SINGAPORE: TAX ON DISPOSAL OF FOREIGN ASSETS

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Tags
Capital Gains
C.O.C.G. Guidance
P.E.H.E.
Section 10L
Section 10(25)
Singapore

INTRODUCTION

On June 6, 2023, the Singapore Ministry of Finance ("M.O.F.") released for public consultation 33 proposed legislative amendments to the Income Tax Act 1947 ("S.I.T.A.").

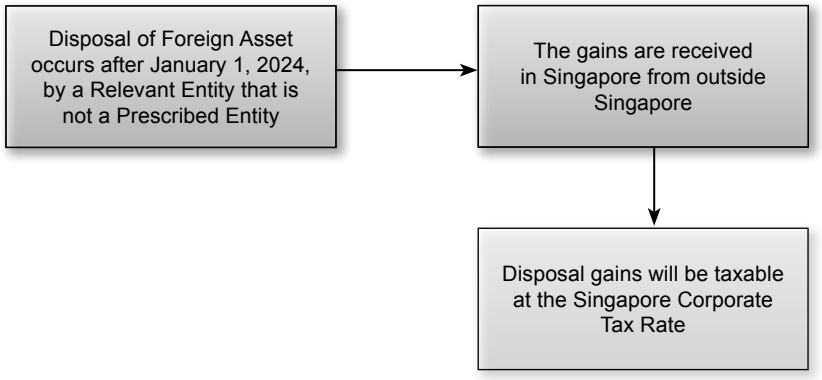
Under the Proposed Section 10L, the proceeds of gains arising from the sale or disposal of a Foreign Asset received in Singapore from outside of Singapore by a Relevant Entity will be treated as income chargeable to tax under Section 10(1)(g) of the S.I.T.A. In addition, the Inland Revenue Authority of Singapore ("I.R.A.S.") will have the power to adjust the disposal gains where the consideration is not at market value. The change in law will be effective from January 1, 2024. It will override anything to the contrary in the S.I.T.A. except for certain Prescribed Entities.

On September 8, 2023, the M.O.F. issued feedback to comments it received in regard to Section 10L. This article explains the context of Section 10L and the I.R.A.S. feedback to comments received.

PURPOSE OF SECTION 10L

Section 10L was introduced to align the treatment of disposal gains from the sale of foreign assets to the E.U. Code of Conduct Group Guidance ("C.O.C.G. Guidance"). In December 2022, updated Guidance on Foreign-Sourced Income Exemption Regimes ((F.S.I.E. Regimes") was introduced to explicitly require capital gains, as a general class of income covered by an F.S.I.E. Regime, to be subject to an economic substance requirement.

OPERATION OF SECTION 10L



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SCOPE OF SECTION 10L

The scope of Section 10L is wide. It overrides all other provisions in the S.I.T.A. that would provide a contrary result, such as treating gains as not taxable or exempt under the S.I.T.A. Hence, the provisions of Section 10L would override Section 13W, which exempts gains or profits from the disposal of ordinary shares under certain constraints.

DEFINITION OF A RELEVANT ENTITY

A Relevant Entity is any entity having financial results that are included in a set of consolidated financial statements prepared by the parent entity of the group, provided that at least one member of the group has a place of business outside Singapore. The term Entity is defined as any legal person, including a limited liability partnership. It does not include an individual, a general partnership, a limited partnership, or a trust.

Based on the above, individually owned businesses, individuals, and foreign businesses that are not operating in or from Singapore are not subject to Section 10L.

DEFINITION OF A PRESCRIBED ENTITY

Section 10L only applies to Relevant Entities that are not specifically excluded. Entities that are specifically excluded are known as Prescribed Entities, and include

- financial institutions defined in the Financial Services and Markets Act 2022;
- entities generating income that is exempt from tax or is taxed at a concessionary rate under the specified provisions of the law related to specific substantive business activities in Singapore. An example is an entity that qualifies for benefits under the global trader program. Examples of entities that will continue to be Relevant Entities are Singapore funds and family offices that benefit from incentives; and
- Excluded Entities, as defined below.

DEFINITION OF AN EXCLUDED ENTITY

An Excluded Entity is a Prescribed Entity that does not qualify as an Entity described in the first two bullets in the preceding paragraph, but meets certain economic substance requirements in Singapore.

Depending on whether the “Excluded Entity” is a Pure Equity-Holding Entity (“P.E.H.E.”) or an entity that is not a (“Non-P.E.H.E.”), prescribed economic substance requirements will need to be met.

P.E.H.E.

This is an entity whose main function is to hold shares or equity interests and derives only (i) dividends, (ii) disposal gains, and (ii) incidental income. The entity will need to comply with various obligations imposed under Singapore law and have its

operations managed and performed in Singapore by employees or other persons that operate through local outsourcing arrangements.

Non-P.E.H.E.

This is an entity that is not a PEHE. The entity will need to have its operations managed and performed in Singapore and have reasonable economic substance in Singapore in terms of employees or other persons who perform services in Singapore under local outsourcing arrangements.

Reasonable economic substance will be determined based on the following factors:

- The number of employees or magnitude of outsourcing arrangements
- The experience and qualifications of the employees or individuals involved in the outsourcing arrangement
- The amount of business expenditure incurred inside and outside of Singapore relative to the entity's income
- Whether key business decisions are made by persons in Singapore

In the M.O.F. feedback, the M.O.F. agreed that a Non-P.E.H.E. need not carry on a trade, business, or profession in Singapore. The requirement will be removed in the final wording of Section 10L.

Economic Substance

During the consultation period, comments were received asking the M.O.F. to legislatively prescribe bright-line tests that would establish whether economic substance requirements have been met. Minimum thresholds would be an example of the requests received. The purpose of this would be to reduce uncertainty for taxpayers in determining if disposal gains are subject to tax.

The M.O.F. did not accept this request, commenting that it would not be practical to prescribe minimum thresholds in legislation because business models and scale of operations vary even within the same sector. However, the I.R.A.S. stated it would provide further guidance through an e-Tax Guide, including examples for certain sectors.

The I.R.A.S. will require Entities to maintain all records reasonably required to ascertain (i) the circumstances in which disposal gains would be considered to have been received in Singapore, (ii) the computation of the taxable gains, and (iii) the relevant economic substance requirements have been met.

It is not clear yet whether the I.R.A.S. will implement an advanced ruling process for Entities regarding sufficient substance. In comparison, Hong Kong an implemented an advanced ruling system to provide certainty to taxpayers.

THE DEFINITION OF A FOREIGN ASSET

The I.R.A.S. will use certain determining factors to assess where an asset is situated. Section 10L describes the appropriate factor for most types of assets:

- For shares, it is where the disposed entity is incorporated.
- For immovable property, it is where the property is located.
- For a ship or aircraft, it is where the owner is resident.
- For intangible movable property, it is where the ownership rights would be primarily enforceable.
- For secured or unsecured debt, it is where the creditor is resident.
- For tangible movable property not covered elsewhere, it is where the property is located.

GAINS RECEIVED IN SINGAPORE

Section 10L applies only in cases where the proceeds of gains arising from the sale of assets located outside Singapore are received in Singapore. The statute defines transactions where the consideration or proceeds of gain are received in Singapore:

- Any amount of the consideration or proceeds is remitted to, transmitted to, or physically brought into Singapore.
- Any amount of the consideration or proceeds is applied towards the satisfaction of any debt incurred in respect of a trade or business carried on in Singapore.
- Any amount of the consideration or proceeds is applied to the purchase of movable property that is brought into Singapore.

"Section 10L applies only in cases where the proceeds of gains arising from the sale of assets located outside Singapore are received in Singapore."

The above definition is almost identical to the wording under Section 10(25) of the S.I.T.A.:

> To avoid doubt, it is declared that the amounts described in the following paragraphs are income received in Singapore from outside Singapore whether or not the source from which the income is derived has ceased:
>
> a) any amount from any income derived from outside Singapore which is remitted to, transmitted or brought into, Singapore;
>
> b) any amount from any income derived from outside Singapore which is applied in or towards satisfaction of any debt incurred in respect of a trade or business carried on in Singapore; and
>
> c) any amount from any income derived from outside Singapore which is applied to purchase any movable property which is brought into Singapore.

It is widely expected that the principles of existing I.R.A.S. guidance under Section 10 (25) will apply to Section 10L. Here are several examples.

Re-investment of Proceeds Outside of Singapore

With respect to Section 10(25), the I.R.A.S. has clarified that proceeds of foreign source income reinvested overseas without repatriation to Singapore should not be considered to have been received in Singapore as a result of reinvestment overseas. Taxation continues to be deferred.

Payment of Overseas Dividend

Similarly, with respect to Section 10(25), the I.R.A.S. has clarified that foreign source income should not be considered to be received in Singapore under Section 10(25) where such income is utilized to pay a single tier, tax exempt dividend directly into a shareholder's offshore bank account and does not involve a physical remittance, transmission, or bringing of funds into Singapore.

Satisfaction of Trade Debts

It is unclear whether the use of foreign income to satisfy debts incurred by a Relevant Entity that is an investment holding company not conducting a trade, business, or operation and not having economic substance in Singapore would be considered as having been received or deemed received under Section 10(25)(b), in light of the Section 10L provisions which emphasize economic substance. Section 10(25)(b) may not provide guidance as the I.R.A.S. position in the context of Section 10(25) is that a passive investment holding company is not considered to be carrying on a trade or business in Singapore.

TAXATION OF DISPOSAL GAINS UNDER SECTION 10L

Given the above provisions, gains arising from the sale of foreign assets that fall within the scope of Section 10L, but are not considered to be received in Singapore, are not subject to tax in Singapore until received or deemed received in Singapore. At that time, the Entity will be taxable on the disposal proceeds, reduced by any expenditure incurred to acquire, protect, preserve, create, or improve the foreign asset or to sell or dispose of the foreign asset.

To the extent that the sales price is determined to be less than the open-market price, the I.R.A.S. is able to adjust the sales price to the open market price.

The M.O.F. feedback also confirmed that it will allow foreign source disposal losses to be set off against foreign source disposal gains that are subject to tax. The set-off will be restricted to foreign source disposal losses that would have otherwise been brought to tax if they were gains. In addition, unutilized foreign source disposal losses may be carried forward indefinitely for setoff against foreign sourced disposal gains in future years.

HONG KONG

Effective January 1, 2023, Hong Kong implemented similar rules to tax foreign-sourced income ("F.S.I.E."), such as dividends, interest, royalties, and capital gains. As a result of the C.O.C.G. Guidance, Hong Kong will make some adjustments to its F.S.I.E. Regime, effective January 1, 2024.

CONCLUSION

The Proposed Section 10L will impose tax on gains derived from the disposal of foreign assets by non-Prescribed Entities that are considered Relevant Entities where the disposal proceeds are received in Singapore. Multinational groups that use Singapore as a holding jurisdiction for regional assets should revisit their holding structures to ensure that the Singapore Entities have adequate economic substance in Singapore. Without such substance, gains realized from the disposal of assets located outside Singapore tax in Singapore could be taxed in Singapore beginning January 1, 2024, if the resulting proceeds that are received in Singapore.