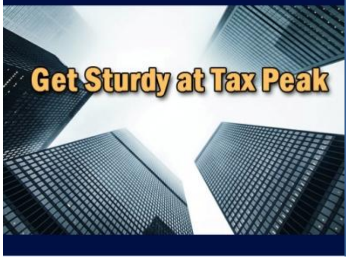

TED: Get Sturdy at Tax Compliance

Get it Right, Right from the Start

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As many companies get busy wrapping up their FY 2016 financial statements, the corporate income tax filing due date for Year of Assessment 2017 is inching closer and it is timely to review the salient points of tax compliance issues. Sharing their insights at a *Tax Excellence Decoded* technical session by the Singapore Institute of Accredited Tax Professionals (SIATP) were Lee Tai Tea, Doreen Chan, and Accredited Tax Practitioner (Income Tax) Nancy Ng from the Corporate Tax Division, Inland Revenue Authority of Singapore (IRAS).

Classification of Income

Companies on tax incentive schemes, such as the Global Trader Programme (GTP) and Pioneer Incentive, may enjoy lower income tax rates on their qualifying income. The key challenge for these companies is to accurately classify the qualifying and non-qualifying income (as well as the accompanying expenses incurred to generate such income) into the correct tax categories.

Unsurprisingly, incorrect classification of income and expenses into the different tax categories ranks among one of the most common compliance errors for incentive companies. For example, GTP companies often erroneously treat the income from sales to overseas persons as qualifying income even though the goods were purchased from local non-GTP suppliers (such income are non-qualifying for GTP purposes).

To reduce classification errors, companies are encouraged to familiarise themselves with the specific legislations or regulations of the incentives applicable to them. They may also consider allocating distinct tax codes to the different types of income and expenses to allow for easy identification and proper segregation into the different tax categories.

It is not uncommon for companies' allocation bases (for common expenses and capital allowances on common fixed assets) to come under IRAS' scrutiny. Therefore, it is advisable for companies to ensure careful thought is put into establishing their allocation bases and (where necessary) communicate their rationale in the tax schedules. Commonly used allocation bases include turnover and gross profit margin.

Foreign-sourced Dividends

A Singapore resident company may enjoy tax exemption on its foreign-sourced dividend remitted into Singapore if the foreign headline tax rate is at least 15%, the foreign-sourced dividend has been subject to tax in the foreign jurisdiction, and the tax exemption is beneficial to the taxpayer. In some cases, companies may wrongly treat their foreign-sourced dividends as tax exempt when it may appear that the qualifying conditions are met, only to find out that they are not.

In a classic example, foreign-sourced dividend received from a Hong Kong-listed company may first appear to have met the "headline tax rate" condition (given Hong Kong's corporate tax rate of 16.5%). However, as the company is incorporated in a tax haven jurisdiction (for example, Bermuda which has a tax rate of 0%), the "headline tax rate" condition is not met. Similarly, foreign-sourced dividend chargeable to tax under a special tax legislation where the highest stipulated tax rate is under 15% (such as Labuan in Malaysia) will likewise fail the "headline tax rate" condition (even though the country, in this case Malaysia, has a headline tax rate of over 15%).

Apart from the "headline tax rate" condition, there may be occasions when foreign-sourced dividends remitted into Singapore are taxed in Singapore because they have not been subject to tax in the foreign jurisdiction. These could be due to special circumstances such as the foreign payer company being in a loss position.

FOREIGN EXCHANGE GAINS OR LOSSES

Generally, foreign exchange differences arising from the translation of year-end balances of foreign currency bank accounts into functional currencies are regarded as capital in nature and hence, neither taxable nor deductible. Companies may designate a specific foreign currency bank account (designated bank account) solely for the purpose of receiving trade receipts and paying revenue expenses in a particular foreign currency. Where the account is not used for any other purpose other than the above designated purpose, IRAS is prepared to treat the account as revenue in nature. Foreign exchange differences arising from the translation of year-end balances in the designated bank account will be taxable or deductible.

NON-DEDUCTIBLE EXPENSES

Companies should note that deduction claims on expenses have to be made based on actual amounts (supported by receipts and invoices) and not estimates. Similarly, deduction claims for cost of sales should be made based on actual closing stock value and not projected figures.

EXPENSES PERTAINING TO DOUBLE TAX

Companies often erroneously claim tax deductions on private car expenses. While motor vehicle expenses incurred on goods and commercial vehicles (such as vans, lorries and buses) are deductible, no deduction is allowed on motor vehicle expenses incurred on S-plate cars, RU-plate cars and company cars even if they are used for business purposes.

If a company provides a monthly car allowance (instead of a reimbursement) to its employee for using his private car for business purposes, the expense will be deductible for the company (but taxable as part of employment income at the hands of the employee). In this scenario, the company will have to declare this car allowance in the employee's Form IR8A.

Tax professionals geared up for the tax-filing season with practical insights from IRAS' Medium Corporations branch.

INTEREST EXPENSES

Interest expenses relating to non-income producing assets are not tax deductible. A common compliance mistake involves the claiming of tax deduction on interest expense incurred on the investment in shares which have not yielded any dividends.

In cases where the company cannot identify and track the use of an interest-bearing loan to specific assets financed by the loan and not all the assets are income-producing, the "total asset method" may be adopted to attribute the common interest expense to the various assets.

Deduction for Internationalisation Scheme

To promote expansion beyond Singapore, companies may claim automatic double tax deduction (DTD) up to $100,000 on expenses incurred on four qualifying activities under the DTD for Internationalisation Scheme. Expenditure exceeding $100,000 will require approval from IE Singapore or Singapore Tourism Board.

Often, companies may wrongly claim expenses on activities that are not part of the four qualifying activities, or exceed the maximum cap of $100,000 without seeking approval from the relevant authorities. Besides avoiding these mistakes, companies should also note that the Scheme is only applicable for qualifying expenditure on up to two employees per trip, mission or fair.

Accredited Tax Practitioner (Income Tax) Nancy Ng answering participants' queries on tax compliance during the session.

Enhanced Tax Deduction for R&D

Companies carrying out research and development (R&D)[1] may claim enhanced tax deduction on qualifying R&D expenditure (comprising staff costs and consumables) under section 14DA of the Income Tax Act. One typical mistake companies make is to claim enhanced tax deduction on post-R&D expenditure (such as repair or maintenance expenses) and capital expenditure (on plant and machinery) even though they are not qualifying R&D expenditure.

Companies that outsource their R&D projects should be aware that they are generally only entitled to claim 60% of the invoices expenses. They should also note that no enhanced tax deduction will be allowed if the company is an R&D service provider which conducts R&D on behalf of the customer or related company (where the R&D results are owned by the customer or related company).

Capital Allowances

Capital allowances (CA) are deductions that companies can claim for wear and tear of plant and machinery bought and used in their trade or businesses. They are, however, not meant for companies' stock-in-trade or other assets which are specifically prohibited under the Income Tax Act (such as S-plate private cars).

Companies are allowed to claim one-year write-off for low-value assets not more than $5,000. However, many companies may not realise that the total claim for one-year write-off for such low-value assets is capped at $30,000 per year of assessment.

Donations

To ensure that companies are allowed to claim enhanced tax deductions on the donations that they have made to approved Institutions of Public Character (IPC), the donation receipts need to be in their names. Each company should ensure that its identification number (and not the identification number of a related or third party through which the donations may be made) is given to the IPC.

Tax compliance is essential in any business and getting it right, right from the start, is key. To minimise tax risks or resources diverted from the core business to manage tax queries and unnecessary tax penalties, not to mention the potential reputational risks from protracted tax disputes, effective internal controls and proper record-keeping are crucial. Of course, having a competent, trusted (and accredited) tax advisor would certainly help ensure a good night's rest too.

[1] More information can be found in IRAS' e-Tax guide on Research and Development Tax Measures

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This technical event commentary is written by Felix Wong, Head of Tax, SIATP. This article is based on SIATP's Tax Excellence Decoded session facilitated by officers from Inland Revenue Authority of Singapore.

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