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Tax framework for Variable Capital Companies

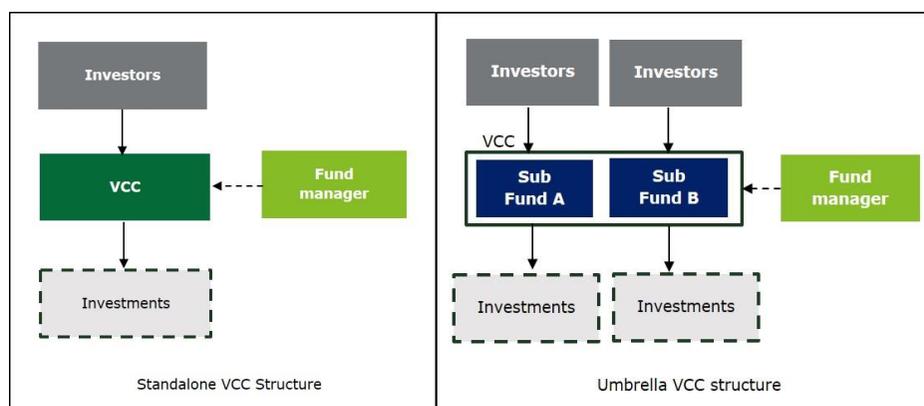
Background

On 1 October 2018, the Singapore Parliament passed the Variable Capital Companies Bill (hereinafter referred to as “the Bill”). The Bill lays down the regulatory framework for a new corporate structure—Variable Capital Company (VCC). The regulatory framework is expected to take effect in 2019.

The VCC was introduced to grow and maintain the international competitiveness of Singapore’s fund industry by encouraging funds to incorporate and operate in Singapore through a more flexible corporate structure.

Broadly, a VCC could function as a standalone corporate entity or as a corporate entity with sub-funds, where assets of each sub-fund are legally segregated from those of other sub-funds. A VCC with sub-funds is akin to an umbrella fund with two or more sub-funds, each holding different assets and having different investors. Unlike existing corporate fund structures, a VCC will enjoy the flexibility of issuing and redeeming shares without requiring shareholders’ approval, enabling investors to exit their investments at any point in time, and paying dividends using its capital.

The illustration below shows how the VCC could be managed by a fund manager in Singapore for either cases:



Tax framework for VCC

In the Singapore Budget 2018, it was announced that a tax framework for VCC will be introduced to complement the regulatory framework with further details to be released by the Monetary Authority of Singapore (MAS). The MAS later released a circular providing initial details of the framework on 31 October 2018.

MAS circular—At a glance

Based on the MAS circular and the previous announcement, below is a summary of the overall tax framework for VCCs:

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| Income tax obligations | VCC will be treated as a single entity for income tax purposes and only one set of corporate tax returns will need to be submitted to the Inland Revenue Authority of Singapore (IRAS) regardless of the number of its sub funds. |
| Tax residency of the VCC | A VCC could be a Singapore tax resident depending on the facts and circumstances and a Certificate of Residence (COR) will be issued in the name of the VCC, with the names of the relevant sub-funds included in the COR. |
| Tax incentives scheme for funds | Sections 13R and 13X of the Income Tax Act (ITA) [^] will be extended to VCCs. Refer below for further details. |
| Approved fund manager managing incentivised VCCs | The 10% concessionary tax rate for Financial Sector Incentive—Fund Management will be applicable to fee income received from managing/advising incentivised VCCs. |
| Goods and services tax | Current GST remission [^] for funds will be extended to VCCs. |

(GST) remission

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| Withholding tax exemption for funds | Current withholding tax exemption for funds will be extended to VCCs, subject to meeting of conditions under section 13R and 13X of the ITA [^] . |
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[^] While the tax incentive schemes for funds and GST remission are set to expire on 31 March 2019, an extension is expected to be announced on or before 31 March 2019.

Tax incentive schemes for funds

The circular confirms an earlier announcement that VCCs will be eligible for an exemption under sections 13R and 13X of the ITA. These exemptions will be granted at the VCC level of which only a single application is required. To qualify, the conditions under both schemes and corresponding economic commitments will be applied on the umbrella VCC. Once granted, the umbrella VCC and all its sub-funds will be covered by the exemption.

The circular notes that the rest of the VCC tax framework will be released by the IRAS.

Some of the key qualifying conditions for section 13R and 13X of the ITA in relation to VCCs are as follows:

Accounting expenses/local business spending

- Incurs at least S\$200,000 in each financial year. The accounting expenses or local business spending requirement as the case applies will be set at the umbrella VCC level regardless the number of sub-funds within the VCC.

Domicile of fund administrator

- Must use a Singapore-based fund administrator.

Others

Section 13R (Singapore Resident Fund)

- Does not have the value of the issued securities of the VCC 100% beneficially owned, directly or indirectly, by Singapore persons (as defined), at all times during the basis period for a year of assessment. This condition is tested on the VCC level

Section 13X (Enhanced Tier Fund)

- A minimum fund size of S\$50 million. The fund size condition is only required to be complied with at the point of application. All other conditions will have to be fulfilled by the VCC fund throughout the life of the fund.
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- (i.e., all sub-funds' shareholders combined).
- A financial penalty will also be applicable for non-qualifying investors. Broadly, non-qualifying investors refers to investors from Singapore who are not individuals and beneficially own (either alone or with their associates) more than 30% or 50% (30%/50% condition—as the case may be) of the issued securities in the approved VCC. The circular provides helpful examples in the application of the 30%/50% condition, considering that sub-funds of a VCC may have different shareholders, including Singapore shareholders.
 - A master-feeder, master-feeder-SPV, or master-SPV fund structure that uses VCCs can also avail itself of the consolidated tax incentive application, subject to meeting of conditions.
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Of note, the investment objective condition is also applicable to the funds in either of the above incentive schemes. Once the fund has been approved, the investment objectives of the fund must remain the same (subject to exceptions and approval from the authorities).

In the case of a VCC, the investment objective must be satisfied at the VCC level. The circular clarified that when there is a breach of the investment activities beyond the scope of what is mandated in the offering documents, the entire VCC (and its sub-funds) will not be able to enjoy the tax exemption on the specified income derived from designated investments for that basis period concerned. Tax exemption for the VCC (and its sub-funds) may still be applicable in any subsequent period during the life of the fund, subject to satisfying the specified conditions in that subsequent period.

Deloitte Singapore's views

The introduction of the VCC framework is a welcome development as it should help with a reduction of administrative burden associated with the application for and management of multiple incentivised funds. The MAS circular provides a confirmation that the VCCs will be able to enjoy the current tax exemptions available under sections 13R and 13X. Importantly, the circular confirms that the conditions for the exemptions will be tested on the VCC level, and not at the sub-fund level. This may lead to cost savings and reduce operational complexity for investors.

We understand that exempt family offices are not among one of the permissible fund manager to manage a VCC at this time. Broadly, funds managed by exempt family offices may qualify for tax exemptions, subject to meeting of conditions. With the current exclusion for exempt family offices to manage a VCC, exempt family offices may not be able to tap on the tax benefits under the VCC framework.

One of the qualifying activities of the Financial Sector Incentive–Standard Tier (FSI-ST) includes managing or providing investment advisory services to an incentivised fund. Although not stated in the circular, a concessionary tax rate of either 12% or 13.5% should be applicable to fee income derived by a FSI-ST company from managing/advising incentivised VCCs.

We expect that the remaining details of the tax framework, including details of income tax treatment for sub-funds, GST registration, and any stamp duty matters will be released in the first quarter of 2019.

Contact

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