Shifting sands, Changing tides – Anchoring your business and investments in Singapore

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Introduction

The trend towards economic nationalism, along with heightened global political instability, has given rise to increased risks and uncertainties for individuals and businesses worldwide, in respect of their assets and investments whether held onshore or offshore. One prime example is recent pressure placed by the European Union (EU) on the offshore jurisdictions, leading to the enactment of economic substance legislation, and some consequent erosion in the traditional use of tax haven holding structures.

This article discusses how individuals and businesses with offshore structures are generally affected by such legislation, as well as how Singapore could function as a safe haven in these uncertain times.

Enactment of economic substance legislation in offshore jurisdictions

Introduction

In 2017, the EU Code of Conduct Group for Business Taxation (COCG) undertook an assessment of the tax policies of several international financial centres. The review resulted in the publication of a list of non-cooperative jurisdictions for tax purposes on 5 December 2017, identifying certain jurisdictions which were deemed to lack economic substance requirements for companies incorporated in those jurisdictions. Subsequently, the British Virgin Islands (BVI), the Cayman Islands, Bermuda, Jersey, Guernsey and the Isle of Man enacted new legislation which came into force on 1 January 2019. Even the United Arab Emirates has recently introduced economic substance legislation with the aim of being removed from the EU's blacklist of uncooperative jurisdictions.

The purpose of the respective legislation is, for example, illustrated in the BVI's draft Economic Substance Code (the Draft Code), which states that the legislation is aimed at BVI-registered entities that take advantage of the BVI's zero tax regime, while carrying on their business substantially in another jurisdiction. Such offshore structures have hitherto been ubiquitous in both personal and family holdings, as well as in the business and commercial context.

We take a closer look at the Draft Code below for the purposes of illustration, whilst noting that the scope and effect of the economic substance legislations are substantially similar across the various offshore jurisdictions.

Scope of the legislation

The economic substance requirements however apply to companies that carry on specific relevant activities in the jurisdiction.

A “relevant activity” is defined as:

a. banking business;
b. distribution and service centre business;
c. financing and leasing business;
d. fund management business;
e. headquarters business;
f. holding business;
g. insurance business;
h. intellectual property business; or
i. shipping business.

Though an investment fund business is not a relevant activity and hence falls outside the scope of the economic substance requirements, the COCG is expected to provide further technical guidance on the economic substance requirements for collective investment funds.

Generally, to satisfy the test for economic substance, the entity must:

a. conduct core income generating activity (CIGA) in the jurisdiction;
b. be directed and managed in the jurisdiction;
c. have an adequate number of employees;
d. incur adequate expenditure in the jurisdiction; and
e. have physical premises in the jurisdiction.

It would appear that assessments will have to be made as to whether the test for economic substance would be met in many of the existing offshore holding structures, due to the applicable requirements of physical activity or presence in the relevant offshore jurisdiction.

Uncertainty over application of legislation

As far as a “holding business” is concerned, which applies to a substantial proportion of entities established in the offshore jurisdictions, the legislation is currently limited to legal entities that only hold equity participations in other entities and only earn dividends and capital gains. Such entities are subject to a reduced economic substance test in that they are not required to be directed or managed in the jurisdiction or conduct CIGA in the jurisdiction. However, they would still need to have adequate employees and premises in the jurisdiction.

The legislation does not define what amounts to adequate or sufficient employees or physical presence, and indeed the Draft Code merely states that such terms are interpreted according to their ordinary meaning. At present, it is uncertain how these requirements may be satisfied.

The corollary of the current definition of “holding business” is that an entity that holds assets other than equity participations, such as cash or real property, would fall outside the scope of the legislation. It is also unclear whether private trust companies (PTC) are caught by the legislation (note: Singapore PTCs are discussed in greater detail below). However, given the relative novelty of the legislation, it would not be prudent to assume that the definition will not be changed to include other forms of asset holding.

In addition, the Draft Code, as well as the equivalent guidelines in other offshore jurisdictions, have gone through several rounds of amendments as negotiations with the EU have progressed. There is thus no certainty at the moment that the draft guidelines on the application of the economic substance legislation as they stand presently will not be subsequently amended further.

Considerations for individuals and businesses owning companies incorporated in

offshore jurisdictions

The economic substance requirements come on the back of a global push towards greater transparency and disclosure. Entities that fail to comply with the requirements are subject to substantial penalties.

This results in a conundrum for individuals and businesses that rely on offshore structures as to how their structures should be regularized—should they maintain more than just a nominal presence in the relevant offshore jurisdictions, leading to greater costs and inconvenience? Or given the present and potential future uncertainties in the scope and reach of the economic substance regulations, should they restructure their assets holdings so as to reduce or remove reliance on offshore structures altogether?

Singapore as a safe haven

Where a restructuring of existing arrangements or the establishment of new structures is being contemplated, investors should consider Singapore as one of the preferred destinations to hold their assets and investments. We explore below, a number of the factors to be considered, both from the private wealth, as well as the commercial perspectives.

General factors

Singapore is a well-established, leading jurisdiction for offshore wealth management and foreign investments, which is underpinned by, among other things, its open economy, strong rule of law, sound financial regulation, stable political environment, and global accounting and legal standards.

In a 2018 study conducted by the Asian Private Banker, Singapore's robust banking sector was identified as its most important strength as an offshore investment and wealth management hub, followed by its efficient regulatory framework, and high quality workforce. This is congruent with Singapore's reputation as a recognised international financial centre due to, among other things, its breadth and depth of institutions that provide ease of access to global financial markets, and developed wealth management services.

Singapore enjoys unique advantages, being strategically located within proximity to Southeast Asia, and having relative political neutrality and regulatory machinery that is aligned with global standards.

Additionally, the regulatory environment in Singapore is exceptionally accommodative to offshore wealth and foreign investment particularly because of its favourable individual and corporate tax regimes, which this article will explore further.

Private Wealth Perspective

Singapore is an increasingly popular destination for high and ultra-high net worth individuals and families who wish to move their assets to a legitimate jurisdiction with a strong reputational advantage. This is due in part to its commitment to global tax transparency, but also the variety of tax incentives available for foreign individuals who set up structures in Singapore. With a well-established wealth management and succession regime, Singapore has flourished as a private wealth hub.

The Single Family Office

In recent years, there has been an influx of family offices being established by foreigners in Singapore. A "family office" is commonly understood as an arrangement put in place to manage the assets and wealth of high net worth families or individuals. The objectives of setting up a family office include ensuring a smooth intergenerational transfer of wealth, reducing the risk of intra-family disputes, providing for a governance and management structure, ensuring alignment of interests, leading to potential higher returns, centralisation of risks and services, and provision for succession planning.

The term "family office" is not defined under Singapore law, however, the regulatory treatment of a "single family office" (SFO) was recently clarified by the Monetary Authority of Singapore (MAS). This added clarity enhances Singapore's attractiveness as a jurisdiction for setting up family offices.

Under the Frequently Asked Questions on the Licensing and Registration of Fund Management Companies issued and updated by the MAS (the Fund Management FAQs), it is provided that, among other things, an SFO is not defined under the Securities and Futures Act (Chapter 289 of Singapore Statutes), and "*typically refers to an entity which manages assets for or on behalf of only one family and is wholly owned or controlled by members of the same family*". Further, the Fund Management FAQs state that the MAS does not intend to license or regulate SFOs, and goes on to highlight that there are existing exemptions from licensing for SFOs under the SFA and the Financial Advisers Act (Chapter 110 of Singapore Statutes) for provision of fund management and financial advisory services, respectively, to its related corporations (e.g. where the SFO manages or advises an investment fund entity that shares a holding company with the SFO).

In the keynote address by Ng Yao Loong, Assistant Managing Director of the MAS, at the Euromoney Asia Private Banking Seminar on 13 September 2018, it was stated that, in order to strengthen Singapore's value proposition as a centre of excellence for managing family wealth, the MAS will "raise the level of sophistication and professionalism of family wealth professionals by partnering institutes of higher learning to develop training targeted at family office professionals" and "strengthen networks between family offices in Singapore, to facilitate mutual learning and participation in investments". This highlights the facilitative approach of the MAS towards SFOs in Singapore, which together with the tax incentives that would apply to SFOs, the various options to structure an SFO, and the general factors (each of which we have touched on above in this article), make Singapore an ideal location for families and/or high net worth individuals to base and carry out their wealth and investment management operations.

Under the Global Investor Programme (GIP), individuals, their spouses, and unmarried children below the age of 21 are eligible to apply for Singapore Permanent Residence (PR) status if they invest at least S$2.5 million in a start-up or expansion of an existing business, or in a GIP-approved fund that invests in Singapore-based companies. Investors applying for PR under the GIP must have (a) a substantial business track record of at least 3 years; and (b) a successful entrepreneurial background of at least 3 years.

Family offices are an approved industry under the GIP, but investors may be subject to slightly different eligibility criteria in terms of business or investment track record, family net worth and assets under management by the family office. If the application is successful, individuals would be even better placed to enjoy the tax incentives available for Singapore residents.

Below, we further discuss how foreigners may enjoy benefits under Singapore's tax regime through (1) trust structures; and (2) fund management structures.

Trust structures

Two main tax incentives are available for trusts administered by a local trustee, namely the Foreign Trust Exemption and the Locally Administered Trust Exemption. A local trustee could be a professional licensed trustee, or a PTC subject to the satisfaction of certain conditions. A PTC is a company incorporated specifically to act as trustee of a trust, and subject to certain conditions, may be exempt from obtaining a trust business licence. A PTC is preferable to appointing an independent trustee for families who wish to retain more control over the trust. Alternatively, if a licensed trustee is hesitant to take on a trust because of certain risks, a PTC may be established to function as trustee.

Foreign Trust (FT) Exemption

A Singapore FT and its underlying holding companies can enjoy tax exemption on specified income derived from designated investments under Section 13G of the Income Tax Act (Cap 134) (the ITA) and the relevant regulations. Any share of income received by a beneficiary is also exempt from tax. However, the FT must be administered by a trustee company in Singapore and neither the settlor nor any beneficiary can be a Singapore citizen or resident in Singapore. In the case of an entity, it must be neither incorporated nor resident in Singapore.

Locally Administered Trust (LAT) Exemption

If a family member is resident in Singapore, the family can in an appropriately structured trust avail of the LAT Exemption Scheme under Section 13Q of the ITA. LATs and their underlying holding companies can thereby enjoy the existing tax exemption granted on Singapore-sourced investment income derived and foreign income received directly by individuals in Singapore. Exempted income received by a beneficiary is similarly tax exempt. The scope of exemption for LATs under the LAT Exemption is however not as wide as that enjoyed by FTs in the FT Exemption. The LAT must also be administered by a trustee company in Singapore and every beneficiary must be an individual or charitable institution, trust, or body of persons established for charitable purposes. The settlor must be an individual and cannot be the sole beneficiary of the LAT.

Fund management structures

It is not uncommon for a family office to be established alongside trust structures. High net worth families typically make use of family offices to assume the day-to-day management and administration of their assets and wealth, as described above.

There are various tax exemption schemes for funds managed by a Singapore fund manager or family office. Generally, funds are subject to tax in Singapore on their income sourced in Singapore and derived from the trading of investments. Gains on sale of investments are taxable if they are revenue in nature. For offshore funds, the presence of a fund manager who habitually exercises authority to conclude contracts may create a taxable presence (PE) in Singapore.

The relevant incentives are (1) Offshore Fund Exemption (Section 13CA of the ITA); (2) Onshore Fund Exemption (Section 13R of the ITA); and (3) Enhanced-Tier Fund Exemption (Section 13X of the ITA). These incentives provide a tax exemption on specified income derived by the fund vehicle from certain designated investments, including stocks, shares, bonds, notes and derivatives.

The fund manager or family office managing the funds could also possibly benefit from a tax incentive known as the Financial Sector Incentive – Fund Management Award (FSI-FM), which grants a concessionary tax rate of 10% on qualifying income, subject to the satisfaction of certain criteria and approval by the authorities.

In general, the appropriate structure (whether a trust, fund and/or any structure) and relevant applicable tax incentives would depend on the specific needs and circumstances of the particular individual investor and/or family.

Corporate Perspective

Introduction

Singapore is a leading offshore hub not only for high net worth individuals, but also for multi-national corporations to set up holding companies. In this section, we wish to highlight examples of such policies including, among other things, various tax incentive schemes headed by the Singapore Economic Development Board (EDB) and Monetary Authority of Singapore (MAS) that are aimed at encouraging the development of high-value and substantive economic activities in Singapore, as well as the various options for corporate structuring in Singapore.

Corporate Tax Incentive Schemes

Several tax incentive schemes under the EDB and MAS are available to companies that grow capabilities and conduct new or expanded activities in Singapore. These include (1) the Pioneer Certificate Incentive and Development and Expansion Incentive (Parts II, III and IIIB of the Economic Expansion Incentives (Relief from Income Tax) Act); (2) the Finance & Treasury Centre Incentive (Section 43G of the ITA); and (3) the Financial Sector Incentive scheme (Section 43Q of the ITA).

Pioneer Certificate Incentive (PC) and Development and Expansion Incentive (DEI)

An approved company under the PC or DEI is eligible for a corporate tax exemption or a concessionary tax rate of 5% or 10% respectively on income derived from qualifying activities.

The qualifying criteria for the PC or DEI include:

a. employment created (including skills, expertise and seniority);
b. total business expenditure which generates spin-off to the economy; and
c. commitment to growing the capabilities (e.g. technology, skillsets, knowhow) in Singapore.

The company must also carry out new, pioneering activities that have not been undertaken by other companies at a scale that is substantive in economic contribution.

Finance & Treasury Centre (FTC) Incentive

The FTC Incentive is aimed at encouraging companies to grow treasury management capabilities and use Singapore as a base for conducting treasury management activities for the region. An approved FTC company is eligible for a concessionary tax rate of 8% on income derived from:

a. qualifying FTC services to approved network companies (ANCs); and
b. qualifying FTC activities carried out on its account with funds obtained from qualifying sources.

To qualify for the FTC incentive, companies must establish substantive activities in Singapore which may include control over the management of cash and liquidity position, provision of corporate finance advisory services, and management of interest rates and foreign exchange.

Additionally, the qualifying criteria include:

a. employment created (including skills, expertise and seniority in the FTC team);
b. total business expenditure which generates spin-off to the economy; and
c. scale of the FTC operations in the depth and breadth of the services and activities.

Financial Sector Incentive (FSI) Scheme

The FSI Scheme (Section 43Q of the ITA) is administered by the MAS and applies to licensed financial institutions including large universal banks, fund managers and capital market players. It is aimed at promoting and encouraging the development of high-growth and high value-added financial activities in Singapore.

Concessionary tax rates of 5%, 10% and 13.5% are awarded under the FSI-Standard Tier, which covers a broad range of qualifying activities including lending, debt and equity capital markets, fund management, trust administration and FSI-Headquarters Services. Award periods range from 5 to 10 years depending on headcount and the scope of activities undertaken.

Multitude of Options for Corporate Vehicle Structure

The Singapore-incorporated company

Incorporating a company in Singapore is straightforward and the process can be completed in a short span of time. The Doing Business 2019 report published by the World Bank Group ranked Singapore third in the world for ease of starting a business. In fact, the report noted that in 2017/18, Singapore had simplified certain post registration procedures making it easier to start a business here.

The regulatory requirements for incorporating a business in Singapore are easy to satisfy. A Singapore incorporated company is only required to have at least one (1) shareholder and a minimum issued capital of at least $1. While a Singapore incorporated company must have a registered office in Singapore, the company does not necessarily need to lease (or buy) premises, as the registered office can be that of the corporate secretarial agent, for instance. Finally, every Singapore incorporated company must have at least one (1) director who is ordinarily resident in Singapore, and must appoint a company secretary who must be a natural person ordinarily resident in Singapore.

Foreign companies and foreign individuals looking to set up companies in Singapore would welcome the fact that there are generally no restrictions on foreign shareholding in Singapore incorporated companies which can be 100% foreign owned.

In addition to being easy to set up, Singapore incorporated companies are easy to maintain, as their ongoing annual compliance requirements are relatively simple and straightforward. Further, there are certain exemptions from the audit requirements, for example, companies that qualify as “small companies” do not need to have their accounts audited. Additionally, Singapore private limited companies may be exempted from holding annual general meetings if certain requirements are met.

Singapore’s Inward Re-domiciliation Regime

The movement of assets into Singapore is further facilitated by the ease of corporate actions including not only incorporation as mentioned above, and internal acquisitions and reconstructions, but also more recently, its inward re-domiciliation regime introduced in October 2017 under which foreign corporate entities may transfer registration to Singapore as a Singapore company limited by shares. This is especially useful for individuals or families who make use of companies to hold their assets, generally as long as re-domiciliation is permitted under the laws of the original jurisdiction of the company, the company is solvent, and satisfies any 2 of the following requirements:

a. value of its total assets exceeds $10 million;
b. annual revenue exceeds S$10 million;
c. has more than 50 employees.

The Variable Capital Company

As part of a general movement towards making Singapore more attractive to investment funds, and to encourage more fund managers to domicile their funds in Singapore, Singapore intends to launch a new corporate structure in 2019.

This new structure would add to Singapore’s full service offerings for any type of fund to be based in this jurisdiction.

The new corporate entity would be known as the Variable Capital Company (VCC) and it would be tailored for collective schemes. It would be open to both open-end and closed-end funds, traditional and alternative funds, and can be a stand-alone entity or an umbrella entity with multiple sub-funds.

We set out below, certain benefits of the new VCC entity:

a. The VCC will be a single legal entity, with its sub-funds operating as separate cells (each without legal personality);
b. Directors of a VCC can dispense with need to hold an annual general meeting (AGM) with at least 60 days' written notice to the members prior to the last date to hold AGM;
c. There is no need for shareholders' approval for a VCC to redeem shares, thereby providing flexibility in the distribution and return of capital; and
d. A VCC's shareholder register is not required to be made public (but open to inspection by a public authority), thus offering privacy to investors.

Employment

Singapore's employment law framework is generally balanced and fair. Singapore adopts a "tripartite" model of partnership between employers, trade unions and the government, which come together to promote fair and responsible employment practices.

It should be highlighted that in Singapore, the activities of trade unions are heavily regulated and industrial actions are rare. The Singapore government takes a strict stance against illegal industrial action, with Prime Minister Lee Hsien Loong stating in his 2013 May Day speech that the government will not tolerate any "*illegal action, or any party undermining [Singapore's] industrial harmony*". Additionally, trade unions may not negotiate on behalf of their members in respect of certain matters specified in Singapore's Industrial Relations Act. For example, trade unions may not negotiate on behalf of their members in relation to promotions, transfers within the employing organisation that are not detrimental to the employee's terms of employment, or termination for redundancy or reorganisation.

Conclusion

As a country that has historically focussed on drawing in foreign investments to build local economic activity, Singapore has rolled out a significant number of incentives to attract investors to its shores. We believe that such incentives will be maintained for the foreseeable future. Singapore should therefore be considered by investors who wish to safeguard their assets and investments in the midst of global political shifting sands and changing tides in regulatory frameworks.

Dentons Rodyk is well positioned to advise any foreign investor considering Singapore as a destination on the benefits, requirements, customized structuring and process for implementation. If you wish to speak to us on any of the above, or require our assistance on the same, please do not hesitate to contact the key persons listed in this article.

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