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Greetings from your Tax & Legal team at Deloitte Singapore

We are pleased to update you on the following:

Income Tax (Amendment) Bill 2023 – Draft provision to tax gains on disposal of foreign assets

On 6 June 2023, the Ministry of Finance (MoF) issued the draft Income Tax (Amendment) Bill 2023 for public consultation.

The Bill proposes various legislative changes arising from tax measures announced in Budget 2023, as well as several non-budget changes 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.

Non-budget changes arising from international tax developments

Among others, one of the more significant legislative changes arising from international tax developments is the promulgation of a new Section 10L (Gains of a relevant entity from the sale of foreign assets).

This provision would, despite anything in the Singapore Income Tax Act (ITA)[1], but subject to certain exceptions detailed within the said provision: -

- Treat gains received in Singapore from outside Singapore
- On or after 1 January 2024 by a relevant entity
- From the sale or disposal of immovable or movable property situated outside Singapore (such property being referred as “foreign assets”)
- As income chargeable with tax under Section 10(1)(g)

One of the key features of Singapore’s income tax regime is the non-taxation of capital gains. The imposition of Section 10L will, in certain prescribed situations, subject capital gains arising from the sale or disposal of foreign assets to tax if such gains are received in Singapore.

We understand that the European Union’s (EU) updated guidance on foreign-sourced income exemption (FSIE) regimes issued in early December 2022 was the primary impetus for introducing Section 10L. In particular, the EU's updated guidance on FSIE requires all types of passive income (including capital gains) to be subject to the economic substance requirement as a pre-requisite for non-taxation.

Please refer to Section 10L of the Income Tax (Amendment) Bill 2023 (pages 7 to 13) and Clause 6 of the explanatory statement (page 3) for more details.

Gains of a relevant entity from the sale of foreign asset

Our preliminary observations on the material aspects of Section 10L are as follows: -

- “Treat gains received in Singapore from outside Singapore”

  The gains arising from the sale or disposal of foreign assets would only be subject to the provisions under Section 10L if such gains are received in Singapore from outside Singapore.

  The meaning of “received in Singapore from outside Singapore”, as defined in Section 10L(7), mirrors the existing “receipt” provisions under Section 10(25) of the ITA.

- “On or after 1 January 2024 by a relevant entity”

  Section 10L applies to gains from the sale or disposal of foreign assets that occurs on or after 1 January 2024. Gains from a sale that occurs prior to 1 January 2024 but are received in Singapore on or after 1 January 2024 by a relevant entity should not be subject to the new provisions.

  The scope of Section 10L is constrained to gains derived by a “relevant entity”. Pursuant to Section 10L(3), a relevant entity is an entity which is a member of a group of entities where at least one member of the group has a place of business outside Singapore. There are further provisions in Section 10L that defines what an entity is and whether it is a “member”

[1] Including, but not limited to, the application of Section 13W of the ITA (Exemption of gains or profits from disposal of ordinary shares)

of a group. An entity which is part of a 'domestic' group, i.e., a group in which none of its members has a place of business outside Singapore, or a 'standalone' entity, i.e., one that is not part of a group, should fall outside the scope of Section 10L. The latter group may include "investment entities" such as fund vehicles. Such entities may, subject to conditions, be excluded from consolidating its underlying investments and potentially qualify as a 'standalone' entity.

Section 10L also contains safe harbours for the following entities, which ordinarily should be regarded as carrying on substantive business activities in Singapore: -

- A financial institution (as defined in the Financial Services and Markets Act 2022); or
- An entity whose income is exempt from tax, or is taxed at a concessionary rate of tax pursuant to certain provisions/tax incentives under the ITA or the Economic Expansion Incentives (Relief from Income Tax) Act

The provisions of Section 10L should not apply to the aforementioned entities.

Separately, entities that qualify as *excluded entities* would also fall outside the ambit of Section 10L.

The definition of an *excluded entity* gives rise to the concept of "economic substance". Different thresholds are applied, depending on whether an entity is a "pure equity-holding entity" or otherwise. Among others, relevant factors to determine if sufficient "economic substance" exists include the number of employees in Singapore, the qualifications and experience of such employees, the amount of business expenditure incurred by the entity and whether key business decisions of the entity are made by persons in Singapore. No bright-line tests are imposed.

It is pertinent to note that the safe harbours and exclusions are tested at the point when the sale or disposal of the foreign asset occurs, not when the gains are received in Singapore.

- "From the sale of immovable or movable property situated outside Singapore"

  Section 10L contains comprehensive 'sourcing' provisions to determine whether a capital gain is sourced outside Singapore. It appears that the sourcing provisions are limited to determining whether gains derived by a relevant entity fall within the ambit of Section 10L and should not have broader import.

  As a corollary, gains from the sale or disposal of "Singapore assets" are not affected by Section 10L. Such gains should continue not to be subject to tax if they are capital in nature pursuant to general tax principles, or be exempt from tax if a statutory exemption, such as Section 13W of the ITA, applies.

There are also provisions in Section 10L that govern the computation of the quantum of capital gains, as well as record keeping requirements.

In relation to the former, we note that capital losses incurred by a relevant entity from the sale or disposal of foreign assets are unlikely to be deductible against other sources of income derived by that entity. Also absent are 're-basing' provisions. Broadly, only expenditure incurred to acquire, create or improve the foreign asset or to sell to dispose of the foreign asset are deductible against capital gains. Depending on the open-market value at the date of sale or disposal of the foreign asset, any built-in gains accruing up to 31 December 2023 are potentially taxable if the foreign asset is sold or disposed on or after 1 January 2024 and the gains are subsequently received in Singapore.

In relation to the latter, the onus of proving, among others, that a relevant entity qualifies for safe harbour or is an *excluded entity* arises when the capital gains are received in Singapore and thus becomes prima facie taxable. The documentation requirements imposed under Section 10L could thus be fairly onerous if the foreign assets are sold or disposed, but the proceeds are received in Singapore by the relevant entity after the passage of many years.

Closing remarks

Whilst noteworthy, this proposed legislative change is not altogether surprising in light of an increasingly multilateral tax policy-making environment.

On a more practical note, it would be interesting to see if the Comptroller of Income Tax would, like the Hong Kong Inland Revenue Department, be proactively embracing "economic substance" advance rulings for affected taxpayers keen to seek tax certainty.

Contacts

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