Bloomberg Tax

Tax Management
International Journal™

October 26, 2023

Section 10L Changes the Singaporean Tax Landscape for MNEs

Ethan Kroll*
Baker McKenzie LLP

Recent amendments to Singaporean tax law may increase the Singaporean tax liability of multinational groups that are engaging in routine asset sales and restructuring transactions, even when the transactions otherwise lack nexus with Singapore. Historically, Singapore did not tax capital gains. Singapore also did not tax foreign source income even when repatriated to Singapore in the form of dividends if those dividends qualified for a statutory tax exemption (See Income Tax Act 1947 ("ITA"), Section 13(8)). Thus, a Singaporean company could sell or otherwise transfer intellectual property (“IP”) to a subsidiary, the subsidiary could use the IP to derive royalties and remit the royalty proceeds to its parent in the form of dividends, and the subsidiary could eventually sell the IP and remit the proceeds from the sale to its parent in the form of dividends, all without triggering Singaporean income tax.

On October 3 of this year, in an effort to make the Singaporean tax regime "consistent with international standards, such as the rules against harmful tax practices agreed by the Inclusive Framework on Base Erosion and Profit Shifting or BEPS, of which Singapore is a member, as well as the EU Guidance on Foreign-Sourced Income Exemption Regimes," Singapore announced that "[f]oreign-sourced disposal gains will be taxable when received in Singapore by entities of multinational enterprise groups that do not have economic substance in Singapore," and that "[t]ighter rules will also apply to disposal gains arising from intellectual property rights, due to the higher mobility of such assets," starting in 2024 (See Second Reading Speech by Senior Minister of State for Finance, Mr. Chee Hong Tat, on the Income Tax (Amendment) Bill 2023, at The Parliament (Oct. 3, 2023)).

The changes that Mr. Tat noted are included in new section 10L, "Gains from the sale of foreign assets," of the ITA. The practical effect of section 10L is to make the proceeds of many transactions occurring wholly outside of Singapore potentially subject to 17% Singaporean income tax. The Inland Revenue Authority of Singapore ("IRAS") is expected to release administrative guidance on the application of section 10L and its intended scope.

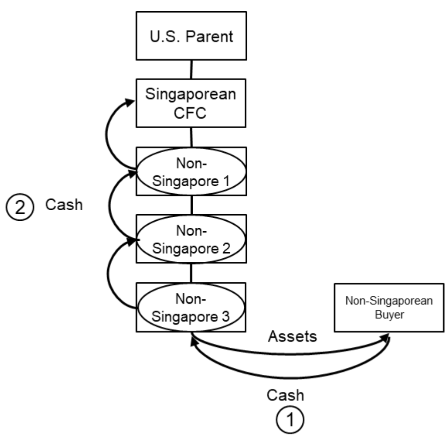
* Ethan Kroll is a partner in Baker McKenzie LLP's Los Angeles office.

In this column, I take a first look at the operation of section 10L, its potential impact on multinational enterprises, and some of the relevant issues that section 10L presents in advance of further clarifications from IRAS.

The Nuts and Bolts of Section 10L

Section 10L falls under Part 3 of the ITA, which addresses the imposition of income tax. Section 10L(1) states: "Despite anything in this Act, gains from the sale or disposal by an entity (called in this section the seller entity) of a relevant group of any movable or immovable property situated outside Singapore at the time of such sale or disposal or any rights or interest thereof (called in this section a foreign asset), that are received in Singapore from outside Singapore, are treated as income chargeable to tax under section 10(1)(g) for the year of assessment relating to the basis period in which the gains are received in Singapore." Section 10L(2) explains that section 10L(1) only applies if (i) Singapore would not otherwise tax the income under the main income tax provision in section 10(1) of the ITA or (ii) the "gains" to which section 10L(1) refers would otherwise be exempt from tax under the ITA. Section 10L(3) provides that section 10L(1) applies to sales or disposals that occur on or after January 1, 2024.

It is helpful to put the above into context with the following simple illustration.



Before section 10L, Non-Singapore 3 could sell assets to Non-Singaporean Buyer and remit the cash to Singaporean CFC without triggering Singaporean income tax so long as Singapore’s foreign-source income exemption applied. Under section 10L, generally speaking, the cash that Singaporean CFC receives may potentially be subject to tax at a rate of 17% even if a dividend of that amount would otherwise be exempt from Singaporean tax under section 13(8) of the ITA.

There is, of course, more to section 10L than the simple illustration above conveys. I discuss the key terms and concepts of section 10L below.

"Gains." Section 10L presumes that transactions to which the section applies will take place at fair market value. If a transaction does not take place at fair market value, section 10L(10) empowers the Comptroller of Income Tax to increase the amount of gain received in Singapore from outside Singapore, which is subject to 17% Singaporean income tax, to equal the following:

(amount of gains received in Singapore from outside Singapore) + (fair market value of the asset) - (sale/disposal price). Accordingly, an in scope transaction that takes place at book value could result in a deemed income inclusion in Singapore even if no amount is ever remitted to or received in Singapore.

More generally, section 10L(12) provides that an entity selling or disposing of "foreign assets" reduces section 10L gain by the combination of (i) amounts it incurred to acquire, create, or improve, protect or preserve the value of, or sell or dispose of the property, and (ii) any unused losses it incurred on the sale or disposal of any other property, where, if the sale or disposal had resulted in gain, the gain would have been chargeable under section 10L. Section 10L(13) provides that expenses (including capital expenditures) that give or gave rise to deductions or capital allowances against taxable income do not reduce section 10L gain, except to the extent they are or were subject to a clawback - referred to as a "balancing charge" under Singaporean law.

Accordingly, if a Singaporean entity sells IP that is within the scope of section 10L for SG$ 100, incurred SG$ 20 to improve the property and also enjoyed deductions or capital allowance of SG$ 20 against taxable income, the entity recognizes SG$ 100 of section 10L gain. If, however, the SG$ 20 in capital allowances were subject to a balancing charge, the entity may reduce its gain by $20, to arrive at a section 10L gain of SG$ 80.

"Entity … of a relevant group." For section 10L to apply, the entity that sells or disposes of foreign assets must be a member of a "relevant group." Section 10L(16) defines an entity to be a legal person (other than an individual), a partnership, or a trust. Section 10L(5)(a) treats an entity as a member of a group if the entity's financial results are included in the parent's consolidated financials or are excluded solely on size or materiality grounds or on the grounds that the entity is held for sale. Section 10L(5)(b) defines a relevant group as a group of entities, all of which are not incorporated, registered, or established in a single jurisdiction, or any of which has a place of business in more than one jurisdiction.

A U.S. multinational enterprise with one or more subsidiaries will therefore typically satisfy the threshold criteria for a relevant group. More importantly, all the non-Singaporean companies and partnerships in the multinational structure will be entities of a relevant group. Thus, section 10L potentially applies in relation to sales or disposals of foreign assets by any member of a multinational group.

"Movable or immovable property situated outside of Singapore." Section 10L(15) provides rules for determining the location of property. While this subsection addresses a wide range of assets, I suspect readers will be most interested in how section 10L identifies the locations of tangible property, debts (e.g., notes), shares of stock, partnership interests, and IP. Section 10L(15)(a)-(b) provide that immovable and tangible movable property are generally situated where the property is located. Section 10L(15)(d) situates secured / unsecured debts where the creditor is resident. Section 10L(15)(g) situates shares of stock or securities (including debentures and debt securities) where the company is incorporated. Section 10L(15)(h) situates equity interests in an entity that is not a company (e.g., a partnership) where the entity's operations are principally carried out.

With respect to goodwill, section 10L(15)(j) situates goodwill relating to "a trade, business or profession … where the trade, business or profession is principally carried on." With respect to "intellectual property rights" or licenses in respect of those rights, section 10L(15)(k) looks to the residence of the owner of the right or license for the location of the right/license. With respect to intangible movable property not otherwise captured by section 10L(15), section 10L(15)(l) locates this property where the ownership rights would be primarily enforceable.

The definitions in section 10L(15) make the breadth of section 10L's scope clear. Shares of stock in a Dutch company, whether or not held by a Singaporean company, represent movable property situated outside of Singapore to which section 10L could apply. The same goes for rights under an IP license between a U.S. licensor and a Brazilian licensee, and a note issued to a non-Singaporean entity, such as a U.S. partnership.

Under section 10L, routine transactions that have no connection to Singapore, and historically would not have raised Singaporean tax concerns if a multinational group were comfortable that dividends would benefit from a foreign source income exemption, now have the potential to create additional tax expense if gains from those transactions are "received in Singapore from outside Singapore."

"Received in Singapore from outside Singapore." Section 10L(9) provides three circumstances in which amounts of gain from the sale or disposal of a foreign asset are treated as received in Singapore from outside Singapore: (a) the amounts are remitted to, or transmitted or brought into, Singapore; (b) the amounts are applied to satisfy debts incurred in respect of a trade or business carried on in Singapore, or (c) the amounts are used to purchase movable property that is brought into Singapore. Section 10L(9) largely tracks existing section 10(25) of the ITA, which, like section 10L(9), articulates the circumstances for when amounts are treated as income received in Singapore from outside Singapore.

Section 10L(9)(a) represents the most likely situation in which a sale or disposal of property will result in amounts being received in Singapore from outside Singapore. If a subsidiary remits cash to a Singaporean bank account of its Singaporean parent, this transaction likely satisfies section 10L(9)(a), as the cash can be considered to have been transmitted or brought into Singapore. If, however, the subsidiary remits a cash equivalent in the form of a note receivable, or some other asset, the answer is less clear. It is also unclear if the sourcing rules under section 10L(15) for determining whether an asset is situated outside of Singapore can be applied in the context of the deemed receipt rules under section 10L(9) and section 10(25) to determine whether amounts are remitted from outside Singapore. Section 10L(15) therefore adds further uncertainty and complexity to the "deemed receipt" analysis under Singaporean tax law.

"Basis period." A basis period is the taxable year that precedes the year of assessment - i.e., the year in which tax is due. For a calendar year taxpayer, 2024 is the basis period for the year of assessment 2025. Thus, if proceeds from a transaction that falls within section 10L's scope are received in a Singaporean bank account in 2024, tax will be due in 2025, the year of assessment that follows the year when the proceeds were received in Singapore.

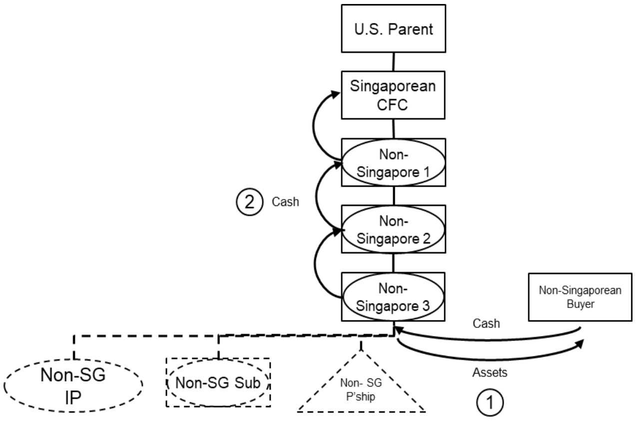
Exceptions to section 10L. The OECD and the EU tend to look favorably on regimes that contain substance requirements, and section 10L includes some exceptions that reflect the government's desire to follow the guidance the EU Code of Conduct Group published in December 2022. Section 10L(6) provides an exception for a prescribed percentage of gains from the sale or disposal of "qualifying intellectual property rights" that give rise to qualifying income under Singapore's IP Development Incentive. Similarly, section 10L(8) provides an exception for gains from the sale or disposal of foreign assets other than IP, where the sale or disposal "is carried out as part of, or incidental to, the business activities or operations of an entity" that benefits from specified incentive regimes or is an "excluded entity." An "excluded entity" is defined in section 10L(16) to include (i) a pure equity-holding entity ("PEHE") that meets prescribed substance requirements, such as having adequate human resources and premises in Singapore to carry out its operations, and (ii) a non-PEHE that has adequate substance taking into account the number of full-time employees it has in Singapore, the qualifications of the employees, the amount of business expenditures it incurs, etc. The rationale behind the exceptions for disposals that are incidental to incentivized activities is likely that companies that benefit from concessionary or incentive rates are required to satisfy substance requirements or make substantive investments in Singapore, and exceptions along the lines above are therefore consistent with the rationale of the guidance the EU Code of Conduct Group published.

While the exceptions in sections 10L(6) and (8) are helpful, they are fairly limited in the context of section 10L as a whole. For one, if a company that does not benefit from the IP Development Incentive disposes of IP, this sale or disposal appears not to be excluded from section 10L. Thus, a company that enjoys a common non-IP incentive, such as a Pioneer or Development and Expansion Incentive, and disposes of IP is still potentially subject to tax under section 10L, unless the entity itself can be considered an excluded entity. In addition, the exceptions apply only to Singaporean companies because non-Singaporean enterprises are not eligible for Singaporean incentives and would seldom carry out actual business operations or hire employees in Singapore. As a result, and as illustrated in the diagram above, there appear to be no exceptions for sales or disposals of IP and other assets by non-Singaporean entities.

Accordingly, one practical consequence of section 10L is that, starting in January 2024, a multinational group will need to identify all of the group's transactions involving sales or disposals of foreign assets, determine whether each transaction is within the scope of section 10L, and then further determine if any gain that falls within section 10L's scope may potentially be received in Singapore.

Below I walk through three basic fact patterns to illustrate the potential application of section 10L.

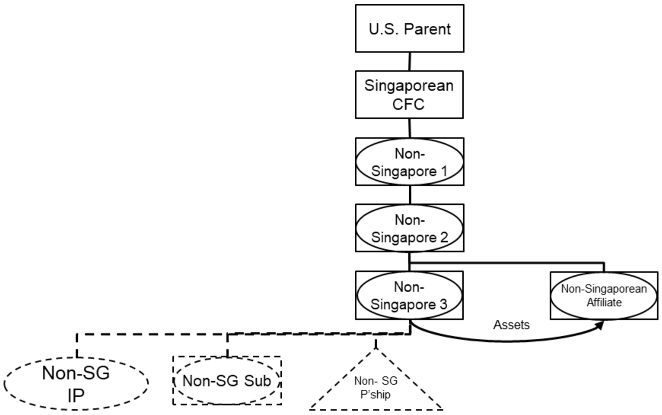
Example 1: An Asset Sale.



This example is similar to the example I use above to illustrate the basic operation of section 10L. In this example, Non-Singapore 3, an indirectly wholly owned non-Singaporean subsidiary of a Singaporean CFC, sells an interest in a non-Singaporean partnership that operates outside of Singapore, shares in a non-Singaporean subsidiary, and IP rights (other than goodwill) that it legally and economically owns to a non-Singaporean buyer. Non-Singapore 3 is a member of a relevant group, the IP rights are situated outside of Singapore because Non-Singapore 3 is a non-Singaporean person, the shares in the non-Singaporean subsidiary are situated outside of Singapore because it is incorporated outside of Singapore, and the interests in the non-Singaporean partnership are situated outside of Singapore because the partnership operates outside of Singapore. No exception to section 10L appears to apply, and if Non-Singapore 3 remits the proceeds of the sale to Singaporean CFC, those proceeds may be subject to Singaporean tax.

The magnitude of the Singaporean tax exposure depends of course on the amount of gain that is recognized on the sale. While section 10L provides rules for determining this gain, section 10L does not indicate how the section 10L gain computation interacts with the gain computation under the law(s) of the parties to the transaction. It will be interesting to see whether IRAS provides guidance that allows the determination of gain/loss under the law(s) governing the transaction to apply for purposes of section 10L as well. This type of guidance would be welcome, as it would eliminate the need to run a separate gain/loss computation solely for purposes of section 10L.

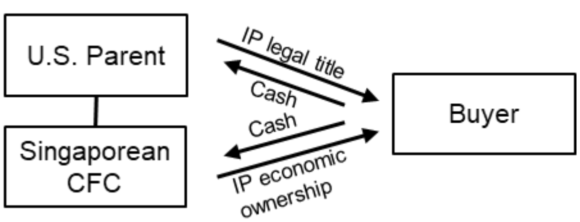
Example 2: A Demerger.



In this example, the assets that Non-Singapore 3 transfers are the same as in Example 1 above. The difference is that the transfer occurs for no consideration pursuant to a demerger statute, or perhaps for shares. The demerger is technically caught by section 10L, and, taking section 10L(10) to its extreme, the Comptroller can technically (i) deem the transfer to be at fair market value even if there is no consideration, and (ii) treat the difference between fair market value and the actual disposal price (being 0) as gains that are deemed to be received in Singapore.

That does not seem to be the correct result, as there is no effort in a demerger to understate the value of property, but, as with other points I note, the statute is not clear.

Example 3: An IP Sale with a U.S. Legal Owner.



In this example, a Singaporean CFC that does not benefit from an IP incentive holds economic rights in and to IP, and the CFC's U.S. parent holds legal title to this IP. The group wants to sell the IP to a buyer, and both the CFC and the U.S. parent are parties to the purchase agreement. From a legal perspective, Singaporean CFC is a licensee of the U.S. parent. Under section 10L(15)(k), Singaporean CFC's IP rights are located in Singapore, and section 10L therefore ought not to apply. Nevertheless, legal title to the IP sits with the U.S. parent. Could the IP therefore be treated as located in the United States for purposes of section 10L?

The answer to this question is important. If the proceeds that Singaporean CFC receives from selling the IP stem from the sale or disposal of an asset that is located in Singapore, then section 10L does not apply. As the transaction is capital in nature, the transaction should be outside the scope of Singaporean income tax, subject of course to the clawback of any allowances claimed against ordinary income with respect to historic IP expenses. If, however, the fact that the U.S.

parent holds IP legal title converts the transaction into a sale of property that is situated outside of Singapore, are the proceeds that Singaporean CFC receives subject to 17% Singaporean income tax under section 10L?

Section 10L(15)(k) is not clear on this point. From an economic standpoint, both U.S. Parent and Singaporean CFC are disposing of property, and it would be ideal if the guidance to section 10L could reflect this fact.

Implications

Until IRAS provides further guidance, section 10L looks to have significant implications for multinational groups. These groups will need to be mindful of section 10L when engaging in routine asset sales and restructuring transactions, even when the transactions otherwise lack nexus with Singapore.

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