Introduction

The 2019 Singapore Budget was handed down on 18 February 2019. It was generally a feel-good affair, notable for initiatives such as the generous Merdeka Generation Package and the Bicentennial bonus.

Compared to previous years, the budget was light on tax-related changes. Many of the tax changes which were announced are relevant to wealth managers and institutional fund managers. These may be seen as a continuation and refinement of the local fund incentives which support the growing importance of Singapore as an asset management and funds domicile hub. Set out below is a summary of these developments.

Fund Tax incentives

As expected, the three main fund tax exemptions of Sections 13CA, 13R and 13X have been renewed. These incentives provide certainty in the Singapore taxation of investment flows and are an important part of the development of a structure which is managed out of Singapore or includes Singapore domiciled fund vehicles. A number of changes have been made as part of the renewal of these schemes.

Removal of 100% Singapore persons requirement

The requirement under the Sections 13CA and 13R schemes that a fund must not have 100% of the value of its issued securities beneficially owned, directly or indirectly, by Singapore persons has been removed. This requirement was originally introduced as an integrity measure to prevent Singapore persons using these structures to route otherwise taxable investment flows.

This change makes the Section 13CA and 13R schemes more relevant for private wealth structures which are established for Singapore families. Previously, Sections 13CA and 13R were not applicable to a fund entity which is wholly owned by Singapore persons and where a private wealth vehicle was held under a trust, it would have been necessary for at least one beneficiary of the trust to be a non-Singapore person. To qualify as a non-Singapore person, the family member would need to be both non-citizen and non-resident, and receive a meaningful distribution from the structure. Issues also arose about how interests in the fund were to be determined through a discretionary trust, given the inherent complexities of identifying beneficial owners in a discretionary trust arrangement.

While the removal of this requirement is a welcome change, one wonders whether it will increase the reliance on Section 13CA for smaller private wealth structures. It is comparatively easy to structure a fund qualifying for the Section 13CA exemption and maintain that quite cost efficiently, without having to meet the qualifying conditions and higher thresholds applicable for the Section 13X scheme.

For institutional managers, this condition was seldom an issue in practice. Its removal does however, make it clear that layers of Section 13CA funds can be managed out of Singapore. Previously, there was a question about whether the Singapore permanent establishment created by the relationship with a Singapore fund manager was disentitling offshore funds managed in Singapore lower down the structure.

Increased flexibility with the design of Section 13X structures

The application of Section 13X scheme to Master-SPV structures has been liberalised. These may now be used in the context of structures which include co-investments, non-company SPVs, and more than two tiers of SPVs below a master fund.
Debt and credit funds are now able to access the 'committed capital concession'. This was previously only available to private equity, real estate and infrastructure funds and enables the minimum fund size condition to be satisfied based on committed rather than drawn-down capital. While this is a welcome change, the requirement to remunerate a manager on the basis of committed capital appears to remain. This is somewhat out of step with the commercial arrangements between fund managers and investors and is an additional refinement which could be made.

It was also announced that Section 13X will be expanded to cover managed accounts. It is not clear whether this change will apply to individuals, or whether it will be limited to the Singapore managed accounts of companies and other types of entities. In practice this will likely be most relevant where the holder of a managed account is an entity having active business operations – one of the conditions for approval of a fund under Section 13X is that it must be established for investment holding purposes only.

Specified Income from Designated Investments

The definitions of 'Specified Income' and 'Designated Investments' are fundamental to the Section 13CA, 13R and 13X schemes. These two expressions work in combination to define the scope of the exemption from Singapore tax which may be enjoyed by an incentivised fund. The definition of 'Designated Investments' will remain an exhaustive list of assets. It will therefore still be necessary to consider the categorisation of each and every asset held by an incentivised fund within this list. This can be a burdensome task depending upon the mandate of a fund and it can be expected that the industry lobbying for a switch to an exclusionary list (as the definition of Specified Income now is) will continue.

Credit facilities and advances have been added to the definition of Designated Investments and some of the counter-party and currency restrictions that apply to other assets have been removed. It is also now no longer necessary for a unit trust to be wholly invested in Designated Investments in order for units in that trust to qualify as Designated Investments. This is a particularly welcome refinement from a compliance perspective, because it removes what was otherwise an artificial distinction between the treatment of ownership interests held in companies and unit trusts. Islamic financial products, which are the commercial equivalent of other types of Designated Investments, will be treated as Designated Investments.

A potentially significant change has been made to the definition of Specified Income. The exclusion of interest and related payments which is deemed sourced in Singapore has been removed. Going forward, such income derived by a qualifying fund managed by a Singapore fund manager will be exempt. This means that lending by credit and special situation funds managed out of Singapore may potentially involve a Singapore borrower as the immediate counterparty. It will be interesting to see if integrity language is crafted to ensure symmetry with the deductibility of interest which is exempt in the hands of an incentivised fund.

Goods and Services Tax

The GST remission allowing Section 13CA, 13R and 13X funds to claim GST on expenses incurred for the purpose of investment activities will be extended. This remission enables a qualifying fund to claim back Singapore GST on its inputs at a fixed recovery rate without having to be registered. It is a practical workaround to the inability of investment funds to voluntarily register for GST purposes which would be the other pathway to enable GST recovery.

Variable Capital Company (VCC)

The 2019 Budget did not contain any changes which are specific to the new variable capital company that is awaiting commencement. The Ministry of Finance did however, separately announce on 14 February 2019 a consultation process for the consequential changes required for the Stamp Duties and GST Acts. Now that the legislation enabling this vehicle has passed, its commencement is anticipated together with the remaining details necessary for this structure to be tested.

For more information about the Singapore Variable Capital Company, click here.

For Trustees

Institutional trusts

The 2019 Singapore Budget contained some important tax changes for institutional trustees. Fortunately, the income tax and GST incentives applying to Singapore REITs and certain infrastructure and leasing business trusts were extended. The lower withholding tax rate of 10% will now be applied to distributions made by a Singapore REIT to non-resident funds managed in Singapore which satisfy the requirements of Section 13CA and 13X. This corrects a known anomaly with the way that the withholding worked. The existing concessions applying to REIT exchange traded funds which were introduced in the 2018 Budget have also been extended.

The Designated Unit Trust and the Approved Unit Trust schemes will be allowed to lapse with some grandfathering to facilitate the transition of these unit trusts to other incentives. The reality is that these schemes have been functionally usurped by other incentives, and in particular Section 13X.

Private trusts

The 2019 Budget did not make any mention of the Sections 13G and 13Q schemes which are widely used in private trust planning. Both schemes are due to expire on 31 March 2019 with existing structures to be grandfathered. It is certainly possible that a separate announcement may be made before the current expiry date for these schemes to be extended. If however they are allowed to lapse, this will be a potentially important development for the local wealth management industry.

Section 13G provides a tax exemption that is broadly equivalent in scope to Sections 13CA, 13R and 13X. It can be relied upon by a trust established by a foreign settlor for the benefit of foreign persons that is administered by a Singapore trust company. It can also apply to certain companies which are established to hold the assets of a qualifying trust. It is an important exemption to encourage non-Singapore settlers and families to use Singapore trust companies. In particular, income distributed by a holding company can be remitted into Singapore without the risk of taxation which would otherwise arise.
Without the Section 13G exemption, one would need to more carefully consider if Section 13CA can be used in the context of private trust planning to achieve the same tax efficient result. In Asia, it is not uncommon for investment powers over trust assets to be reserved to a settlor or their appointees in an investment committee. In such circumstances a trustee will primarily be responsible for trust administration and other fiduciary duties which mostly relate to the distribution of trust income and capital. Where the investment functions do not rest with a Singapore trustee company at all, Section 13CA may not be available as the basic requirement to have a licensed or exempt Singapore fund manager will not be satisfied. If Section 13G is indeed allowed to lapse, new foreign trust arrangements should be analysed carefully to ascertain the Singapore tax exposure in each case.

In our view, the potential lapsing of Section 13Q is less problematic than Section 13G. The intention of Section 13Q was to create parity in the taxation of income derived by a family trust administered by a Singapore trust company with the taxation of the income derived by an individual. There are a number of issues with this incentive in practice. This includes the lack of any specific exemption applying to trading gains, as well as the apparent inability to opt out and rely upon the tax transparency treatment articulated by the IRAS. In many cases where a trust was settled for the benefit of a Singapore family, the same or potentially an even better Singapore tax outcome could be obtained by relying upon tax transparency if this were available.

The international context of the 2019 Singapore Budget

The 2019 Singapore Budget is clearly supportive of the local asset and wealth management industry and it positions Singapore well amongst its international peers.

In our view, international trends are independently providing impetus for fund sponsors and private individuals to look for tax efficient onshore structures. Late last year, tax haven jurisdictions such as the Cayman Islands, BVI and the Channel Islands released economic substance legislation in response to international pressure tied into the Organization for Economic Cooperation and Development (OECD)’s Base Erosion and Profit Shifting (BEPS) initiative. The full implications of these new laws are yet to be fully digested and specific guidance on their application is expected shortly. At a high level they are intended to require, as a matter of law, a sufficient level of economic substance where an offshore company carries on as a business, one of a number of activities. Alongside these new rules, enhanced anti-money laundering regimes have been adopted in these jurisdictions as part of separate legislative changes.

At best, these developments will translate into higher compliance and ongoing costs associated with structuring through haven jurisdictions. In some circumstances, the use of a haven entity will become unworkable going forward and there will be a need to restructure. These new legislative developments will clearly be considered alongside the reputational questions posed by offshore structures which, rightly or wrongly, have come under attack as somehow indicative of grubby tax planning. The spectre of data leaks such as the Panama Papers and the Paradise Papers have certainly not helped.

It is within this broader international context that Singapore can be seen as particularly well positioned. The long-standing insistence upon economic substance as a pre-condition to accessing domestic tax incentives provides a robust foundation for Singapore-based structures which will shortly be enhanced with the commencement of the VCC. From October 2017, foreign corporate entities can also apply to transfer their registration to Singapore (inward re-domiciliation) which may be used to transition existing entities to Singapore without extensive or complicated restructuring. It is our view that the combination of these push and pull factors augur well for Singapore as an asset management and wealth planning hub.