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Client Alert

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Singapore: New tax on gains from the disposal of foreign assets

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In brief

A new Section 10L in the Income Tax Act 1947 (ITA), which taxes gains received in Singapore from the sale of foreign assets by businesses without economic substance in Singapore in the Income Tax (Amendment) Bill 2023, has been passed by Parliament on 3 October 2023 and will come into force on 1 January 2024. This enactment aligns Singapore's tax regime with international norms.

In this alert, we discuss the potential impact of the new Section 10L on taxpayers and highlight issues that companies may consider in assessing the potential impact to their businesses ahead of time.

In this issue

Key takeaways

- The Income Tax (Amendment) Bill 2023 introduces a new Section 10L, which taxes gains received in Singapore from the sale of foreign assets by a seller entity without economic substance in Singapore. Whether a seller entity has economic substance will be assessed on an entity-by-entity basis, and no bright-line test has been prescribed.
- The Section 10L that has been passed into law contains significant changes as compared to the draft bill that was previously released for public consultation in June 2023.[1] That said, ambiguities with regard to its application remain and the IRAS is expected to release further guidance through an e-Tax Guide.
- Taxpayers (especially those with pending reorganisation or disposal of assets) should review the new legislation and their existing structures early, and seek advice on the potential impact of Section 10L ahead of time.

In more detail

Background on the new Section 10L

In the Second Reading of the Income Tax (Amendment) Bill 2023, Parliament affirmed that the enactment of the new Section 10L is not to tax capital gains in Singapore. Rather, the intention of introducing Section 10L is part of Singapore's longstanding policy to align Singapore's tax regime with international standards, such as the rule against harmful tax practices agreed by the Inclusive Framework on Base Erosion and Profit Shifting, as well as the European Union (EU) Guidance on Foreign-Sourced Income Exemption (FSIE) regimes.[2]

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[1] Please also see our previous client alert on the draft bill for the proposed Section 10L titled, Singapore: Proposed tax on gains from the disposal of foreign assets, published on 30 June 2023.

[2] The EU Code of Conduct Group had published an updated guidance in December 2022 on FSIE regimes, which expressly refers to capital gains as a category of income covered by a regime that should be subject to the economic substance requirement.

Operation of Section 10L and timing

Under the new Section 10L, gains from the sale or disposal by a "**seller entity**" of a **relevant group** of foreign assets that are received in Singapore are treated as income chargeable to tax under Section 10(1)(g) if the gains would not otherwise be treated as chargeable income or would otherwise be exempt from income tax.

The new Section 10L applies to gains from the sale or disposal of foreign assets that occurs on or after 1 January 2024. Any Section 10L gains will be regarded as the seller entity's taxable income in the year of assessment relating to the basis period when the gains are received in Singapore. However, the period of assessment for whether an entity fulfils certain economic substance requirements or qualifies for certain exemptions is the basis period when the sale or disposal occurs. Hence, an entity that falls within an exclusion or exemption (e.g., as an excluded entity) at the time of sale or disposal would still be able to take the benefit of the exclusion or exemption even if it does not have the same status at the time of remittance of proceeds.

Section 10L in detail

We set out below some of the key features of the provision and its potential impact on taxpayers.

What is a "seller entity"?

For Section 10L to apply, the seller entity that sells or disposes of foreign assets must be a member of a "relevant group."

"Seller entity" is defined to be a legal person (other than an individual), a partnership or a trust. The entity is a member of a group if its assets, liabilities, income, expenses and cash flows are included in the parent entity's consolidated financials; or are excluded from consolidation solely on size or materiality grounds or on the ground that the entity is held for sale.

A group is a "relevant group" if: (i) the entities of the group are not all incorporated, registered or established in a single jurisdiction; or (ii) any entity of the group has a place of business in more than one jurisdiction.

Accordingly, an MNC with one or more subsidiaries in Singapore will generally be considered as a relevant group.

What are the exemptions and exclusions from Section 10L?

The scope of exemptions and exclusions from Section 10L is considerably narrower as compared to the draft bill that was released for public consultation in June 2023.

Under the new Section 10L, there is no longer a blanket exclusion for entities enjoying certain tax incentives (such as the Development and Expansion Incentive).

Instead, the exclusions now apply to gains from disposals of foreign assets (other than intellectual property (IP) right) that are (among others) carried out as follows:

a. As part of, or incidental to, the business activities of a prescribed financial institution

b. <u>As part of, or incidental to, the incentivised business activities or operations</u> of entities that derives income that is exempt from tax, or is taxed at a concessionary rate of tax, under certain specific tax incentives

c. By an "**excluded entity**" (discussed below) in the basis period in which the sale or disposal occurred

As explained during the Second Reading of the Income Tax (Amendment) Bill 2023, tighter rules also apply to gains arising from the disposal of IP rights. In particular, where the foreign asset being disposed of is a patent, an application for a patent or any copyright subsisting in software, only a prescribed percentage of Section 10L gains can potentially be excluded. The prescribed percentage will be determined in accordance with the "modified nexus approach" that currently applies to determine the percentage of qualifying income under the IP Development Incentive, based on the amount of R&D expenditure incurred.

Notably, there are no exclusions or exemptions for the disposal of other IP rights apart from those as discussed above.

What is an "excluded entity"?

Generally, an excluded entity is one that has adequate economic substance in Singapore. The requirements for economic substance differ for a pure equity-holding entity (PEHE), and an entity that is not a PEHE, as follows:

Entity	Substance requirements
PEHE	• The entity submits to a public authority any return, statement or account required under the written law under which it is incorporated or registered, being a return, statement or account

	which it is required by that law to submit to that authority on a regular basis. • The operations of the entity are managed and performed in Singapore (whether by its employees or other persons where the activities performed by such other persons for the entity are subject to the direct and effective control of the entity); and • The entity has adequate human resources and premises in Singapore to carry out its operations.

Non-PEHE	• The operations of the entity are managed and performed in Singapore (whether by its employees or other persons where the activities performed by such other persons for the entity are subject to the direct and effective control of the entity); and
	• The entity has adequate economic substance in Singapore, taking into account the following considerations:
	  • The number of full-time employees of the entity (or other persons managing or performing the entity's operations) in Singapore;
	  • The qualifications and experience of such employees or other persons;
	  • The amount of business expenditure incurred by the entity in respect of its operations in Singapore; and
	  • Whether the key business decisions of the entity are made by persons in Singapore.

As part of the public consultation process, the Ministry of Finance (MOF) has clarified that it would not be practical to prescribe minimum thresholds to establish economic substance as business models and scale of operations of entities may vary. IRAS would thus have the discretion to determine if an entity has "adequate economic substance" in Singapore, and is expected to provide further guidance through an e-Tax Guide on how the substance requirements can be met.

What is a "foreign asset"?

Section 10L also prescribes rules for determining the situation of movable and immovable property, particularly as follows:

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

Notably, IP rights are regarded as being situated where the "owner" of the IP right is resident. It remains to be seen how this rule may apply in cases where the ownership of the IP may be bifurcated (such as based on the legal and economic ownership of the IP) and are held by two different entities resident in different jurisdictions.

When are proceeds "received in Singapore"?

Section 10L(9) sets out when gains from the sale of foreign assets are regarded as received in Singapore. This is consistent with the existing deemed receipt rules under Section 10(25) of the ITA.

Similar difficulties surrounding what amounts to "receipt" may arise depending on the circumstances. Where the consideration for the sale or disposal of the foreign assets are payments in-kind (e.g., shares, receivables), whether such payments can be received in Singapore and when they are deemed to be received will have to be carefully considered.

How to compute the amount of Section 10L gains?

Section 10L requires the foreign assets to be disposed of or sold at their open market value. If a transaction does not take place at open market value, the Comptroller of Income Tax is empowered to deem the following amount as gains received in Singapore from outside Singapore:

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

In computing Section 10L gains (and subject to certain exclusions that may apply), the seller entity may claim a tax deduction on: (i) amounts it incurred to acquire, create, or improve, protect or preserve the value of, or sell or dispose of the property; and (ii) any "unused" losses it incurred on the sale or disposal of any other property (where, if the sale or disposal had resulted in gain, the gain would have been chargeable under Section 10L).

Where the Section 10L gains are received in Singapore in different basis periods, the deductible expenses (for Section 10L purposes) also have to be reasonably apportioned between the relevant basis periods.

Interaction with existing provisions in the ITA

Section 10L deems gains from the disposal of foreign assets that are received in Singapore as **chargeable income** under Section 10(1)(g) of the ITA. This may have wider ramifications when interpreting existing provisions under the ITA, which at its core draws a distinction between income and capital. That said, some comfort can be drawn from the Second Reading speech that Parliament's intention in enacting Section 10L is not to tax capital gains in Singapore.

From an international tax perspective, taxpayers should also consider the potential characterisation of such gains for the purposes of applying Singapore's tax treaties. It is perhaps useful to note that Section 50A of the ITA (unilateral tax credits) has also been amended to provide that unilateral tax credits would be given for any foreign tax paid in respect of a gain that is treated as income under Section 10L.

Recommendations and conclusion

The new Section 10L has been drafted in a broad manner to ensure that Singapore complies with the EU Code of Conduct Group's updated guidance on FSIE regimes. Existing difficulties in applying the deemed receipt and receipt rules with respect to income under the ITA are also now extended to Section 10L gains, which adds another layer of complexity.

While the new Section 10L has provided some additional clarity from the draft bill that was released for public consultation, there remain areas that would benefit from additional guidance, such as the situation of certain assets and the assessment of economic substance for the relevant entities.

Taxpayers should therefore review their existing structures and the potential impact of the new Section 10L ahead of time, and consider engaging IRAS and/or the MOF early to obtain more clarity where needed.

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