

Tax Bytes

Advance Ruling Summary No. 2/2022

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Greetings from your Tax & Legal team at Deloitte Singapore. We hope that you and your loved ones are staying safe and healthy despite these challenging times. As we navigate ourselves through this trying period, we are committed to giving you the support you need.

We are pleased to update you on the following:

Advance Ruling Summary No. 2/2022

On 3 January 2022, the Inland Revenue Authority of Singapore (IRAS) published the [Advance Ruling Summary No. 2/2022](#) (the Ruling Summary), which relates to the tax treatment of security tokens. A security token is a digital token that represents a stake or an investment in an underlying asset, e.g., shares in company, bonds, etc.

An overview of the issue, background information, and the outcome of the Ruling Summary are provided below.

Issue

Whether:

- a. The security tokens issued by a trust (the Trust) should be regarded as equity instruments, and hence akin to units in the Trust;
- b. Distributions from such security tokens should constitute trust distributions in the hands of the holders of a token (Tokenholders) and should be treated as identical to trust distributions paid to unitholders for Singapore tax purposes; and
- c. Singapore tax or withholding tax is applicable on distributions made by the Trust (out of tax-exempt income or gains) to the holders of the security tokens.

Background

The issued capital of the Trust comprised of the following:

- Ordinary units (Units); and
- Class 1 units issued in the form of security tokens (Tokens). Each Class 1 unit, represented by one Token, is equivalent to X number of Units in the Trust

The Tokens are a tokenised form of the Class 1 units in the Trust. Each Token holder is a holder of a Class 1 unit. The rights and obligations of each Class 1 Unit are the same as that of each Token, except in terms of the number of voting and distribution rights.

The Trustee will maintain a register of both the holders of Units (Unitholders) and Tokenholders, i.e., holders of Class 1 units.

The Tokenholder, including those holding fractions of a Token, is entitled to an undivided interest in the Trust and rights to the residual profits and assets of the Trust, just like other holders of existing Units.

In the event of a winding up of the Trust, the rights of the Unitholders and Tokenholders are equal and rank equally below the creditors of the Trust.

The Trust is only expected to derive tax-exempt income. The investment returns of the Trust will be pooled for distribution to the investors, i.e., Unitholders and Tokenholders. The fund manager of the Trust will apportion the amount available for distribution among the investors on a pro rata basis.

For accounting purposes, the Tokens are characterised as equity based on the Singapore Financial Reporting Standard 32 Financial Instruments: Presentation.

Outcome

- a. The Token will be regarded as an equity instrument for income tax purposes.

- b. The distributions from the Tokens will be regarded as trust distributions in the hands of the Tokenholders. Accordingly, the income tax treatment of the distributions made to the Tokenholders would follow that of the distributions made to the Unitholders.
- c. The distributions would not be subject to tax in Singapore in the hands of the Tokenholders because they are made out of tax-exempt income derived by the Trust.

Deloitte Singapore's view

The characterisation of the security token appears to be the crux of the issue, and once determined, the general income tax rules and/or withholding tax obligations will apply to the distributions derived by the Tokenholder accordingly.

To determine the characterisation of a security token, the IRAS will examine the legal form of the security token, rights, and obligations tied to the security token as well as the terms and conditions of the underlying asset to determine the nature of the security token and the nature of the returns derived from the security tokens. As such, the analysis is fact-specific, and characterisation must be considered case-by-case. The IRAS approach in the Ruling Summary is consistent with the IRAS' [e-tax guide concerning the Income Tax Treatment of Digital Tokens](#).

In this case, the security tokens conferred certain contractual rights and economic entitlements to the Tokenholder, akin to those conferred to the Unitholder. As a result, the distributions from the Tokens were determined to be akin to trust distributions, and the income tax treatment would therefore be applied consistently.

An observation *vis-à-vis* the Ruling Summary is that, whilst there is nothing specific in either the foregoing e-tax guide or the Ruling Summary on the point, practice to date has been to also consider IRAS' [e-tax guide concerning the Income Tax Treatment of Hybrid Instruments](#) when considering the characterisation of tokens in relevant cases, in combination with the e-Tax concerning the Income Tax Treatment of Digital Tokens. The IRAS appears to have implicitly adopted a similar approach when providing its Ruling, as factors of importance to the analysis listed in the “relevant background and facts” section of the Ruling Summary are broadly consistent with those referenced in the e-tax guide concerning the Income Tax Treatment of Hybrid Instruments. As such, the Ruling Summary provides helpful insight as regards how the IRAS is considering token characterisation, and it is comforting that such an approach is aligned with the prevailing approach from within the practice.

Contacts

Should you have any comments or questions arising from this newsletter, please

contact either the listed contacts below, or any member of [Singapore Tax & Legal team](#).

Low Hwee Chua
Head of Tax & Legal
Deloitte Singapore

+65 6216 3290
hwlow@deloitte.com

Matthew Lovatt
Director
Deloitte Singapore

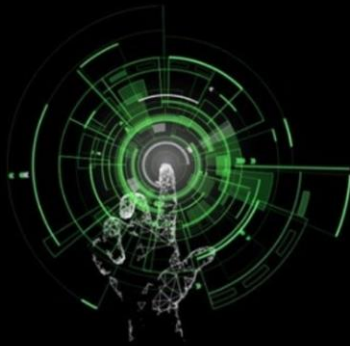
+65 6800 4591
mlovatt@deloitte.com

Michael Velten
Partner
Deloitte Singapore

+65 6531 5039
mvelten@deloitte.com

Jazlyn Ng
Manager
Deloitte Singapore

+65 6800 2211
jazng@deloitte.com



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