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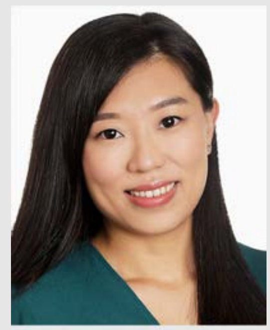
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In this article, the authors explain changes to the taxation of foreign-source income in Hong Kong, Malaysia, and Singapore.

Jurisdictions in Asia continue to be supportive of international tax initiatives to level the playing field and progress toward an equitable future. In complying with changing international tax practices, Asian governments have taken a balanced approach to ensure their jurisdictions remain attractive to investors. This is reflected in the Hong Kong government's legislative amendments to align Hong Kong's tax treatment of foreign-source income with updated international tax standards, including the EU's guidance on foreign-source income exemption (FSIE) regimes. These amendments took effect January 1, 2023, with no grandfathering arrangement, and seek to ensure Hong Kong's FSIE regime does not contain harmful preferential tax elements as it safeguards against double taxation.

Malaysia updated its FSIE regime in 2022 to conform to the EU's guidance while ensuring it remains friendly to multinational enterprises and individuals. The FSIE modifications of the Hong Kong and Malaysia regimes contribute to their competitiveness and attractiveness as holding jurisdictions.

Further modifications to the Hong Kong and Malaysian FSIE regimes are underway to align the taxation of capital gains with the EU Code of Conduct Group's FSIE guidance, updated in late 2022. To conform to the updated standards, Singapore has introduced a new section 10L in the Singapore Income Tax Act 1947 (Singaporean ITA). The legislature passed the bill for the new provision October 3, 2023. Singapore's new section 10L imposes tax on gains from the sale of foreign assets if the recipient does not have economic substance in Singapore.

This article provides an overview of the amended FSIE regimes in Hong Kong and Malaysia, and discusses current developments in Hong Kong, Malaysia, and Singapore over the tax treatment of the relevant foreign-source gains.

Hong Kong

Foreign-Source Income Since January 1, 2023

Hong Kong implements a territorial system of taxation under which persons are only liable to pay profits tax in Hong Kong if they carry on a trade, profession, or business in Hong Kong and derive Hong Kong-source income.

Before Hong Kong's FSIE regime amendments (which took effect January 1, 2023), all foreign-source income was not subject to Hong Kong profits tax.

Under the new regime, four types of foreign-source income that are received in Hong Kong (or deemed to be received) by entities of an multinational enterprise group carrying on a business in Hong Kong are deemed to be Hong Kong-source income, and so taxable in Hong Kong, unless the economic substance requirement is met (if applicable) or another exemption applies.

Under the rules that took effect on January 1, 2023, the changes only affected four types of foreign-source income (specified foreign-source income):

- dividend income;
- interest income;
- income from intellectual property; and
- gains derived from the sale of equity interests (including gains that are capital in nature).

Certain specified foreign-source income is excluded from the rules.

From January 1, the regime was expanded to include all types of foreign-source disposal gains (discussed in further detail below).

Where the deeming rule applies, the foreign-source income would be taxed in the year of assessment in which it is received in Hong Kong.

Covered Entities

The rules only apply to MNE entities, which include any legal person or arrangement that prepares separate financial accounts (such as partnerships and trusts) of a corporate group that operates in more than one jurisdiction. The rules can therefore apply to a stand-alone entity as long as it has a permanent establishment in another jurisdiction.

There is also no de minimis exception. The rules apply regardless of the amount of specified foreign-source income received, and the revenue or asset size of the entity, or the MNE group to which it belongs.

Income 'Received in Hong Kong'

Only income that is received in Hong Kong is covered by the regime. To make this determination, Hong Kong has largely followed the approach adopted in Singapore. Income is regarded as received in Hong Kong if:

- the sum is remitted to, transmitted to, or brought into Hong Kong;
- the sum is used to satisfy any debt incurred in a trade, profession, or business carried on in Hong Kong; or
- the sum is used to buy movable property that is brought into Hong Kong.

That said, the statutory definition of received in Hong Kong is non-exhaustive, so there can potentially be other circumstances in which income is deemed to be received in Hong Kong. As such, income received in an offshore bank account can still be regarded as "received in Hong Kong" depending on the purpose for which the income is applied after receipt.

Exceptions and Exemptions

Certain exceptions and exemptions can apply such that the income deemed to be Hong Kong-source may not be taxable depending on its nature.

Economic Substance Requirement

Non-IP income (dividend income, interest income, and non-IP disposal gains) will not be deemed to be sourced in Hong Kong if the taxpayer satisfies the economic substance

Table 1. Economic Substance Requirement as Applicable to Pure Equity Holding Entities and Non-Pure Equity Holding Entities

Pure Equity Holding Entity	Non-Pure Equity Holding Entity
To meet the economic substance requirement, pure equity holding entities must satisfy the following requirements: 1. Comply with every applicable registration and filing requirement under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), the Limited Partnerships Ordinance (Cap. 37), the Business Registration Ordinance (Cap. 310), and the Companies Ordinance (Cap. 622). 2. Carry out or arrange to be carried out in Hong Kong "specified economic activities." For pure equity holding entities, "specified economic activities" mean the holding and management of equity participations in other entities. 3. Have adequate human resources and premises for carrying out specified economic activities.	To meet the economic substance requirement, non-pure equity holding entities must satisfy the following requirements: 1. Carry out or arrange to be carried out in Hong Kong "specified economic activities." For non-pure equity holding entities, "specified economic activities" mean making the necessary strategic decisions for any assets it acquires, holds, or disposes of, and managing and bearing principal risks for those assets. 2. Have an adequate number of qualified employees in Hong Kong to carry out and incur an adequate amount of operating expenditures in Hong Kong for carrying out specified economic activities.

requirement in the year in which the income accrues.

What the economic substance requirement entails depends on whether the taxpayer is a pure equity holding entity, which is an entity that only holds equity interests in other entities, and only earns dividends, disposal gains from the sale of equity interests, and income incidental to the acquisition, holding, or sale of equity interests (such as interest income received on depositing dividends received); or a non-pure equity holding entity, as detailed in Table 1.

The Inland Revenue Department has clarified that borrowing money for financing equity investments and earning incidental income (for example, exchange gains) would not disqualify taxpayers from being a pure equity holding entity. However, making interest-free loans to investee entities, lending surplus funds arising from foreign-source dividends to a group treasury company, or using surplus funds to participate in a group cash pooling arrangement to earn interest can disqualify the taxpayer.

Specified economic activities can be outsourced to a third party or a group entity, provided certain conditions are satisfied. These include the requirements that the entity must exercise adequate monitoring and control. The number of qualified employees employed and the amount of operating expenditures incurred by the outsourced entity in Hong Kong must be commensurate with the level of specified economic activities carried out. The taxpayer should have proper documentation (for example, a service agreement) setting out details of the outsourcing arrangement (the identities of the relevant parties, the nature of specified economic activities outsourced, the fees charged, the monitoring mechanism, and so forth).

If the economic substance requirement is not satisfied in the year of assessment during which the specified foreign-source income accrued to the MNE entity, then the income will be taxable in the year of assessment in which it is received in Hong Kong.

Participation Exemption

For dividend income and gains derived from the sale of equity interests, a further participation exemption can apply. The income will be exempt if the following three conditions are satisfied:

- the taxpayer is a Hong Kong tax resident (a Hong Kong incorporated company or a foreign incorporated company that is normally managed and controlled in Hong Kong), or a non-Hong Kong resident with a permanent establishment in Hong Kong and the income is attributable to the taxpayer's Hong Kong PE;
- the taxpayer continuously held not less than 5 percent of the equity interest in the

investee company for at least 12 months immediately before the income accrued to the taxpayer; and
- if the income is a dividend or disposal gain, it is subject to tax in a foreign jurisdiction at an applicable rate of not less than 15 percent, or if the income is a dividend, the underlying profits of the immediate investee company out of which the dividend is paid, or the aggregate amount of downstream dividends and profits of up to five tiers of investee entities (including the immediate investee company) that is subject to tax at an applicable rate of not less than 15 percent is equal to or greater than the amount of the subject dividend income.

The participation exemption is also subject to the application of antiabuse rules.

Nexus Approach

Under the nexus requirement, IP income may only be exempted to the extent it is derived from qualifying IP (which is limited to patents and equivalent assets and copyright in software only) and has a sufficient nexus with Hong Kong by reference to a nexus ratio. This is defined as qualifying expenditures as a proportion of the overall expenditures incurred by the taxpayer to develop the IP asset. Qualifying expenditures are restricted to research and development connected to the IP asset carried out by either the taxpayer, a non-associated person, or in Hong Kong by a Hong Kong resident associated person of the taxpayer.

Accordingly, other expenditures, including the costs of acquiring, licensing, managing, protecting, and commercializing the IP, and R&D expenditures carried out by a non-Hong Kong resident associated person or an associated person outside Hong Kong, would not be regarded as qualifying expenditures. A 30 percent uplift on qualifying R&D expenditures can, however, be applied to the extent the entity has incurred any nonqualifying expenditures.

Because other IP such as trademarks and copyright not subsisting in software do not constitute qualifying IP, income deriving from these assets cannot be excluded under the nexus requirement.

Expansion of FSIE Regime

On January 1 the Hong Kong government expanded the scope of the FSIE regime to cover foreign-source disposal gains arising from the sale of any property for valuable consideration, whether the gains are capital or revenue in nature, including gains derived from the disposal of debt instruments, movable and immovable properties, IP, and so forth.

As referenced above, foreign-source disposal gains will be deemed to be Hong Kong-source unless the economic substance requirement is met in the year the income accrues (for gains derived from the disposal of non-IP assets) or the nexus requirement is met (for gains derived from the disposal of IP assets).

The following additional exemption and relief measures are also available:
- gains from the disposal of non-IP assets that are derived from, or are incidental to, the carrying on of a business as a trader, such as, for example, gains derived from the sale of immovable properties by property developers, are carved out from the regime; and
- gains derived where the asset is transferred between associated companies (that is, where at least 75 percent of the beneficial interest or voting rights in the transferor and transferee is held or controlled by the other, or a third party holds or controls at least 75 percent of the beneficial interest or voting rights in both the transferor and transferee) can be deferred, if both the selling and acquiring entities are chargeable to profits tax in Hong Kong and remain associated for two years after the transfer.

Double Taxation

To provide relief against double taxation when specified foreign-source income is subject to tax both abroad and in Hong Kong, the rules introduce a unilateral foreign tax credit if no double tax agreement has been entered into with the relevant jurisdiction. This would also apply if there is a DTA but it does not provide relief from tax, functioning as if a DTA providing for an FTC were in place. A unilateral tax credit is therefore only available to Hong Kong residents.

For non-Hong Kong residents, foreign tax paid would be deductible as an expense in accordance with existing provisions of the Inland Revenue Ordinance.

Compliance and Administration Issues

To enhance tax certainty, MNE entities can apply for an advance ruling on whether they comply with the economic substance requirement. Any advance ruling obtained is valid for up to five years, provided the taxpayer's circumstances remain unchanged.

Recommendations

As a result of the changes to Hong Kong's FSIE regime, MNE entities carrying on a business in Hong Kong must consider how these changes may affect their business. This includes exploring whether the entity has sufficient economic substance in Hong Kong, whether steps can be taken to satisfy the economic substance requirement (including through outsourcing specified economic activities), whether the income can be received outside Hong Kong, and whether any capital disposal gains can be onshored. In appropriate circumstances, an advance ruling can be sought to obtain certainty.

While the Inland Revenue Department has provided some general guidance as to how it interprets the rules, a degree of uncertainty remains over how the rules are applied in specific circumstances. Care must therefore be taken to ensure that certain income streams will not result in unexpected tax liabilities.

Malaysia

Foreign-Source Income Before January 1, 2022

Before January 1, 2022, Malaysia's tax system was territorial. Under the Malaysian Income Tax Act (Malaysian ITA), income is taxed in Malaysia if it is sourced in (accrued in or derived from) Malaysia or received in Malaysia from outside. Foreign-source income received in Malaysia by a resident company (other than a resident company carrying on the business of banking, insurance, sea transport, or air transport) has been exempted from tax since the 1998 year of assessment. In the 2004 year of assessment, the exemption was extended to foreign-source income received in Malaysia by resident individuals.

Current FSIE Regime

From January 1, 2022, an amended paragraph 28, Schedule 6 of the Malaysian ITA came into force to limit the availability of the FSIE to foreign-source income received in Malaysia by nonresidents only. Effectively this means that any foreign-source income received in Malaysia by a Malaysian tax resident is subject to income tax under the ITA. Generally, all types of foreign income received in Malaysia by a resident is subject to tax under these new rules, including dividend income, interest income, employment income, royalties, and so forth. Under these rules, foreign capital gains that are received in Malaysia by residents are not subject to Malaysian tax.

As a transitional measure, a lower tax of 3 percent applied when the foreign-source income was received in Malaysia over the period of January 1, 2022, to June 30, 2022. The prevailing tax rates for foreign-source income received in Malaysia after June 30, 2022, are progressive rates of 0 to 30 percent for resident individuals and a fixed rate of 24 percent for resident companies.

Income 'Received in Malaysia'

The Malaysian ITA now provides that income of any person accruing or deriving income in Malaysia or receiving income in Malaysia from outside is subject to income tax. "Received" is not defined in the Malaysian ITA. However, under the Guidelines on Tax Treatment in Relation to Income Received From Abroad issued by the Inland Revenue Board (IRB) December 29, 2022 (Malaysian Guidelines), the income is considered to be received in Malaysia when it is transferred or brought into Malaysia whether in the form of cash or through an electronic funds transfer.

Exemptions on the Receipt of Foreign-Source Income

On July 19, 2022, two income tax exemption orders were gazetted to bring back the FSIE in a limited form, and with further safeguards. Both orders are effective from January 1, 2022, through December 31, 2026.

Under the Income Tax (Exemption) (No. 5) Order 2022, all foreign-source income received in Malaysia by a resident individual, save for foreign-source income received by an individual from a partnership business in Malaysia, is exempt from income tax. This exemption is subject to the condition that the exempted foreign-source income must have been subject to tax of a similar character to income tax in the originating territory (tax of a similar character).

In addition, the Income Tax (Exemption) (No. 6) Order 2022 exempts all foreign-source dividends received in Malaysia by:

- a resident individual, in relation to a partnership business in Malaysia;
- a limited liability partnership registered under the Malaysian Limited Liability Partnerships Act 2012; and
- a company incorporated or registered under the Malaysian Companies Act 2016.

There is an exception for those persons who are carrying on the business of banking, insurance, or sea or air transport.

This exemption is subject to the conditions that:

a. the foreign-source dividends have been subjected to tax of a similar character; and

b. the headline tax of the tax of a similar character must not be less than 15 percent.

In this regard, the Malaysian Guidelines further set out IRB's interpretation of the conditions to the exemption orders and clarify their application. Notably, for resident taxpayers to avail themselves of the exemption on foreign-source dividends under the Income Tax (Exemption) (No. 6) Order 2022, the Malaysian Guidelines require resident taxpayers to have economic substance in Malaysia. This means that the resident taxpayers must employ an adequate number of employees with the necessary qualifications to carry out specified economic activities in Malaysia and incur an adequate amount of operating expenditures for carrying out the specified economic activities in Malaysia.

To illustrate the application of the exemption orders, we can consider a case in which a Malaysian company receives foreign-source dividends from an investee company located in Country A, and then proposes to issue dividends to its shareholder in the United States. Under the Income Tax (Exemption) (No. 6) Order 2022, the Malaysian company will be able to enjoy the tax exemption on the foreign-source dividend that is received in Malaysia from the investee company, provided that the exemption conditions are met.

If the investee company in Country A benefits from a tax incentive in Country A, the Malaysian Guidelines clarify that the foreign-source dividend received by the Malaysian company is still to be treated as subject to tax of a similar character, provided that the tax incentive is enjoyed by the investee company, which is in compliance with the applicable substantive requirements in Country A. This means that the foreign-source dividend received by the Malaysian company may still be eligible for a tax exemption in Malaysia, provided other conditions to the exemption are also met.

As for the declaration of dividends by the Malaysian company, Malaysia is under a single-tier dividend system of taxation, which means that the tax paid on a Malaysian company's profits is the final tax, and dividends distributed to U.S. shareholders are not subject to Malaysian tax.

Tax Treatment of Foreign-Source Capital Gains

Malaysia has committed to amending its tax treatment of capital gains in the context of its FSIE regime, to align itself with updated international tax standards, like the EU's updated guidance on FSIE, that prevent harmful tax practices.

In this regard, Finance (No. 2) Act 2023 (Finance Act), which was gazetted on December 29, 2023, amends the Malaysian ITA to include the taxation of capital gains. Under the Finance Act, all gains or profits arising from the disposal of capital assets by companies, LLP, trust body or cooperative society, since January 1 are treated as income and subject to tax under the Malaysian ITA. The amendments do not affect individuals, and as such, capital gains received by individuals are not subject to the tax under the amendments. A "capital asset" is broadly defined under the Finance Act to be any movable or immovable property, including any rights or interests related to it.

That said, the Finance Act introduces a new paragraph 38 to Schedule 6 of the Malaysian ITA,

Table 2. Tax Rates on Capital Gains for Disposal of Capital Assets in Malaysia

Date of Acquisition	Tax Rate
Capital assets acquired before January 1, 2024	Taxpayer may elect either of the following tax rates: a. 10% on every ringgit of chargeable income from the disposal of the capital asset; or b. 2% of gross on the disposal price of the capital asset.
Capital assets acquired on or after January 1, 2024	10% on every ringgit of chargeable income from the disposal of the capital asset.

which provides for an exemption for gains or profits from the disposal of capital assets situated in Malaysia, except for:

- gains from the disposal of shares of a Malaysian company that is not listed on the stock exchange; and
- gains from the disposal of shares by foreign controlled companies that derive value from real property in Malaysia.

These amendments also effectively mean that gains or profits from the disposal of capital assets situated outside Malaysia are not covered under the exemption under the new paragraph 38. This means that, under the amendments, any foreign capital gains received in Malaysia by a resident taxpayer will be subject to tax under the new rules and be taxed at the prevailing rates (that is, 24 percent for companies).

Under the Finance Act, the tax rates on the capital gains for the disposal of capital assets situated in Malaysia are as shown in Table 2.

In this regard, a subsidiary legislation, Income Tax (Exemption) (No. 7) Order 2023 was legislated to provide a tax exemption on disposals of shares of unlisted Malaysian companies. The exemption operates from January 1 to February 29, and as such, the new rules on the taxation of capital gains from the disposal of unlisted Malaysian companies are expected to effectively come into force March 1.

Double Taxation

Double taxation may arise because the foreign-source income received in Malaysia was already taxed by the originating country, in the form of foreign withholding tax or foreign income tax. Double taxation relief is available in Malaysia in the form of bilateral tax credits (in which a DTA is available between Malaysia and the originating country) or unilateral credits (in which there is no DTA between Malaysia and the originating country). In this regard, the tax credits for a year of assessment must be claimed within two years after the end of that assessment year.

Compliance and Administration Issues

Under the self-assessment system in Malaysia, taxpayers are required to self-declare all taxable income and submit a tax return to the IRB within the prescribed timeline. They are required to declare all foreign-source income received in Malaysia and take a filing position as to whether it fulfils the relevant conditions under the exemption orders. For audit purposes, Malaysian taxpayers are required to keep documents, such as dividend vouchers, notices of assessments, and other relevant documents, that indicate that the foreign-source income has been subject to foreign tax.

In the event of uncertainty, the Malaysian taxpayer may consider applying to the IRB for an advance ruling on the interpretation and application of the new foreign-source income rules and exemption orders. However, once an advance ruling is issued, it is considered final and binding, irrespective of whether it is favorable to the Malaysian taxpayer.

Recommendations

The changes to the Malaysian tax regime show that Malaysia is aligned with the steps taken by nations to eliminate unfair tax practices internationally. These efforts are also meant to increase Malaysia's revenue collection and to reduce any perceived inequalities between different domestic income groups. That said, from an international tax planning perspective, existing holding structures that may have relied upon the FSIE regime before January 1, 2022, may need to be reviewed to ensure that they continue to remain sustainable from a tax perspective under the current rules.

In addition, given the substantial changes to the Malaysian tax regime that are brought about under the Finance Act, any future tax planning involving Malaysian entities or structure should take into account these new changes. We also anticipate a period of uncertainty given the commencement of the new tax regime, as the Malaysian tax authorities provide clarification on the interpretation of some of the new provisions. As such, it is important to watch this space over the next few months to see how the new tax regime will be administered in practice.

Singapore

Singapore's FSIE regime is widely perceived to be aligned with international standards to prevent tax avoidance. In October 2021 the EU Council endorsed the EU Code of Conduct Group's view that Singapore's FSIE regime is not harmful.

Under the regime, foreign-source income is subject to tax if "received in Singapore from outside Singapore," but can be exempted from taxation in certain circumstances. Generally, a Singapore tax resident that receives foreign-source dividends, foreign branch profits or foreign-source service fees is exempt from paying tax if:

- the income has been "subject to tax of a similar character" in the foreign jurisdiction;
- the "highest rate of tax of a similar character" of the foreign jurisdiction is at least 15 percent; and
- the exemption would be beneficial to the Singapore tax resident.

Enactment of Section 10L

On October 3, 2023, the Singapore Parliament passed the Income Tax (Amendment) Bill 2023, introducing section 10L, which came into force on January 1. The Inland Revenue Authority of Singapore (IRAS) is expected to publish an e-tax guide to clarify the scope and application of section 10L.

In the second reading speech for the bill, Singapore Senior Minister of State for Finance Chee Hong Tat said that the new section 10L is intended to "address international tax avoidance risks relating to nontaxation of disposal gains in the absence of real economic activities." He added that more stringent rules will apply to "disposal gains arising from intellectual property rights, due to the higher mobility of such assets." The introduction of section 10L into the existing Singaporean ITA framework is intended to align the tax treatment of foreign-source gains with the EU's updated guidance on FSIE regimes, as well as prevent harmful tax practices in line with international standards agreed on by the inclusive framework on base erosion and profit shifting. It is not intended to impose a tax on capital gains.

Section 10L imposes taxes on gains that are received in Singapore if the gains arise from the sale or disposal of any foreign "moveable or immoveable property," or "any rights or interest thereof," by businesses that do not have economic substance in Singapore. The provision applies to sales or disposals that take place on or after January 1 of this year. Gains are to be included in the relevant entity's taxable income in the year of assessment that relates to the basis period when they are received in Singapore. However, an entity that qualifies for an exclusion or exemption (for example, as an excluded entity) at the time of the sale or disposal can still benefit from the exclusion or exemption even if it does not have the same status at the time the proceeds are remitted.

Entities That Fall Within the Scope of Section 10L

For section 10L to apply, the entity selling or disposing of foreign assets must be a member of a relevant group.

A seller entity is defined as a legal person that is not an individual, a partnership, or a trust. Generally, an entity is regarded as a member of a group if its financials are included in the parent entity's consolidated financials or are excluded from consolidation based only on grounds of size or materiality, or that the entity is being held for sale.

A group is a relevant group if "the entities of the group are not all incorporated, registered or established in a single jurisdiction," or "any entity of the group has a place of business in more than one jurisdiction." As such, if a multinational corporation has at least one subsidiary in Singapore, it would generally be regarded as a relevant group.

Situation of Assets

There are prescribed rules under section 10L on determining the situation of assets. For example, immovable property and tangible movable property are generally situated at the property's physical location. Secured and unsecured debts (other than judgment debts or securities) are situated where the creditor resides. In the case of shares in a company or securities issued by a company, and any right or interest in these assets, the determining factor is where the company is incorporated. Intangible movable properties are situated where the ownership rights are primarily enforceable. IP rights are situated where the owner of the IP right resides. It remains to be seen how this rule would apply if the legal and economic ownership of the IP right are held by two different entities resident in different jurisdictions.

Receipt or Deemed Receipt of Section 10L Gains

Section 10L(9), which sets out the circumstances under which gains from the sale of foreign assets are treated as received in Singapore, is largely consistent with the deemed receipt rules in the existing section 10(25) of the Singaporean ITA. Amounts of income are treated as received in Singapore if they are:

- remitted to, transmitted to, or brought into Singapore;
- applied in or toward the satisfaction of any debt incurred in relation to a trade or business carried on in Singapore; or
- applied to purchase movable property brought into Singapore.

If the consideration for the sale or disposal of foreign assets is payments in-kind, such as shares or receivables, taxpayers would need to carefully consider whether the payments may potentially be treated as received in Singapore.

Computation of Gains

If a foreign asset is disposed of or sold at a price that is less than its open market value, the IRAS may deem the following amount as gains that are received in Singapore from outside Singapore:

Amount of gains received in Singapore from outside Singapore + Open market value - Actual sale/disposal price

Subject to certain exclusions, the seller entity may claim tax deductions on amounts it incurred to "acquire, create, or improve" the asset; "protect or preserve" the value of the asset; or sell or dispose of the asset. In addition, deductions may potentially be claimed for any unused losses it incurred in selling or disposing of any other foreign asset (if any gains arising from the sale or disposal would have been chargeable under section 10L).

For section 10L purposes, if the gains are received in Singapore in different basis periods, the deductible expenses should be reasonably apportioned.

Exclusions or Exemptions

Section 10L will not apply if the disposals of foreign assets (other than IP rights) are, among others, carried out as part of or incidental to:

- business activities of a prescribed financial institution; or
- business activities or operations of entities deriving income that is exempt from tax or is taxed at a concessionary rate of tax under certain tax incentives.

An exclusion will also apply if the disposal is made by an excluded entity (as discussed below) in the basis period in which the disposal took place.

More stringent rules apply if the gains arise from the disposal of an IP right. No exclusions or exemptions are available for the disposal of an IP right unless it is a patent, an application for a patent, or any "copyright that subsists in software." Only a prescribed percentage of the section 10L gains may be excluded, to be determined based on a "modified nexus approach," which is the approach currently used to determine the percentage of qualifying income under the IP Development Incentive based on the amount of R&D expenditure that has been incurred.

An excluded entity is an entity with adequate economic substance in Singapore. Both pure and non-pure equity holding companies are regarded as excluded entities if, among other things, operations are "managed and performed in Singapore," regardless of whether this is by entity employees or other persons (if certain conditions are met). Pure equity holding companies must also have "adequate human resources and premises" to carry out operations in Singapore. Non-pure equity holding companies must also have "adequate economic substance" in Singapore, taking into account the number of full-time employees and their qualifications, business expenditures incurred in Singapore, and whether key business decisions are made by persons in Singapore.

Section 10L and Singaporean ITA Provisions

Section 10L deems gains from the disposal of foreign assets received in Singapore as income chargeable under section 10(1)(g) of the Singaporean ITA. Given that the Singaporean ITA draws a distinction between income and capital, a question arises as to how section 10L may affect the interpretation of existing provisions in Singapore. Could the new provision imply that the scope of section 10(1)(g) may be expanded to include gains currently considered to be capital? Taxpayers should also consider the potential characterization of section 10L gains for the purposes of obtaining relief from double taxation under Singapore's tax treaties.

Recommendations

Ambiguities remain as to how section 10L may apply in practice, such as the deemed receipt rules for section 10L gains, where assets are situated, and how economic substance for seller entities is to be assessed. As such, taxpayers should consider early on the potential effect of section 10L on their structures and any impending asset disposals. Taxpayer may also consider engaging in discussions with the IRAS or the MOF to obtain clarity on the practical effect of section 10L.

Concluding Remarks

Although the governments of Hong Kong, Malaysia, and Singapore have carefully considered the design of their updated FSIE regimes to conform to international standards, there is still a need to address questions about how the new rules are to be interpreted or applied in certain circumstances. We can expect the tax authorities to issue more guidance, which will address taxpayers' concerns to some extent about how the new rules may affect their structures and transactions.

Notwithstanding that there remain some uncertainties about the practical effects of the new rules, the updated FSIE regimes demonstrate the considerable efforts made by Hong Kong, Malaysia, and Singapore to achieve an equitable future while safeguarding against undesirable tax outcomes and double taxation. ■