SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Taxation (TX)

EXAMINATION DATE: 21 June 2018

Section 1
General comments

The Taxation module was an open-book examination. Nevertheless, an appendix containing relevant tax rates and allowances was attached to the question paper.

As in the previous examination session, a general observation made during the marking of the examination scripts was the tendency of quite a number of Candidates reproducing in verbatim the provisions of the statute and/or other reference materials in their answers to some of the questions. For some of these Candidates, they did not extend any analysis based on the facts of the case presented to them in the question. Candidates need to realise that in an open-book examination, credit cannot be given for merely reproducing or regurgitating content from reference sources. To earn the marks, they need to apply the tax laws and principles specifically to the facts of the case and to arrive at a reasoned conclusion or recommendation.

Section 2
Analysis of individual questions

Question 1

Question 1 presented in Parts (a) and (b) two scenarios involving respectively serious fraudulent evasion and tax avoidance.

For Part (a), many Candidates were able to characterise the proposed acts as amounting to serious fraudulent evasion for which sanctions are provided in section 96A of the *Income Tax Act* (*ITA*), although some Candidates incorrectly viewed the proposed arrangement as a tax avoidance scheme and applied the anti-avoidance provision in section 33 *ITA*. Many Candidates also realised that if the tax practitioner agreed to act in accordance with the client's wishes, the tax practitioner would be abetting in the evasion and liable to the same sanctions as the client. Fewer Candidates mentioned that as a Chartered Accountant, the tax practitioner could also be subjected to disciplinary action for professional misconduct. Concerning the assertion on the application of the time bar, most Candidates were aware that the statutory time bar did not apply in cases involving wilful intent to evade tax.

For Part (b), many Candidates understood how the arrangement in question, if unchallenged by the Inland Revenue Authority of Singapore (IRAS), would have resulted in income tax savings. However, many of them failed to explain how anti-

avoidance provisions (e.g. those in section 31(4) *ITA* or the general anti-avoidance provision in section 33 *ITA*) could have been invoked to negate the tax savings otherwise arising. Furthermore, there were quite a number of Candidates who discussed stamp duty implications when the requirement of the question was clearly restricted to income tax savings.

Question 2

Question 2 described alternative arrangements of providing medical and hospitalisation benefits to employees and required Candidates to advise on the income tax and the Goods and Services Tax (GST) implications of these arrangements.

Concerning the income tax implications (Part (a)), many Candidates were aware of the restriction of deduction of medical expenses imposed on employers but they were less clear as to what constitutes a transferable medical insurance scheme (i.e. Alternative #2) in respect of which the higher 2% cap applies. From the employee's perspective, Candidates generally knew that the medical allowance in Alternative #1 was taxable in full whereas the arrangements in Alternative #2 would not result in taxable benefits by virtue of the relevant IRAS administrative concessions.

Concerning the GST implications (Part (b)), Candidates' performance was mixed. Quite a number of Candidates discussed the GST implications for the medical/hospitalisation service providers rather than from the perspective of the employer (HH) as required by the question.

Question 3

Question 3(a) tested Candidates on the IRAS administrative practice of taxing service companies based on an imputed 5% profit margin. Candidates had to point out that the 5% profit imputation basis was available only in respect of the human resource management services. The servicing and engineering services were not routine support services eligible for that basis and therefore transfer pricing analysis had to be carried out to arrive at arm's length pricing of those services. Only a few Candidates seemed to be aware of this.

For Part (b), most Candidates were aware that the profits in question were sourced outside Singapore but many of them did not provide any explanation to support their answers.

Part (c)(i) was generally well attempted. Candidates were able to apply the deemed source rules in section 12(7)(d) *ITA* and impute a Singapore source to the rental payments. They also addressed the associated withholding tax implications.

Part (c)(ii) required Candidates to explain how a tax treaty could mitigate the Singapore income tax exposure associated with the rental payments for the use of

the machinery. Many answers correctly referred to the possibility of a tax rate lower than 15% being prescribed under the Royalties article of the tax treaty. However, Candidates should note that the definition of 'royalties' for the purposes of the Royalties article does not cover rental payments from leasing movable property in all of Singapore's tax treaties. In those treaties where the Royalties article does not apply to rental payments, the payments may be insulated from Singapore income tax by virtue of the provisions in the Business Profits article if the lessor does not have a permanent establishment (as defined in the treaty) in Singapore to which the payments may be attributed. This alternative scenario was only very rarely considered.

Part (d)(i) required Candidates to compute the stamp duty and GST on the acquisition of a leasehold interest in an industrial property. Some Candidates confused the acquisition of a long-term leasehold interest in a property with the renting of the property under a short-term lease/tenancy. This resulted in an incorrect calculation of the stamp duty liability.

Part (d)(ii) required Candidates to consider whether the various expenditures incurred in connection with the purchase and renovation of the industrial property qualified for income tax deductions or capital allowances. The following comments are pertinent:

- Most Candidates were aware that the purchase consideration and incidental acquisition costs were neither deductible nor eligible for any form of capital allowances;

- While many Candidates were correct to point out that the initial repairs in the form of the installation of a new roof to the building was a non-deductible capital expenditure, it was often the case that no reasons were provided in support of the answer. A few Candidates mistakenly thought that the expenditure qualified for the deduction in section 14Q *ITA* even though the work undertaken involved a structural construction/renovation;

- Generally, Candidates were aware that the expenditure on office renovations (up to $300,000) qualified for the deduction in section 14Q *ITA*. However, not many realised that as the expenditure was incurred prior to the commencement of business, it would be deemed to be incurred on the date of commencement of business on 1 October 2018 and the deductions over three years of assessment would commence only from the Year of Assessment 2020; and

- Concerning the interest expense, very few Candidates realised that the interest attributable to the period from 1 July 2018 to 30 September 2018 was not deductible as the building was not in use during that period and therefore the interest was not payable on capital employed in acquiring taxable income.

For Part (e), Candidates had to characterise the supplies of support services for GST purposes and to ascertain if there was a liability to register for GST. Both the servicing & engineering services and the human resource management services were zero-rated international services under sections 21(3)(g) and (j) *GSTA* respectively. Surprisingly, many Candidates had difficulty applying one or both of these provisions and this led to an incorrect conclusion that one or both of the supplies was standard-rated.

Part (f)(i) concerned the claim of input tax credit for pre-registration GST. Answers were generally poor, with many Candidates not even realising that the GST had been incurred prior to the date of GST registration and therefore failing to consider any of the conditions for the claim of pre-registration input tax.

Part (f)(ii) was well attempted, with most Candidates able to appreciate how the Major Exporter Scheme (MES) is beneficial to a GST-registered business with substantial imports and whose supplies are substantially zero-rated.

Question 4

This question required Candidates to draft a set of comparative computations for scenarios where a business is to be carried on through a sole proprietorship and where the business is to be carried on through a company.

The computation of adjusted profits for Part (a) was reasonably attempted although there was a significant number of Candidates who did not appreciate the difference between a non-deductible profit appropriation item and a deductible expense. This meant that items such as Mdm Nguyen's life insurance premium, rental of apartment, and salary were not disallowed in computing her adjusted profit. Conversely, in computing the company's adjusted profit, these same items (which now took the form of deductible remuneration expenses) were incorrectly disallowed.

Performance for Part (b) was mixed. A few Candidates missed out earning a substantial number of marks because their answers were incomplete. Although specifically required by the question that under the company scenario, Candidates had to do both a corporate tax computation and a personal tax computation for Mdm Nguyen, the latter computation was omitted. Furthermore, under the sole proprietorship scenario (Mdm Nguyen's personal tax computation), quite a number of Candidates incorrectly reflected employment income (i.e. salary, housing benefit, etc.) in the tax computation. Other common errors made in the personal tax computations included:

- not taxing the Singapore rental income based on deemed deductible expenses (excluding interest) of 15% of the gross rent as this was more beneficial to Mdm

Nguyen than claiming the actual rental expenses (excluding mortgage interest) incurred;

- not taking into account the share of the partnership loss in arriving at the earned income for the purposes of computing the working mother's child relief; and

- not capping the total personal reliefs to $80,000 (where appropriate). With effect from Year of Assessment 2018, the total personal income tax reliefs available to resident individuals is capped at $80,000.

Future TX Candidates are strongly encouraged to prepare detailed templates for a personal income tax computation and a corporate income tax computation as part of their examination preparation. Should an examination question require either computation to be furnished, these detailed templates can be completed as necessary based on the facts presented and copied from your spreadsheet programme into the e-Exam software saving you valuable time during the examination as well as acting as a memory jogger.