, approved donations b/f and current year donations may also be set off against the company's statutory income. The assessable income of the company before group relief is the company's statutory income net of these setoffs. Under section 37C, current year unabsorbed capital allowances, trade losses, and approved donations can be transferred. The normal chargeable income of the company is assessable income after these group relief transfers. Under section 43(5), a partial tax exemption of up to $52,500 of a company's normal chargeable income is available prior to the application of the prevailing corporate tax rate of 22%.

4. Group taxation regime

This section examines the mechanism of the group taxation regime in Singapore.

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[11] *Ibid.* ¶ 311.
[12] *Ibid.* ¶ 103.

4.1. General information

In December 2001 the Government established the Economic Review Committee (ERC), comprised of members from the public and private sectors with terms of reference including a review of policies regarding taxation. In April 2002 the ERC subcommittee concerned with tax policy (ERC Subcommittee) recommended the implementation of a group relief system with the objectives of giving companies the flexibility to use subsidiaries to start new ventures and encouraging innovation.[13] Possible parameters of the system included a shareholding requirement of 75 percent and transferring 100% of current year unutilized capital allowances and losses. The Minister of Finance (Minister) announced the Government's adoption of the ERC Subcommittee's recommendation for a group relief system in his May 2002 Budget Speech. The Government estimated that group relief would cost $170 million per year.[14]

The group relief system works against a backdrop of company/corporate law laid out in the Companies Act (CA).[15] Companies incorporated in Singapore (domestic companies) are governed by the CA.[16] The CA makes a distinction between "companies" and "corporations." "Only those sections that are stated to apply to 'corporations' apply to a foreign company."[17] The group relief system does not apply to foreign companies. Therefore, no distinction will be made in this report between "companies" and "corporations."

Under the CA, a corporation is related to another corporation if it is in a holding-subsidiary relationship, or if it is a subsidiary of a common holding company. A holding-subsidiary relationship exists if the holding corporation: 1) controls the composition of the board of directors of the subsidiary; 2) controls more than 50% of the voting power of the subsidiary; or 3) owns more than 50% of the issue share capital of the subsidiary (not counting non-voting preference shares). Related corporations may be referred to as a group, but there is no definition of a "group" in the CA.[18] The legitimacy of setting up holding company-subsidiary relationship to minimize liabilities has been established in Singapore.[19]

The general rule is that "companies within a group are still separate legal entities even if the group is managed as a single entity for operational purposes."[20] A holding company does not own property of its subsidiary. "A business run by a subsidiary is not to be considered the holding company's business."[21] In certain cases, however, a group of companies may be treated as a single corporate entity. For example, the CA requires that consolidated accounts must be prepared in respect of the group consisting of a holding company and its subsidiaries.[22] "[I]t is permissible for directors (especially directors of a

[13] Economic Review Committee: Subcommittee on Policies Related to Taxation, the CPF System, Wages & Land, *Restructuring the Tax System for Growth and Job Creation*, 11 April 2002, p. 30.
[14] Minister of Finance, *Budget Statement 2002*, p. 27.
[15] Chapter 50, 1994 revised edition.
[16] W. Woon, *Company Law*, 2d edition 1997, p. 3.
[17] *Ibid.* p. 21.
[18] *Ibid*. pp. 11-12.
[19] *Ibid.* p. 62.
[20] *Ibid.* p. 47.
[21] *Ibid.* p. 49.
[22] *Ibid.* p. 69.

holding company) to consider the interest of the group as a whole when making decisions, as long as they do not sacrifice the interests of any company within a group. . . . The reason for this is that each company within the group has its own set of creditors."[23]

In addition to the group relief system under the ITA, there is a group registration system under section 30 of the Goods and Services Tax Act.[24] The Goods and Services Tax (GST) is a consumption tax on the supply and import of goods and services in Singapore. Businesses that are registered for GST collect the tax at each stage of the transaction process involving a good or service. Under the group registration system, registered businesses who qualify need only complete one GST return for the group, ignoring inter-company transactions.[25]

There is also relief under section 15 of the Stamp Duties Act from ad valorem stamp duty on transfer of shares upon reconstruction or amalgamation of companies and transfer of assets between associated companies.[26]

As discussed in 4.3, a claimant company may make subvention payments to the transferor company for the loss transferred. IRAS has indicated that the transfer of the losses for compensation will not be subject to GST as long as the consideration is not in the form of services.[27]

4.2. Scope and availability

Companies may qualify for group relief if they 1) belong to the same group of companies and 2) have the same accounting year end.[28] A group consists of a domestic company, i.e., a company incorporated in Singapore, and its domestic company group members. Two domestic companies are members of the same group if: a) at least 75% of the ordinary share capital in one company is beneficially held, directly or indirectly by the other; or b) at least 75% of the ordinary share capital in each of the two companies is beneficially held, indirectly by a third domestic company. The ERC Subcommittee thought that a 75% threshold would make the Singapore group relief system as competitive as most other group taxation regimes in the world.[29] Companies may be members of more than one group. In addition to foreign companies, certain specialized companies taxed under the ITA and certain companies receiving investment incentives under the EEIA are excluded from group relief.

In determining whether the 75% shareholding requirement is satisfied, two tests are applied: Ordinary Shareholding Requirement (First Level Test); and Profits and Assets Test (Second Level Test). In determining ownership, any holdings by foreign companies are disregarded. Any shareholdings of a company held by an individual or not a

[23] *Ibid.* p. 275.
[24] Chapter 117A, 2001 revised edition.
[25] *See* Sum Y. L., *op. cit.*, ¶ 1918.
[26] Chapter 312, 2000 revised edition.
[27] IRAS Circular "Goods and Services Tax Treatment of Transfer for a Consideration of 'Qualifying Deductions' Allowed Under the Income Tax Group Relief System", *e-Tax Guide*, 2003/GST/3, issued on 16 July 2003, paragraph 7.
[28] This and the following subsection are largely drawn from the IRAS Circular "Loss Transfer System of Group Relief", *e-Tax Guide*, 2002/BC/6, issued on 23 October 2002.
[29] ERC Subcommittee, *op. cit.,* p. 31.

company, e.g., a trade association, are also not taken into account. The 75% shareholding requirement must be satisfied at the end of the basis period, i.e., accounting period, for the Y/A. In the First Level Test only ordinary shares are taken into account. Ordinary shares are shares that have a right to share in profits not based on a fixed quantum or fixed rate percentage. In the Second Level Test holders of ordinary shares must demonstrate that they are beneficially entitled, directly or indirectly, to at least 75% of i) any residual profits of the company available for distribution to the company's equity holders, and ii) any residual assets of the company available for distribution to the company's equity holders upon winding up. Equity holders include creditors entitled to variable profit participation.

Group relief is elective on a company by company basis. Each eligible transferor company elects by filing with its company income tax return a transferor group relief form stating the total loss items it wishes to transfer, and listing in ascending priority order the claimant companies to which it wishes to transfer the loss items. Each eligible claimant company elects by filing with its company income tax return a claimant group relief form listing the transferor companies from which it wishes to claim the loss items. For the companies listed, the only requirements are: 1) they have the same accounting year end as the company completing the form; and 2) they have membership in a group with the company completing the form. The elections are final and irrevocable.

Companies who are members of a group and have the same accounting year end agree to transfer the loss items by the way they complete their forms. A transferor company will not be able to transfer the loss items to a claimant company unless the claimant company includes the transferor company on the claimant company's list of companies from which it can claim the loss items. Similarly, a claimant company will not be able to claim the loss items from a transferor company unless the transferor company includes the claimant company on the transferor company's list of companies to which it can transfer the loss items. Even if eligible entities agree to transfer the loss items from or to one another, whether the transfer takes place depends on the priority orderings and the amount of loss to be transferred.

The group relief system works on a Y/A basis. Eligibility is done Y/A by Y/A. Elections are made on a Y/A by Y/A basis. Loss items are transferred on a Y/A by Y/A basis.

Only current unabsorbed capital allowances, trade losses, and approved donations can be transferred. Prior years' unabsorbed losses/capital allowances/approved donations cannot be transferred. The following items cannot be transferred: losses attributable to operation of foreign branches; investment allowances under the EEIA; losses regarding exempt income activities; and losses in certain activities or trade that are only deductible against assessable income from the activities or trade.

The group relief system allows transfer of 100% of the current year unutilized trade losses/capital allowances/approved donations. The ERC Subcommittee thought that transferring anything less than 100% of the current unabsorbed loss items, if there were minority shareholders outside the corporate group, would "bring about additional

administrative complexities, including the issue of how much loss to be transferred to sibling companies (since sibling companies do not own each other)."[30]

4.3. Basic operation

Under the group relief system, parent and subsidiaries continue to be separate taxpayers, each keeping their own books and accounts and submitting their own company tax returns. Each company is responsible for its own tax liability. The tax liability of a group is simply the sum of the tax liabilities of the members of the group. There is no anti-fragmentation provision in the ITA so that each company can, as described in 3.5 above, exempt up to $52,500 of chargeable income, whether or not they are related to other taxpayers.

Protections for creditors and minority shareholders of transferor companies may require claimant companies to make subvention payments to the transferor companies. Under the CA, directors do not have duties *per se* to creditors. However, "if directors act in a manner that prejudices the creditors of the company when the company is insolvent, they may be held to be guilty of a misfeasance."[31] Under the CA, shareholders who are registered have the rights of membership.[32] These rights include the rights to vote at general meetings and to be treated fairly.[33] Normally the will of the majority of members voting prevails. However, the CA provides protection to minority members from potential abuse of the majority's voting power.[34] As IRAS has articulated for purposes of the Goods and Services Tax (GST), discussed in 4.1, the transfer of loss items may be viewed as the transfer of a "business asset" with value from the transferor company to a claimant company, because the loss items could have been utilized against future income of the transferor company and will be utilized against current income of the claimant company.[35] If the loss items are transferred without subvention payments, the rights of creditors or minority members of the transferor company may be violated. For purposes of the income tax, IRAS sees no requirement for subvention payments. However, if these payments are provided for non-tax reasons, they are neither deductible to the claimant company nor assessable as income for the transferor company.

Profits and losses of companies in a group are not consolidated. Receipts, exemptions, deductions, allowances, and credits are calculated on a separate company basis and adjusted afterwards to reflect the transfer of group loss items. Intra-group transactions are not netted out. The prevailing tax rate of 22% applies to all companies, whether or not they are members of a group.

Under the general anti-avoidance provision section 33, the Comptroller of Income Tax (Comptroller) is empowered to disregard or vary an arrangement if the purpose or effect of the arrangement is to 1) alter the incidence of any tax payable, 2) relieve any person of tax liability, or 3) reduce or avoid any tax liability which would otherwise have been

[30] *Ibid.* note 11.
[31] W. Woon, *op. cit.*, p. 272.
[32] *Ibid.* p. 141.
[33] *Ibid.* p. 148.
[34] *Ibid.* p. 159.
[35] IRAS Circular "Goods and Services Tax Treatment of Transfer for a Consideration of 'Qualifying Deductions' Allowed Under the Income Tax Group Relief System," *op. cit.,* paragraph 5.

imposed. However, this section does not apply to any arrangement carried out for bona fide commercial reason. Factors the Comptroller would consider in deciding whether to disregard or vary an arrangement under section 33 include "whether artificiality is present; whether various intermediaries or transactions have been interposed to reduce or avoid tax; and whether transfer pricing has occurred."[36] Other relevant avoidance provisions in the ITA are discussed in the following subsections.

4.4. Issue: loss items

In determining the chargeable income of a company, capital allowances, trade losses and approved donations are set off against the gains or profits from all sources, i.e., statutory income, of the company in the following order: (a) unabsorbed capital allowances brought forward (B/F) from a prior Y/A followed by capital allowances for current Y/A; (b) unabsorbed trade losses B/F from a prior Y/A followed by trade losses for current Y/A; and (c) unabsorbed approved donations B/F from a prior year followed by approved donations for current Y/A. What can be transferred are 1) current Y/A unabsorbed capital allowances, 2) current year unabsorbed trade losses, and 3) current year unabsorbed donations.

The example below illustrates the order of setoff that a transferor company has to follow under the group relief system.[37]

Transferor Company	Quantum	Amount of loss items to be transferred under GR
Statutory income	$100,000	
Capital allowances:		
Brought forward from prior Y/A	($60,000)	Not a loss item
Current year	($35,000)	NIL
Trade Losses:		
Brought forward from prior Y/A	($40,000)	Not a loss item
Current year	NIL	NIL

In this example, there are no current year trade losses to be transferred. But there is $35,000 of current year capital allowances that could be transferred if they are not first absorbed by the statutory income of the company. But they are completely absorbed because there is still $40,000 of statutory income to absorb the current year capital allowances after the $60,000 of capital allowances brought forward from prior Y/A is set off against the original $100,000 of statutory income.

If a transferor company has loss items for transfer after application of the rules for the order of setoff, the loss items are to be transferred under the group relief system in the

[36] A. Tan, J. Sng G. N., and Tan H. T., *Singapore Master Tax Guide Handbook*, 22nd edition 2003, chapter 20.2.1.
[37] IRAS Circular "Loss Transfer System of Group Relief," *op. cit.,* paragraph 36.

following order: (a) first, current year unabsorbed capital allowances, if any; (b) second, current year unabsorbed trade losses, if any; and (c) lastly, current year unabsorbed approved donations, if any.

The example below illustrates what can be transferred.[38]

Transferor Company	Quantum	Amount of loss items to be transferred under GR
Statutory income	$80,000	
Capital allowances:		
Brought forward from prior Y/A	($70,000)	Not a loss item
Current year	($120,000)	($110,000)
Trade Losses:		
Brought forward from prior Y/A	($80,000)	Not a loss item
Current year	($100,000)	($100,000)

In this example, $10,000 of the $120,000 current year capital allowances is absorbed by the $10,000 of statutory income remaining after absorption of the $70,000 of capital allowances brought forward, leaving $110,000 of unabsorbed current year capital allowances to be transferred. Since there is no more statutory income to absorb trade losses, the full $100,000 of current year trade losses are unabsorbed and, thus, available for transfer.

Full amounts of unabsorbed current loss items must be transferred to the extent that these can be absorbed by the claimant company. For example, if Transferor has loss items of $400,000 to transfer to Claimant Company A, which has $200,000 of assessable income, and to Claimant Company B, which has $300,000 of assessable income, in that order, $200,000 of the transfer would be absorbed by A before the remaining $200,000 of loss could be transferred to B.[39] One implication of transferring full amounts of unabsorbed loss items is that the partial exemption of up to $52,500 of chargeable income may be wasted by a claimant company.[40]

Finally, the utilization of loss items under the group relief system against the assessable income of a claimant company (remaining after the existing setoff rules for capital allowances, trade losses, and approved donations are applied within the claimant company) will be made in the following order: (a) current year unabsorbed capital allowances transferred in under the group relief system; (b) current year unabsorbed trade losses transferred in under the group relief system; and (c) current year unabsorbed donations transferred in under the group relief system.

Under the anti-avoidance measure section 37(5), if in any Y/A there are unabsorbed trade losses or approved donations, the amounts of unabsorbed trade losses or approved

[38] IRAS "Group Relief System," *e-Tax Guide*, 2002/BC/6, issued on 23 October 2002, example 6.
[39] *Ibid.* example 7.
[40] D. Sandison, *Tax Planning & Compliance in Asia: Singapore*, 2002, ¶ 25-100.

donations can be carried forward by the company to the next Y/A so long as continuity of ownership is maintained. In the case of donations, they can only be carried forward for five Y/As. Continuity of ownership is maintained if there is no substantial change in the shareholders of the company between the last day of the year in which the loss was incurred or donation made and the first day of the Y/A in which the loss or donation is to be utilized. There is not a substantial change in ownership as long as the same shareholders own at least 50% of the paid-up capital or nominal value of the shares on both dates. General practice is to determine shareholder ownership "at the level of the ultimate individual shareholders, however, application of this principle can be somewhat haphazard, particularly in complex group structures or joint venture arrangements."[41] Under section 23, if in any Y/A there are unabsorbed capital allowances, the amounts of unabsorbed capital allowances can be carried forward by the company to the next Y/A, so long as not only continuity of ownership is maintained, but also the company carries on the same trade or business. The relevant comparison dates for continuity of ownership are the last day of the Y/A in which the allowances arise and the first day of the Y/A in which the allowance is to be utilized. As noted in 3.4, the claim of annual capital allowances can be postponed. There is no requirement for continuity of ownership to postpone the claim. There is no carry back of unabsorbed trade losses, unabsorbed capital allowances, or unabsorbed approved donations.

Group membership is determined on a Y/A by Y/A basis and only current unabsorbed loss items can be transferred. Therefore, membership of the group in the preceding Y/A, or in the following Y/A, does not affect eligibility for group transfers in the current Y/A. No losses transferred are recaptured in subsequent years.

Under the group relief system only current trade losses/capital allowances/approved donations can be transferred. To exploit the group relief system, a company with appreciated trade assets that it acquired before joining the group could sell the assets once it joined the group. The built-in gain realized by the sale could then be offset by the transfer of loss items from other members of the group. Alternatively, a company with income might acquire a company for which losses are expected but have yet to be recognized in the profit and loss account. Once the built-in losses were recognized, they would be transferred. IRAS, however, with the anti-avoidance power under section 33, discussed in 4.3, has announced that it will deny the transfer of losses that "have already been incurred by the transferor company prior to being acquired."[42]

4.5. Issue: intragroup transfer of assets

The tax treatment in Singapore of intra-group sales depends on whether the assets sold are fixed assets of a business. The treatment can be examined in the context of the following example. Seller (S) transfers assets at the price of 100 to a Buyer (B) in Year 1. S has purchased the assets at the price of 70. Both S and B are members of a corporate group. In Year 2, B sells the assets at the fair market price of 110 to a third party outside of the group.

[41] *Ibid.*

[42] IRAS Circular "Loss Transfer System of Group Relief," *op. cit.*, paragraph 59.

As noted in 3.2, if the assets are trading stock for B, receipts from the sale of the assets are revenue receipts. Trade income in the amount of 110 minus 100 or 10 is accrued in Year 2 upon the sale of the asset to the third party. Similarly, if the assets are trading stock for S, trade income in the amount of 100 minus 70 or 30 is, in general, accrued in Year 1 by S. As an anti-avoidance measure, upon the discontinuance or transfer of a business, under section 32, the value of the trading stock will, in general, be taken to be its open market value. However, if the trading stock is sold to another trader in Singapore as trading stock, then the value of the trading stock will be the amount realized upon the sale. Therefore, under these conditions S could agree with B to price the trading stock at 70 and, thus, defer accrual of the trade income of 30 in Year 1. Only when the trading stock is sold in Year 2 to a third party at the price of 110, would the income of 30, and the additional trade income of 10, be accrued.

As also indicated in 3.2, if the asset is not trading stock of S, the receipt of 100 by S in Year 1 is a capital receipt and S has no taxable gain *per* se from the sale to B. However, as indicated in 3.4, if S has claimed capital allowances on the 70 cost of the asset, in general, a balancing charge of the difference between the selling price and the written-down value of the asset would be deemed income of S, up to the capital allowance already claimed. If the asset is not trading stock of B, the receipt of 110 by B in Year 2 is a capital receipt and B has no taxable gain *per se* from the sale to the third part. But if B has claimed capital allowances on the 100 cost of the asset, B will have a balancing charge to income of the difference between 110 and the written-down value of the asset, not to exceed the capital allowances claimed by B.

Under section 24(1), however, if the seller and buyer are under common control or one has control over the other and the general anti-avoidance provision under section 33, discussed in 4.3, does not apply, S and B can, in general, elect to disregard the sale for purposes of capital allowances. If S and B take this election, B steps into the shoes of S and continues to receive the capital allowances that would have gone to S, rather than claiming a capital allowance on the basis of the cost incurred by B.[43] Therefore, in the example above, the balancing charge that would otherwise be chargeable income of S would be transferred to B and deferred until B sold the asset to the third party. Section 24(4) precludes this election: 1) unless the seller or the buyer use the asset to generate chargeable income; or 2) if the asset was leased by S to B prior to the sale. "These provisions essentially prevent the 'washing out' of balancing charges through tax-exempt entities, or through the manipulation of attributable values under a leasing arrangement. They do not however prevent such transfer through a company with bona fide tax losses, although the wider application of sec. 33 may have to be considered in such case."[44]

4.6. Leased plant and machinery

Under section 10D there are provisions relating to finance or operating leases of plant or machinery that may affect the outcome discussed in 4.4 and 4.5. A finance lease is defined under section 10D(3) to be a lease that transfers substantially the obsolescence, risks or rewards incidental to ownership from the lessor to the lessee. An operating lease is a lease that is not a finance lease.

[43] *See* Sum Y. L., *op. cit.*, ¶ 518.
[44] D. Sandison, *op. cit.*, ¶ 25-100.

Under regulations issued by the Minister pursuant to section 10D, a finance lease shall be treated as a sale agreement under any of the following conditions: 1) the lessee has an option to purchase the plant and equipment; 2) the leased asset is of "limited use"; 3) the plant and machinery in a sale and lease-back transaction has been previously used by the lessee or any other person; 4) the lessor and the lessee are related to each other with (a) the lessee financing the purchase of the asset, (b) the lease being not at arm's length; or (c) the majority of the lessor's finance leases are with related parties; or 5) the lease is a leveraged lease. For purposes of this regulation, persons are related if one can control or significantly influence the other of if they are under common control or influence.[45] If the finance lease is treated as a sale agreement, the lessee claims the tax deduction for interest and capital allowances. The lessor is taxed on interest income and cannot claim capital allowances.[46] If leased assets are treated as sold for purposes of capital allowances, the implication for the discussion of loss items in 4.4 is that the capital allowances are loss items for the lessee, not the lessor, to currently deduct, transfer under group relief, or carry forward. An implication for the discussion of intra-group transfers in 4.5 is that if the value of the lease exceeds the written-down value of the assets, the lessor/seller S will have a balancing charge to income unless lessor S and lessee/buyer B elect to defer the charge under section 24(1), which they can if S has not previously leased the asset to B.

If the lease is an operating lease or a finance lease not treated as being sold, the lessee claims tax deductions for the lease payments, and cannot claim the capital allowances. The lessor is taxed on lease rental income and can claim the capital allowances. If the lease is an operating lease, the lessor can apply the capital allowances against income other than the lease income, carry the allowances forward, and transfer the allowances under group relief, as with other capital allowances. However, if the lease is a finance lease treated as not being sold, the capital allowances can only be claimed against lease income.[47] Under section 10D(2)(b), the allowances cannot be carried forward or transferred under the group relief system. If finance leased assets are not treated as sold, the implication for the discussion of loss items in 4.4 is that the capital allowances, which are retained by the lessor, may not be available except to currently deduct against leasing income. The implication for the discussion of intra-group transfers in 4.5 above is that the lessor will not by virtue of the lease become a seller and, thus, potentially accrue a balancing charge or allowance.

5. Indirect methods

This section examines the efficacy of certain indirect methods for corporate groups to offset loss items of one company of the group against the income of another company in the group if group relief is not available to these companies. In examining any particular method, we should always keep in mind that the method should be employed for bona fide commercial reasons lest it runs afoul of the general anti-avoidance provision under section 33, discussed in 4.3 and referenced in 4.4 and 4.5.

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[45] Income Tax (Income from Finance Leases) Regulations 1992.
[46] *See* Sum Y. L., *op. cit.*, ¶ 509.
[47] *Ibid.*

5.1. Shifting income

We are given a profit-making company (P) and related loss-making company (L). P and L wish to offset the profits and losses in the same Y/A. For some reason, e.g., failure to meet the 75% shareholding requirement, the group relief system is not available.

An attempt to shift income from P to L through overcompensation or under-pricing is likely to run afoul of the general anti-avoidance measure section 33. For example, if L sells a trade asset to P at an inflated price, income could be shifted from P to L. Loss-making L would pay no additional tax from the greater revenue; but P's tax would be reduced when it resold the trade asset, because of the higher cost of the asset. The Comptroller would, however, likely assert his power under section 33 to disregard the arrangement, vary the arrangement, or make adjustments which he considers appropriate.[48]

To avoid these difficulties, L enters into a transaction in which it sells its fixed assets at an open market price to P to accrue income. The fixed asset is still in the group. But no use has been made of L's loss. The gain is non-taxable, because the receipt is capital. L could instead sell its plant and machinery, upon which capital allowances have been claimed, to P. Again this would, in general, generate no taxable gain for L. But if the open market price exceeds the written-down value of the asset, L would incur a balancing charge to offset its loss. P and L would forego a section 24 election for related parties, discussed in 4.5, so that P could claim an initial or accelerated capital allowance on the open market value of the fixed assets.

L, rather than selling its fixed assets, could sell its trading stock at an open market price to P and, thus, accrue additional income equal to the difference between the open market price and the cost of goods sold to offset its existing loss. The stock would still be held within the group.

5.2. Leasing

There is a profit-making member (P) and a loss-making member (L) in the same corporate group. Certain machinery is subject to accelerated capital allowances. L wishes to acquire the machine and use it for production in its factory. If L owns the machine, the capital allowance is of no current value because L does not have positive taxable income in the current fiscal year. However, if P owns the same asset, P can claim the accelerated capital allowance amount and reduce its taxable income in an accelerated manner. P and L are both members of the corporate group, and it does not matter who owns the machine, as long as L can actually use it in its factory. Therefore, instead of L becoming the owner of the asset, P purchases the asset and leases it to L.

If the lease is a finance lease, then under conditions described in 4.6, the machinery leased by P to L will be treated as being sold by P to L, defeating the possible planning technique. If the lease is a finance lease not treated as being sold, P can only apply the allowances to the lease payments from L, again defeating the possible planning technique Only if the lease is an operating lease can P can claim the accelerated capital allowances against other income.

[48] *See* A. Tan, J. Sng G. N., and Tan H. T., *op. cit.,* chapter 20.2.1.

5.3. Issuing hybrid security instruments

A loss-making member (L) of the group requires financing for its business operations. If L obtains financing by issuing debt, L will deduct the interest paid, which will be of no immediate value because L is in a loss situation. Moreover, if funds are lent by a profit-making member (P) of the same group, P will have to include in its taxable income the interest that it will receive from L. Therefore, resident company L issues hybrid instruments that are to be classified as equity for tax purposes, but are similar to debt in economic terms, such as preferred shares whose interest rate corresponds to the market interest rate. If the Commissioner agrees that these instruments are to be classified as equity, when P receives dividends, P benefits from the exemption for the Singapore income dividends received. L cannot deduct the dividends paid, but this would be immaterial because L does not have positive trade income anyway. In Singapore the CA prohibits L from paying dividends unless these are paid out of profits.[49] However, the income tax definition of trade or business profits is different from the company law definition of profits. For example, a company can pay dividends out of capital profits, as long as the capital of the company is intact.[50] In such a case, it could still be possible for L to pay out dividends in Singapore even when the company has tax losses.

5.4. Corporate restructuring and mergers

A profit-making company (P) wishes to make use of the losses incurred by a related loss-making company (L) through a merger. There is no separate provision in the ITA for corporate reorganisations. Corporate restructuring and mergers are carried out in Singapore through the transfer of a business, a transfer of shares, or both.[51]

A transfer of shares will not allow losses to be transferred out of a company. Rather, as noted in 4.4, a transfer of shares may violate the continuity of ownership requirement for trade losses and capital allowances to be carried forward. As noted in 3.4, capital allowances can, however, be indirectly carried forward by postponing the claims for annual allowances.

While losses cannot be transferred out of a company, except through the group relief system, business can be transferred into the company with losses. As noted in 4.5, P could transfer its trading stock in a business at cost or book value to L for additional shares in L under a section 32 election, and then have the trade income upon sale be recognized by L. P could transfer the fixed assets of the business to L for additional shares in L under a section 24 election, discussed in 4.5, for related parties shifting any balancing charge to L. The losses in L could then offset income generated by business transferred to L.

5.5. Use of partnership

There is a loss-making company (L) and a profit-making company (P) within the same corporate group. P and L jointly establish a transparent entity (T), e.g., a partnership. T conducts a new business venture. T reports losses during the initial stages of its venture.

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[49] W. Woon, *op. cit.,* p. 612.
[50] *Ibid.* p. 617.
[51] Sum Y. L., *op. cit.,* ¶ 1301.

Under section 36, where two or more persons carry out a trade or business, the income of any partner from a partnership is the share of the income of the partnership to which the partner is entitled. The profit sharing ratio (PSR) for the partner determines the partner's share of the trade income/loss, other income, capital allowances, and allowed donations of the partnership.[52] Once loss items are allocated to the partners, the ability for the partners to carry them forward is as discussed in 4.4. If a partner is a company, the anti-avoidance provisions of section 37(5) apply to the carry forward of the company's share of the partnership's trade losses, capital allowances and approved donations.[53]

As a partnership, T's losses flow through to P and L. Accordingly, P can deduct the losses currently. While L may be able to carry forward loss items, they are not of immediate use. The PSR can change if one partner contributes additional capital to the partnership or another partner withdraws capital.[54] Thus, during T's initial stages, L's capital contribution could be relatively low compared with P. Once T started to make a profit, P could reduce its relative contribution to the capital of T. However, if the PSR is altered with out bona fide commercial reason, the arrangement could be subject to attack by the Comptroller under the generic anti-avoidance measure section 33.

6. Cross-border aspects

This section first briefly describes the taxation of overseas income and non-resident companies. Selected issues in the cross-border aspects of group taxation are then discussed.

6.1. Taxation of overseas income

The territorial nature of Singapore's income tax system means that overseas income, i.e., income not sourced in Singapore, becomes taxable only if it is received or deemed received in Singapore. Dividends from non-resident companies (overseas dividends) are overseas income. Under section 13, overseas dividends, branch profits and service income received in Singapore on or after 1 June 2003 from another country are exempt from tax if the income has been subject to tax in the other country and the highest corporate rate (headline rate) of tax in the other country is at least 15%. Overseas income remitted is determined after deducting the allowable expenses incurred in producing the income remitted. As an administrative concession, IRAS allows overseas losses to be set-off against overseas income in determining the amount of overseas income remitted.[55]

For companies receiving overseas income, there is the potential for double taxation if tax has been paid on overseas income in another country. For resident companies, there is unilateral relief and bilateral relief from double taxation. In addition to exemptions, there is unilateral relief in the form of a credit. Where Singapore does not have a double taxation agreement (DTA) with a country, under section 50A, there is a unilateral credit for certain overseas income received from the country. Where Singapore does have a DTA with the country, under section 50, there may be bilateral relief in the form of a

[52] A. Tan, J. Sng G. N., and Tan H. T., *op. cit.,* chapter 11.2.
[53] *Ibid.*
[54] Sum Y. L., *op. cit.,* ¶ 606.
[55] IRAS Interpretation & Practice Note No. 20, *e-Tax Guide*, 1995/IT/5, issued 28 December 1995, paragraph 7(d).

deduction, exemption, or credit. For Commonwealth countries with which Singapore does not have a DTA, under section 48, there is bilateral relief in the form of a credit. Foreign tax credits cannot be carried forward. Moreover, credits cannot exceed the amount of Singapore tax payable on the overseas income. The Singapore tax payable is determined on a source-by-source and country-by-country basis.[56]

6.2. Taxation of non-resident companies

As noted in 3.1, a non-resident company is generally given the same tax treatment as a resident company. Income tax is payable on the Singapore income of the company and overseas income of the company remitted to Singapore. The prevailing corporate rate generally applies to all income net of exemptions, deductions, allowances, and carry forwards.

The trade income of a non-resident company is Singapore income, only if the income is attributable to a permanent establishment in Singapore of the non-resident company.[57] Under an administrative practice of IRAS, overseas income received by a non-resident company is taxable only if the company is operating from or in Singapore.[58] A reduced withholding rate may apply to certain non-trade Singapore income. In particular, there is no withholding tax on dividends that are Singapore income, i.e., paid by resident companies.

For non-resident companies, there is only the bilateral Commonwealth credit for double taxation of overseas income upon receipt in Singapore. There is no bilateral DTA credit under section 50 or unilateral credit under section 50A for non-resident companies.

6.3. Scope of group relief system

Whether group relief is available to non-resident companies depends on whether the companies are domestic or foreign. If a company is a domestic company, i.e., incorporated in Singapore, group relief is available to the company. Therefore, even if the management and control of a domestic company is outside of Singapore, i.e., the company is a non-resident company, group relief is available to the company. However, if the company is a foreign company, group relief is not available, whether the company is resident or non-resident.

Whether group relief is available to domestic companies that are subsidiaries, parents, or brother (sister) companies of a foreign company, i.e., not Singapore incorporated, and have the same accounting year end, depends on whether the domestic companies belong to the same group, as described in 4.2. Any holdings by companies that are not domestic companies are disregarded. For example, if a domestic subsidiary A that is 90% owned by a foreign parent owns 90% of a domestic subsidiary B, companies A and B, but not their foreign parent, would be members of the same group. However, domestic brother company C and domestic sister company D, each 90% owned by a foreign parent, would not be members of the same group. Moreover, even if a domestic parent directly owns

[56] A. Tan, J. Sng G. N., and Tan H. T., *op. cit.,* chapter 14.3.5.
[57] See IRAS "Income Tax Guide on E-Commerce, " *e-Tax Guide*, 2001/EC/1, issued on 23 February 2001, paragraph 12.
[58] IRAS Interpretation & Practice Note No. 20, *op. cit.,* paragraph 7(a).

90% of domestic brother company E and indirectly owns 90% of domestic sister company G, companies E and G are not members of the same group if the domestic parent owns G through a foreign subsidiary F, of which the parent owns 100%.[59]

If a non-resident company maintains a branch in Singapore (Singapore branch), whether group relief is available to the branch depends on whether group relief is available to the company. For example, if a non-resident foreign company maintains a Singapore branch, group relief is not available to the Singapore branch even if the foreign company is wholly owned by a domestic company. In the example above involving the foreign subsidiary F, even if F, which is owned by a domestic parent, has a Singapore branch, group relief is not available to the Singapore branch. However, if a non-resident domestic company maintains a Singapore branch, group relief is available to the branch.

Whether Singapore or overseas loss items of a corporate group can be offset against the Singapore or overseas income of the group depends on the interaction between the territoriality principle and the group relief provisions. Under the territoriality principle, overseas losses of a company cannot be offset against the Singapore income of the same company, let alone against the Singapore income of another company in the same group. As noted in 6.1, overseas losses of a company may be offset against the overseas income of the same company for purposes of determining the overseas income remitted by the company. There is, however, no provision under the group relief system to offset overseas losses of a member of a corporate group against the overseas income of another member of the group. Thus, only Singapore loss items of a member of a group can be offset against the Singapore and remitted overseas income of other members of the group.

It should be noted that a domestic non-resident company may benefit from the group relief regimes both in Singapore and in the country of residence of the company, if the country of residence taxes world-wide income but provides group relief for world-wide losses on the basis of residence. For example, if the company has Singapore losses, the company may offset the losses against both the income of the Singapore group of companies and the income of the country-of-residence group of companies.[60]

6.4. Treaty issues

Singapore has 46 comprehensive DTAs in force with other countries for the avoidance of double taxation. Although Singapore is not a member of the OECD, these DTAs generally follow the format of the OECD Model Tax Convention on Income and Capital (OECD Model).[61] In particular, the DTAs contain a non-discrimination provision that contains elements of Article 24 of the OECD Model. “Briefly, nationals of a contracting country should not be subject to taxation more onerous than that levied on a resident of Singapore. The article also provides that permanent establishments have to be treated the same way as their legal equivalents in Singapore.”[62] The exclusion of foreign companies and their branches from the scope of group relief raises the issue of whether the foreign companies that are covered by a DTA may claim the benefits of group relief under the non-discrimination provision of the DTA. The non-discrimination provision typically

[59] IRAS, “Seminar on Group Relief,” *e-Tax Guide*, 2002/BC/6, issued on 23 October 2002.
[60] D. Sandison, *op. cit.,* ¶ 21-100.
[61] A. Tan, J. Sng G. N., and Tan H. T., *op. cit.,* chapter 14.5.1.
[62] *Ibid.* chapter 14.5.3.

contains an exclusion for investment incentives which are only provided to domestic companies. But there is no exclusion in the provision for group relief which is not provided to foreign companies.

6.5. Planning issues

The introduction of group relief in Singapore raises new cross-border planning issues that did not previously exist. Any resolution of these issues should be done for bona fide commercial reasons, as is allowed under the general anti-avoidance provision of section 33.

As noted in 6.1, foreign tax credits cannot be carried forward. An implication of being required to transfer full amounts of unabsorbed loss items is that credits may be wasted by a claimant company, because the credits are of no value if Singapore losses have already been used to offset overseas income remitted. One planning implication is that if a company is in such a situation, it should not claim the credit because a claim of foreign tax credits requires the company to gross up the foreign income remitted with the foreign tax credit.[63]

As discussed in 6.3, if a non-resident foreign parent FP directly holds the shares in resident domestic brother-sister subsidiaries A, C, and D, these subsidiaries are ineligible for the loss-transfer system of group relief. These subsidiaries would be eligible if a domestic parent DP were inserted between FP and the subsidiaries A, C, and D through a transfer of shares. There should not be a problem of continuity of ownership of A, C, and D to prevent their loss items from being carried forward. However, there may be Singapore non-tax costs and non-Singapore tax and non-tax costs which outweigh the Singapore tax benefit of being able to transfer losses among these subsidiaries. If the costs outweigh the benefits, then the corporate group may attempt to use the indirect methods with their limitations discussed in 5 for offsetting loss items against the income of the group. The presence of a foreign subsidiary F between two domestic subsidiaries E and G precludes the domestic subsidiaries from transferring losses. The corporate group could engage in a reorganization by a transfer of shares to pull out F from the chain of ownership to G without disturbing continuity of ownership of G, but the Singapore non-tax costs and non-Singapore tax and non-tax costs of this reorganization may outweigh the Singapore tax benefits of this reorganization. If the costs outweigh the benefits, the corporate group can consider utilizing the indirect methods to offset loss items of the group against the income of the group.

Only Singapore loss items of a member of corporate group can be offset against the Singapore and remitted overseas income of other members of the group. The group may attempt to use the indirect methods to offset overseas losses against Singapore and remitted overseas income of the group. In addition to the limitations discussed in 5, however, the group may run afoul of the anti-avoidance measure under section 53(2A), which allows the Comptroller to assess tax on a resident company in the name of a closely connected non-resident company controlling business with the resident company.

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[63] D. Sandison, *op. cit.,* ¶ 14-100.

7. Policy discussion

The introduction of group relief in Singapore is a step in the right direction. Allowing the current unabsorbed Singapore loss items of companies in a group to offset the Singapore income and remitted overseas income of other companies of the group has the potential to reduce the effective corporate tax rate of the group and encourage more risk-taking and enterprise in Singapore by companies in the group.

The approach taken is gradual and cautious. As the ERC Subcommittee recognized, "It is administratively complicated to implement a group relief regime. It is also difficult to estimate the revenue loss."[64] Nevertheless, the ERC Subcommittee and others have proposed that changes in the system be considered.

7.1. Shareholding requirement

In making the recommendation for introducing a group relief system in Singapore, the ERC Subcommittee recognized that even at 75% "the shareholding requirement may be too high for some companies to qualify for group relief, particularly those that enter into joint ventures with strategic partners."[65] It recommended that the Government should consider: 1) "lowering the shareholding threshold further after it has fully assessed the impact of group relief;" and 2) "the implementation of consortium relief as part of the group relief regime, after the basic features of the group relief regime have been put in place."[66]

The ERC Subcommittee did not suggest how much the shareholding threshold should be lowered. But it did suggest an example of consortium relief "which defines a company to be owned by a consortium if not less than 75 percent of its ordinary share capital is both directly and beneficially owned by companies which each owns at least 5 percent." [67] The Government has indicated it will study the ERC Subcommittee's recommendation to introduce consortium relief and "more complex group relief measures . . . more carefully before making its decision."[68]

7.2. Overseas Losses

The ERC Subcommittee also recommended that, after the basic features of the group relief regime were put into place, the Government study the relaxation of group relief rules to allow the transfer of overseas losses.[69] The ERC Subcommittee focused on the transfer of overseas losses to offset Singapore income, and correctly noted that this would, as discussed in 6.3, violate the territoriality principle upon which the Singapore income tax system is based.[70]

The group relief rules could instead be relaxed to allow overseas losses of a corporate group to be transferred to offset the overseas income of the group. Overseas losses of a

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[64] ERC Subcommittee, *op. cit.,* p. 31.
[65] *Ibid.*
[66] *Ibid.* pp. 31-32
[67] *Ibid.* p. 31
[68] Minister of Finance, *Budget Statement 2002*, p. 27.
[69] ERC Subcommittee, *op. cit.*, p. 32.
[70] *Ibid.*

company, foreign or domestic, can already be offset against the overseas income of the company for purposes of determining the amount of overseas income remitted to Singapore by the company. The rules could be relaxed, perhaps by an administrative concession, to allow the current unabsorbed overseas losses of companies eligible for relief to be offset against the overseas income of the group. The territoriality principle would not have to be violated, because overseas losses would not be offset against Singapore income. For purposes of the foreign tax credit, Singapore tax payable could still be calculated on a source-by-source and country-by-country basis. Relaxing the group relief rules in this manner could encourage risk-taking and enterprise overseas by companies in the group who wish to remit their profits to Singapore.

7.3. Other changes

While recognizing the advantages of a gradual and cautious approach, other suggestions have been made for changes in the group relief regime. Rather than require the full amount of unabsorbed losses to be transferred, the group would be allowed to choose the amount to be transferred.[71] This would allow the partial exemption and foreign tax credits of the claimant company not to be wasted, as discussed in 4.4 and 6.5 respectively. Rather than exclude domestic companies held by foreign parent or domestic subsidiaries in a chain of ownership, as discussed in 6.3, these domestic entities would be made eligible for group relief.[72] Further expansion of eligibility for group relief could occur by not excluding foreign companies from participation. This would address the anti-discrimination issue under Singapore's DTAs, raised in 6.4.

[71] D. Sandison, *op. cit.,* ¶ 21-100.
[72] *Ibid.*