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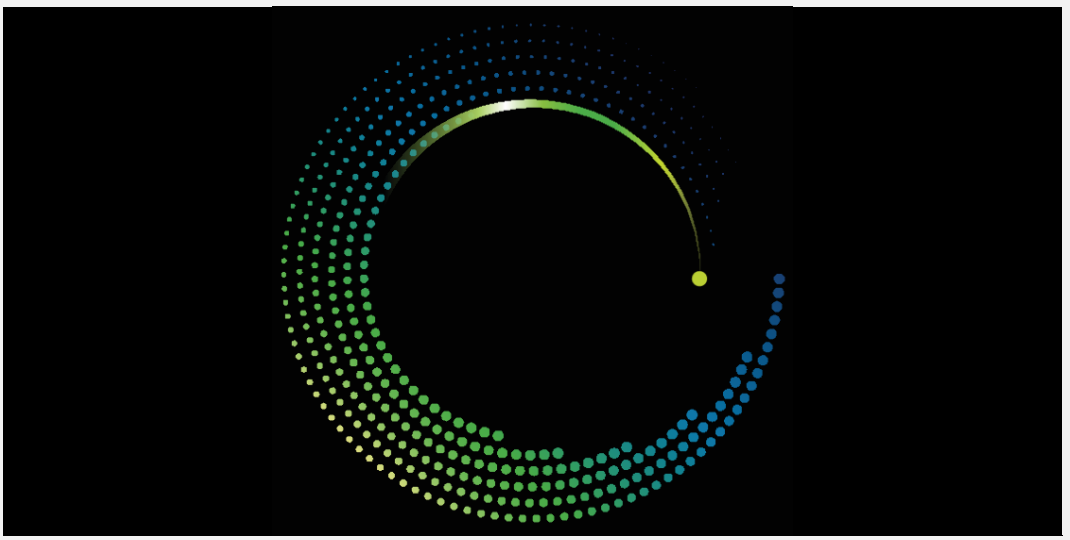

Tax Bytes

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Greetings from your Tax & Legal team at Deloitte Singapore.

We are pleased to update you on the following:

The Ministry of Finance (MOF)'s responses to the key feedback received on the draft Income Tax (Amendment) Bill 2023—Section 10L

On 8 September 2023[1], the MOF published a Summary of Responses to Public Consultation on the Draft Income Tax (Amendment) Bill 2023.

Their responses to the key feedback received on the proposed legislative amendments can be found here.

As a general recap, Section 10L would, despite anything in the Singapore Income Tax Act (ITA), but subject to certain exceptions detailed within the said provision, bring to tax foreign asset disposal gains received in Singapore, where the seller does not have sufficient economic substance locally. Section 10L is set to be effective from 1 January 2024.

Please click on this link to access our previous tax alert on Section 10L for more details. For additional context, companies would be well-advised to note at the outset that the concept of having economic substance locally is a core tenet underlying Section 10L; references made to Hong Kong reflect the situation that similar economic substance requirements have been introduced into Hong Kong's tax landscape since 1 January 2023.

[1] Kindly note that this alert seeks to discuss only the MOF summary of responses on the draft Income Tax (Amendment) Bill 2023 pertaining to Section 10L that were published on 8 September 2023; it does not discuss the broader changes reflected in the subsequent Income Tax (Amendment) Bill 2023 published on 18 September 2023.

The pertinent updates to Section 10L are as follows:

1) Strict definition of pure equity holding entity (PEHE)

A PEHE is now defined as an entity whose function is to hold shares or equity interests in any other entity; and that has no income other than dividends, gains from sale or disposal of such interests and incidental income from the holding of such interests.

Investment holding entities (IHE) that hold capital investments in the form of debts/bonds/notes/convertible instruments/funds would be excluded from the definition of PEHE.

In addition, the requirement for non-PEHEs to "carry on a trade, business, or profession in Singapore" has been removed; this addresses feedback that IHEs would otherwise have difficulty fulfilling this given the passive nature of their activities.

To illustrate the aforementioned updates:

- An IHE that owns only shares on capital account should be regarded as a PEHE.
- An IHE that owns shares and debt on capital account should be regarded as a non-PEHE. For example, an IHE that carries out lending activities, including providing shareholder's loans to its subsidiaries/investee entities, should be regarded as a non-PEHE.

PEHEs are generally subject to reduced economic substance requirements vis-à-vis non-PEHEs. Consequently, an IHE owning foreign assets but is classified as a non-PEHE, may wish to consider whether there are restructuring opportunities prior to 1 January 2024 to manage adverse tax implications arising from the implementation of Section 10L. Leveraging on Hong Kong's similar experience, determining economic substance for non-PEHEs is likely to involve greater subjectivity.

2) No bright-line tests in establishing whether economic substance requirements are met

No bright-line tests or quantitative thresholds would be prescribed in the legislation to establish whether economic substance requirements are met. Instead, the Inland Revenue Authority of Singapore (IRAS) would provide further guidance through an e-Tax Guide, including examples for certain sectors. Among others, relevant factors to determine whether economic substance requirements are met include:

- The number of employees in Singapore
- The qualifications and experience of such employees
- The amount of business expenditure incurred by the entity
- Whether key business decisions of the entity are made by persons in Singapore.

The 8 September 2023 update by MOF also provided that the following tax treatment would be allowed in relation to Section 10L:

1) Foreign-sourced disposal losses can be set-off against foreign-sourced disposal gains that are taxable. The set-off would be restricted to foreign-sourced disposal losses that would otherwise have been taxable if they were gains. Unutilised foreign-sourced disposal losses may be carried forward indefinitely to set-off against foreign-sourced disposal gains in future years.

2) Expenses incurred to protect or preserve the value of the foreign asset are deductible against foreign-sourced disposal gains that are taxable, provided that such expenses have not been deducted against any other income.

Closing remarks

Due to multilateral tax policy-making considerations, it appears that the 1 January 2024 start-date for Section 10L is a "must-have", even if it results in a very compressed timeframe for affected taxpayers to react.

From a timeline perspective, the IRAS is expected to issue further guidance on Section 10L, but only after the said legislation has been passed. That said, the Hong Kong Inland Revenue Department's guidance regarding their new Foreign-sourced Income Exemption regime could provide useful reference points, so there is arguably no need to wait for further guidance by IRAS, to review existing structures in light of the new Section 10L.

Given the limited window period between now and 31 December 2023 before the new Section 10L takes effect, companies may wish to review their current Singapore investment holding structures and assess if significant risks may arise and whether there are opportunities for risk management. Although keeping gains from the sale of foreign assets by an affected entity offshore may be a way to manage Singapore tax exposure, this will involve administrative and tracking costs. We would be pleased to assist further where required.

Contacts

Should you have any comments or questions arising from this newsletter, please contact either the listed contacts below, or any member of the **Singapore Tax & Legal team**.

Daniel Ho
Head of Tax
Deloitte Singapore

+65 6216 3189
danho@deloitte.com

Chua Kong Ping
Tax Partner
Deloitte Singapore

+65 6800 2966
kchua@deloitte.com

Michael Velten
Financial Services Tax Leader
Deloitte Southeast Asia

+65 6531 5039
mvelten@deloitte.com

Loh Eng Kiat
Tax Partner
Deloitte Singapore

+65 6800 2779
ekloh@deloitte.com

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