

## Tax alert

# Singapore Variable Capital Company

On 23 March 2017, the Monetary Authority of Singapore (MAS) issued a consultation paper<sup>1</sup> on the proposed framework for Singapore Variable Capital Companies (S-VACC) and a draft S-VACC Act.

### Executive summary

This tax alert summarizes key aspects proposed by the MAS in the consultation paper and the draft S-VACC Act.

Singapore's reputation as an Asian fund management hub is well documented. In 2015<sup>2</sup>, Singapore's assets under management (AUM) grew by 9% to S\$2.6 trillion and the number of registered and licensed fund managers grew to 628. The factors that have contributed to the astronomical rise of Singapore's asset management sector include a stable, supportive government; a favourable and clear tax system; a strong legal system; and a great place to live, work and play. These pillars are underpinned by one solid foundation – long-term vision. Singapore has always looked ahead in a bid to invent its future.

While Singapore's dominance in Asia as a fund management hub cannot be denied, many funds distributed and managed from Singapore are domiciled in Luxembourg, the Cayman Islands and Ireland. One key reason for this is Singapore's legal and tax framework for fund vehicles. A Singapore fund can be set up as a Company, a limited partnership or a unit trust. The current corporate law requirements and tax rules for each of these vehicles have certain limitations which have limited the number of funds that could have been set up in Singapore. The addition of the S-VACC, a flexible corporate form fund vehicle, to Singapore's portfolio of vehicles provides the fund industry with a vehicle that is tailor-made to address many of these limitations.

Variable capital corporate form funds have been successfully legislated by several countries. Most notably, Luxembourg, Ireland, the Cayman Islands and the United Kingdom each offers a variable capital corporate form fund. In 2016, Hong Kong also issued a legal, regulatory and tax framework for an open-ended fund company. The MAS has based the draft S-VACC Act on international best practices established by these jurisdictions.

While Singapore is looking to provide its fund industry a shot in the arm, the tax treatment accorded to the S-VACC will play an important role in determining whether the S-VACC will be a success. The consultation paper does not include proposals on how an S-VACC may be taxed. The MAS has requested for comments on the consultation paper and the draft S-VACC Act by 24 April 2017 and has welcomed feedback from the industry on tax aspects.

<sup>1</sup> <http://www.mas.gov.sg/News-and-Publications/Consultation-Paper/2017/Consultation-Paper-on-the-Proposed-Framework-for-Singapore-Variable-Capital-Companies.aspx>

<sup>2</sup> MAS 2015 Singapore Asset Management Survey

## Key features

### *For an S-VACC*

- ▶ S-VACCs will be governed by a new S-VACC Act to be administered by the Accounting and Corporate Regulatory Authority (ACRA).
- ▶ An S-VACC structure can only be used for a Collective Investment Scheme (CIS), as defined by the Securities and Futures Act (Cap 289) (SFA).
- ▶ S-VACCs can be set-up as open-ended or closed-ended funds.
- ▶ Umbrella funds / sub-funds with segregated assets and liabilities can be created within the S-VACC as separate "cells". Each cell will be registered with the ACRA but will not have an independent legal personality.
- ▶ Re-domiciliation of equivalent foreign corporate form funds, as S-VACCs, will be permitted.

### *For Investors in an S-VACC*

- ▶ An S-VACC will not be required to disclose its register of shareholders to the public.
- ▶ S-VACCs will be allowed to freely redeem shares and pay dividends out of capital.
- ▶ Redemption of shares and capital reduction must be carried out at the net asset value (NAV) of the S-VACC. However, limited exceptions apply.

### *Governance and operational aspects*

- ▶ An S-VACC will have to be managed by a licensed, regulated or a specified exempted fund management company.
- ▶ An S-VACC must have at least one Singapore resident director and one director that is also a director of its fund manager. Additional requirements have been proposed for Authorised Schemes (i.e., a scheme for retail investors).
- ▶ An S-VACC must have its registered office in Singapore and a Singapore-based company secretary.
- ▶ For Authorised Schemes and Restricted Schemes (i.e., a scheme for accredited investors), the S-VACC must have an approved custodian.

- ▶ The MAS will ensure that S-VACCs comply with Anti-Money Laundering and Countering Financing of Terrorism requirements.

On the tax front, the consultation paper states that the S-VACC structure is expected to act as a platform for fund managers to anchor their substantive operations in Singapore, where control and management will be executed from Singapore. The MAS is currently studying the tax regime for S-VACCs, including exploring the feasibility of extending the current fund vehicle tax schemes to S-VACCs.

## Comments

The S-VACC has the potential to be an exciting addition to Singapore's fund ecosystem as long as the tax treatment, internationally and in Singapore, supports the MAS's intentions for introducing the vehicle.

### *Tax aspects*

Every fund structure aspires to be tax-neutral as investors should not be penalised for pooling their investments in a fund vehicle set up in a location that offers robust commercial, economic, regulatory and tax advantages.

Two fundamental tax aspects of every fund structure are:

- ▶ Taxation of the fund vehicle in the country where it is set up; and
- ▶ Taxation of the fund vehicle in the country where it invests.

### *Taxation of the S-VACC in Singapore*

As the MAS evaluates the tax regime for the S-VACC, it will be helpful to learn from the tax experiences of similar vehicles in Luxembourg, Ireland, the Cayman Islands and the United Kingdom.

In Luxembourg, for instance, corporate form funds with variable capital, known as SICAV (Société d'Investissement à Capital Variable), are not liable to corporate income or capital gains tax. In Ireland, while in theory Irish Collective Asset-Management Vehicle (ICAV) are liable to tax, they are exempt from tax by virtue of being authorised by the Central Bank of Ireland. These measures were put in place to ensure that the fund vehicle does not suffer tax on its income in its country of incorporation in addition to the tax paid in the country where the income is sourced.

In our view, for an S-VACC to be a compelling choice, it would need to be eligible for Singapore's existing fund tax incentive schemes pursuant to sections 13R or 13X of the Income Tax Act (ITA) such that its income is

exempt from Singapore tax so long as the conditions of the relevant fund tax incentive scheme are met.

However, as these schemes were designed to apply to a company, a partnership or a trust, one will need to consider whether some of the conditions of these schemes can be applied "as is" to an S-VACC.

- ▶ For example, the minimum fund size condition of S\$50 million and the minimum local business spend of S\$200,000 under the section 13X fund tax incentive scheme should ideally be applied at the level of the S-VACC itself rather than each cell within the S-VACC. This is consistent with the approach adopted with respect to unit trusts. Further, multiplication of the economic conditions by the number of cells in the S-VACC would make the section 13X fund tax incentive commercially unviable for many S-VACCs.
- ▶ Another example would be the application of financial penalties on non-qualifying investors under the section 13R fund tax incentive scheme. Generally, section 13R penalises certain investors if they (alone or with their associates) own interest in a section 13R approved company in excess of a prescribed threshold. Whether this rule (as well as the related association tests) should be applied at the level of each cell or at the level of the S-VACC will need to be carefully considered.

The key will be to apply Singapore's fund tax incentive schemes to S-VACCs in a fair and consistent manner.

If an S-VACC does not qualify for a fund tax incentive scheme, or fails to meet the conditions of the scheme, its income should be subject to tax in Singapore in accordance with the existing tax legislation.

#### *Taxation of the S-VACC internationally Treaty benefits*

Singapore has an extensive tax treaty network, especially in the Asia-Pacific region. The success of the S-VACC will, at least in part, depend on whether an S-VACC can access Singapore's treaty network.

Treaty partners define and interpret whether an entity should be treated as eligible for tax relief in accordance with the relevant tax treaty as well as local tax rules and practices. In general, to qualify for relief under a treaty:

- ▶ An entity must be a person who is a resident of at least one of the contracting states to the treaty.

- ▶ To be considered as a resident of a contracting state, an entity must be 'liable to tax' in that state under the laws of that state. A treaty partner will generally demand a certificate of residence (COR) issued by the relevant authority in the jurisdiction in which an entity claims to be tax resident.

It is therefore imperative that an S-VACC is considered to be a "person resident in Singapore". If not, an S-VACC could be faced with higher withholding taxes in the country where its income is sourced. The Luxembourg SICAV as well as the Irish ICAV have faced this issue from some tax treaty partners. It is important to note that the OECD Model Convention with respect to Taxes on Income and Capital as well as the UN Model Double Taxation Convention state that for the purposes of each Model Convention, the term "person" includes a company and the term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes.

As per the draft S-VACC Act, an S-VACC is included in the definition of "company". Section 2(1) of the ITA defines the term "person" to include a company. Further, the term "resident in Singapore", in relation to a company is defined in the ITA to mean a company or body of persons the control and management of whose business is exercised in Singapore.

Therefore, if an S-VACC is considered to be a company under the ITA and is able to demonstrate that its control and management is exercised in Singapore, it may be able to access Singapore's tax treaties.

It will be important for the Inland Revenue Authority of Singapore (IRAS) to be willing to issue a COR to S-VACCs if the place of its control and management is indeed in Singapore. In our experience, Singapore companies under the section 13R and 13X schemes that are controlled and managed in Singapore have been able to obtain CORs from the IRAS and have successfully accessed Singapore's tax treaties. We expect Singapore to continue to support its taxpayers, including S-VACCs in this regard and where required, engage foreign competent authorities under the Mutual Agreement Procedure article of the relevant tax treaty.

#### *Base Erosion and Profit Shifting (BEPS)*

Action 6 of the BEPS Project aims to counter the abuse of tax treaties by preventing the granting of treaty benefits in inappropriate circumstances. Action 6 prescribes a specific anti-abuse rule (the limitation of benefit rules) and a general anti-abuse rule (the principal purposes test). Countries will adopt these rules by signing a Multi-lateral Instrument (MLI). As a BEPS Associate, Singapore is committed to certain 'minimum

standards', which includes Action 6. It will be interesting to see how an S-VACC is viewed from an Action 6 and MLI perspective. One view is that an S-VACC (which will be managed by a Singapore fund manager) as the pooling and/or investment vehicle adds substance in Singapore as compared to a structure where pooling takes place outside Singapore. In any event, it remains important to document the commercial rationale for adopting a particular fund structure.

#### *Other tax aspects*

##### *Goods and services tax (GST) and withholding tax*

If an S-VACC is granted an approval under a fund tax incentive scheme, apart from corporate tax, in our view, it must also be allowed to claim the other benefits under the scheme, including GST remission and exemption from withholding tax obligations on certain payments.

##### *Re-domiciliation and conversions*

While the consultation paper has referred to the potential re-domiciliation of foreign corporate form funds, as S-VACCs, there is no mention of whether the existing Singapore fund vehicles could be converted into an S-VACC. To encourage immediate use of S-VACCs once enacted, in our view, conversion of existing fund vehicles into S-VACCs should be permitted. Further, both re-domiciliation and conversion should be allowed in a tax-neutral manner.

##### *Stamp duty*

In our view, the issue, redemption or repurchase of shares of an S-VACC should not attract stamp duty.

##### *Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standards (CRS)*

In the absence of specific FATCA / CRS provisions for S-VACC structures, an analysis of similar provisions would have to be made to determine their FATCA / CRS obligations. In practice, given that similar structures exist in trust form in Singapore as well as in company form overseas, reliance may be placed on existing analysis for similar structures.

##### *Transfer pricing*

The ITA defines the term "related party" in relation to two distinct persons. As each cell within an S-VACC is not a distinct person, one would need to analyse whether transactions between two or more cells within an S-VACC would need to adhere to the arm's length principle and transfer pricing documentation under the ITA.

##### *Tax compliance obligations*

To reduce administrative burden, each S-VACC should be allowed to file a single income tax return rather than a return per cell within that S-VACC. The IRAS should also agree that non-resident investors in an S-VACC are not required to file a tax return in Singapore solely on account of having invested in shares of an S-VACC.

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