
# Proposed taxation of gains on disposal of foreign assets

June 2023

**In brief**

In the draft Income Tax (Amendment) Bill 2023 (the 'draft Bill') published on 6 June 2023 for public consultation, the Ministry of Finance (MOF) has proposed a tax on gains from sale or disposal of any movable or immovable property situated outside Singapore (collectively 'foreign assets') that are received in Singapore by a relevant entity which does not have economic substance in Singapore.

The proposed change will apply to gains from sale or disposal of foreign assets occurring on and after 1 January 2024.

As the proposal has not been legislated, businesses should monitor this development and consider its implications.

**In detail**

Singapore adopts a territorial basis of taxation where tax is imposed on (i) Singapore-sourced income and (ii) foreign-sourced income received in Singapore, unless a specific exemption applies. Under Singapore's foreign-sourced income exemption (FSIE) regime, specified classes of foreign-sourced income (i.e. dividend, service income and branch profit) received in Singapore by a Singapore tax resident is exempt from tax provided certain conditions are met.

In a periodic review conducted by the European Union (EU) in October 2021[1] as part of its initiative to combat harmful tax competition, Singapore's FSIE regime was found not harmful. In December 2022, the EU Code of Conduct Group guidance was updated to require an FSIE regime to include capital gains as a general class of taxable items.[2] To align Singapore's regime to the guidance, MOF has proposed introducing section 10L.

The proposed section 10L imposes tax on gains derived by a **relevant entity** on or after 1 January 2024 from the sale or disposal of **foreign assets** when the gains are **received in Singapore**, unless the exceptions noted below apply.

[1] See Council of European Union's Outcome of Proceedings dated 24 November 2021 (14342/21) at https://data.consilium.europa.eu/doc/document/ST-14341-2021-INIT/en/pdf

[2] See Council of European Union's Report dated 24 November 2022 (14674/22) at https://data.consilium.europa.eu/doc/document/ST-14674-2022-INIT/en/pdf

Relevant entity

An entity refers to any legal person (other than an individual), a general partnership, limited partnership and a trust. An entity is a **relevant entity** if it is a member of a group where at least one member has a place of business outside Singapore. In turn, the entity is a **member of a group** if its assets, liabilities, income, expenses and cash flows are included in consolidated financial statements prepared by the parent entity of the group.

*Exceptions*

The proposed section 10L does not apply to:

- financial institutions;
- entities with certain tax incentive schemes; and
- entities that meet the following economic substance requirements:

| | **Pure equity-holding entity (PEHE)** | **Non-pure equity-holding entity (non-PEHE)** |
|---|---|---|
| Definition | An entity:<br>• whose primary function is to hold shares or equity interests; and<br>• derives only (i) dividends or similar payments from shares or equity interests, (ii) gains from sale or disposal gains of shares or equity interests; and (iii) income incidental to the activities of holding shares or equity interests. | An entity that is not a pure equity-holding entity. |
| Economic substance requirement | The entity is required to:<br>• comply with every obligation to submit any regular return, statement or account under the written law under which it is incorporated or registered; and<br>• have its operations managed and performed in Singapore, whether by its employee or other persons. | The entity is required to:<br>• carry on a trade, business or profession in Singapore;<br>• have its operations managed and performed in Singapore, whether by its employee or other persons; and<br>• have reasonable economic substance in Singapore. Factors considered are:<br>(i) number of employees (or other person managing or performing the entity's operations) in Singapore;<br>(ii) the qualifications and experience of the employees;<br>(iii) the amount of business expenditure incurred in and outside Singapore relative to the entity's income; and<br>(iv) whether key business decisions of the entity are made by persons in Singapore. |

Foreign assets

Movable and immovable properties (or any right or interest therein) situated outside Singapore are considered foreign assets. The proposed provision contains its own set of rules to determine where assets are situated. They include:

- Immovable property – where it is physically located.
- Shares or securities – where the company/ issuer was incorporated.
- Intellectual property rights and licence – where the owner of the right or licence is resident.
- Tangible movable property (not otherwise specified) – where it is physically located.

Received in Singapore

Gains from sale or disposal of foreign assets will be considered received in Singapore when they are:

- remitted to, transmitted or brought into Singapore;
- applied in or towards satisfaction of any debt incurred in respect of a trade or business carried on in Singapore; and
- applied to purchase any movable property which is brought into Singapore.

This is identical to section 10(25) of the Income Tax Act 1947 (the Act) that currently applies to clarify when foreign sourced income is considered received in Singapore.

If section 10L is engaged, the Comptroller may substitute the open market price of the foreign asset for the actual sales proceeds (if the latter is less) when computing the taxable gain.[3]

**PwC's comments**

Given that the draft bill may be subject to change, it is premature to comment on its provisions in detail. That said, this proposal, when enacted, will represent a significant shift in Singapore's tax regime which currently does not tax capital gains. Hence, we have offered below some initial observations.

Scope of charge

The proposed section 10L treats all foreign-sourced gains from the sale or disposal of foreign assets that are received in Singapore by relevant entities as income chargeable to tax under section 10(1)(g) of the Act (unless an exception noted above apply).This is notwithstanding such gains may be capital in nature (based on tax principles) or otherwise exempt from tax based on statutory safe harbour provisions (such as section 13W of the Act for share disposals).[4]

Section 10(1)(g) operates to catch any payment of an income nature that does not otherwise fall within the scope of the charging section. It can apply to gains from a transaction undertaken with a profit motive which is not one carried out in the ordinary course of a trade or business. Accordingly, any losses are not a trade loss and cannot be set-off against another source of income or be carried forward for utilisation in future years. By treating the gains on sale of foreign assets as section 10(1)(g) income, it appears that any corresponding losses may not be available for set-off against other income even if derived within the same year.

In reality, a person who derived a gain from the disposal of one foreign asset and a loss from another will only have the net gain available for remitting into Singapore. Taxing the gain from the former but ignoring the latter would result in a measure of gains that would exceed the actual net accretion in wealth.[5] It is hoped that the MOF could reconsider the scope of section 10L to allow for losses offset expressly. In this connection, it is noted that the equivalent provision in Hong Kong's FSIE regime does allow such a set-off against assessable profits for the year of assessment in which the sales proceeds are received in Hong Kong and any losses not so setoff may be carried forward.

[3] Subsection (8) read with subsections (10) and (11).

[4] Subject to certain exceptions, section 13W provides that gains derived by a company from the disposal of ordinary shares that take place between 1 June 2012 and 31 December 2027 will not be taxed if the company has legally and beneficially held at least 20% of the ordinary shares in the investee company continuously for at least 24 months immediately prior to the disposal. The operation of section 13W will be very much curtailed when section 10L is introduced.

[5] This is particularly so when read with subsection (10), which confines deductions to expenses incurred to 'acquire, create or improve the foreign asset or to sell or dispose of [that] asset', thus disregarding any losses from other assets. That said, it should be noted that the taxpayer in these circumstances will not be able to remit more than the net gain to Singapore (as part of the gains would have been applied to set off losses), so the amount that ought to be taxed in Singapore will naturally be capped to the net gain received in Singapore. To avoid doubt and a convoluted reasoning in determination of the taxable amount, it is preferable spelling out the measure of assessable gain clearly.

Economic substance

Entities likely to be affected by the proposed section 10L include investment holding companies (IHCs). While there are reduced economic substance requirements if the IHC only holds equities (and hence qualifies as a PEHE), it is common for IHC to hold a diversified portfolio including debt securities. These IHCs would be classified as non-PEHE which are subject to a higher economic substance threshold, including the requirement to carry on a trade or business. IHCs that do not carry on a trade or business and which only derive passive-sourced income from holding long-term investments will not meet the threshold to be excluded from the scope of the proposed rule. If the intent is to curb international tax avoidance through 'letter-box' holding companies, substance could be determined by considering whether control and management is exercised in the country in which the entity is established, and not necessarily by reference to the trade or business test found in section 10(1)(a) of the Act.

Perhaps in recognition of the diversity in types of businesses and their mode of operations, there was no quantitative threshold prescribed for "reasonable economic substance". As it is unavoidable that a qualitative rule will result in some uncertainty for non-PEHEs, it will be useful if the Inland Revenue Authority of Singapore (IRAS) can issue some guidance on how it will administer this rule. Alternatively, the IRAS may consider creating a class of express advance ruling on economic substance, as this subject may be dealt with more expeditiously given its narrow focus.

Last but not least, a key criterion of Singapore's development initiatives for the asset and wealth management sector is the requirement for fund management expertise to be based here, such that there is economic substance underpinning the growth of assets under management. It will be useful if the authorities can clarify that funds managed by asset management companies and family offices in Singapore, regardless of their trading or investment strategies, should not be affected by this proposed change.

Substitution for open-market price and cost base computation

This proposed provision is largely consistent with those found in other parts of the Act, where the Comptroller is given the powers to substitute open market price for the actual sales price (if the latter is lower) to safeguard revenue loss. That said, transactions with third parties would in general be carried out at arm's length. It is hoped that in administering this provision, the IRAS will respect these transactions as concluded and not ask for excessive documentary proof. Further, it is not uncommon for group restructuring to be carried out at book values. This would appear no longer feasible upon enactment of this provision in its current form (unless the gains will not be received in Singapore).

As section 10L taxes capital gains, it is hoped that the relevant cost base could be adjusted for inflation.

**Concluding remarks**

The proposed section 10L comes on the back of increasing efforts to curb cross-border tax avoidance and prevent double non-taxation. In today's international tax policy environment, this proposal is not entirely surprising. Hong Kong has similarly introduced an FSIE regime on 1 January 2023 under which certain foreign income received in Hong Kong will be subject to tax. We provide in the appendix a brief comparison of the scope of the Hong Kong's FSIE regime with section 10L's, as well as the respective economic substance requirements. Do note that the Hong Kong's regime is currently undergoing further revision in the light of the updated EU Code of Conduct Group guidance.[6]

The draft bill is not yet law, and there may be further changes following feedback from the ongoing public consultation. The MOF has indicated that it will publish a summary of the feedback received and its responses in August 2023. In the meantime, businesses should follow these developments closely and carefully evaluate their potential implications and whether they can satisfy the economic substance requirements.

[6] See PwC Hong Kong's News Flash on 11 April 2023 at https://www.pwchk.com/en/hk-tax-news/2023q2/hongkongtax-news-apr2023-5.pdf

## 1. Comparison of Singapore's proposed section 10L to Hong Kong's FSIE regime

| | Proposed section 10L (Note 1) | Hong Kong's FSIE regime | | | |
|---|---|---|---|---|---|
| **Exceptions (Note 2)** | **Gains on disposal of all foreign assets** | **Interest** | **Dividend** | **Gains from sale of equity interests** | **Intellectual property income** |
| Economic substance requirement | ✓ | ✓ | ✓ | ✓ | |
| Participation requirement[7] | | | ✓ | ✓ | |
| Nexus requirement[7] | | | | | ✓ |

Note 1: Foreign-sourced income received in Singapore is subject to tax, unless certain exemptions apply, e.g. section 13(8) and 13(12) of the Act, The current treatment is not included in this table.

Note 2: Specific exceptions, e.g. financial institutions and entities enjoying certain tax concessions, are not included in this table.

## 2. Comparison of economic substance requirements between Singapore and Hong Kong

### (A) PEHEs

| | Singapore | Hong Kong |
|---|---|---|
| **Definition** | An entity:<br>• whose primary function is to hold shares or equity interests; and<br>• derives only (i) dividends or similar payments from shares or equity interests, (ii) gains from sale or disposal of shares or equity interests; and (iii) income incidental to the activities of holding shares or equity interests. | An MNE entity[8] which only:<br>• holds equity interests in other entities; and<br>• earns dividends, disposal gains; and income incidental to the acquisition, holding or sale of such equity interests. |
| **Economic substance requirements** | The entity is required to:<br>• comply with every obligation to submit any regular return, statement or account under the written law under which it is incorporated or registered; and | The MNE entity is required to:<br>• satisfy every applicable registration and filing requirement under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), the |

[7] For information on the nexus and participation requirements under Hong Kong's FSIE regime, see PwC Hong Kong's News Flash on 31 October 2022 and 19 December 2022 at https://www.pwchk.com/en/services/tax/publications/hongkongtax-news-oct2022-15.html and https://www.pwchk.com/en/hk-tax-news/2022q4/hongkongtax-news-dec2022-18.pdf respectively.

[8] Under the Hong Kong FSIE regime, MNE entity refers to person that is, or acts for, an MNE group or an entity included in an MNE group. An entity is defined as a legal person (other than a natural person) or an arrangement that prepares separate financial accounts, such as a partnership and a trust. A MNE group refers to a group that includes at least one entity or permanent establishment that is not located or established in the jurisdiction of the ultimate parent entity of the group.

| | | |
|---|---|---|
| | • have its operations managed and performed in Singapore, whether by its employee or other persons. | Limited Partnerships Ordinance (Cap. 37), the Business Registration Ordinance (Cap. 310); and the Companies Ordinance (Cap. 622); and<br>• have adequate human resources and premises for carrying out the specified economic activities[9] in Hong Kong. |

**(B) Non-PEHEs**

| | **Singapore** | **Hong Kong** |
|---|---|---|
| **Definition** | An entity/ MNE entity that is not a PEHE | |
| **Economic substance requirements** | The entity is required to:<br>• carry on a trade, business or profession in Singapore;<br>• have its operations managed and performed in Singapore, whether by its employee or other persons; and<br>• have reasonable economic substance in Singapore. Factors considered are number of employees (or other person managing or performing the entity's operations) in Singapore, qualifications and experience of employees, amount of business expenditure incurred in and outside Singapore relative to the entity's income; and whether key business decisions of the entity are made by persons in Singapore. | The MNE entity is required to:<br>• employ adequate number of employees with necessary qualifications to carry out the specified economic activities[10] in Hong Kong; and<br>• incur adequate amount of operating expenditure for carrying out the specified economic activities in Hong Kong. |

[9] Specified economic activities for a PEHE in Hong Kong is the holding and managing of its equity participants in other entities.

[10] Specified economic activities for non-PEHE in Hong Kong is the making of necessary strategic decisions in respect of any assets the entity acquires, holds or disposes of; and managing and bearing principal risks in respect of such assets.

# Contact us

If you would like to discuss any of the issues raised, please get in touch with your usual PwC contact or any of the individuals listed below.

**Chris Woo**

Tax Leader
+65 9118 0811
chris.woo@pwc.com

**Tan Ching Ne**

Partner and Corporate Tax Leader
+65 9622 9826
ching.ne.tan@pwc.com

**Lennon Lee**

Partner and Financial Services Tax Leader
+65 8182 5220
lennon.kl.lee@pwc.com

**Paul Lau**

Partner, Financial Services Tax
+65 8869 8718
paul.st.lau@pwc.com

For further details on our industry specialists, please click here.