

Enhancement to the Enhanced-Tier Fund Tax Incentive Scheme

Financial Services
Tax Bulletin

June 2015

On 23 February 2015, the 2015 Budget Statement was delivered. It was then announced that with effect from 1 April 2015, the existing concession for master-feeder fund structures under the Enhanced-Tier Fund Tax Incentive Scheme (the “ETF Scheme”) will be enhanced to apply to special purpose vehicles (SPVs) held by the master fund, subject to conditions. The recent Monetary Authority of Singapore (MAS) FDD Cir 05/2015 dated 29 May 2015 provides details and clarifications with regard to the enhancement (the “2015 ETF Enhancement”). We discuss the salient points of the MAS circular below.

Background

The ETF Scheme was first introduced in 2009 to provide greater flexibility for fund managers in sourcing their mandates (in that unlike other fund management tax incentive schemes, the ETF Scheme does not impose limitations in the amount of investments made by Singapore resident persons in the fund). Among other conditions, the ETF Scheme imposes economic commitments being (1) a minimum of S\$50 million fund size at the point of application and (2) a minimum annual local business spending of S\$200,000.

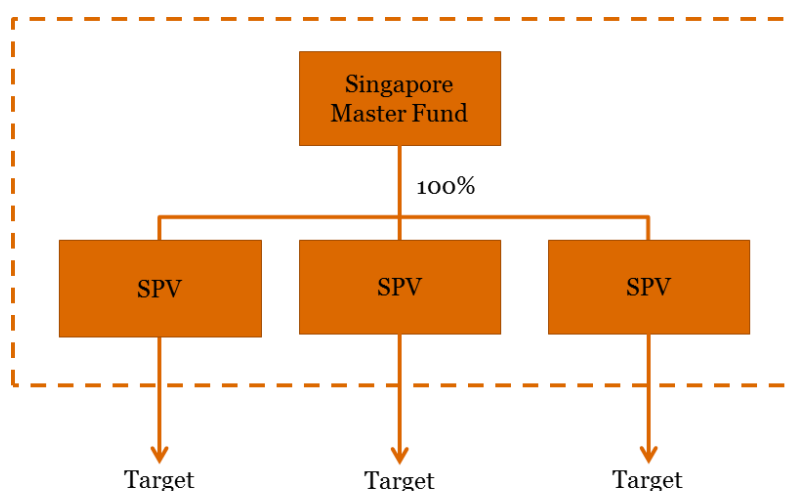
A year later, recognising that it is common for fund structures to be in the form of master-feeder fund structures, the ETF Scheme was enhanced to allow master-feeder fund structure to submit a consolidated application for the ETF Scheme. The economic commitments for master-feeder fund structure can be met on a collective basis, and the quantum varies depending on whether the feeder fund trades.

The above enhancement was of course welcomed by the industry. However, soon after, the industry (in particular players in the private equity, real estate and infrastructure space) realised that the 2010 enhancement which focused on inclusion of feeder fund is not sufficient. This is because the enhancement has not taken into account that such funds commonly invest through SPVs for various commercial and legal reasons.

Prior to the 2015 ETF Enhancement, each of these SPVs had to independently apply and meet the conditions under the ETF Scheme or other tax exemption scheme on a standalone basis. This causes additional costs and compliance burden to funds and fund managers. The 2015 ETF Enhancement seeks to address this issue.

The 2015 ETF Enhancement

With effect from 1 April 2015, master-feeder-SPV and master-SPV fund structures can submit a consolidated application for the ETF scheme and meet the economic commitments on a collective basis. For the purposes of this bulletin, such structures are referred to as the “umbrella ETF structure”.



The following additional conditions apply for applications for the umbrella ETF structure:

- (1) the master fund must be a (i) Singapore-incorporated company which is tax resident in Singapore; (ii) Singapore-constituted trust whose trustee is a Singapore tax resident; or (iii) Singapore-registered limited partnership with all partners who are Singapore tax residents;
- (2) the master fund must be tax resident in Singapore for each basis period;
- (3) the SPVs must be set up as companies and are wholly owned by the master fund; and
- (4) the economic commitments have to be met on a multiple-fold basis.

It is not surprising that many of us will be focusing our attention on the fourth condition being the quantum of economic commitments. As with the 2010 enhancement, the quantum depends on whether the feeder fund (if any) trades. To put it simply, each entity in an approved ETF structure (except feeder funds that do not trade and do not derive any taxable income) contributes to one set of economic commitment. Please refer to the table below for an illustration.

Entity	Count towards multiplier?
Trading feeder fund	Yes
Non-trading feeder fund	No
Master fund	Yes
SPV	Yes

For example, where a fund structure includes one trading feeder fund, one non-trading feeder fund, a master fund and two SPVs, the multiplier for the economic commitments is 4 (i.e. S\$200 million fund size and S\$800,000 annual local business spending).

The economic commitments can be met on a collective basis by entities in the approved fund structure. Private equity, real estate and infrastructure funds can continue to meet these economic commitments by way of committed capital (subject to existing conditions).

Any subsequent additions of SPVs to an approved umbrella ETF structure will have to be approved by the MAS. The new economic commitments on a multiple-fold basis will have to be met at the point of addition of the new SPV(s). Similarly, an advance notice needs to be given to the MAS for any withdrawal of SPV(s) from an approved umbrella ETF structure. The economic commitments will be revised downwards accordingly.

PwC's observations

The 2015 ETF Enhancement is certainly a great step forward to address the industry needs (especially in the private equity, real estate and infrastructure space). This again shows that the authorities are clued in to what is happening in the industry, and are open to feedback and improvements. Some of our observations / comments are set out below.

Collective basis of satisfying the economic conditions

This is a very reasonable approach. It is possible that the master-feeder-SPV overall size may be large, say S\$500 million, and annual expenses significant, say S\$5 million. But not all of the fund's investments which happen via individual SPVs may exceed the \$50 million investment or S\$200,000 annual expenses threshold. Allowing the conditions to be satisfied on a collective basis for the whole structure, provides reasonable flexibility to the fund and fund managers.

Co-investment structures

It is becoming increasingly common for investors to make co-investment alongside the fund. Such co-investment commonly happens at the SPV level when certain investors are keen to increase participation in certain projects. The enhancement, as it currently stands, does not allow co-investments since the SPV has to be wholly-owned by the master fund.

The MAS circular clarified that where an entity withdraws from an approved ETF fund structure, the entity could avail itself to other tax incentives available to fund vehicles on a

prospective basis, subject to it meeting the conditions of the scheme. In the case of a Singapore SPV, the other possible tax exemption scheme that it can avail itself to is the Singapore Resident Fund Scheme (the “SRF Scheme”). As the SRF Scheme requires the SPV not to be 100% owned by Singapore persons (which includes the Singapore master fund), this limits the possibility of having co-investment from Singapore investors. Furthermore, the SRF imposes penalties on non-qualifying relevant owners (broadly Singapore corporate investors individually owning more than 30% of the SPV). Hence, even if the SPV may have foreign co-investors, the SRF Scheme still limits co-investment from Singapore corporate investors.

The halfway house the authorities could have considered would have been to allow the SPVs to be covered under the umbrella ETF scheme, as long as the SPV is 100% held by investors who qualify under the SRF Scheme or the ETF Scheme.

Singapore resident master fund

Lastly, although it is not common for a Singapore master fund to be in the form of a limited partnership, the condition requiring all partners of the master fund (including all limited partners) to be Singapore tax residents makes the practical application difficult. The intent behind this seems to be fair. The authorities seem to want increased substance in Singapore, both at the SPV level as well as the master fund level, to mitigate risks around tax residency of the SPVs.

What's next?

New fund structures

For managers setting up new fund structure, you should definitely consider the benefits of and the applicability of the umbrella ETF structure. In terms of timing, it is possible for you to add additional SPV(s) when projects / investments are identified during the life of the fund.

Existing fund structures

For existing fund structures, you should weigh the benefits and cost (monetary and non-monetary such as compliance burden) of transiting into the umbrella ETF structure. Existing fund structure where certain SPVs may have issue meeting the S\$200,000 business spending requirement on a standalone basis may find it useful to transit into the umbrella ETF structure as the business spending requirement can be met collectively by entities in the umbrella ETF structure.

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