Section 10L: Foreign To You?

New Foreign-Sourced Disposal Gains Tax Regime

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KEY TAKEAWAYS

- From 1 January 2024, foreign-sourced disposal gains received in Singapore by an entity of a relevant group from the sale or disposal of a foreign asset are treated as income chargeable to tax under Section 10(1)(g) of the Income Tax Act 1947 (ITA) under certain circumstances.
- Losses from foreign asset disposals may be set off against foreign-sourced disposal gains that are chargeable to tax.
- The economic substance requirement is generally applied at the entity level.

"For the purpose of Section 10L of the ITA, the tax residency of the lender will determine whether the loan is situated outside Singapore; how the loan is recognised in the borrower's books is irrelevant. For example, if a loan is given by a company which is tax resident in a jurisdiction outside Singapore, the loan is considered a foreign asset under Section 10L," shared officers from the Inland Revenue Authority of Singapore (IRAS) at a webinar organised by the Singapore Chartered Tax Professionals.

A Notable Shift: Foreign-Sourced Income Regime in Singapore

Previously, gains from the sale of foreign assets that are capital in nature are not taxable in Singapore.

To address international tax avoidance risks relating to non-taxation of disposal gains in the absence of real economic activities, Singapore has amended its foreign-sourced income regime to subject gains from the sale or disposal of foreign assets under specific circumstances to tax.

The new foreign-sourced disposal gains tax regime is legislated under Section 10L of the ITA and applies to a sale or disposal of foreign assets that occurs on or after 1 January 2024. Under the new regime, foreign-sourced disposal gains received in Singapore by an entity of a relevant group from the sale or disposal of a foreign asset are treated as income chargeable to tax under Section 10(1)(g) of the ITA if:

a) the gains are derived by the entity without adequate economic substance in Singapore, or
b) the gains are from a disposal of foreign Intellectual Property Rights (IPRs).

For foreign assets (other than IPRs), deductions against foreign-sourced disposal gains are allowed for certain expenditures relating to the acquisition, creation or improvement of the foreign asset, the protection or preservation of the value of the foreign asset, or the sale or disposal of the foreign asset. Expenditures that have been allowed a deduction against any other income, or capital allowances made against any other income, are not eligible for further deduction.

Losses incurred from foreign asset disposals may be set off against foreign-sourced disposal gains that are chargeable to tax where, had the sale or disposal resulted in gains, those gains would have been chargeable to tax when received in Singapore.

Unutilised losses may be carried forward to set off against future taxable foreign-sourced disposal gains.

Who are Affected?

Section 10L applies only to entities of relevant groups. A group is a relevant group if the entities of the group are not all incorporated, registered, or established in Singapore, or any entity of the group has a place of business outside Singapore.

To illustrate, let's take the example of a Singapore company (Co A) with an overseas branch (Branch B). Assuming Co A has no related entities, Section 10L will not apply as Co A and Branch B belong to a single legal entity.

However, if Co A is wholly-owned by another Singapore company (Co C), the two entities will fall within the scope of Section 10L as one of the entities (Co A) has a place of business in a foreign jurisdiction by virtue of the foreign branch (Branch B), and Co A's assets, liabilities, income, expenses and cash flows are included in the consolidated financial statements of Co C.

What Income is Covered?

Section 10L covers gains from the sale or disposal of any movable or immovable property situated outside Singapore. Common examples include gains from the sale or disposal of:

- immovable properties situated outside Singapore,
- equity securities and debt securities registered in a foreign exchange,
- loans where the creditor is a resident in a jurisdiction outside Singapore, and
- IPRs where the owner is a resident in a jurisdiction outside Singapore.

Economic Substance Requirement

Foreign-sourced disposal gains from the sale or disposal of foreign assets (not being IPRs) will not be brought to tax if the entity has adequate economic substance in the basis period in which the sale or disposal occurs.

Economic substance requirement (ESR) is generally applied at the entity level, although it can also be applied at the holding company level on behalf of its special purpose vehicles (SPV) if certain conditions are met. While ESR is applicable to both pure equity-holding entities and non-pure equity-holding entities, the criteria differ between the two types of entities.

For a pure equity-holding entity to meet the ESR, it needs to fulfil the following conditions in the basis period in which the sale or disposal occurs:

a) the entity complies with statutory filing obligations,
b) the entity's operations are managed and performed in Singapore (by employees or outsourced services), and
c) the entity has adequate human resources and premises in Singapore to carry out its operations.

In contrast, a non-pure equity-holding entity is required to fulfil the following to meet the ESR:

a) the entity's operations are managed and performed in Singapore (by employees or outsourced services), and
b) the entity has adequate economic substance in Singapore, considering factors such as the number of full-time employees in Singapore, business expenditure, and the location where key business decisions are made.

Foreign Intellectual Property Rights

For the sale or disposal of qualifying foreign IPRs (such as patents, patent applications and copyrights in software), a Modified Nexus Ratio should be used to determine the extent of gains that will not be taxable when received in Singapore; the remaining amount of gains will be subject to tax under Section 10L, regardless of whether the entity has adequate economic substance in Singapore.

In comparison, for the sale or disposal of non-qualifying foreign IPRs (such as marketing-related IP assets), the full amount of gains will be subject to tax when received in Singapore, regardless of whether the entity has adequate economic substance in Singapore.

Location and Ownership of IPRs

The tax residency of the IPR owner is used to determine where the IPR is situated for the purpose of Section 10L. The location where the IPR is registered is irrelevant.

"Where the legal owner of the IPR is a non-Singapore resident holding company and the economic owner of the IPR is a Singapore resident company, the sale of the economic ownership of the IPR by the Singapore resident company will not be considered a sale of foreign asset. This is because the Singapore resident company is the owner of the contractual rights to the benefits of the IPR and the gains from the disposal of the economic ownership of the IPR are considered as sourced in Singapore," IRAS clarified.

Adjustment to Open-Market Price

In a situation where the 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 amount of gains received in Singapore, B is the open-market price, and C is the sale or disposal price of the foreign asset.

The difference between the open-market price and the actual price of the foreign asset will be taxed in the year when there is an amount of gain received in Singapore. However, if no amount of gain is received in Singapore, the difference will not be brought to tax.

Foreign Tax Credit

Where the foreign-sourced disposal gains received in Singapore have been taxed in the foreign jurisdiction, the Singapore tax resident entity may claim double taxation relief, unilateral tax credit, or elect for the foreign tax credit pooling system to alleviate the foreign tax suffered. The foreign tax credit may be claimed within four years after the year of remittance.

Conclusion

The new Section 10L represents a significant change in the foreign-sourced income regime in Singapore. Businesses should take a moment to evaluate whether they are affected by the legislative changes and, if so, review their business and tax strategies to mitigate any unintended tax consequences.

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