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Greetings from your Tax & Legal team at Deloitte Singapore.

We are pleased to update you on the following:

New Income Tax e-Tax Guide—Tax treatment of gains or losses from the sale of foreign assets

On 8 December 2023, the Inland Revenue Authority of Singapore (IRAS) published the e-Tax Guide: Income Tax—Tax treatment of gains or losses from the sale of foreign assets.

This e-Tax Guide provides guidance on the application of Section 10L following the gazetting of the Income Tax (Amendment) Act 2023 (Act 30 of 2023) on 30 October 2023.

Our previous commentary on Section 10L can be found:

- here, in relation to draft Income Tax (Amendment) Bill 2023 on 6 June 2023; and
- here, in relation to key feedback received by the Ministry of Finance (MOF) on the draft Income Tax (Amendment) Bill 2023 on 8 September 2023.

Overview

The introduction of Section 10L which is driven by international standards to address avoidance risks, marks a pivotal[1] shift in Singapore's tax approach for foreign-sourced capital gains. Previously excluded from taxation, these gains will, under certain conditions from 1 January 2024, become taxable under Section 10(1)(g) of the Income Tax Act 1947 (ITA).

Where gains arising from the sale or disposal of foreign asset is subject to Singapore income tax pursuant to Section 10L, deductions against those gains are allowed for certain expenditures related to the acquisition, improvement, protection, or disposal of the foreign asset, including financing expenses. Expenditures already deducted against other income, or specific types of capital expenditures, are not eligible for further deduction.

Losses from foreign asset disposals may be set off against foreign-sourced disposal gains that are chargeable to tax and unutilized losses may be carried forward for set off against future taxable gains arising from foreign asset disposals.

Under the foreign tax credit system, an entity may claim relief for taxes paid in foreign jurisdictions on the same gains, minimizing double taxation.

Other salient features of the e-Tax Guide are discussed in the subsequent sections.

Scope of Section 10L

Starting from 1 January 2024, gains arising from the sale or disposal of foreign assets (foreign-sourced disposal gains) will be subject to tax under Section 10(1)(g) of the ITA when received in Singapore by an entity[2] of a relevant group[3]. The applicability of Section 10L is contingent on the following conditions:

- the gains are not already subject to tax under Section 10(1) of the ITA; or
- the gains are exempt from tax under the ITA.

Certain entities may be excluded from the scope of Section 10L, subject to satisfying certain conditions. However, entities deriving gains from the sale or disposal of non-qualifying foreign Intellectual Property Rights (IPRs) will be subject to tax when such gains are received in Singapore.

Exclusions

The following persons are excluded from the scope and effect of Section 10L:

- A group with only Singapore entities operating only in Singapore;
- Foreign entities (i.e., not incorporated, registered or established in Singapore) that are not operating in or from Singapore; and
- Individuals, except those to whom Section 13(1)(zu) of the ITA does not apply. This new tax exemption provision applies to capital gains derived from the sale or disposal of foreign assets when such gains are assessable as the income of an individual. For example, for tax transparency treatment relevant to a partnership, an individual partner's share of capital gains from foreign assets disposal is now, by virtue of Section 13(1)(zu), exempt from tax. However, this exemption does not apply if the gains are considered business revenue gains.

[1] As noted in 3.2 of this e-tax guide, prior to 1 January 2024, Singapore does not tax gains from the sale or disposal of assets that are capital in nature, whether they are foreign-sourced or Singapore-sourced.

[2] Any legal person (including a limited liability partnership) but not an individual, a general partnership or limited partnership or a trust.

[3] A relevant group must have at least one entity incorporated, registered or established outside Singapore or has any entity with a place of business outside Singapore.

The sale or disposal of the foreign asset (not being an IPR) is excluded from the scope of Section 10L if it is:

- carried out as part of or incidental to the business of entities carrying out certain financial services;
- carried out as part of, or incidental to, the business activities or operations of an entity which are incentivised under certain tax incentives in Singapore in the basis period in which the sale or disposal occurred; or
- carried out by an entity that is able to meet the economic substance requirement in Singapore in the basis period in which the sale or disposal occurred.

Treatment of foreign IPRs

The taxation of gains from qualifying foreign IPRs is determined by calculating a 'modified nexus ratio' based on the 'modified nexus approach.' This approach, set by the Organisation for Economic Cooperation and Development (OECD), ties tax benefits to the existence of a nexus between income from the IPR and the expenditures contributing to that income. Qualifying IPRs means patents, patent applications, and copyrights in software as recognized under specific laws.

The modified nexus ratio determines the percentage of gains from the sale or disposal of qualifying foreign IPRs that will not be subject to tax when those gains are received in Singapore by the entity.

Gains from the sale or disposal of non-qualifying foreign IPRs, such as marketing-related IP asset (see Example 2 in paragraph 9.8 of the e-Tax Guide), are fully taxable when received in Singapore, regardless of whether the entity has adequate economic substance in Singapore.

Transitional arrangements

To facilitate a smoother transition to this system, a transitional nexus ratio using a three-year rolling average or expenditure incurred during the research and development (R&D) period is allowed. This provides entities time to adapt to the tracking and tracing requirements of the modified nexus approach.

The distinction in tax treatment between IPRs and other assets highlights the unique and mobile nature of intellectual property in income generation. Detailed rules on expenditures and transitional measures indicate an effort to balance strict regulatory requirements with practical operational considerations for businesses.

Economic substance requirements (ESR)

As per MOF's Summary of Responses to Public Consultation on the Draft Income Tax (Amendment) Bill 2023, this e-Tax Guide is meant to provide further guidance to determine whether ESR are met including examples for certain sectors.

The e-Tax Guide specifies that ESR will be determined based on an analysis of the entity's core income generating activities in Singapore in the year of disposal of the asset.

The determination of "adequate economic substance" is subjective. While it would vary across sectors and industry, it has to be commensurate with the business model and operational scale.

Further, it is explicit in the e-tax guide that the ESR is to be assessed at the entity level, not at a group or jurisdictional level (except for special purpose vehicles). It applies to both pure equity-holding entities and non-pure equity-holding entities, but the criteria differ between the two types of entities. The economic substance criteria are more stringent for entities involved in significant financial transactions or business operations beyond mere equity holding.

Section	Pure equity-holding entity	Not a pure equity-holding entity
Definition	An entity that holds shares or equity interests in other entities and earns income only from dividends, gains from sales of these shares/equity interests, or incidental income.	Any entity that is not a pure equity-holding entity.
Economic Substance Requirements	• Must submit required returns, statements, or accounts to a public authority. • Operations managed and performed in Singapore (by employees or outsourced services). • Adequate human resources and premises in Singapore. A mere registered address is insufficient.	• Operations managed and performed in Singapore. • The entity must have adequate economic substance in Singapore, considering factors like the number and qualifications of employees, business expenditure, and where key business decisions are made.
Examples	Entities meeting these conditions, like a company with an employee in Singapore managing investments and complying with local regulatory filings, satisfy the economic substance requirement.	A company with full-time employees in Singapore managing investments and making key business decisions, and incurring significant local business expenditure, would meet the requirement.

Outsourcing of economic activities

The ESR allow for outsourcing arrangements where an entity (which is subject to the ESR) outsources some or all of its economic activities to third parties or group entities.

Where economic activities are outsourced, the outsourced activities must be conducted in Singapore, with the outsourcing entity retaining direct and effective control, including adequate monitoring and management. The entity providing outsourced services must allocate dedicated resources, such as manhours, specifically for these services. Additionally, the outsourced entity should charge a market-rate fee, in compliance with transfer pricing rules and it can support multiple entities as long as its resources match the complexity and level of the services provided.

The e-Tax Guide had provided 3 examples involving Singapore-listed Real Estate Investment Trust (S-REIT), Private Trust and Registered Business Trust. A similar observation across these three examples is that the respective trust

deeds that set out the functions and responsibilities of the various outsourced entities would likely be relied on by the IRAS in determining if the economic substance requirement is met.

Special purpose vehicles

Special purpose vehicles (SPVs) are entities commonly established to ring-fence the risks of investments and does not have headcount or significant expenses (i.e., it would not meet the ESR requirements).

In such instances, the IRAS will apply the ESR requirements at the level of the SPV's immediate parent, if that parent entity:

- effectively controls the SPV;
- derives economic benefits from the activities carried out by the SPV; and
- shapes the fundamental investment strategies implemented by the SPV.

Where the immediate parent is also a SPV, the ESR will be imposed on the relevant intermediate or ultimate holding parent entity.

Adjustment to open-market price

When a foreign asset is sold or disposed of by an entity for less than its open-market price, the Comptroller may calculate the taxable gains in Singapore using the formula:

$$A + B - C$$

Where:
A is the gains received in Singapore,
B is the open-market price, and
C is the sale or disposal price.

The open-market price is determined by the asset's market value on the sale date or, if impractical due to the asset's special nature, a value deemed reasonable by the Comptroller. If no gains are received in Singapore, no tax is imposed on the price difference. However, if there are gains received in Singapore, the tax applies to the difference between the open-market price and the actual sale price in the year the gain is received.

We would like to highlight example in paragraph 11.4 of the e-tax guide that a critical aspect for Section 10L is the valuation of transactions, especially among transfer of assets between related parties. If there is a variance between the transacted price and the open market value of an asset, the difference may be taxable in Singapore under Section 10L when **any** portion of the gain is received in Singapore.

Administrative requirements

The administrative requirements for entities in Singapore concerning the reporting of gains and losses from the disposal of foreign assets in their annual income tax returns includes providing detailed information on such gains and losses, including:

- unremitted gains or unutilised losses carried forward;
- current year gains or losses;
- gains received or losses utilized in Singapore;
- gains used during the year (such as being utilized for the payment of dividends) and not considered to be received in Singapore;
- tracking of expenses related to these gains or losses, and economic substance information (for e.g., number of employees, amount of

operating expenditure, information on outsourcing arrangements if business activities are outsourced) in Singapore.

Additionally, entities are required to retain and, when requested, provide supporting documents surrounding sale of foreign asset/IPR disposed and calculations to arrive at gains/losses derived, payroll documents showing the number of Singapore employees in the financial year the gains/losses were accrued, and details of foreign tax paid, among others. These records are essential for the Comptroller to ascertain the taxable amount from these foreign asset transactions.

Advance rulings

An entity can apply for an advance ruling on the adequacy of economic substance (known as ESR AR application[4]) concerning the sale or disposal of foreign assets. This application is pertinent if the sale or disposal is anticipated within one year from the application date. The issued ruling, if granted, can remain valid for up to five Years of Assessment (YAs). This ruling covers the period in which the initial and any subsequent sales or disposals are expected to occur. It applies to gains from foreign-sourced disposals, under the condition that the original facts and representations made during the application remain consistent and no changes occur in the relevant tax laws or their interpretations.

Further observations

a. The new regulations under Section 10L mark a significant change in the treatment of gains and losses from the disposal of foreign assets in Singapore. Notably, while these gains or losses are taxed under Section 10(1)(g), the provisions allowing unutilized losses to be carried forward are a positive development. This contrasts with the usual limitation under Section 37(3), which permits only losses from the carrying on of a trade, profession, business, or vocation to be carried forward. However, the provisions of Section 10L does not explicitly permit losses to be carried back, and it is not clear if shareholder continuity tests pursuant to Section 37 would be imposed on the carry forward of losses from the sale or disposal of foreign assets.

b. The introduction of the option to apply the ESR at different levels of a holding structure (i.e., immediate/intermediate/ultimate holding entity level) is a welcome development. However, the term “Special Purpose Vehicle” lacks a formal definition in Section 10L, creating uncertainty, particularly around whether the ESR look-through approach applies solely to a pure equity-holding entity. This ambiguity underlines the importance of exercising due care when applying ESR to any entity within a holding structure that is not the direct entity selling or disposing the foreign asset.

c. In determining whether foreign branch profits qualify for exemption from Singapore income tax when such profits are received in Singapore, Section 10L should be considered if the branch profits comprise gains or profits from the sale of foreign assets.

d. The taxability of gains received by a Singapore entity from the liquidation of a foreign company hinges on whether such distributions are interpreted as “sale or disposal” under Section 10L of the Income Tax Act 1947. While liquidation distributions may not conventionally constitute a sale, as there is no buyer-seller transaction, they could be seen as a form of disposal. It remains to be seen if IRAS will address this issue in its update to the e-Tax Guide.

[4] IRAS will provide more information on the administrative procedures for ESR AR applications on its website in January 2024.

e. Advance rulings for ESR provide a level of certainty for future transactions. For instance, if a taxpayer receives an advance ruling confirming adequate economic substance for the sale of a foreign asset (Asset A) in the YA 2025, this ruling should also apply to the sale or disposal of another foreign asset (Asset B) in YA 2028. This continuity is contingent upon the stability of the tax laws and the **IRAS' interpretation**, along with the consistency of the facts and representations from the original application. As such, taxpayers may want to engage with the IRAS for clarifications on the applicability of the advance ruling for any subsequent disposals of foreign assets, ensuring compliance and understanding of the scope of the ruling scope within its validity period.

f. The e-Tax Guide clarifies that where a Singapore resident entity is the economic owner of an IPR but where the legal owner of that IPR is a non-Singapore resident, that IPR would not be considered as a foreign asset (i.e., Section 10L does not apply). The gains from the sale or disposal of such IPRs are considered sourced in Singapore and its characterisation as a non-taxable capital or a taxable trading gain should be determined based on ordinary tax principles.

g. Section 10L lacks a definition of the term "intellectual property right" and the e-Tax Guide does not offer further guidance on the scope of this term. To gain clarity, taxpayers may find it beneficial to seek clarification on whether certain intangible assets, such as distribution rights, customer relationships, domain names, are considered IPR or fall under the category of non-IP intangible assets. This distinction is crucial for accurately determining the *situs* of such assets.

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