30 August 2023

Tax alert

Proposed taxation of gains from sale of foreign assets received in Singapore by businesses without economic substance

The Ministry of Finance (MOF) recently proposed legislative amendments to the Singapore Income Tax Act 1947 (SITA) to tax gains from the sale or disposal of foreign assets that are received in Singapore by businesses without economic substance in Singapore even if the gains are capital in nature or tax exempt (e.g., under Section 13W of the SITA), unless certain exceptions are met. The proposed legislation is currently under public consultation and if passed, is expected to apply to gains received in Singapore from outside Singapore from the sale or disposal of foreign assets on or after 1 January 2024.

The proposed change appears to be a departure from the long-standing Singapore tax treatment of not taxing gains on disposal of assets as long as they are capital gains (whereby capital gains are not taxed in Singapore).

The rationale of the proposed change is to align the tax treatment of gains from the sale of foreign assets to the EU Code of Conduct Group guidance, which aims to address international tax avoidance risks. The proposed change is also in line with Singapore's focus on anchoring substantive economic activities in Singapore.

This alert provides a summary of the proposed changes and our observations. As the proposal has not been legislated, you should monitor this development and the potential implications for your business. EY has also submitted feedback to the MOF as part of the public consultation process.

Backdrop

Current tax treatment

Under Section 10(1) of the SITA, income accruing in or derived from Singapore (Singapore-sourced) or received in Singapore from outside Singapore (foreign-sourced) is subject to tax in Singapore unless otherwise exempted.

Under Singapore's foreign-sourced income exemption (FSIE) regime, specified foreign-sourced income (i.e., dividends, service income and branch profits) received in Singapore by a Singapore tax resident is exempt from tax, subject to meeting certain conditions.

Singapore does not impose tax on gains of a capital nature. However, the SITA does not define "revenue" (income) or "capital". Whether a receipt is revenue or capital in nature is therefore a question of facts and circumstances.

Section 13W of the SITA provides a safe harbour tax exemption for gains derived by a company from the disposal of ordinary shares where the divesting company held at least 20% of the ordinary shares in the investee company for a continuous period of at least 24 months immediately prior to the date of share disposal. If the conditions are not met, the tax treatment of such gains will continue to be determined based on normal tax rules.

Tax updates

The MOF released the draft Income Tax (Amendment) Bill 2023 for public consultation on 6 June 2023. Aside from the amendments to implement budget measures, a new Section 10L was introduced, which operates to treat gains from the sale or disposal of "foreign assets" that are "received in Singapore" by a "relevant entity" on or after 1 January 2024 as income chargeable to tax under Section 10(1)(g) of the SITA, unless exceptions apply. The proposed section 10L applies even if the gains are capital in nature or tax exempt (e.g., under Section 13W of the SITA).

Where the disposal occurs prior to 1 January 2024, the gains received in Singapore on or after 1 January 2024 by a relevant entity would not be caught under the scope of Section 10L.

The proposed legislation seeks to align the tax treatment of gains from the sale of foreign assets to the EU Code of Conduct Group guidance. In December 2022, the EU Code of Conduct Group guidance was updated to require an FSIE regime to include capital gains as a category of income which should be subject to the economic substance requirement[1].

Foreign assets

Foreign assets refer to movable or immovable properties situated outside Singapore. The proposed legislation sets out specific rules on where these properties are situated, and include (amongst others):

- Immovable property and tangible movable property are situated where the property is physically located.
- Intangible movable property is situated where the ownership rights in respect of the property are primarily enforceable.
- Secured or unsecured debt (other than a judgment debt or securities) is situated where the creditor is resident.
- Shares or securities (including any right or interest in such shares or securities) are generally situated where the company/ issuer was incorporated.

Received in Singapore

Section 10L(7) sets out when gains from the sale or disposal of foreign assets are regarded as received in Singapore. Gains are received in Singapore when they are:

- Remitted to, transmitted or brought into Singapore.
- Applied in or towards satisfaction of any debt incurred in respect of a trade or business carried on in Singapore.
- Applied to purchase any movable property which is brought into Singapore.

These rules are similar to the existing remittance rules under Section 10(25) of the SITA.

Relevant entity

The proposed Section 10L applies to entities that are part of a consolidated group of entities where at least one member of the group has a place of business outside Singapore.

An entity is excluded from the scope of Section 10L if it is:

- A financial institution.
- An entity whose income is exempt from tax, or is taxed at a concessionary tax rate under certain specific tax incentives schemes in Singapore.
- An Excluded Entity, i.e., entity that meets certain economic substance requirements (elaborated below).

Economic substance requirements for excluded entities

Pure equity-holding entity*	Non-pure equity-holding entity

▶ Comply with registration and filing requirement
▶ Operations of the entity are managed and performed in Singapore (whether by its employees or other persons)
	▶ Carries on a trade or business profession in Singapore
	▶ Operations of the entity are managed and performed in Singapore (whether by its employees or other persons)
	▶ Has reasonable economic substance in Singapore taking into account:
	  ▶ Number of employees (or other persons managing or performing the entity's operations) in Singapore
	  ▶ Qualifications and experience of the employees
	  ▶ Amount of business expenditure incurred by the entity in and outside Singapore
	  ▶ Whether the key business decisions of the entity are made by persons in Singapore

[1] "Council of European Union's Report dated 24 November 2022 (14674/22)", *The European Council website*, https://data.consilium.europa.eu/doc/document/ST-14674-2022-INIT/en/pdf.

* Refers to an entity whose primary function is to hold shares or equity interests, and derives only (i) dividends or similar payments from shares or equity interests, (ii) gains on the sale or disposal of shares or equity interests, or (iii) income incidental to its activities of holding shares or equity interests.

Overall comments

Section 10L, if enacted, would be a significant departure from the long-standing Singapore tax treatment of capital gains on disposal of assets (whereby capital gains are not taxed in Singapore), and is reflective of Singapore's focus on anchoring substantive economic activities in Singapore. We provide some initial comments below.

Scope of Section 10L

The proposed Section 10L treats all gains from the sale or disposal of foreign assets that are received in Singapore by relevant entities as income chargeable to tax under Section 10(1)(g) of the SITA, unless exceptions apply, even if such gains are capital in nature or tax exempt (e.g., under Section 13W of the SITA). Nevertheless, Section 10L should not undermine Singapore's semi-territorial taxation regime where foreign-sourced income is only taxable in Singapore when received in Singapore. Hence, the impact of Section 10L may be limited to the extent that such gains on sale of foreign assets are not remitted to Singapore.

We also note that Section 10L currently does not provide for a carve out or exclusion in the case of intra-group transfers. In order not to deter or hinder genuine intra-group restructurings that are carried out for bona fide commercial reasons, it is hoped that special provisions could be provided for intra-group transfers, similar to the stamp duty relief for transfer of assets between permitted entities (with necessary modifications). If this is not within the expectation of the EU Code of Conduct Group, then to at least consider a regime that allows for deferral on tax for such intra-group restructuring involving foreign assets until upon a sale or disposal to a party outside the group.

Remittance rules

With a separate set of remittance rules under Section 10(L(7), it raises uncertainty on whether the Inland Revenue Authority of Singapore's (IRAS) administration of the remittance rules in Section 10L(7) would mirror the administration of Section 10(25). For example, the remittance rules are not triggered where a non-Singapore entity without any operations in Singapore merely receives an amount to its Singapore bank account, but this is an administrative concession under Section 10(25).

Exceptions for tax incentivised companies

We note that the exceptions that apply to tax incentivised companies do not include entities incentivised under the various fund incentive schemes such as Sections 13D, 13O,13U and 13V under paragraph 10L(6)(b). As such, they will need to rely on being an Excluded Entity, which requires an annual factual assessment. Considering the far-reaching implications of not being an Excluded Entity for such entities, investors may desire certainty and request annual advance rulings from the IRAS to confirm the Excluded Entity status. However, the conditions for the tax incentive schemes under Sections 13D, 13O, 13U and 13V are substance-based and include being managed or directly advised by a prescribed fund manager in Singapore. Given a very large number of entities under these incentive schemes, it is not practical for them to reach out to the IRAS on a case-by-case basis to seek ruling or confirmation that Section 10L does not apply. It is hoped that this matter would be addressed by either including these exemptions within the scope of paragraph 10L(6)(b), or by giving the Minister power to designate additional types of entities for the purposes of paragraph 10L(6)(b).

Economic substance requirements

It is common for investment holding entities that hold shares or equity interests in other entities to provide debt financing (in addition to equity financing) as part of the financing or capital structure for their underlying investments. In this regard, clarity is required as to whether such investment holding entities fall under the definition of "pure equity-holding entity". If this is not the intention, it is suggested that the requirement for the entity to carry on a trade, business or profession in Singapore (in order to be considered as an Excluded Entity) be removed as there could be entities that do not fall within the definition of "pure equity-holding entity" but are not carrying on a trade, business or profession in Singapore.

Further, we note that the conditions for economic substance are subjective and compliance with them can be onerous. An e-tax guide providing further guidelines on when the conditions will be deemed to be met would be helpful.

Conclusion

As the proposed Section 10L is still in draft form and may be subject to change, it is too early to comment on its provisions in detail. EY has also submitted feedback to the MOF as part of the public consultation process. The MOF has indicated that they will publish a summary of the main comments received, together with their responses, in August 2023. Meanwhile, taxpayers should monitor this development and the potential implications for their businesses.

If you would like to know more about the issues discussed or EY services, please contact one of the following or your usual EY contact:

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