# Tax

# Client Alert

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BAKER & McKENZIE

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Please note that the information contained in this Memorandum should not be relied upon as legal advice or regarded as a substitute for detailed advice in individual cases.

## Investing from Japan: Use of Singapore Holding Company

Effective 1 April 2009[1], 95% of dividend income received by a Japanese corporate recipient will be exempt from Japanese corporate tax if it owns at least 25% of the shares in the dividend-paying foreign investment. Along with the introduction of this new foreign dividend exemption regime, important changes will also be made to the Japanese Controlled Foreign Corporations ("CFC") rules.

As a result of these changes, Japanese MNCs will now be able to invest more easily into foreign jurisdictions without having to pay much Japanese corporate tax on dividend income from their foreign investments. In addition, the amendments to the Japanese CFC rules mean that certain approved foreign subsidiaries of the Japanese MNC will no longer be subject to CFC tax on dividend income received from their own foreign subsidiaries, provided that the approved foreign subsidiaries of the Japanese MNC own at least 25% of the shares in their dividend-paying foreign subsidiaries.

Japanese MNCs may wish to consider taking advantage of these amendments by continuing to expand their overseas investments. Notwithstanding this, to the extent that Japanese MNCs plan to extend their reach to investing in Asian jurisdictions such as China and India, they may wish to consider setting up a holding vehicle in Singapore. Obviously, Japanese MNCs should always keep in mind the holding company substance requirements which aim to prevent treaty shopping.

The following discussion outlines the possible reasons why Singapore can be considered a favourable jurisdiction for Japanese MNCs to consider when setting up a holding company.

### 1. Corporate Income Tax Rate

As a result of the 2009 Budget, the corporate income tax rate in Singapore has been reduced from 18% to 17% with effect from Year of Assessment 2010. With such a relatively low corporate income tax rate in the Asia Pacific Region and an

[1] Subject to the approval of Japanese Diet with respect to the 2009 tax reform bill.

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extensive treaty network, Singapore has been well positioned as a desirable location for setting up holding companies.

However, Japanese MNCs in the past tended to avoid Singapore when choosing a location for setting up regional holding companies because the low corporate tax rate in Singapore triggered the application of the Japanese CFC rules. The recent amendments to these rules mean that Japanese MNCs can now take advantage of Singapore's low tax rate without triggering Japanese CFC rules in respect of certain dividend income.

## 2. Straightforward Tax Regime

Singapore's tax regime is based on a territorial concept. Income tax is imposed on Singapore-sourced income and with certain exception, foreign-sourced income received in Singapore. Singapore does not impose any tax on capital gains. Thus, gains arising from the disposal of investments or assets of the Singapore holding company which are of a capital nature are not subject to any tax. There are also no CFC rules or thin-capitalisation rules in Singapore.

This means that an MNC can use Singapore effectively as a base from which to invest in the region because the Singapore holding company will not be subject to CFC tax on income earned by its foreign subsidiaries in the region.

## 3. Extensive Treaty Network

Singapore has an extensive tax treaty network. To date, Singapore has entered into comprehensive double taxation agreements with 60 countries, including Japan, India and China. However, there is no tax treaty between Singapore and the United States of America.

By setting up a Singapore holding company which is tax resident in Singapore (i.e. the control and management of its business is exercised in Singapore), the Japanese MNC may avail itself of treaty benefits which include the ability to claim a foreign tax credit against its Singapore tax payable on foreign income received in Singapore if it has been subject to tax therein. In addition, a Singapore tax resident company can avail itself of a reduced rate (and in some cases, tax exemption) under a double taxation agreement on certain passive income received in Singapore from a treaty country, for example, interest and royalty payments, if any (see below for the domestic withholding tax rate).

## 4. Withholding Taxes

Under Singapore domestic law, withholding tax is imposed on the following payments made to non-resident entities:

(a) Interest payment, at the rate of 15%.

(b) Royalties for movable property, at the rate of 10%.

(c) Payments for the right to use scientific, technical, industrial or commercial knowledge or information, at the rate of 10%.

(d) Technical assistance and services fees (i.e. know how payments), at the rate of 17% (prevailing corporate tax rate).

(e) Management fees, at the rate of 17% (prevailing corporate tax rate).

In a 1977 Press Statement, the Ministry of Finance clarified that with respect to (d) and (e) above, where the services are performed outside Singapore, and for item (e), if the services are performed between related parties, the management fee represents a pure reimbursement of the costs incurred without any profit-markup, withholding tax will not be applicable.

As discussed above, it may be possible to seek a reduced withholding tax rate or an exemption of withholding tax under a particular double tax treaty, if applicable. For a Japanese MNC looking to use Singapore as a base from which to invest in the region, it is worth nothing that the Singapore-China double tax agreement reduces the withholding tax on interest to 10%.

## 5. Foreign-Sourced Income Exemption

Foreign-sourced dividends, branch profits and service income received in Singapore are exempt from tax ("**FSIE Scheme**"). This means that a Singapore holding company receiving any of the following types of income in Singapore is not subject to any tax.

There are two conditions which must be satisfied in order to qualify for this exemption:

(1) the foreign income concerned must be received from a jurisdiction with a headline tax rate of at least 15%; and

(2) the income must have been subject to tax in the jurisdiction from which it is received.

It is still possible to apply for specific exemption from the Comptroller of Income Tax, if any of the two conditions stated above cannot be satisfied. If any of these conditions fails, the Singapore holding company may still be entitled to a foreign tax credit, provided it is a resident in Singapore.

As a result, the Singapore holding company of an MNC will not have to pay tax on its dividend income earned from its subsidiaries in India and China, for example, if some tax has already been paid on dividends in these jurisdictions.

## 6. Dividends by Singapore Holding Company

Dividends paid by a Singapore holding company that is a Singapore tax resident are not subject to any tax in the hands of its shareholders, regardless of whether they are Singapore tax resident. There is also no withholding tax on dividends paid to foreign shareholders.

As a result, a foreign MNC with a holding company in Singapore may invest into the region through its Singapore holding company without being subject to withholding tax on dividends when the Singapore holding company repatriates its profits to the MNC.

## 7. Potential Tax Incentives Available for Holding Company

Under certain circumstances, it is possible for a Singapore holding company to apply and qualify for Headquarters ("**HQ**") incentives. Such incentives are introduced to encourage multi-national companies from various industries to locate their regional or global HQ in Singapore.

Currently, there are two types of HQ incentives schemes offered by the Economic Development Board, i.e. Regional Headquarters Award (“**RHQ**”) and International Headquarters (“**IHQ**”) Award.

*i.* *RHQ Award*

The outstanding feature of the RHQ is its “fast-tracked” application procedure. Companies applying for this award will be assessed based on the information they provide in a prescribed form, and will be conferred RHQ status if they can satisfy all of the published criteria for such an award.

A company with RHQ status enjoys a concessionary rate of 15% for a maximum 5 years on incremental qualifying income. If it satisfies all the minimum requirements by Year 3 of the incentive period, it will enjoy 15% concessionary tax rate for an additional 2 years on the qualifying income.

*ii.* *IHQ Award*

The IHQ Award is available to companies which are willing to make commitments that are substantially more than what is required under the RHQ Award.

Under the IHQ Award, qualifying income including management fees, sales/ trading income and royalties, is subject to tax at the concessionary tax rate of 0%, 5% or 10% on incremental qualifying income for 5 to 20 years. The tax rates are customized based on commitment level. A company granted IHQ status may also be considered for any of the tax incentives provided under the *Economic Expansion Incentives (Relief from Income Tax) Act* as well as an exemption for dividends.

## 8. Other Incentives

Other tax and investment incentives offered in Singapore include:

- Global Trader Programme;
- Pioneer Status;
- Pioneer Service Companies;
- Development and Expansion Incentive;
- Investment Allowance Incentive; and
- Research and Development and Intellectual Property Hub Scheme.