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International Assignment News Alert
Angel Investors Tax Deduction Scheme

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Angel Investors Scheme
One of the announcements in this year's Singapore Budget was the introduction of the much awaited Angel Investors Tax Deduction ("AITD") scheme, intended to provide tax incentives to angel investors making capital infusions in Singapore-based start-ups. SPRING Singapore has recently released further details on this new scheme, which are set out below.

Objectives
One of the high-level objectives of this scheme is to encourage private sector investment into start-ups to enable them to expand, to introduce new technology and to up-skill their employees to increase productivity. Providing such enterprises with additional funds during their nascent stage, as well as access to experienced business 'know-how' will help to drive their operations, both locally and globally, and contribute to Singapore's long-term growth. This scheme is especially welcome at a time when funding is still difficult to access from banks.

Key criteria
The key criteria of the AITD announced by SPRING are as follows:

- Individual "angel investors" can claim a deduction of 50% of the amount of their qualifying investment against their taxable income.
- The investor must first apply to SPRING to obtain "angel investor" status by demonstrating his/her entrepreneurial track record or senior management experience in the particular fields.
- Within 12 months of receiving "angel investor" status, the individual must invest in shares in an approved small and medium enterprise (SME). The total investment must reach at least S$100,000 within 12 months of the date of the first investment.
- Shares must be held for a minimum of two years from the date of the last investment tranche made during the 12-month qualifying investment period.
- The deduction will only be allowed on the first S$500,000 of qualifying investments each year, and will be applied against any form of taxable income earned during in the year in which this two-year holding period is eventually met.
- The scheme is currently scheduled to run from 1 March 2010 (i.e. retrospective applications will be permitted) until 31 March 2015.

A welcome move
The introduction of this scheme is well timed as it should help overcome the challenges that are presently felt by start-up enterprises. It is widely known that such enterprises lack access to ready and long-term capital, but often the greatest challenge is access to individuals with business experience, acumen and expertise who can help drive such start-ups forward whether through process and product efficiencies, venturing into newer businesses or expansion into newer markets.

The AITD scheme intends to address some of these key challenges in two ways.

Firstly, by having a minimum qualifying investment of S$100,000 as well as limiting scheme eligibility to individuals with the necessary business or technology background will ensure that such start-up enterprises will have access to high quality entrepreneurs, who can provide not only meaningful capital but have the business connectivity and acumen to guide such start-ups and boost their competitiveness and success.

While the investment range (i.e. S$100,000 to S$500,000) under the AITD could be considered high compared with other incentive schemes overseas, it does ensure that high calibre "angels" who can provide board-level guidance to such start-ups are attracted; so the more stringent qualifying criteria for the AITD has been introduced for a good reason.

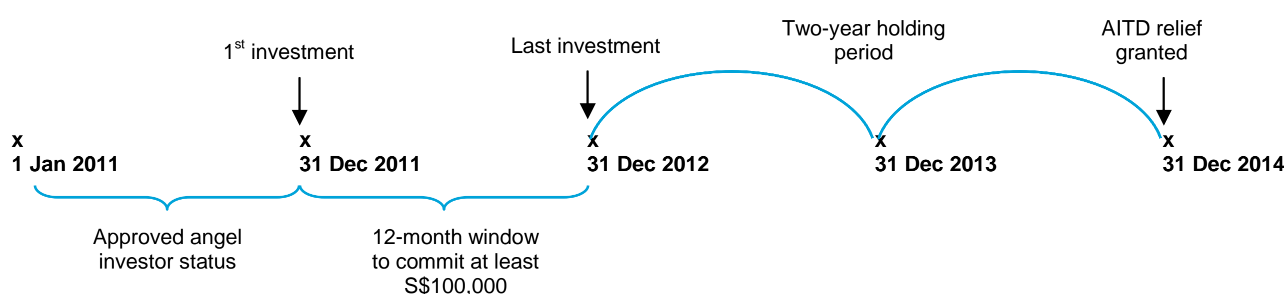
Secondly, the two-year holding period also ensures that the angel investor will stay committed at least in the medium-term to driving the start-ups forward. This period is considerably shorter compared to a similar incentive scheme in the UK, the Enterprise Investment Scheme (EIS), which requires a three-year holding period, so a fine balancing act has been achieved in this regard.

Key challenges

While the introduction of the AITD scheme is a very positive step, the scheme, in its present form, gives rise to some factors that which could potentially reduce its attractiveness and, therefore, take-up by entrepreneurs.

(i) Timing of tax relief

The timing of the eligibility milestones may result in a significant time lag between the initial application for angel investor status and actually receiving the tax relief, as the time-line below illustrates:



If an individual is granted investor status on 1 January 2011, he will enjoy "approved angel" investor status until 31 December 2011. So, for example, if an investor were to make an initial S$100,000 investment on the last day of his approved angel status (31 Dec 2011), he would be required to hold this stock until 31 December 2013. While there is no doubt that the holding period for the shares should clearly be a fundamental pre-requisite for the tax relief (to provide the recipient SME with medium-term stability), the significant time-lag in obtaining the tax relief could render the present value of the future tax incentives a less attractive proposition, especially if the personal income tax rate falls.

This issue gets even more compounded if the investor makes a series of qualifying investments during the qualifying period. The investor has a 12-month window from the date of his first investment to make additional investments, and the two-year holding period is counted from the date of the last investment. To continue the example above, if he were to make his initial investment on 31 Dec 2011, then a further investment on 31 December 2012 (on the last day of this window), he would be required to hold his entire portfolio until 31 December 2014 in order to qualify for the AITD tax relief, i.e. three years from the date of his first investment!

In our view, restarting the holding period clock based on subsequent investments could therefore result in dissuading additional investments rather than encouraging them.

(ii) Income reducer vs Tax reducer

The AITD is an income reducer relief rather than a tax reducer. Tax rebate measures often result in greater tax savings to the individual compared to income reducing measures. The EIS in the UK for example provides a 20% tax rebate for angel investors, which can be applied in the year of, or the year *prior* to the investment, which accelerates the tax rebate.

(iii) Tax relief on capital losses

There is no capital gains tax in Singapore and accordingly the law does not allow for deduction against capital losses. However, it is worth noting that there is no capital gains tax on qualifying profits under the EIS as well and, as an additional incentive, the EIS allows losses incurred on disposal of shares to be offset against other forms of taxable income in the current or prior year. This acts as an additional cushion to the angel investor against downside risk which the AITD does not provide.

What more should be done

- To ensure effective implementation of the AITD scheme, relief should be made available in the year the investment is made. If the two-year holding period is not met, the IRAS could claw-back the tax relief which had previously been granted from the individual, as is the case in the UK.

- Timing of the two-year holding period for each investment tranche separately, rather than restarting the clock for the entire investment each time there is a subsequent injection of capital, would also encourage "top-up" investments.

- Offering tax relief on capital losses similar to the EIS would provide a good safety net as it acts as insurance to individuals given that their investments could well turn bad.

- The deduction cap based on the investment limit of S$500,000 in any year should be removed or increased. Such a capping could prove counter-productive as this may result in the investors spreading funding over a period of time to maximise their tax breaks rather than investing in one go, which may be the need of the hour.

Summary

The introduction of the Angel Investor Tax Deduction scheme is a key component of Singapore's strategy to use market forces to encourage start-ups to grow, to up-skill and to move up the value chain, and will certainly be welcomed. The long-term success of the scheme and whether it will drive the small and medium enterprises forward remains to be seen. However comparison with similar schemes overseas suggests entrepreneurs may require more generous tax incentives to invest in potentially high-risk businesses, especially in the current uncertain economic climate.

On the other hand, although the challenging qualification criteria and government scrutiny for approved angel investor status may put off some individuals, maintaining this high standard should protect the businesses themselves and should be a significant deterrent for speculative and inexperienced investors who would not be suitable for such investments.

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