Reporter

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DENTONS RODYK

Editor's Note

Dentons Rodyk Dialogue 2017 – *The Future of E-Commerce*

Welcome to the second issue of Dentons Rodyk Reporter 2017.

This issue is specially produced for the inaugural Dentons Rodyk Dialogue, to be held on 11 April 2017. The Dialogue is a culmination of the collaborative partnership between Dentons Rodyk and the Singapore Management University, and will focus on The Future of E-commerce.

In an era of unprecedented disruption where traditional business models are faced with impending obsolescence, e-commerce is revolutionising the way people shop on a global scale. In Southeast Asia, e-commerce is expected to exceed US$88 billion by 2025. This rapid growth of e-commerce is defining new standards in customer experience, bridging cross-border trade, and demanding new skills.

Gracing the occasion as Guest of Honour is Dr Janil Puthucheary, Minister of State, Ministry of Communications and Information and Ministry of Education, who is also the second minister in charge of Smart Nation.

The esteemed keynote speaker is Mr Maximilian Bittner, CEO and founder of Lazada Group who rode on the e-commerce wave and transformed the e-commerce landscape in the region. With Alibaba's injection of S$1 billion, Lazada is now the leading e-commerce player in the region.

A legal commentary by Dentons Rodyk's senior partner Gilbert Leong and a panel discussion comprising Dentons Rodyk's regional CEO and global vice-chair, Philip Jeyaretnam, SC, senior partner Gilbert Leong and Lazada's general counsel Gladys Chun, will cover the legal complexities and opportunities businesses may face when dealing with e-commerce.

In this issue, two articles on e-commerce are featured; the first is by Dentons Rodyk's tax partners Edmund Leow, SC and Seow Jia Xian on taxation of the digital economy. The second piece is by Dentons Rodyk's deputy managing partner Gerald Singham with partner Mark Tan on the impact of e-commerce on competition law.

We hope you will find this issue of Dentons Rodyk Reporter and the Dentons Rodyk Dialogue both useful and insightful.

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Feature Article – E-commerce

Taxing the Digital Economy: Impending changes to GST in Singapore

Background

Should digital downloads, streaming services and online purchases from foreign entities be subject to goods and services tax (GST) in Singapore? How about off-premise cloud computing?

On 20 February 2017, many in Singapore tuned in to listen to Finance Minister, Heng Swee Keat, delivering the Government's Budget Statement (the Budget Speech). Not many, however, may have noticed a brief, but significant comment made by the Minister regarding the Base Erosion Profit Shifting (BEPS) Project, as well as adjustments being made by some countries to their GST systems in the context of increasing digital transactions and cross-border trade. These international developments have far-reaching effects, whether on multinational or local enterprises, or even consumers, given the pervasiveness of the internet in business and daily living.

The BEPS Project was initiated by the Organisation for Economic Co-operation and Development (OECD) and the G20 countries, to combat tax planning strategies which allow multinational enterprises to artificially shift profits to low or no-tax locations where there is little or no economic activity. The BEPS final package of reports was issued in October 2015, and in June 2016, Singapore joined as an associate member to work together with the OECD and G20 countries on the implementation of the final package measures (To find out more, please visit https://www.iras.gov.sg/irashome/News-and-Events/Newsroom/Media-Releases-and-Speeches/Media-Releases/2016/Singapore-Joins-Inclusive-Framework-for-Implementing-Measures-against-Base-Erosion-and-Profit-Shifting--BEPS-/).

The problem

Although the BEPS package is heavily focused on direct or income taxes, Action 1 of the final package (Addressing the Tax Challenges of the Digital Economy) notes that because the digital economy is increasingly becoming the economy itself, it would not be feasible to ring-fence the digital economy from the rest of the economy for tax purposes – and that includes indirect tax, or for Singapore's purposes, GST.

The evolution of technology has dramatically increased the capability of private consumers to shop online and the ability of businesses to sell to consumers globally without the need to be present physically or in the consumer's country. Without any update in countries' tax rules to address the ever-changing business models in the digital economy, nor standardisation among countries on how cross-border supplies are taxed, tax leakages are fueled, and also, as indicated by our Finance Minister, uneven playing fields are created between local businesses which are GST-registered, and foreign-based businesses which are not.

Generally, indirect taxes such as Singapore's GST, are taxes on consumption based on the destination principle, meaning tax applying in the location in which the product or service is "consumed". For this reason, domestic supplies as well as imports of products into Singapore from suppliers that are GST-registered, are in principle GST chargeable at standard rates, whereas exports of products consumed outside of Singapore are GST zero-rated (i.e. GST charged at 0%).

For services, GST in Singapore is chargeable depending on the belonging status of the supplier. Where a supplier of service belongs in Singapore, the supply is considered to be made in Singapore and GST chargeable. However, generally speaking where the supplier belongs in Singapore but the customer of the service belongs outside of Singapore, the service may be considered an "international service" which is GST zero-rated.

With the advent of the digital economy, however, a country with laws still based on traditional business models would struggle to effectively tax imports of digital products and services or intangibles. Examples of tax leakages in Singapore arising from GST not being charged and collected would include:

a) online or e-commerce sales of low value non-dutiable goods by overseas suppliers, imported to Singapore customers by air or post, import

value of which falls below the S$400 import relief threshold; or

b) supplies of digital or remote services to customers in Singapore, for example, supplies to digital content including e-books, movies, TV shows and music, or online supplies of games, apps, software or educational distance learning courses.

In both instances above, the relevant good or service is being consumed in Singapore. However, in instance a), the S$400 import relief threshold was intentionally legislated about the same time GST was first introduced in Singapore on 1 April 1994, ostensibly to facilitate the high volumes of small value consignments. It is likely that the key consideration at that point was that compliance costs in accounting for small amounts of GST could very well outweigh the potential GST collected, if all imports regardless of value were subject to import GST. The unprecedented rise in e-commerce transactions since then, has however put tremendous pressure on tax authorities to track and police situations in which online retailers exploit tax breaks by under-declaring the value of their shipments, or by splitting a single transaction into multiple packages.

In relation to instance b), such services would not be taxable in Singapore under the current rules, as such supplies made by suppliers belonging outside of Singapore are not considered chargeable for supplies made in Singapore. This is currently the case, even if such services are not consumed overseas, but in fact in Singapore. These rules now appear inadequate to address the myriad situations in which the consumption of services, with the use of technology, no longer have to take place at the same location in which the supplier belongs or the service is provided. In fact, with some services of today with borderless natures, it comes close to impossible to make such a determination, for example in cloud computing, where the supplier company may be in one location, but the servers, on which numerous applications are run and simultaneously accessed by millions of users from multiple locations, are located at data centres in a variety of other locations.

Apart from the issue of tax leakage, there is the issue of unfair competition for local retailers as well, where as a result of GST not being charged and collected in instances a) and b) above, consumers in Singapore then favour overseas suppliers over domestic GST-registered suppliers of the same good or service. This issue has garnered enough attention, for it to have been raised as a point in the Budget Speech currently under study by the Government. In the old economy, the content that is now delivered digitally would have been delivered in the form of physical media such as books, tapes, records, etc. These are classified as goods rather than services, and would have attracted import GST.

Across the globe, and certainly the OECD (International VAT/GST Guidelines published on 6 November 2015), countries have adopted destination principles (meaning, taxation as the place of consumption rather than the place of production) as a core concept to be encapsulated in their indirect or GST laws. However, this leads to further questions such as, who is then liable to account for GST in supplies of digital goods and services? What mechanisms should be used for compliance and payment of GST? What solutions would be appropriate for Singapore's economy?

Possible solutions

1 Remove or lower current import relief

One possible option, in relation to instance a) above in a cross-border supply of tangible goods, is clearly the reduction or removal of import relief. Examples of countries which have already moved or are moving towards the lowering or removal of import relief include Australia, Switzerland, and the European Union (EU).

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This appears to be a relatively straightforward option for the Government as it does not require the introduction of new GST legislation, and in terms of mechanisms, may rely on the pre-existing system for collecting import GST. While this serves to plug the tax leakage on this front, and also to even out the playing field for supplies of such goods, on the other hand, companies and in particular import intermediaries face much heavier compliance costs in accounting for GST on high volumes of small value consignments. Should the Government choose to reduce or remove import relief, our view is that this should be accompanied by measures to improve the existing system of tax collection, in order to mitigate the increased costs of compliance for businesses.

2 Requiring overseas suppliers to register for GST

The removal or reduction in import relief provides a possible solution for cross-border supplies of goods, but how about digital or remote services such as those in instance b), which do not pass through any customs collection points and are contracted directly by the end consumer without the intervention of domestic intermediaries?

One measure that Singapore could consider, that has also been implemented in other jurisdictions such as Australia, the EU, South Africa, and South Korea, is requiring offshore suppliers of digital services to register and remit GST on sales of services where the consumer is located in Singapore. Such a measure, if successfully implemented, would effectively contribute towards levelling the playing field between overseas and domestic suppliers, and at the same time also generate more tax revenue for the Government.

The actual implementation of such a measure would obviously be challenging for such offshore suppliers, as their clientele is likely to spread across multiple jurisdictions, each with their own separate indirect tax systems to be monitored and complied with. It has been suggested that the additional burden for these suppliers can be mitigated through a “simplified GST registration and compliance regime” (BEPS Action 1), as has been, or will be implemented in countries such as Australia and New Zealand.

Under the Australian model, an overseas supplier who sells low value goods to Australian consumers and has an annual turnover of AU$75,000 or more will be required to register and account for GST on goods imported to Australia. It has been said that this is not an especially high threshold and many foreign sellers are expected to exceed it. While foreign sellers caught by these new provisions will need to register for GST and file periodic GST returns, they can elect a limited form of GST registration to reduce their compliance burden. This allows them to only file GST returns on a quarterly basis (rather than monthly as might otherwise be the case), but the trade-off is that they cannot recover input tax credit for the GST included in their Australian costs (in practice, such costs may not be material for many foreign sellers).

However even if a similar simplified regime may be introduced in Singapore, there is the issue of convincing the suppliers to comply, meaning, an additional enforcement issue from the Government’s perspective. This approach is dependent on the overseas supplier complying with the requirement to register, collect and remit the GST. Without implementing a suitable mechanism to collect the tax in the particular jurisdiction, it is unlikely that the tax would be paid and it would be difficult for tax authorities to audit and sanction them. In Australia, entities that are required to be GST registered but do not do so will be subject to compulsory registration upon identification and may have a range of administrative penalties imposed under the existing law. It has also been suggested that as a “last resort” measure, the Australian Government may possibly also use its powers to block access to overseas retailers’

websites if they fail to comply with the new rules. While this measure is unlikely to have an impact on small companies, it is possible that big companies which contribute significantly to the digital economy may nevertheless comply for reputational reasons.

It has also been suggested that such a model is likely to require not only extensive changes to existing tax collection processes but also enhanced international and inter-agency (tax and customs administrations) co-operation to help ensure compliance by overseas suppliers. Such co-operation is more effective in member state countries such as in the EU, however it remains to be seen how independent states such as Singapore may co-operate with other countries. One possible avenue would be to piggyback on existing international conventions for bilateral or multilateral co-operation on direct taxes.

3 Activate the reverse charge mechanism

One other measure that Singapore could consider in addressing cross-border supplies of digital services in instance b) above, is activating the reverse charge mechanism under section 14 of the Goods and Services Act. The reverse charge mechanism works by allowing (or sometimes requiring) the customer to account for the tax on supplies received from foreign suppliers (i.e. customers self-account for GST). For obvious reasons, this is not practicable for Business-to-Customer (B2C) situations since private consumers are not required to register and account for GST.

The reverse charge mechanism may however apply in Business-to-Business (B2B) transactions, for example in the EU, where the customer must account for the tax, regardless of whether the supplier is based in the EU or otherwise. In the B2B context in Singapore, there is the issue of whether the reverse charge would also apply to customers who are not GST-registered. Even if the recipients are GST-registered, it is expected that in most situations, domestic businesses would be able to claim an input tax credit on the GST accounted for, resulting in an effective zero collection of GST revenue on such transactions, i.e. self-accounting of GST would essentially be offset by the same amount of input tax credits claimed. From the business perspective, the implementation of a reverse charge system will also inevitably require additional compliance efforts involved in the changing of internal processes to address such additional requirements.

The main business sectors from which GST revenue could potentially be collected from, would be the financial services sector and the residential property sector which make exempt supplies. Such companies can only claim input tax credits to a limited extent. Generally, input tax incurred in the making of exempt supplies is not claimable unless the De Minimis Rule is satisfied.

The reverse charge mechanism is thus not likely to be an effective solution on its own, given the above limitations.

Conclusion

It is unclear at this point, which direction the Government will choose in relation to this issue, but it is clear that the eventual solution(s) would have to strike a balance among multiple objectives, including the efficient collection of tax, minimisation of compliance burdens, promotion of local fair competition (but also free movement of goods and services), and the upholding of the destination principle.

It also bears noting that indirect tax rules and systems cannot be considered in a vacuum in the context of the digital economy, which also raises important questions on how *direct* tax rules and systems should be modified to adapt to constantly changing economic and business models. As mentioned above, the BEPS package is in fact focused mainly on direct taxes, and the measures contemplated will have a substantial impact on indirect taxes and GST, for example with respect to the definition of “permanent establishment”, transfer pricing, and tax information exchange among jurisdictions.

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Just as we have seen a paradigm shift in the way that businesses are being conducted in the digital economy, we have likewise also seen how countries have started rethinking and reinventing tax systems, rules and concepts in a coordinated manner—the tax revolution too, has begun.

Dentons Rodyk acknowledges and thanks Jaryl Cheong for his contribution to the article.

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Feature Article – E-commerce

The benefits and harms of e-commerce on competition law

Introduction

Electronic commerce has gained significant popularity globally in recent years. As the internet became more familiar, and traditional biased attitude towards bricks-and-mortar retail shops fade, more businesses begin to embrace e-commerce and more consumers shop online. Competition law is also becoming increasingly widespread in the ASEAN region, with all ASEAN member countries enacting forms of competition legislation and each having a competition law regulator to ensure the enforcement of such law.

Antitrust regulators in more mature jurisdictions such as Europe, the United States and Japan have realised the importance and a few have taken further by commencing investigations, or conducting market research and/or economic studies involving this sector.

This article highlights the main competitive benefits brought about by e-commerce and related competition law risks.

Competitive benefits

1. **Lower prices:** E-commerce generally increases competition within the market and has proven to lower prices. The lowering of search costs, in combination with cost savings through improvements in the supply chain, has significant pro-competitive effects. There is also direct evidence that the adoption of e-commerce has resulted in lower average prices in relation to certain products such as air tickets, books, cars, CDs and life insurance.

2. **More efficient distribution:** E-commerce can streamline supply chains and significantly reduce distribution costs. For example, manufacturers and end customers may connect more easily and transact directly, obviating the need for the middleman. The resulting benefits would include: (i) improved efficiency in the supply and distribution of different types of goods; (ii) increase in variety of goods supplied; (iii) development of omni-channel business mode; and (iv) a change of the role of intermediaries, e.g. by eliminating the need for certain types of intermediaries or by enabling the emergence of new types of intermediaries.

3. **Stronger competition:** E-commerce may also increase market competitiveness by potentially lowering barriers to entry. For example, establishing an online presence would be cheaper than investing in a physical brick-and-mortar retail store. In addition, with market network platforms such as Amazon and Qoo10 offering smaller retailers a low-cost route to reach to the market, it might seem that entry barriers have become much lower.

4. **Better choices:** E-commerce can reduce search costs, and with buyers being better informed, sellers may need to compete harder to win and retain business. New products and services may be introduced faster, and the variety of products offered may increase. Online retailers are much less constrained than their brick-and-mortar counterparts by rack or shelf space and can typically stock a wider range of products. Reduced search costs makes it easier for consumers to locate what they want, supporting a shift of demand towards niche products.

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5. **More information:** E-commerce makes it easier for firms to collect detailed data about consumer purchasing behaviour and potentially use the data to the mutual benefit of the firm and the consumer, for example by personalising the shopping experience for each customer.

6. **Wider geographic market:** E-commerce businesses can increase the size of their geographic markets just as long as there is access to a wide logistics network. Online shoppers nowadays have access to a far greater range of suppliers, including suppliers from other countries. This is because the cost for consumers to visit a website is independent of its geographic location. Other factors such as cheaper and faster shipping further reduce barriers associated with buying from retailers located further away. For digital goods and services that can be delivered electronically the geographic market will be limited by bandwidth rather than by distance.

Anti-competitive risks

On the flipside, there have been certain anti-competitive behaviour which have arisen (e.g. due to network effects or price transparency) or which are facilitated or intensified due to e-commerce.

i. **Price obfuscation:** Some online retailers, by virtue of their business, are adversely affected by price comparison due to e-commerce, these retailers may attempt to engage in price obfuscation tactics that make it more difficult for consumers to search and compare prices online. For example, add-on pricing schemes where a retailer will advertise prices of low-quality products on a price comparison website but do not make the price of higher-quality upgrades easily observable. Customers will only be aware of the additional prices when they are at the retailer's website. In this way, the margin earned on high-quality versions might be competed away by lowering the price of the low-quality product to attract consumers. Retailers would have an incentive to maximise the proportion of customers who choose to upgrade, e.g. by taking a low-cost, high-value feature out of the low quality version and make it available in the high quality version.

ii. **Better conditions for collusion:** Greater price transparency may also facilitate collusion among firms as monitoring of competitors' behaviour becomes easier. The risk of co-ordinated outcomes may also increase with the growing use of intelligent software systems that use pricing algorithms in combination with market data to set prices. Such systems are more effective as they are better at detecting and punishing deviant behaviour and are less tempted than their human counterparts by short-run gains to deviate from the collusive outcome.

iii. **Network effects:** If retailers find it difficult to switch between one selling platform to another (due to losing of their reputation) and when platform users cannot or do not multi-home (i.e. use multiple platforms in parallel), such platforms are competitive bottlenecks, potentially capable of exercising market power and leveraging it into adjacent markets. Network effects coupled with vertical restraints, can cause foreclosure in the relevant markets

iv. Vertical restraints are restrictions imposed by parties on different levels of the distribution chain, for example, the restrictions placed by a manufacturer and a wholesaler. Vertical restraints are often applied to protect non-price dimensions of competition (e.g. in the form of exclusive or selective distribution arrangements

to prevent free riding on a distributor's provision of customer service) and may be seen as pro-competitive.

Examples of vertical restrictions in e-commerce:

i. Price recommendations: Over two in five retailers face some form of price recommendation or price restriction from manufacturers;

ii. Restriction on selling online: Almost one in five retailers are contractually restricted from selling on online marketplaces;

iii. Most Favoured Nation clauses: Almost one in ten retailers are contractually restricted from submitting offers to price comparison web sites;

iv. Cross border market sharing clauses: Over one in ten retailers report that their suppliers impose contractual restrictions on cross-border sales.

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Arbitration Review

The adoption of institutional arbitration rules and their effect on the right to appeal in domestic arbitrations

Introduction

In recent years, it has become increasingly commonplace for commercial parties involved in complex commercial transactions to include an arbitration clause as their chosen dispute resolution mechanism within the terms of the contract. Indeed, arbitration now seems to be commercial parties' first choice for dispute resolution in view of obvious benefits such as the clear policy of finality of arbitral awards, as well as confidentiality of arbitral proceedings.

In adopting the arbitral rules to govern the arbitration proceedings between parties, the arbitration clause (which in essence constitutes the arbitration agreement between the parties) typically provides that arbitral proceedings are to be governed by the arbitral rules of particular institutions. This commonly includes the adoption of International Chamber of Commerce (ICC) Rules, or Singapore International Arbitration Centre (SIAC) Rules. Yet, parties may not immediately be cognisant that in entering into such an arbitration agreement that adopts the said institutional rules, they may well be taken to have waived their right to appeal on questions of law insofar as domestic arbitrations are concerned.

The waiver of the right to appeal on questions of law

Article 35(6) of the 2017 ICC Rules (in force from 1 March 2017) states:

"Every award shall be binding on the parties. By submitting the dispute to arbitration under the Rules, the parties undertake to carry out any award without delay and shall be deemed to have waived their right to any form of recourse insofar as such waiver can validly be made."

In similar vein, Rule 32.11 of the 2016 SIAC Rules states:

"…by agreeing to arbitration under these Rules, the parties agree that any Award shall be final and binding on the parties from the date it is made, and undertake to carry out the Award immediately and without delay. The parties also irrevocably waive their rights to any form of appeal, review or recourse to any State court or other judicial authority with respect to such Award insofar as such waiver may be validly made."

While at first blush, the provisions may not seem controversial, parties may not immediately recognise the true significance of the provisions. The transaction document typically makes reference to the institutional rules as a whole, and the issue of whether and how Article 35(6) of the ICC Rules or Rule 32.11 of the SIAC Rules operate to exclude a right to appeal may come to light only when there is a dispute that has gone to arbitration, and when the dissatisfied party seeks recourse against the award.

The provisions operate to exclude, in particular, recourse against an award in the form of an appeal to the High Court on questions of law pursuant to section 49 of the Arbitration Act (Cap 143A). Section 49(1) of the Arbitration Act provides:

"A party to arbitral proceedings may (upon notice to the other parties and to the arbitral tribunal) appeal to the

Court on a question of law arising out of an award made in the proceedings."

Of particular importance is section 49(2) which provides that parties may agree to exclude the jurisdiction of the Court under this section:

"Notwithstanding section (1), the parties may agree to exclude the jurisdiction of the Court under this section and an agreement to dispense with reasons for the arbitral tribunal's award shall be treated as an agreement to exclude the jurisdiction of the Court under this section."

Indeed, such agreement can be made by parties adopting institutional rules in their arbitration agreement which have the effect of excluding the right of appeal under section 49(1). It is doubtful, however, that such exclusion of right of recourse extends to the setting aside of an arbitral award under section 48 of the Arbitration Act. This is simply by reason of the absence of an equivalent section to section 49(2) whereby parties may agree to exclude the jurisdiction of the Court.

By adopting and agreeing to submit disputes to arbitration under the ICC Rules or the SIAC Rules, parties hence agree to exclude their right to appeal on questions of law in domestic arbitrations. The operation of the principle first came before the Singapore Court in *Daimler South East Asia Pte Ltd v Front Row Investments Holdings (Singapore) Pte Ltd* [2012] SGHC 157 (Daimler).

In Daimler, pursuant to a joint venture agreement, the plaintiff and defendant agreed that all related disputes were to be finally settled under the Rules of Arbitration of the International Chamber of Commerce. Subsequently, parties entered into arbitration proceedings which resulted in a partial award in favour of the defendant. By way of an originating summons, the plaintiff sought leave of the High Court to appeal against the partial award on a question of law. The defendant then applied to strike out the originating summons on the ground that any and all rights of appeal under section 49 of the Arbitration Act had been waived and were thereby excluded when parties agreed to submit their disputes to arbitration under the ICC Rules. The Court found in favour of the defendant and held that it was undisputed that parties could exclude the right of appeal by adopting institutional rules of arbitration. Accordingly, on the facts, parties had agreed to exclude their right of appeal under section 49(1) of the Arbitration Act by adopting the ICC Rules.

The operation of the above principle and the holding in Daimler have recently been applied again by the Singapore High Court, and the Court again had no difficulty with striking out the plaintiff's originating summons seeking leave of the High Court to appeal the arbitral award on a question of law.

Conclusion

While commercial parties may turn to arbitration as the choice dispute resolution mechanism in its transaction document, parties are advised to be alive to the fact that by adopting certain institutional arbitration rules within the arbitration agreement and conducting the arbitration under the auspices of those institutions, they will be taken to have agreed to waive their right to recourse against the award by way of appeal on a question of law in the context of domestic arbitrations. Being mindful of the necessary implications would prevent any unwelcome surprises at preclusions from appeal during a later stage.

Dentons Rodyk acknowledges and thanks associate Kayleigh Wee for her contribution to the article.

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Business Bulletin

Disclosures in corporate transactions: A comparison of the UK/Singapore and US approaches

Introduction

In negotiating the terms of a sale and purchase agreement, whether for a transfer of shares or business assets of a company, a purchaser will often have to rely on the results of its due diligence and the seller's warranties. For a purchaser, the process of negotiating warranties serves to encourage the seller to disclose facts and events that may not otherwise be known in the course of its due diligence. Where such disclosures are not made, the purchaser may be able to claim damages as a result of the breach of the warranty.

To balance the risks that come with the giving of warranties, the sale and purchase agreement is commonly accompanied by a seller's disclosure letter. Disclosures are made by excluding, or carving out the incorrect facts or events otherwise covered under the warranty, to the extent that a disclosure could preclude a purchaser from claiming against a breach of the warranty.

Disclosures can take the form of general disclosures or specific disclosures. Examples of general disclosures can include information that is available publicly or information that is otherwise available to the purchaser such as all matters expressly provided in the sale and purchase agreement and all matters which would be revealed by public searches against the company, such as its business profile information, whether it is involved in any litigation or its ownership rights to intellectual property or real property. In situations where due diligence (extensive or otherwise) has been afforded to the purchaser, the seller may attempt to have all due diligence information accepted as a disclosure to all warranties. In such instances, the seller may include a general disclosure to the effect that, all matters "fairly disclosed" in the documents that were made available to the purchaser for due diligence are disclosed or deemed to have been disclosed.

Specific disclosures, on the other hand, are made in relation to a certain warranty and accordingly specific disclosures are typically cross-referenced to one or more specified warranties.

Naturally, it would be in the seller's interest to make extensive general disclosures while the purchaser would, conversely, resist and seek to accept only specific disclosures. However, as the form and substance of the disclosure letter can be used to a seller's or a purchaser's advantage, it may be worthwhile to examine how different jurisdictions may take different approaches to disclosures and in particular how the concept of "fair disclosure" or what constitutes "fairly disclosed" can be construed in different terms.

UK and Singapore approach

The general practice and mechanism for disclosure in the UK and Singapore are similar. Disclosures are typically contained in a separate disclosure letter where the seller would invariably attempt to have all due diligence information accepted as a general disclosure to all warranties and to include specific disclosures which will be typically cross-referenced to a specific warranty. Nonetheless, it is common for such specific disclosures to be treated as effective disclosures to all warranties.

English law, however, requires a disclosure to be "fair" and in order to be considered as such, a seller is required to disclose "facts and circumstances…sufficient in detail to identify the nature and scope of the matter disclosed and to enable the purchaser…to form a view whether to exercise any of the rights conferred on him by the contract."(*Edward Prentice v Scottish Power*, [1997] 2 BCLC 264 at 271).Therefore, as stated in the case of *New Hearts Ltd v Cosmopolitan Investments Ltd* [1997] 2 BCLC 249 at 259, mere reference to a source of information in a disclosure letter may not be in itself sufficient to constitute fair disclosure. However, it should be noted that in the cases of *Man v Freightliner Limited* [2005] EWHC 2347 and *Infiniteland v Artisan Contracting Ltd* [2005] EWCA Civ 758, the court indicated that it could give effect to clauses which provided that inferences from the disclosure of documents would be deemed to have been disclosed or that matters which are fairly disclosed are deemed disclosed.

In Singapore, while the High Court in *Vita Health Laboratories Pte Ltd and others v Pang Seng Meng* [2004] SGHC 158 expressed that the "essence of any disclosure letter, subject to the terms of its contractual setting, is candour", it did not elaborate or set out any parameters as to what "fair disclosure" entails.

Nonetheless, the English cases emphasize the effect of the language contained in the sale and purchase agreement and the disclosure letter, and in particular the use of the term "fair disclosure". If such a term is used, a purchaser should, before accepting such a term, always seek to clarify the extent to which such fair disclosure would enable them to make an informed assessment of the nature, implication and extent of such matters.

US approach

The practice and mechanism for disclosure in the US is arguably more onerous on the seller.

Disclosures in the US generally come in the form of a disclosure schedule integrated into the sale and purchase agreement which may include both general and specific disclosures to specified warranties. However, general disclosures are not common and are typically resisted by a US purchaser, with the implication that the seller would either seek to reduce the scope of the warranties in the sale and purchase agreement; or failing which, it would need to disclose such facts and events as an exclusion or carve-out of such warranty. Indeed, a US purchaser will commonly seek to provide in the sale and purchase agreement that specific disclosures are not treated as effective disclosures in relation to all warranties unless specifically cross-referenced.

However, since US disclosures are usually specific to the warranties, disputes between seller and purchaser in the US tend to focus on the impact of knowledge by the purchaser of a false or inaccurate disclosure rather than what constitutes "fair disclosure". Thus, in negotiating warranties, a US seller will also attempt to include materiality and/or knowledge qualifiers. It should be noted that different states in the US adopt different stances on the effect of such knowledge. For example, in New York, so long as a warranty is part of the basis of the parties' bargain, a purchaser who has knowledge of a breach of the warranty prior to signing can still be considered to have relied on the warranty such that the breach would not be taken as disclosed, as seen in the case of *CBS, Inc. v Ziff-Davis Publishing Co* 75 N.Y.2d 496, 553N.E2d 997, 554 N.Y.S.2d 449 (New York 1990). However, in the Minnesota case of *Hendricks v Callahan* 972 F.2d 190 (8th Cir. 1992), a purchaser was unable to recover damages for a breach of warranty as it had knowledge of the breach.

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Conclusion

For a purchaser in a sale and purchase process, the disclosure letter or schedule serves as the last but critical part of its due diligence investigations where the discovery of new facts or events may entail a renegotiation of the warranties and/or the purchase price. In certain situations, it may even result in a purchaser pulling out of a transaction. For the seller, the disclosure letter or schedule provides a mechanism by which it can seek to limit the scope of its warranties.

Depending on where the sale and purchase takes place or where the seller and the purchaser come from, whether the UK, Singapore, the US or other jurisdictions, it is clear that the form of the disclosure letter and its content matters. It is therefore important for sellers and purchasers, and accordingly their advisers, to ensure that whichever approach is taken in the disclosures, they fully understand the meaning and effect of its terms.

Dentons Rodyk acknowledges and thanks associate Zhong Iek Ka for his contribution to the article.

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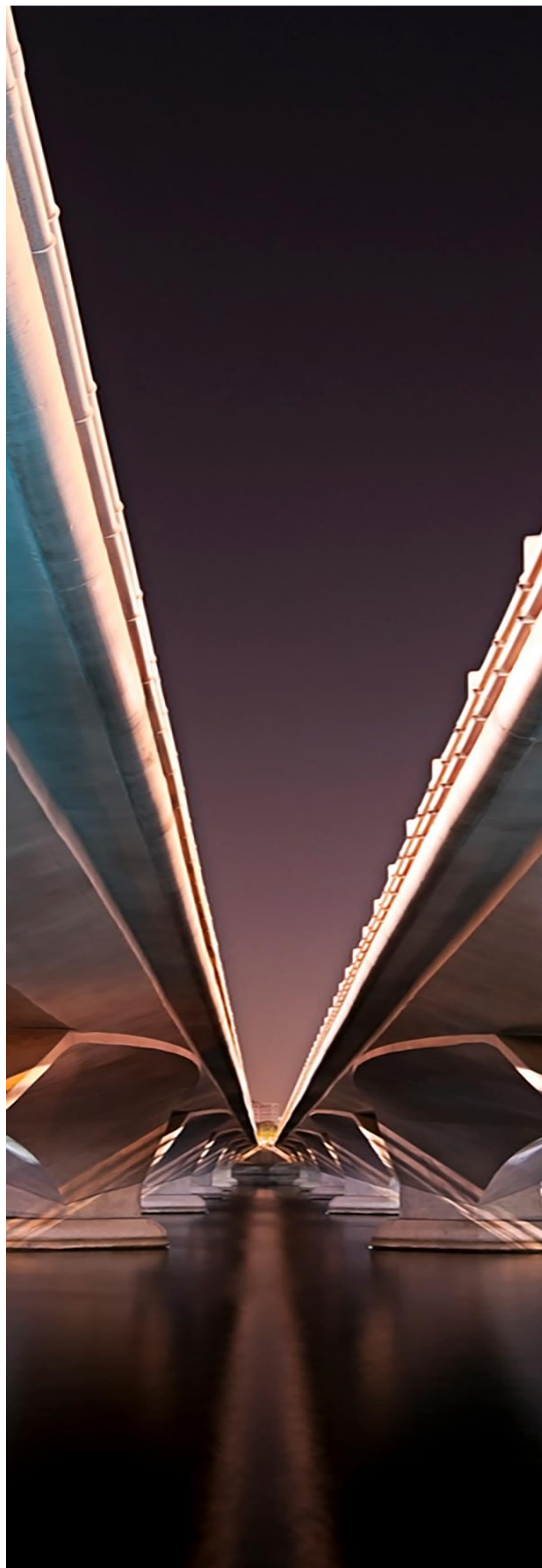

Listing framework for Dual Class Shares – A closer look into safeguards

Background

The subject of Dual Class Shares (DCS) has given rise to much debate in the context of public listed companies. Briefly, a DCS structure departs from the default one-share, one-vote concept by allowing companies to issue different classes of shares with different voting rights (e.g. non-voting shares, shares with multiple votes). This results in certain shareholders (typically the founding shareholders) obtaining voting rights disproportionate to their shareholdings and financial investment. The pros and cons of DCS structures have been debated extensively, with proponents advocating that DCS structures allow companies greater flexibility in capital management, and investors a wider range of investment opportunities.

Consultations by the SGX-ST

The Singapore Exchange Securities Trading Limited (SGX-ST) had in April 2016 sought the advice of the Listings Advisory Committee (LAC) on whether companies with a DCS structure (where shares in one class carry one vote each (OV shares) while shares in another class carry multiple votes each (MV shares)) should be permitted to list on the SGX-ST, and if so, the safeguards to be adopted. While voting in favour of permitting DCS structures to list on the SGX-ST, the LAC nevertheless identified the following key risks with DCS structures:

a) entrenchment risks, where owner managers entrench management control of the company;

b) expropriation risks, where owner managers seek to extract excessive private benefits from the company, to the detriment of minority shareholders;

c) risks of poor quality listings; and

d) risk of lack of clarity when investors invest in DCS structures.

Subsequently on 16 February 2017, the SGX-ST released a consultation paper on “Possible Listing Framework for Dual Class Share Structures”, seeking to explore whether such a listing framework for DCS structures should be introduced and if so, what safeguards might be appropriate. This consultation paper comes in the backdrop of recommendations from the Committee on the Future Economy for the Singapore Government to permit DCS structures for listed companies, particularly given that DCS listings are increasingly being considered for industries such as information technology and life sciences.

Proposed safeguards

Additional listing criteria for DCS structures

To address the risks of poor quality listings, the LAC proposed to admit companies with a compelling reason for adopting a DCS structure, based on a holistic assessment, taking into account the listing applicant’s “industry, size, operating track record and raising of funds from sophisticated investors”.

Once the SGX-ST assessed the applicant as suitable for listing, the LAC proposed that the SGX-ST refer such applications to the LAC for a second-stage review. It is envisaged that such second-stage review will continue for an initial period after implementation of the listing framework. The restriction to new listing applicants aims to prevent existing listed companies from circumventing this restriction by engineering corporate restructurings, spin-offs or reverse takeovers.

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Possible additional listing criterion supplemented by the SGX-ST include restricting listings to new issuers with a minimum market capitalisation of S$500 million for primary listings on the Mainboard of the SGX-ST and requiring issuers to have raised funds from sophisticated investors.

Safeguards against entrenchment risks

(i) Maximum voting differential between each MV share and OV share to be 10 to 1, where each MV share carries up to 10 votes and each OV share carries one (1) vote – to minimise the concentration of voting rights in owner managers.

(ii) Restriction on issuance of MV shares post-listing, except in the event of a rights issue – to prevent further entrenchment of voting rights in owner managers, or further dilution of voting rights of existing shareholders.

(iii) Automatic conversion of MV shares in the event (A) the owner manager sells or transfers his MV shares (with such transfer being restricted to another owner manager, an executive director or an executive office); or (B) where an owner manager no longer holds the position of the executive chairman or the chief executive officer or equivalent, in both cases unless shareholders approve otherwise in a general meeting where the voting is on the basis that one MV share is limited to only one vote (Enhanced Voting Process) – to ensure that MV shares are solely for owner managers to retain control to facilitate business decisions, and not to make their shares more valuable than OV shares.

(iv) Sunset clauses providing for the automatic conversion of MV shares into OV shares at a fixed future date post-listing – to ensure that special rights are only available for an incubation period during which founding shareholders have the flexibility and security to plan for and make strategic business decisions on the future and growth of the company.

Safeguards against expropriation risks

(A) Independence element on the Board – to provide assurance of independent scrutiny on owner managers' actions.

(B) Enhanced Voting Process on appointment of independent directors – to ensure that holders of OV shares have a greater say on the appointment of independent directors.

(C) Independent risk committee of directors – to oversee the company's risk management framework and policies.

(D) Coat-tail provision in the event there is a change of control of the DCS company – to ensure that holders of OV shares are able to participate in a take-over offer on an equal footing with holders of MV shares, by ensuring that where an offer is made to holders of MV shares, a concurrent and commensurate offer is made to holders of OV shares.

Measures to increase clarity to investors

To complement the safeguards against entrenchment risks and expropriation risks, listing applicants with DCS structures would be required to comply with the disclosure requirements specified in the Companies Act (Chapter 50) of Singapore, regardless of their place of incorporation.

These disclosure safeguards include requiring shareholders' approval by way of a special resolution for issuance of shares with different voting rights, setting out information on the voting rights of each class of shares in the notice of meeting, and setting out in the constitution of the issuer the rights for different classes

of shares. The SGX-ST would also require issuers to disclose holders of MV shares at the point of listing and in the issuer's annual report.

On the other hand, the SGX-ST will clearly demarcate, on trading screens, the securities of issuers with DCS structures.

Issues and alternative safeguards

The proposed safeguards are not without flaws. One key issue with the minimum market capitalisation of S$500 million is that if DCS structures were intended to support the growth of start-up companies, emerging companies in nascent industries (e.g. fintech) would be unlikely to satisfy this requirement. Alternatives to using a quantitative indicator may be to introduce DCS listings under Catalist instead, or restrict access to only institutional investors and qualified retail investors.

There is also scope to explore expanding the Enhanced Voting Process to cover more trigger events e.g. in board nominations (and not just limited to independent directors), winding up proposals, proposals to vary the rights of non-voting shares. These trigger events need not apply uniformly to all issuers with DCS structures, and the means of implementing these may vary. For example, companies may exclude special rights entirely for certain transactions, or require that an independent committee of directors be set up and/or independent financial advisers be engaged for deliberating and advising shareholders on specified transactions. Taking one step further, if a corporate action is rejected by shareholders after a specified number of times, an additional safeguard may be to restrict any proposals for the same corporate action for a fixed duration after.

To align the interests of owner managers with the issuer, the SGX-ST may also consider imposing a minimum equity threshold to be held by founding shareholders through a moratorium period.

Lastly, the proposed review of and changes to the Code of Corporate Governance to strengthen corporate governance practices and to enhance board independence, would dovetail with and complement the proposed listing framework for DCS structures.

Conclusion

As with the introduction of any new regulatory framework, the listing framework for DCS structures continues to be a work in progress depending on market reactions, investor appetite and investor environment – but it is a start.

What the SGX-ST needs to grapple with, and what investors in Singapore need to understand and appreciate, is finding the optimal balance between promoting Singapore as an attractive investment destination for IPO listings and protecting investors in Singapore from the very issuers that the SGX-ST hopes to attract. Too many safeguards would prove inimical to this pursuit.

The discussions on a listing framework are part of a bigger, evolving conversation on investor environment in Singapore. The hope is that with time, shareholders are given the options, and are empowered to make informed, investment decisions, without a regulatory big brother's oversight. In the context of DCS structure, factors such as an initial discounted share price, the long-term share price potential and the presence of investors other than the founding shareholders, would be relevant considerations to each individual investor depending on his investment priorities.

Dentons Rodyk acknowledges and thanks senior associate Wong Huiyi for her contribution to the article.

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Revisions to Companies Act (Cap.50) of Singapore – New requirements with effect from 31 March 2017

Introduction

Service providers who used to face grouses or challenges when asked for details on companies' shareholders and ultimate beneficial owners would now have an easily understandable and frequently-quoted legislation to point to when asking for details on controllers and nominee directors.

The Companies (Amendment) Bill was passed by Parliament on 10 March 2017, and subsequently the Accounting and Corporate Regulatory Authority (ACRA) announced that the changes to the Companies Act would be implemented in phases. The first phase will be implemented on 31 March 2017, and the remaining two phases would take effect later in 2017 and early 2018 respectively.

The objective for the latest revisions has been to ensure that our corporate regulatory regime continues to stay robust and support Singapore's growth as a global hub for businesses and investors while ensuring that corporate entities are not used for any illicit purposes or to facilitate flow of illegal funds.

This article sets out the **key legislative changes** that will impact companies and will take effect from 31 March 2017, for your guidance and incorporate our comments on some of the changes. The changes that would take effect in subsequent phases are not covered below.

Position with effect from 31 March 2017	
Company administration	**Comments**
A. Requirement to retain and use a common seal would be removed -> Companies are no longer required to use the common seal in the execution of documents as a deed or other documents such as share certificates.	Companies can choose not to purchase the common seal or keep custody over common seals – thus reducing the costs of acquiring and maintaining a seal. Companies may however choose to retain a seal if dealing with foreign jurisdictions that require execution of a document under a seal. Documents that used to be executed by seal would be effective if signed by authorised persons (without any requirement to affix the common seal on the document). Such authorised persons would be the same as the current position - either a director and the company secretary; two directors of a company; or a director of a company in the presence of a witness who attests the signature.
B. Requirement to maintain register of nominee directors and nominators and containing the particulars of the nominators -> Companies would require nominee directors to disclose their nominee status and nominators to their companies. This would be a private register to be produced to regulatory authorities when requested.	This requirement would help to determine the true status of a local director if companies are being set up in Singapore by foreign entities or individuals - it should however be noted that a nominee director should be fully aware of the business and activities of the company so as to discharge one's duties as a director effectively.
C. Requirement to maintain a register of controllers • All companies incorporated in Singapore and foreign companies would be required to maintain registers of registrable controllers.	The objective behind the new register of controllers is to make the ownership and control of corporate entities more transparent and reduce opportunities for the misuse of corporate entities for illicit purposes. As it is now, banks and corporate service providers are

- A Controller is defined as an individual or a legal entity that has a "**significant interest**" in or "**significant control**" over the company.

"Significant interest"

A controller who has significant interest in a company may include any of the following:

- For companies with share capital:
  - An individual who has interest in more than 25% of the shares or shares with more than 25% of total voting power in the company

- For companies without share capital:
  - An individual who has the right to shares in more than 25% of the capital or profits of the company

"Significant control"

A controller who has significant control on a company is a person who:

- holds the right to appoint or remove directors who hold a majority of the voting rights at directors' meetings;
- holds more than 25% of the rights to vote on matters that are to be decided upon by a vote of the members of the company; or
- exercises or has the right to exercise significant influence or control over the company.

Existing companies would have a transitional period of 60 days from the date of commencement of the new law (31 Mar 2017) to set up the register of controllers, after which they must have and continue to maintain the required registers.

Companies newly incorporated on or after 31 Mar 2017 will have a transitional period of 30 days to set up the register.

- The registers of registrable controllers can be maintained at the company's registered office or the registered office of the registered filing agent.
- Companies would have to declare to ACRA the location of the company's register of controllers when filing the company's annual returns.
- The register can be maintained in paper or electronic format.

Listed companies and Singapore financial institutions are exempted from the new requirement.

already required to identify the ultimate controller of an entity under existing AML/KYC requirements.

This new requirement would be helpful in providing a statutory basis for gathering information in order to maintain a register of controllers of corporate entities when such entities are being incorporated.

- A corporate service provider (providing corporate secretarial or filing agent services) would be required to determine definitively the existence and particulars of controllers and to record the responses in the register of controllers.
- Information collected on the beneficial ownership of companies during the client due diligence phase can be used to be entered into the register.
- The registers should be readily available if public agencies request access to the registers, otherwise, the register of controllers would be a confidential register (not available to the public). The information in the registers would be helpful in administering or enforcing anti-money laundering-related legislation in Singapore.
- Companies can discharge their duties by sending notices to the relevant parties and recording their particulars, as well as sending further notices to any other parties that have been revealed as potential controllers. Notices can be sent and replies may be received, in electronic or hard copy format. The company would then not be liable should recipients of these notices fail to respond or provide inaccurate responses.
- Companies are required to (i) keep the information in their registers up-to-date and (ii) correct inaccuracies in said information.
- This is likely to mean that a company must minimally send a notice to every registrable controller whose particulars are contained in the register of registrable controllers at least once annually.

D. Requirement to maintain public register of members for foreign companies • Foreign companies will be required to keep a public register of members. This is similar to the current requirement for public companies to maintain their registers of members.	• Further information would be required to be collected when establishing branches in Singapore in order to maintain this register of members (in addition to a register of controllers). However in contrast to a register of controllers, the register of members would be available for public review if required.
Other requirements • **Requirement for a liquidator to retain records of wound up companies for five years instead of two** • **Requirement for officers/partners/managers of struck off companies to retain accounting records and registers of beneficial owners for five years**	

As evident above, most significant changes to take effect from 31 March 2017 are requirements to maintain new registers of nominee directors and registrable controllers in order to determine the 'true' beneficial ownership and control of business entities. These changes are anticipated to enhance Singapore's global reputation as a trusted and clean financial hub where illicit flow of funds through setting up of entities in Singapore is strictly prohibited.

While the new requirements would increase obligations on companies to maintain new registers and service providers to request additional information from clients, one can at least point to the legislation and its objectives when making the requests for such information and record the responses (or lack thereof) accordingly.

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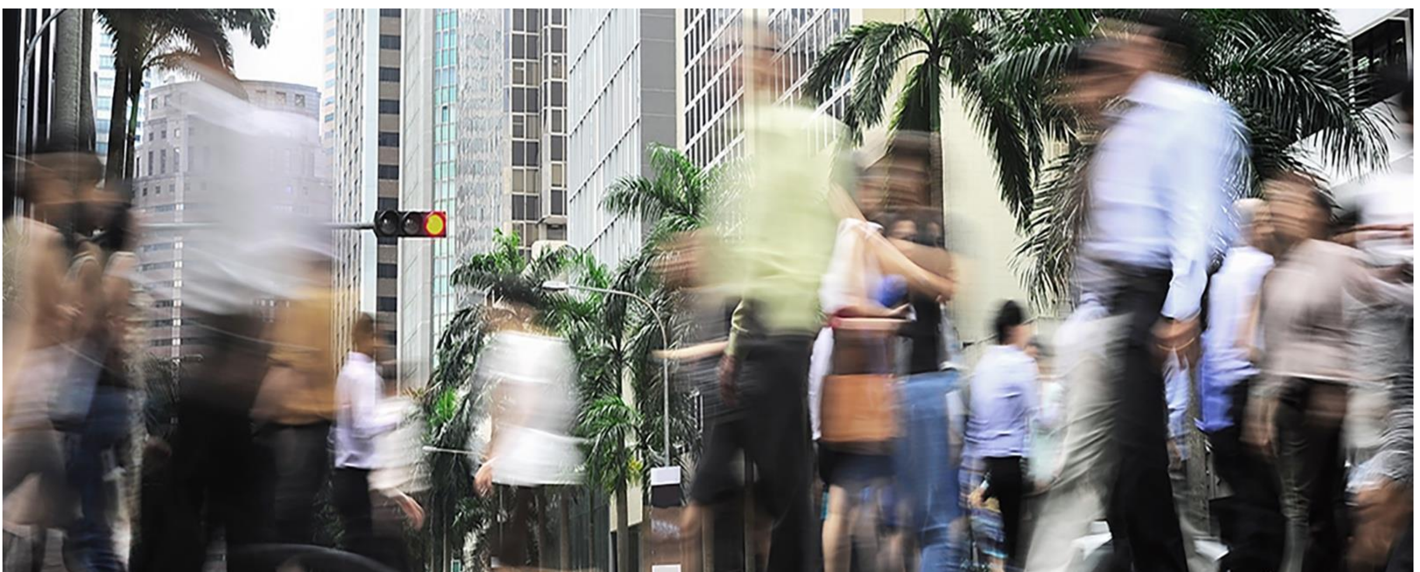

Litigation Brief

Avoiding the perils of joint investments in real property

A case study of *Cheong Woon Weng v Cheong Kok Leong* [2016] SGHC 263

Introduction

Often, joint investments in real property present potential pitfalls, especially if the parties are closely related to each other and dispense with the formalities of proper records, which may often be the case. In this article, we examine the recent High Court decision of *Cheong Woon Weng v Cheong Kok Leong* [2016] SGHC 263, on the issue of establishing a beneficial interest in a joint investment of a real property. The case is currently pending appeal.

Essentially, the case raises the importance of ensuring properly drafted trust instruments are in place to record trust arrangements. This is crucial to avoid disputes over the ownership of jointly held property.

Facts

Cheong Woon Weng (CWW) and Cheong Kok Leong (CKL) are brothers. CWW is the elder of the two. A condominium property in the western part of Singapore was purchased in July 2000 at S$880,000. It was registered solely in CKL's name.

A dispute arose as to the ownership of the property. CWW averred that his younger brother CKL proposed a joint investment in the property, to which he agreed. Both brothers visited the show flat of the property development, chose the unit, selected the building materials and also discussed the financing of the property. CWW claimed that there was an oral agreement, and pursuant to the Memorandum of Loan and a Collateral Agreement, he had half the beneficial ownership of the property. CWW claimed that as part of the agreement with this younger brother, he had contributed S$200,000 towards the purchase price of the property.

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CKL did not deny that he received a sum of S$200,000 from his elder brother. However, CKL disputed the nature of the payment; he alleged that the sum was extended as a loan to him to buy the property, and it had since been fully repaid. CKL also counterclaimed for a sum of S$120,000, which he claimed were given to CWW as loans.

Issues

The issues to be decided at trial were, among others:

(a) whether the two brothers made an agreement to co-own the property;

(b) if the agreement to co-own the property was made, whether a trust was created, whereby the younger brother, who had sole legal ownership of the property, held half-share of the beneficial ownership on trust for his elder brother;

(c) whether CWW had advanced the sum of S$200,000 as a loan to CKL or as a contribution for a joint investment in the property; and

(d) whether CKL had made payments of a total of S$320,000 to CWW (including the further loan of S$120,000), and whether this discharged his obligation under the agreement for co-ownership of the property with CWW.

The decision

The court accepted that an oral agreement had been entered into prior to the purchase of the property, pursuant to which the Plaintiff would bear the S$200,000 down payment, and that parties would be equal beneficial owners of the property even though the property was to be registered in CKL's sole name.

The Collateral Agreement signed between the parties indicated that the Plaintiff would obtain a share in the property which was proportionate to his contribution to the purchase price.

The trial judge found that both parties had not intended for the Memorandum of Loan and Collateral Agreement to embody their entire agreement to the exclusion of the Oral Agreement. The parol evidence rule was not applicable, and extrinsic evidence is admissible to vary the written agreements.

The oral agreement had evinced the parties' intention for the Defendant to be the registered owner of the property which was to be held on trust for both parties as tenants-in-common of equal shares, consistent with the parties' conduct from the time of purchase to many years thereafter. The Collateral Agreement then conferred on the Plaintiff an interest in the property in return for his contribution of S$200,000.

Both the Collateral Agreement and the Memorandum of Loan made reference to CWW's contribution to the purchase of the property. If it was merely a loan, as alleged by CKL, there would be no need for a term in the Collateral Agreement requiring CWW's consent before the property was sold.

If the Memorandum of Loan was to be interpreted as a loan, it would be one encompassing the possibility that CWW would never get his money back if the property was not sold, and this made no commercial sense.

Although CWW had only contributed S$200,000 (out of the purchase price of S$880,000), he was entitled to half of the property because this was what the parties had agreed to.

The trial judge further found that the cheques totalling S$87,000 received by CWW from CKL were payments for his share of the income from rental of the property, and does not amount to repayment of the alleged loan.

CKL's counter-claim was dismissed as he had failed to adduce sufficient evidence to prove that he had made any other payments to CWW besides the S$87,000 received by his elder brother.

CKL was ordered to furnish all documents relating to the property in order to ascertain the income and expenses. CKL was also ordered to sell the property and distribute half the proceeds of sale to CWW, after deducting expenses and tax.

Takeaway

It is possible to assert beneficial ownership of a property if one can prove a trust was created by the legal owner for the benefit of the beneficial owner. In this case, the court found that a common intention constructive trust was created based on the contemporaneous documents and upon the conduct of the parties.

However, it is difficult to prove the intention of parties as to the agreement to jointly hold a property, if such agreement is not properly reduced in writing. Where family relations are involved, and oral agreements are the norm, matters can be especially complicated, which is shown in the subject case. Hence, the key takeaway would be for parties (even and especially for family members) to expressly and clearly set out their intention in a properly drafted document to reflect the true terms of their agreement.

Dentons Rodyk acknowledges and thanks associate Quek Ling Yi for her contribution to the article.

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Property Notes

New stamp duties on shares transfer – Acquisition and disposal of equity interests in residential property holding entities

Introduction

Purchases of residential properties in Singapore by companies attract Additional Buyer Stamp Duty (ABSD) of 15% rate in addition to usual Buyer Stamp Duty (BSD) of up to 3%. Seller Stamp Duty (SSD) is also payable if residential properties are sold within the restricted period from date of purchase. Prior to 11 March 2017, we witnessed many deals involving the sale and purchase of shares in property holding companies instead of direct sale and purchase of the residential properties owned by these companies. In the former cases, the stamp duty paid by the Purchaser of shares was 0.2% of the net asset value of the relevant company or of the share sale consideration (whichever is higher) instead of the ABSD and BSD chargeable on the underlying residential assets.

In the light of several high profile transactions involving such sale and purchase of shares of property holding companies, the Government responded strongly with sweeping changes to the stamp duty legislation, in particular, with the introduction of new sections 23 and 23A to D of the Stamp Duties Act (the Act).

Additional Conveyance Duties (ACD) will now apply in respect of certain qualifying acquisitions and dispositions of equity interests in residential Property Holding Entities (PHE) on or after 11 March 2017. An Entity could be a company, partnership (including limited liability partnership) or property trust.

What are the Qualifying Acquisitions

The purchaser (transferee of shares) is a significant owner of the entity immediately before the execution of the conveyance of shares or becomes one upon execution of the conveyance. The threshold for significant ownership is 50% of equity ownership or 50% of the voting power.

This will include the equity ownership or voting power of associates of the purchaser. Associates of an individual include the immediate family members of the individual and partners of the individual. Associates of a purchaser entity include holding entity which owns 75% or more of the voting capital and 50% or more of the voting power of the purchaser entity.

What are the Qualifying Disposals

The Vendor (transferor of shares) is (or was) a significant owner of the entity and the equity interest disposed of was acquired on or after 11 March 2017 and disposed of within the prescribed period (of three years) after acquisition, on a "first in first out" basis.

The “entity” should be a Residential PHE, which can be a Type 1 PHE or Type 2 PHE or both (as defined in the Act).

Type 1 PHE means a target entity where the market value of its residential properties makes up at least 50% of its total tangible assets (TTA).

Type 2 PHE means a target entity which has 50% or more beneficial interests in one or more entities (related entities) which is a Type 1 PHE, and the sum of the market value of the residential properties owned by the target entity and its related entities is at least 50% of the TTA of the target entity and its related entities.

The ACD payable on the Contract for purchase of equity interest in respect of a qualifying acquisition is a stamp duty equivalent to ABSD of 15% and BSD (up to 3%) in addition to the usual share sale stamp duty of 0.2%. The ACD payable on the Contract for sale of equity interest in respect of a qualifying disposition is a stamp duty equivalent to SSD at flat rate of 12%.

Other than contracts for sale and purchase of equity interests, conveyance via gift, settlement and assignment are also caught by the aforesaid new laws.

The Government has also introduced a new section 23C of the Act which gives the Commissioner of Stamp Duties broad powers to disregard avoidance arrangements which have the effect of increasing or reducing the equity interests in the company so as to trigger the relevant ACD.

We urge you to be extremely cautious in any attempt to change the shareholding in any of your residential PHEs, whether these are direct or indirect PHEs because transfer of part equity interests may be caught under the aforesaid new laws.

You may wish to consider the following examples of various Transactions of a PHE:

Example Transactions^

Conveyance 1 - on 1 June 2017, X owns no shares in a PHE and buys 30% of the shares.

Conveyance 2 - on 1 Dec 2018, X buys a further 30% bringing his total ownership to 60%.

Conveyance 3 - on 1 March 2019, X buys a further 30% to bring total ownership to 90%.

Conveyance 4 - on 1 July 2021, X sells 50% of shares in the PHE, bringing down his ownership to 40%.

Conveyance 5 - on 1 November 2021, X sells 10% bringing his total ownership to 30%.

Conveyance 6 - on 1 January 2023, X buys 15% bringing total ownership to 45%.

Conveyance 7 - on 1 January 2024, X buys another 15% bringing total ownership to 60%.

We assume the aforesaid laws apply and X is a significant owner if his equity ownership in the residential PHE is 50% or more.
* Duty A - ABSD 15% and BSD 3% less $5400
** Duty B - SSD 12%

Please note:

Duty A is not chargeable on Conveyance 1 because X does not become a significant owner as a result of the conveyance.

Duty A is chargeable on Conveyance 2 and amount of duty is computed on basis of all shares bought since 11 March 2017 (that is, 60%).

Duty A is chargeable on Conveyance 3 on basis of the 30% acquired.

Duty B is chargeable on Conveyance 4 but only in relation to shares bought within the holding period of three years. Shares acquired first deemed to be sold first. As such, only 20% shareholding acquired under Conveyance 2 and disposed under Conveyance 4 will be used in computing the duty.

Duty B is chargeable on Conveyance 5 even though X no longer a significant owner.

Duty A is not chargeable on Conveyance 6 as X is not a significant owner and does not become one as a result of the conveyance.

Duty A is chargeable on Conveyance 7 as X becomes a significant owner as a result of this Conveyance. The duty is computed on basis of difference between 60% and the least percentage since X was last a significant owner (i.e. 30%).

^Adapted from the Explanatory Statement to the Stamp Duties (Amendment) Bill No. 18/2017

The Government has stated that the policy rationale for the ACD is to address the stamp duty differential between a direct sale/purchase of residential properties, and an indirect sale/purchase of equity interests in residential property-holding entities. However, our observation is that the scope of application of the ACD is wider than expected, with possible surprise or unintended effects on unsuspecting parties. This could be seen, for example, in:

- The "Significant Ownership" concept – which includes equity ownership or voting power of not only the purchaser/seller, but that of their associates
- The Type 2 PHE concept – which extends ACD not only to direct equity interests in PHEs but indirect equity interests in PHEs
- ACD rate for sale – a flat 12% within three years of purchase, rather than the tiered SSD rates for residential properties
- Stamp duty on shares – ACD for purchase applies in addition to, and not in place of, 0.2% stamp duty on shares
- Stamp duty relief – Section 15 and 15A relief is now no longer available on instruments to which ACD applies, meaning, relief not only does not apply to ACD, but in fact also can no longer be claimed on the 0.2% stamp duty on such instruments
- Time of stamping of agreements – contracts/agreements for the sale/purchase of equity interests in PHEs is subject to ACD upon execution of contract, rather than upon completion. This shift of timing from completion to contract, applies to all share sales and not just PHE share sales in view of amendment to section 22(1) of the Act.

Even without these changes, the Government would have been able to take similar action under the pre-existing general anti avoidance rule (GAAR) in the Stamp Duties Act, in respect of certain share transfers. Of course, the new provisions are much more specific, and remove much of the uncertainty on this issue. In particular, the pre-existing GAAR would not apply if parties had bona fide commercial reasons for entering into the transactions as they did. This limitation no longer applies to the new provisions. A new detailed GAAR, on top of existing laws, has been created in the provisions of section 23C specifically for ACD avoidance, signalling the Government's resolve to plug any potential loopholes in the new legislation.

In summary, the new laws warrant caution in dealings of equity interests (whether in full or in part) in residential PHEs, especially if purchaser (transferee of shares) is a significant owner of the entity immediately before the dealing or becomes one upon such dealing.

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Regional Report

The introduction of GST in India - What businesses should look out for in 2017

Introduction

The Constitution Amendment Bill for Goods and Services Tax (GST) has been approved by The President of India and the GST council have decided to enforce GST from 1st July 2017.

It was agreed that tax revenue from small tax payers with annual turnover of less than INR15 million under the GST regulations will be divided between the states and the centre in the ratio of 9:1 for the purposes of scrutiny and audit. All taxes above this annual turnover threshold will be equally shared between the states and the centre.

Currently, businesses in India have to contend with indirect taxes and restructure their systems and supply chain to fit this current tax regime. With GST being introduced, it will reform the Indian economy by creating a common Indian market and reducing the cascading effect of tax on the cost of goods and services. GST will have a far-reaching impact on almost all aspects of the business operations in the country. Further, it will lead to increased tax compliance which may attract more foreign direct investments across sectors due to tax transparency and ease of doing business.

These are some of the salient features of the proposed GST system:

1. GST is defined as “any tax on supply of goods and services other than on alcohol for human consumption”.
2. The power to make laws in respect of supplies in the course of inter-state trade or commerce will be vested only in the Union Government. States will have the right to levy GST on intra-state transactions, including services.
3. Central taxes such as central excise duty, additional excise duty, service tax, additional custom duty and special additional duty as well as state-level taxes such as VAT or sales tax, central sales tax, entertainment tax, entry tax,

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purchase tax, luxury tax and Octroi will be subsumed under the GST.

4. Entertainment tax, imposed by states on movie, theatre, etc, will be subsumed under GST, but taxes on entertainment at panchayat, municipality or district level will continue.
5. GST may be levied on the sale of newspapers and advertisements. This would mean substantial incremental revenues for the Government.
6. Stamp duties, typically imposed on legal agreements by states, will continue to be levied.
7. Administration of GST will be the responsibility of the GST Council.

Impact of GST on businesses in India

Sourcing	•Inter-state procurement could prove viable •May open opportunities to consolidate suppliers/vendors •Additional duty/CVD and Special Additional duty components of customs duty to be replaced
Distribution	•Changes in tax system could warrant changes in both procurement and distribution arrangements •Current arrangements for distribution of finished goods may no longer be optimal with the removal of the concept of excise duty on manufacturing •Current network structure and product flows may need review and possible alteration
Pricing and profitability	•Tax savings resulting from GST structure would require repricing of products •Margins or price mark-ups would also need to be re-examined
Cash flow	•Removal of the concept of excise duty on manufacturing could result in improvement in cashflow and inventory costs as GST would now be paid at the time of sale/supply rather than at the time or removal of goods from the factory
System changes and transaction manage-ment	•Potential changes to accounting and IT systems in areas of master data, supply chain transactions, system designs •Existing open transactions and balances as on the cut-off date need to be migrated out to ensure smooth transition to GST •Changes to supply chain reports (e.g., purchase register, sales register, services register), other tax reports and forms (e.g., invoices, purchase orders) need review •Appropriate measures such as training of employees, compliance under GST, customer education, and tracking of inventory credit are needed to ensure smooth transition to the GST regime

Source: http://www.ey.com/in/en/services/ey-goods-and-services-tax-gst

While companies should still be wary of the exact fixing of the rate at which tax will be charged and chances of inflation in the early days of implementation, on the whole, GST should improve the gross domestic product of the country in the long run.

Some of the other major benefits of GST implementation include reduced logistics cost, supply chain efficiency, reduction in costs for tax and regulatory compliance, better market penetration and export effectiveness.

Taxation of M&A transactions

Amendments have been proposed in relation to the tax treatment of the sale of unquoted shares, receipt of listed securities and capital gains taxable if securities transaction tax was not paid on acquisition of shares in the Indian Union budget for the financial year 2017-2018.

‘Fair market value’ deemed to be sale consideration for sale of unquoted shares

Under the existing provisions of the Income Tax Act, income chargeable under “capital gains” is computed by taking into account the full value of consideration received on transfer of a capital asset. It is proposed that where the sale consideration of a capital asset, being unquoted shares, is less than the fair market value, the full value of consideration shall be deemed to be the fair market value for the purposes of computing the income under “capital gains tax”. Hence, the actual price paid may not be considered to be the sale consideration. However, it is uncertain how the fair market value of an unquoted share of a company will be determined.

From an M&A transaction perspective of structuring and reorganisation, this proposed change may lead to unfavourable tax consequences for a group as a whole notwithstanding the actual value at which such shares were proposed to be transferred. Thus, it could force such transactions to take place at fair market value and consequential tax considerations have to be seriously considered.

One potential issue that may arise is that there are no proposed exceptions for transfer for an unquoted share by a holding company to a subsidiary company which could invite significant amount of unnecessary litigation. Similar to how a transfer of a capital asset by a holding company to its wholly-owned subsidiary company is exempted from tax, it is advisable for the same exception to apply in this scenario.

Receipt of listed securities at less than fair market value to be taxable

The Finance Bill 2017 (the Finance Bill), expected to come into force on 1 April 2018, proposes the following to be included as being taxable under "other income":

a. sum of money without consideration, the aggregate value of which exceeds INR50,000; or
b. any immovable property without consideration (the stamp duty value of which exceeds INR50,000) or for a consideration which is less than the stamp duty value by an amount exceeding INR50,000; or
c. any property, other than immovable property, without consideration (the aggregate fair market value of which exceeds INR50,000) or for a consideration which is less than the aggregate fair market value of the property by an amount exceeding INR50,000.

From an investor's viewpoint, the proposed changes could impact private placement transactions. In effect, investments would likely need to be made at the fair market value. If this is not adhered to, there may be potential tax outflows of up to 30% of the discount (to the fair market value) granted to the specific resident investors. The impact on non-resident investors should also be considered given the exchange control regulations in India and double tax avoidance agreements entered into between India and the investors' respective home jurisdictions.

Capital gains taxable if securities transaction tax not paid on acquisition of shares

Provided that the sale of equity shares or units of equity is subject to Securities Transaction Tax (STT), long-term capital gains resulting from any transfer of such equity shares or units of an equity oriented fund is exempt from tax under the current provisions of the Income Tax Act. Many taxpayers have been misusing this exemption to declare their unaccounted income by entering into sham transactions. Hence, it has now been proposed that this exemption would only be applicable if STT was paid on the acquisition of such equity shares. Whilst curing this misuse, this amendment could also negatively affect certain genuine investment transactions like domestic private equity investments, strategic investments by domestic investors, preferential allotments to certain investors including financial institutions, shares acquired through off market transactions, employees allotted shares under an employee stock option scheme, shares acquired through a merger or demerger, etc. In such cases, shares would have been previously acquired by the investor without payment of STT.

Customs duty and the introduction of "beneficial owner"

On 1 February, 2017, India's Finance Minister Arun Jaitley introduced the Finance Bill. The Finance Bill introduced the concept of "beneficial owner" to subsection (3A) section 2 of Customs Act, 1962, stating that "beneficial owner means any person on whose behalf the goods are being imported or exported or who exercises effective control over the goods being imported or exported".

Further, subsections (20) and (26) of section 2 (i.e. definitions of exporter and importer respectively) have been amended accordingly to replace the words "any owner", with words "any owner, beneficial owner".

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Rationale of amendment

In India, companies are given a unique Importer Exporter Code (IEC) which they use for import/export activities. However, companies have been misusing the code by “loaning out” their IECs to hide non-compliance for purposes of saving on duty payable at the time of import, where the final recipient is, in many situations, not the IEC holder. Therefore, in order to enforce accountability under the Customs Act and recover duty payable, the government is including “beneficial owners” as a legal basis for pursuing investigations of tax fraud and duty avoidance.

Impact on Singapore companies

Potential difficulties surrounding the exact definition and application of beneficial ownership may have implications on Singapore companies doing businesses with India in the trade and industry sector. Singapore companies must be particularly prudent when exporting goods into India and ensure that the parties in India they are dealing with comply with the applicable laws and regulations and possess the necessary IECs. In applying the beneficial concept, if ownership lies with the Singapore company, this could lead to the possibility of the Singapore company being made liable to duty and accountable for custom compliance under the Customs Act, as they would now be considered the importer.

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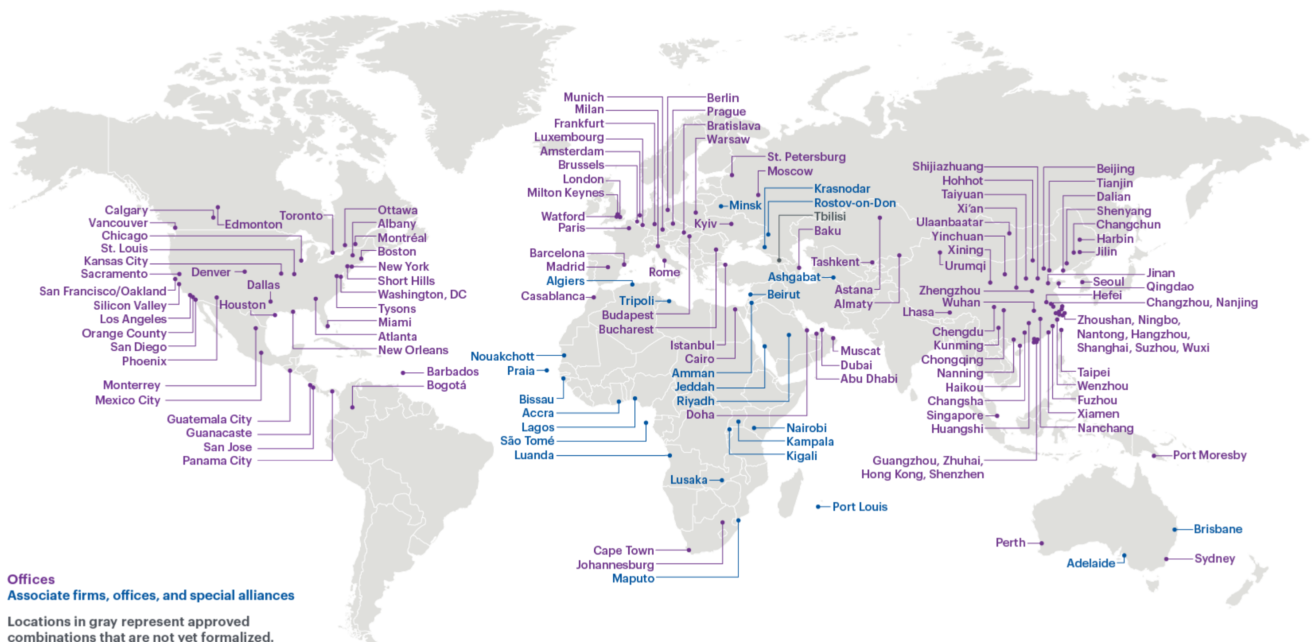

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