IRAS Consultation

Tax Deduction for Parent Company's Shares Acquired through a Special Purpose Vehicle (SPV) for Employee Equity-Based Remuneration (EEBR) Scheme

INLAND REVENUE AUTHORITY OF SINGAPORE

Published by
Inland Revenue Authority of Singapore

Published on 7 April 2011

Consultation Paper on Proposed Framework for Tax Deduction of Parent Company's shares acquired by SPV for EEBR Scheme

---

1. Invitation To Comment

1.1 A corporate group may use an intermediary Special Purpose Vehicle (SPV), in the form of a company or a trust, to administer its Employee Equity-Based Remuneration ("EEBR") scheme. Recognising this, the Minister for Finance announced in Budget 2011 the extension of tax deduction to cost incurred by a company in acquiring its parent company's shares through a SPV for such a purpose, subject to certain conditions.

1.2 This Consultation Paper sets out in section 4 the proposed framework for the above tax change.

1.3 We seek your views and comments on the proposed framework, particularly on the various aspects set out in section 5.

2 Submission

2.1 To facilitate review, please submit clear and succinct comments, using examples to illustrate the basis and rationale for your views and comments wherever possible. Your response should preferably not be more than four pages in length.

2.2 We reserve the right to make public all or parts of any written submission made in response to this Consultation Paper and to disclose the identity of the contributor. All views and comments received will be considered.

2.3 The closing date for submission of your views and comments is 27 April 2011. Your submission should include your name, the organization you work for or represent, your email address and telephone number. Please address your submission to :

Comptroller of Income Tax
Inland Revenue Authority of Singapore
Tax Policy & Ruling Branch
55 Newton Road
Singapore 307987

OR

Email to public_consultation@iras.gov.sg

3 Current Tax Deduction of Cost of Parent Company's Shares used for EEBR Scheme

3.1 Currently, tax deduction is allowed to a company on cost incurred to acquire its own shares (i.e. treasury shares) if such shares are granted to its employees under an EEBR scheme. Similarly, if a parent company transfers its treasury shares to any employees of its subsidiary company under an EEBR scheme and recharges the subsidiary company, the subsidiary company may claim tax deduction based on the lower of the:

(a) amount recharged by the parent company; and

(b) actual cost incurred by its parent company to acquire the treasury shares.

Where the employees make payments for shares vested under the EEBR scheme, the subsidiary may only claim tax deduction on such amount net of payments made by the employees.

3.2 The term "treasury share" is currently defined in section 2(1) of the Income Tax Act ("ITA") to mean:

(a) in relation to a company incorporated under the Companies Act or any corresponding previous written law, a treasury share as defined in section 4(1) of that Act; and

(b) in relation to a company incorporated under the law of a country other than Singapore, a share issued by the company which is subsequently acquired and held by it.

3.3 Based on the current definition, only shares of a company that are acquired and held by it would qualify as treasury shares.

3.4 In practice, a corporate group may administer its EEBR scheme through a SPV. In a typical arrangement, the SPV would acquire the parent company's shares from the open market[1] and deliver them to employees of group companies. The group companies may be charged for the shares delivered to their employees. Shares acquired under such an arrangement are not treasury shares based on the current definition of the term in the ITA. Accordingly, under Section 15(1)(q) of the ITA, no tax deduction can be allowed to a company on any cost incurred on its parent company's shares delivered by the SPV to its employees.

4 Proposed framework for tax deduction of cost of shares acquired through SPV

4.1 Under the proposed framework, the parameters under which cost incurred by a company on its parent company's shares delivered by a SPV to its employees under an EEBR scheme may qualify for tax deduction are:

(a) the SPV is set up as a company or a trust, solely to administer the EEBR scheme for employees of companies within a corporate group[2]. Shares acquired by the SPV must be held in trust for employees of the group companies[3];

(b) the SPV has acquired the parent company's shares directly from the open market, or has acquired from the parent company its treasury shares, for the purpose of fulfilling obligations to the employees under the EEBR scheme. In other words, the shares must not be newly issued shares of the parent company[4].

(c) The amount of tax deduction[5] is given based on the following:

---

[1] Open market refers to purchase from the stock exchange (other than from initial public offer) if the parent company is listed. For unlisted companies, the purchase must be from a third party at the shares' prevailing open market value.

[2] A corporate group comprises a holding company and its subsidiaries as defined in Section 5 of the Companies Act (i.e. more than 50% shareholding for both local and foreign companies). This is consistent with the definition adopted in section 14P of the ITA.

[3] This is to align with the requirement under the Companies Act, which prohibits a subsidiary from owning shares in its holding company except where the beneficial interest in the shares vests with the employees at all times.

[4] The policy is not to allow deduction for new shares issued by a company whether they are issued directly or through a SPV to employees to fulfill obligations under an EEBR scheme. This is because there is strictly no actual cost outlay incurred by the corporate group in such a case.

[5] The rules are intended to ensure, and hence maintain the policy, that only an amount up to the actual cost outlay incurred by a company or its group for fulfilling the obligations under its EEBR scheme is tax deductible.

(i) where the SPV acquires the parent company's shares from the open market, the lower of

- the amount charged to the company for the shares delivered to its employees, and
- the cost incurred by the SPV in acquiring the parent company's shares from the open market;

(ii) where treasury shares are acquired by the SPV from the parent company, the lowest of

- the amount charged to the company for the shares delivered to its employees,
- the cost incurred by the SPV, and
- the cost incurred by the parent company in acquiring the shares,

less any amount payable by the company's employees for the shares.

5 For Consultation

5.1 We seek your views and comments on the proposed framework, particularly on the following aspects:

(a) Vehicles commonly used by corporate groups in administering EEBR schemes

A corporate group normally sets up a SPV in a form of a company or a trust to administer its EEBR scheme for employees of the group.

Besides a company or a trust, are there other vehicles commonly used to administer EEBR schemes? If yes, do you know what these vehicles may be and why they are preferred over a company or a trust?

Regardless of the form of vehicle used for such a purpose, does a corporate group typically take steps to ensure the independence of the SPV from the group? If so, why is this necessary and what steps are typically taken to ensure this?

(b) Requirement for SPV set up solely to administer an EEBR scheme

This requirement means a SPV that administers an EEBR scheme and also carries on other business or corporate activities for a corporate group does not meet one of the parameters for tax deduction. What are the issues and concerns that a corporate group may face arising from this requirement and how in your view may such issues and concerns be addressed to comply with the requirement?

Under what circumstances does a corporate group prefer not to set up a SPV solely to administer an EEBR scheme? What are typically used in place of the SPV in such cases? If another company within the group were responsible for this role, what other activities would the company typically carry out besides administering the EEBR scheme? How does the company ensure independence in its role as administrator of the EEBR scheme and other roles?

(c) Funding of SPV in acquiring shares to fulfill obligations under an EEBR scheme

A SPV set up to administer an EEBR scheme has to secure the parent company's shares in order to deliver them to employees on vesting of the shares. What are the ways a SPV may typically secure shares for this purpose?

If the SPV were to purchase the shares from the open market or the parent company, how is its acquisition of shares typically funded? Does the SPV typically onward charge back the company whose employees receive the vested shares to recover the funds used? If yes, how does the SPV determine the amount of charge back and how is the charge back typically done? Please illustrate with an example and accounting entries for both the SPV and company.