KPMG

Tax alert

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Taxing gains on the sale of foreign assets

The Ministry of Finance (MOF) released 33 proposed legislative amendments to the Income Tax Act 1947 on 6 June 2023 for public consultation. Besides 19 proposed amendments to effect tax measures announced in the 2023 Budget Statement on 14 February 2023, there are 14 non-Budget proposed amendments arising from international tax developments and MOF's periodic review of Singapore's tax system to better reflect policy objectives and to improve tax administration.

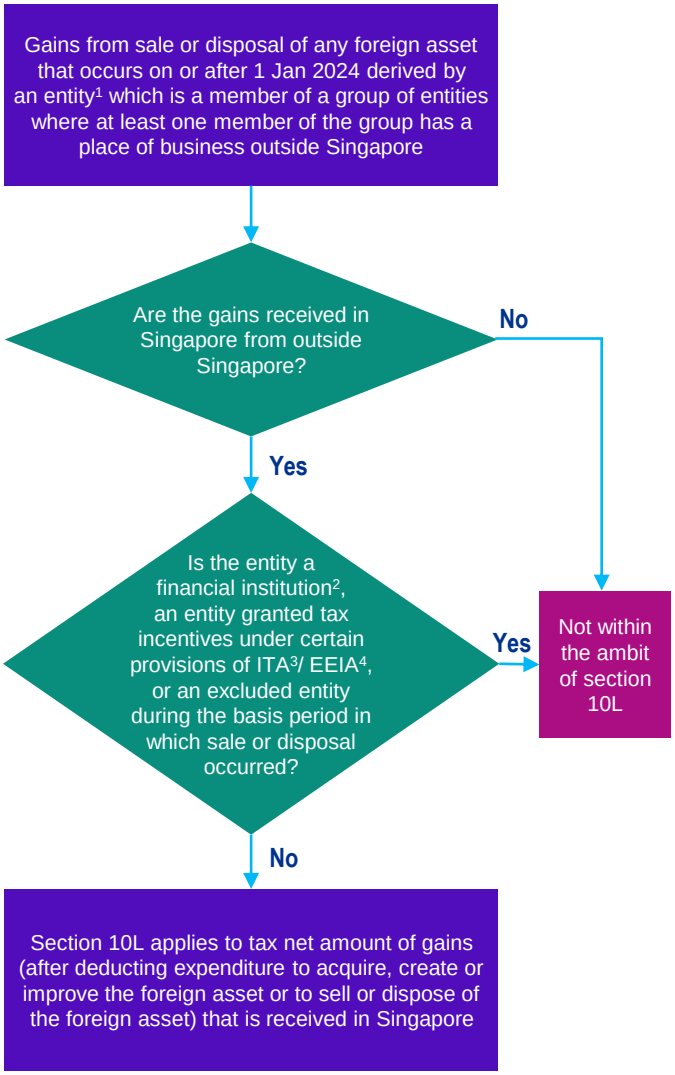
A key non-Budget proposed amendment is the introduction of section 10L to tax gains from the sale or disposal of any immovable or movable property situated outside Singapore (collectively "foreign assets") that are received in Singapore by businesses without economic substance in Singapore.

In this tax alert, we focus on section 10L and provide insights on the proposed change which will apply to gains from the sale or disposal of foreign assets occurring on and after 1 January 2024.

Section 10L in detail

The introduction of this new section is meant 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 change is in line with Singapore's focus on anchoring substantive economic activities locally.

The flowchart on the right depicts the scope of section 10L.



Note:

1 Entity refers to
a) any non-individual legal person (including a limited liability partnership);
b) a general partnership or limited partnership; or
c) a trust.

2 as defined in the Financial Services and Markets Act 2022

3 Section 13A, 13E, 13P. 43C, 43E, 43I, 43J, 43L, 43N, 43P, 43Q, 43R or 43U of the Income Tax Act 1947

4 Parts 2, 3 or 4 of the Economic Expansion Incentives (Relief from Income Tax) Act 1967

Some of the key features and implications of the proposed section 10L are summarised below.

Non-obstante provision

- It is important to note that the proposed section 10L starts with a non-obstante clause (i.e. "Despite anything in the Act") giving it wide powers to override any other provisions in the Singapore Income Tax Act (SITA).
- It is also specified in the provision that section 10L would apply if the gains would not otherwise be treated as income for Singapore tax purposes or if the gains would otherwise be exempt from tax under the SITA.
- Hence, the provisions of section 10L would override other specific tax exemption provisions, such as section 13W (Exemption of gains or profits from disposal of ordinary shares). This would mean that gains from the sale of ordinary shares in a foreign company that are received in Singapore by an in-scope entity may be taxed under section 10L going forward, notwithstanding that such gains may qualify for exemption under section 13W.

Section 10L should not apply to the following entities:

- Entities whose assets, liabilities, income, expenses and cash flows are not included in the parent entity's consolidated financial statements in accordance with generally accepted accounting principles
- Entities which form part of a local group of entities, where none of the members of the group has a place of business outside Singapore
- A financial Institution, as defined in the Financial Services and Markets Act 2022
- An entity whose income is exempt from tax or is taxed at a concessionary rate of tax under the prescribed provisions of the law (such as entities enjoying the Pioneer, Development and Expansion Incentive, Global Trader Programme, Finance and Treasury Centre incentives). Note that entities availing of the Singapore fund tax incentive schemes (e.g. section 13D, 13O and 13U tax incentives) are not specifically excluded from the scope of section 10L
- Non-resident individuals and foreign businesses that are not operating in or from Singapore
- An entity that qualifies as an "excluded entity", which essentially refers to an entity with reasonable economic substance in Singapore

Definition of an excluded entity

Broadly, an entity may qualify as an "excluded entity" if it meets certain economic substance requirements in Singapore.

For a pure equity-holding entity (which refers to an entity whose primary function is to hold shares or equity interests in other entities; and that has no income other than dividends, gains from sale or disposal of such interests and incidental income from the holding of such interests), one of the main conditions for it to qualify as an "excluded entity" is that the operations of the pure equity-holding entity has to be managed and performed in Singapore, whether by its employees or other persons.

Entities that are not pure equity-holding entities, on the other hand, would be subject to higher economic substance requirements, taking into account factors such as whether the entity carries on a trade or business in Singapore, the number, qualifications and experience of its employees (or other persons), the amount of business expenditure incurred by the entity and whether its key business decisions are made in Singapore.

Received or deemed received provision

The proposed section 10L only applies in case of gains arising from the sale of foreign assets that are "received in Singapore" from outside Singapore. The following gains from the sale or disposal of any foreign asset are treated as "received in Singapore" from outside Singapore:

a) any amount from such gains that is remitted to, or transmitted or brought into Singapore;
b) any amount from such gains that 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 such gains that is applied to the purchase of any movable property which is brought into Singapore.

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, should not be subject to tax in Singapore until they are received or deemed received in Singapore.

The aforesaid provisions, with respect to gains considered to be "received in Singapore", are similar to existing provisions under section 10(25) of the SITA. With respect to the provisions of section 10(25), the IRAS has clarified that foreign-sourced income utilised to reinvest overseas without being repatriated to Singapore should not be considered "received in Singapore" at the point of reinvestment. This means that the taxation of such foreign-sourced income is temporarily deferred until the investment is sold and the proceeds are brought into Singapore. Given the similarity in provisions relating to what is considered "received in Singapore" under sections 10(25) and 10L, it would be helpful to see similar specific IRAS clarification on the aforesaid rules to provide certainty in terms of usage of foreign income.

Another example where the IRAS has clarified that the foreign-sourced income should not be considered "received in Singapore" [under section 10(25)] is where such income is utilised to pay one-tier tax-exempt dividend directly into the shareholder's offshore bank account and does not involve any physical remittance, transmission or bringing of funds into Singapore. Similar clarification by the IRAS for section 10L provision would be welcome.

It is unclear whether the use of foreign income to satisfy debts incurred by an included entity (e.g. an investment holding company that does not have a trade, business or operations nor economic substance in Singapore) would be considered as received or deemed received under section 10(25)(b), in light of the section 10L provisions which emphasise economic substance.

Computation of disposal gains or losses

Based on how the section 10L provisions have been drafted, only expenditure incurred to acquire, create or improve the foreign asset or to sell or dispose of the foreign asset is allowed as a tax deduction in computing the gains chargeable to tax.

The current provisions do not allow for the rebasing of the cost of assets to those as at the effective date of the new section 10L when computing the taxable amount of disposal gains to avoid any retrospective application of section 10L provisions. We understand that a similar issue is also present in the Hong Kong foreign-sourced income exemption (FSIE) regime and that the Hong Kong government has raised this concern with the EU for consideration. Discussion outcomes between the Hong Kong government and the EU on this matter should be taken into consideration by the MOF when finalising the section 10L provisions.

Intra-group transfer relief

Currently, there are no specific carve-out provisions for the transfer of foreign assets between associated companies and arising from internal group restructuring exercises. It would be useful to see such provisions included in the final legislation for section 10L.

Key takeaways

MNEs with headquarters outside Singapore and using Singapore as a platform/intermediate jurisdiction to invest overseas will have to revisit their holding structure to ensure it has adequate economic substance in Singapore, so that the gains on disposal of foreign assets (on or after 1 January 2024) that are received in Singapore are not subject to tax in Singapore.

Singapore-based fund managers should closely monitor future developments in this area, as well as further clarifications/guidance to be issued by the IRAS on implementation details, given that investment entities availing of the Singapore fund tax incentives are not specifically carved out from section 10L provisions. Based on the draft provisions, investment holding entities that carry out lending activities (including providing shareholder's loans to its subsidiaries/investee entities) could be subject to higher economic substance requirements based on a narrow interpretation of the current definition of "pure equity-holding entity". Such entities, which in most cases have minimal operations, could thus be impacted by the new provisions, depending on how the economic substance requirements are to be administered in practice.

The economic substance requirements, however, recognise that there could be outsourcing of operations to other persons. In this regard, the substance of the Singapore-based fund manager of investment holding entities can be taken into account when assessing the reasonableness of the relevant entity's economic substance in Singapore.

Another point to note is that the maintenance of contemporaneous documentation by in-scope entities to substantiate the fulfilment of the relevant economic substance requirements in the basis period in which the sale or disposal occurred would be of paramount importance, especially if the gains are only received in Singapore in subsequent basis periods.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

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