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From: HI
Sent: Thursday, September 26, 2002 3:43 PM
To: CCG; CHL; CLM; GSH; HCH; JL; LFY; LTC; RW; SKY; TWC; VJ; WTC
Cc: LCT
Subject: TRANSITIONAL PROVISIONS OF GST - PRACTICAL APPLICATION

Our Ref: OM-Pro.Con/054

26 September 2002

MEMORANDUM

To: All Project Managers

From: Andrew Loh

TRANSITIONAL PROVISIONS OF GST - PRACTICAL APPLICATION

With the imminent increase in the GST rate with effect from 1 January 2003, attached herewith is an article from DLS on the practical application of the transitional provisions relating to supplies in the construction industry for your information.



DLS-GST.pdf

Regards
on behalf of Andrew Loh

...@DLS Consultancy

Executive Summaries
for the practitioner

Volume 2 Issue 3 : September 2002

A Davis Langdon & Seah Consultancy Information Sheet

MITA(P) No. 162/01/2002

GOODS AND SERVICES TAX : 3% or 5% ?

With the imminent increase in the GST rate with effect from 1st January 2003, this article looks at the practical application of the transitional provisions relating to supplies in the construction industry

INTRODUCTION

The announcement by the Government that the Goods and Services Tax (GST) will increase from 3% to 5% with effect from 1st January 2003 requires the business community in Singapore to prepare the necessary groundwork and familiarise itself with the implications arising from the change in their business activities.

Transitional arrangements are necessary particularly in the case of transactions spanning the implementation period. The Inland Revenue Authority of Singapore ("IRAS") has recently issued a handbook entitled "GST Rate Change – A guide for GST-registered businesses" which sets out the transitional rules to be observed for supplies of goods and services straddling 31st December 2002.

WHAT IS GST?

Goods and Services Tax (GST) is a tax on the taxable supply of goods or services made in Singapore by a taxable person in the course or furtherance of any business carried out by him.

In general, goods sold or services performed in Singapore are taxable. The only exceptions are financial services and the sale or lease of residential properties which are exempt supplies.

Basic Terms in GST

Taxable person	A person who is required to register or is registered for GST. Only a taxable person can charge GST.
Taxable supply	A supply of goods or services made in Singapore other than an exempt supply.
Exempt supply	GST is not chargeable on an exempt supply. Generally, any GST incurred in making exempt supplies cannot be claimed as input tax.
Output tax	The GST charged on the sale of goods or provision of services, collected by the GST registered person and payable to the Comptroller.
Input tax	The GST paid by the GST registered person on supplies of goods and services used for the making of taxable supplies.
Time of supply	The time when supply of the goods or services has taken place for accounting of GST.
Tax invoice	An invoice in an approved form that includes certain specific information.

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GST AND THE CONSTRUCTION INDUSTRY

Supplies in the construction industry, with its unusual payment system and development process, attract a unique set of requirements for GST reporting:

- All supplies of construction activities, including professional fees, construction works, etc, are subject to GST irrespective of the type of properties in which the works are carried out.
- Sales or lease of residential properties are exempt from GST i.e. developers of residential properties are unable to collect any output tax from their sales or lease of residential properties and the GST incurred in delivering the properties cannot be claimed as input tax.
- Generally, supplies of construction activities provide for progress payments scheme, and GST is chargeable at the earlier of the following:
  - When a payment is received for the supplies; or
  - When a tax invoice is issued.
- Indemnity payments by insurance companies and damages for breach of warranty are not subject to GST.
- Out of court settlements and damages in respect of taxable supplies are subject to GST.
- Liquidated damages are NOT subject to GST.

TRANSITIONAL MATTERS

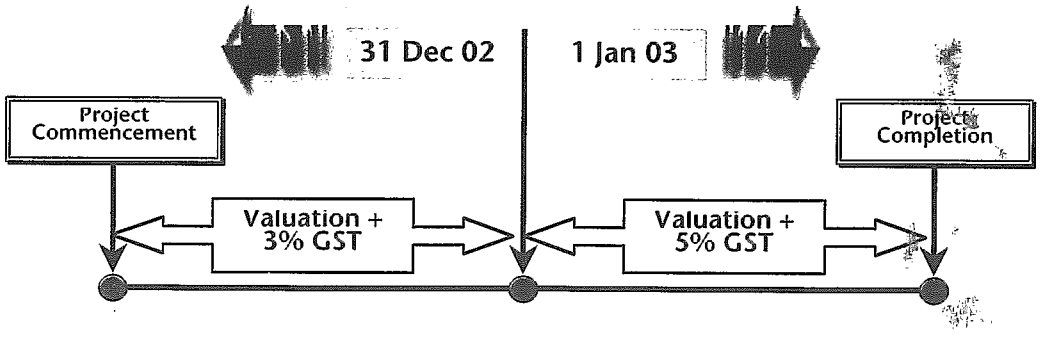
We shall now consider some of the salient transitional matters arising from the change in the GST rate. As the transitional rules can vary across transactions, professional advice should be obtained on their application before acting on them.

1 Progress Payments – Ongoing Contracts

Payment for construction services is normally made periodically. The Contractor typically receives such payments for work done (including variations and unfixed materials) when certain milestones are achieved or upon issue of payment certificates by the contract administrator.

For contracts that straddle 1st January 2003, the transitional rules provide that:

- Supplies on or before 31st December 2002 ⇨ GST is chargeable at 3%
- Supplies on or after 1st January 2003 ⇨ GST is chargeable at 5%



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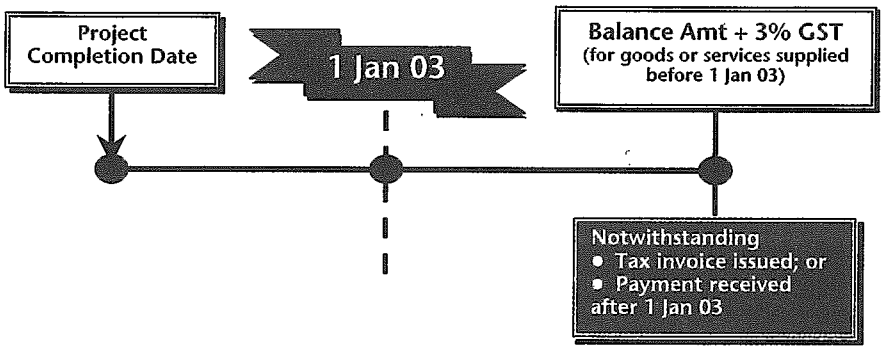
To draw a clear line between work done before and after the change in rate, a valuation should be carried out in each project to determine the value of work done (including variations and unfixed materials) of the Contractor and all sub-contractors as of 31st December 2002. The new GST will then apply to all valuations after the effective date.

The above equally applies in the case of disbursement of professional fees.

2 Final Account – Completed Projects

Settlement of final accounts to establish the final value of the works (including all variations) normally takes place sometime after completion of the project. Any balance payments arising from the difference between the final contract sum and the previous certified payments are effected thereafter in a final certificate.

For projects where the works are fully completed before 1st January 2003, the transitional rules allow any balance payment made on or after 1st January 2003 to be charged at 3% GST. This is because such payments relate to goods delivered and/or services performed before the commencement of the new rate.



3 Retention Payment

Most contracts provide for retention and the release of such retention monies is linked to the achievement of prescribed milestones or performance of the contract but usually on completion of the works and/or upon satisfactory discharge of contractual obligations under the defects liability/maintenance period.

The transitional rules in respect of the release of retention monies after 31st December 2002 can be summarised as follows:

- Project completed before 1st January 2003
  - ⇨ GST is chargeable at 3% on the whole retention amount.
- Project PARTIALLY completed as of 31st December 2002
  - ⇨ GST is chargeable at 3% on the apportioned retention amount that bears to the value of work completed as of 31st December 2002.
  - ⇨ GST is chargeable at 5% on apportioned retention amount that bears to the value of work done on or after 1st January 2003.

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Apportionment of retention sum

Prior to payment of any retention monies, the respective portion of retention that attracts 3% or 5% GST must be identified. Apportionment of retention amount may be based on valuation of works as of 31st December 2002 relative to the contract sum.

Illustrated Example

1. Contract particulars:
   - Contract Sum ... $15,000,000
   - Limit of Retention (5% of Contract Sum) ... $ 750,000

2. Scenario 1 – Where Contract Works FULLY completed on or before 31st December 2002:
   - Retention subject to 3% GST (notwithstanding amount is released on or after 1st January 2003) ... **$750,000.00**

3. Scenario 2 – Where Contract Works PARTIALLY completed on 31st December 2002 and retention is released on or after 1st January 2003:

   Applying the same contract particulars as in item 1 together with the following additional information:
   - Valuation as of 31st December 2002 ... $12,000,000
   - First half of the retention amount released upon completion say on 31st March 2003
   - Second half of the retention amount released after maintenance period say on 31st March 2004

   3.1 Prior to release of the retention amount, apportion retention based on valuation of works as of 31st December 2002 relative to the contract sum as follows:

   - Portion of retention subject to 3% GST:

     $\frac{12,000,000}{15,000,000}$ x $750,000 = **$600,000.00**

   - Portion of retention subject to 5% GST:

     $750,000.00 less $600,000.00 = **$150,000.00**

   3.2 Total amount payable when first half of retention is released on 31st March 2003:

	Amount	GST	Sub-Total
Retention subject to 3% GST	$375,000.00	$11,250.00	$386,250.00
Retention subject to 5% GST	-	-	-
Total Amount Payable	**$375,000.00**	**$11,250.00**	**$386,250.00**

   3.3 Total amount payable when second half of retention is released on 31st March 2004:

	Amount	GST	Sub-Total
Retention subject to 3% GST	$225,000.00	$6,750.00	$231,750.00
Retention subject to 5% GST	$150,000.00	$7,500.00	$157,500.00
Total Amount Payable	**$375,000.00**	**$14,250.00**	**$389,250.00**

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4 Tender Deposits

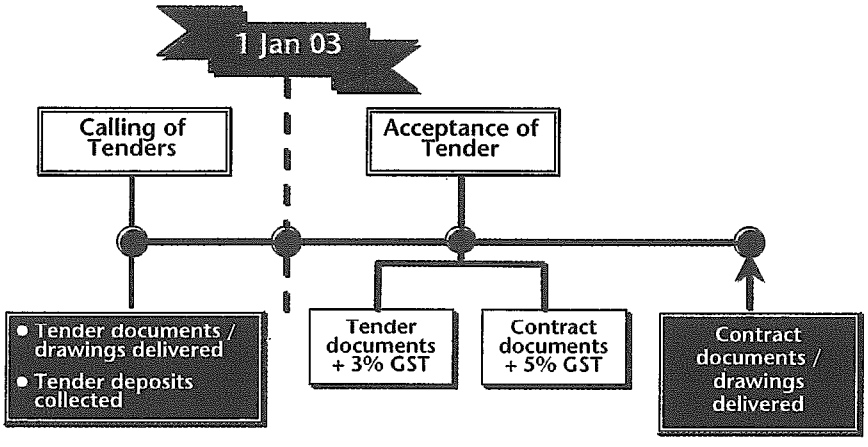
Tender deposits are stipulated in almost all tenders:

- As a security to ensure that tenderers comply with the conditions of tendering. The amounts are subsequently refunded and therefore GST is not chargeable on such deposits.
- For the purchase of copies of tender/contract documents and drawings. GST then becomes payable.

It is common industry practice to collect tender deposits from all tenderers when tenders are called. Upon acceptance of the tender, the tender deposit of the successful tenderer is retained for defraying the cost of printing the tender and/or contract documents and drawings.

Where the tender exercise straddles 1st January 2003, GST is chargeable on printing of documents and drawings as follows:

- Before 1st January 2003 ⇨ 3%
- On or after 1st January 2003 ⇨ 5%



It is good practice to review all tenders called prior to the implementation of the new rate to ensure sufficient funds are provided.

5 Insurances

Owners should also consider, in view of their own GST status, whether or not to adjust the GST included in the insured value of their property for reinstatement cost purposes.

The foregoing provision also applies to contract insurances. GST should be adjusted, as appropriate, in the computation of the Total Sum Insured under Section I of the Contractors' All Risks Policy.

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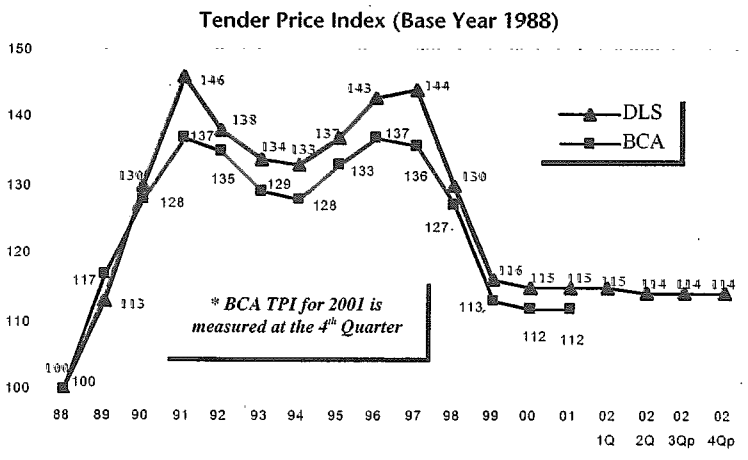
CONCLUSION

The implementation of a change in the GST rate places, initially at least, an additional administrative burden on registered businesses. Accounting systems must be adjusted to be able to identify and account for the correct amounts of input tax and output tax.

Each business should evaluate its own requirements and existing system limitations to identify the most efficient way to address the impact of the new GST on the way of doing business.

As construction cost is an essential factor in assessing development costs, we would like to share with you the latest Davis Langdon & Seah Singapore Pte Ltd Tender Price Index (DLS TPI) with forecasts for the 3rd and 4th Quarters of 2002.

DLS TPI is a measure of the comparative tender price movements based on the projects handled by DLS Singapore Pte Ltd. TPI reflects the tender price level of contracts let out over the years. Other than material and labour costs, TPI takes into account the element of competition, risk and profits. Besides the DLS TPI, two other established indices are the Building and Construction Authority Tender Price Index (BCA TPI) and PWD TPI.



Marginal, flat, soft, dull - all these terms can be used to describe the tender prices and the market at the moment.

Tender prices showed marginal movements in the 1st and 2nd Quarters of 2002 as compared to 2001. This will be the scenario for the next two quarters of 2002.

The economic situation, which is still soft and low demand in the industry, can best explain this flat and dull trend of the TPI.

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