Investment Management

Harvest*

Investment Management Industry Updates

Issue 2 • September 2007

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PricewaterhouseCoopers

Welcome to the latest issue of PricewaterhouseCoopers' (PwC) investment management newsletter.

It has been over 6 months since the 2007 Budget was presented by the Government. There was considerable excitement generated in the investment management industry due to the significance of some of the announcements such as the removal of the infamous "80:20 rule" and expansion of the definition of designated investments. The authorities have since issued circulars providing details of these announcements.

In this issue, PwC highlights the key aspects of these circulars and other corporate tax developments affecting the investment management industry in Singapore.

New framework replacing the 80:20 rule

Details of the much awaited framework to replace the 80:20 rule were issued by the Monetary Authority of Singapore (MAS) in a circular dated 31 August 2007 (the August Circular).

The new framework applies to funds existing before 1 September 2007 as well as those set up thereafter. For the former, there is an option of applying the new framework with effect from 1 September 2007 or from the next financial year beginning on or after 1 September 2007.

On the whole, the new framework should help alleviate some of the compliance issues and uncertainty previously faced by fund managers in Singapore. To a certain extent, the new framework will also facilitate access to funds of Singapore investors for Singapore fund managers. Nonetheless, some areas of the new framework will have to be clarified in order to facilitate its implementation.

Broadly speaking, a qualifying fund will now be granted tax exemption at the fund level, regardless of the residency status of its investors, provided it is not 100% owned by Singapore investors. Tax, if any, will be collected from the investor depending on his specific profile.

The key distinguishing features between the old and new regime are as follows:

- A fund that has more than 20% of its issued securities held by Singapore investors can now have access to the tax exemption scheme that was previously only available to funds that meet the 80:20 rule.
- The new framework still carries conditions, but unlike the 80:20 rule, the conditions under the new framework are more within the control of the fund manager.
- The new framework separates investors of a qualifying fund into two categories – qualifying and non-qualifying. If the fund has any non-qualifying investors, such investors will be required to account for a "quasi" tax (known as the "financial amount") on their share of the fund's profits, without affecting the tax exempt status of the fund or the qualifying investors.

- One aspect of the old rules that created compliance and tracking issues for fund managers was the requirements under Regulation 5. While it was not explicitly stated in the August Circular, it seems clear that Regulation 5 should no longer be applicable under the new framework.

Some other key elements of the new framework are as follows:

- A qualifying fund, in the context of a company, is a company that is not resident in Singapore, and where the value of its issued securities is not 100% beneficially owned by investors in Singapore (which includes resident individuals, resident non-individuals and Singapore-based permanent establishments of non-residents) and the company does not have a Singapore presence or business activity (other than a fund manager).

- A qualifying investor is:

  i. An individual investor.

  ii. A "bona fide non-resident non-individual investor" that:

    a. does not have a Singapore presence or business activity (other than a fund manager), or

    b. has a permanent establishment in Singapore but does not use funds from its operation in Singapore to invest in the qualifying fund.

  iii. A designated person.

  iv. An investor other than those listed in (i), (ii) and (iii), where the investor owns not more than 30% (50% where there are 10 investors or more in the fund) of the qualifying fund.

  It is interesting to note the definition provided for "bona fide non-resident non-individual investor" - "one which carries out substantial business activities for genuine commercial reasons and has not as its sole purpose the avoidance or reduction of tax". This definition raises some concerns. For instance, it is not clear how the definition will be applied to a special purpose vehicle set up by qualifying investors, or another fund (i.e. a fund of funds) investing into a qualifying fund. The new framework surely cannot seek to charge the financial amount on these investors, since this would not be in line with what it hopes to achieve. It would certainly help if the MAS could provide clarification in this regard.

- An investor that does not come within the definition of a qualifying investor is a non-qualifying investor. Such an investor will have to pay the financial amount to the IRAS. This is calculated by attributing a percentage of the income figure in the qualifying fund's audited accounts to that non-qualifying investor based on his interest in the fund on the last day of the financial year.

  The interesting point to note is that where the fund is not resident in Singapore, a non-qualifying investor will potentially be "taxed" twice. This is because according to the circular, he will pay the financial amount, but will also be subject to normal tax rules when he receives his distribution from the fund in Singapore. There is no basis for a credit for his financial charge against his actual tax. Whether this was intentional or an oversight is not clear. But what is clear is that it gives the approved Singapore resident fund a serious leg-up, as a result of its ability to pay exempt dividends (see below).

  The only investors of course that are likely to be subject to this treatment are non-individual investors based in Singapore (other than designated persons) who take large (more than 30%) stakes in a fund. This seems to convey the message that the new framework is intended to facilitate the management in Singapore, of funds that are not closely-held by non-individual investors in Singapore.

- To implement the collection of the financial amount, certain reporting requirements have been imposed on the fund manager and non-qualifying investors.

Finally, it has been clarified that the above changes will also apply to approved Singapore-resident fund companies. This is an enhancement from what was stated in the Budget speech in February this year. This is a welcome announcement since it puts Singapore domiciled funds on an equal (or even advantaged) footing with their offshore counterparts.

All in, we think the changes are a step in the right direction, and in line with expectations. Of course, there are some areas that require further clarification, which PwC will be working with the industry to obtain.

Financial sector incentive scheme – Fund management (FSI-FM)

With the introduction of the new framework, the FSI-FM will now grant the 10% concessionary tax rate imposed on fund management or investment advisory fees derived in respect of a qualifying fund that does not have any non-qualifying investors. If a qualifying fund has any non-qualifying investors in any year, the entire fee paid to the fund manager will not qualify for the 10% tax rate whether the manager holds the FSI-FM status or not. For obvious reasons this does not make sense.

List of designated investments

In our previous issue, we mentioned our continuing dialogue with the authorities on the subject of designated investments. This is a specific list of investments entitled to tax exemption under Singapore's offshore fund exemption regime. The request was to include two important asset categories in the list - loans and commodities. The 2007 Budget announced the inclusion of qualifying loans and commodities. Subsequently, the MAS issued a circular on 11 June 2007 (the June Circular) to provide more details on the matter. The June Circular says that with effect from 15 February 2007, the following will be included in the list of designated investments:

i. Qualifying loans, ie:

   a. loans that are traded by the fund and are not originated by the fund, and

   b. loans that are originated by the fund but granted to non-Singapore based companies where the deduction of interest expense is not taken against Singapore-sourced income.

ii. Commodity derivates (both over-the-counter and exchange-traded) and physical commodities where:

   a. the trade volume of physical commodities does not exceed 15% of the total trade volume of commodity derivatives and physical commodities, and

   b. the trading of physical commodities is in connection with and incidental to any related commodity derivatives trading.

Clearly, this should provide an impetus to Singapore's pitch as the preferred investment management centre in Asia. In particular, the inclusion of loans that are originated by the fund in the list of designated investments should create significant opportunities, and the inclusion of loans in general has recognised the importance of the non-performing loans (NPLs) as a separate asset class for funds.

Investments in partnerships

Partnerships are considered tax transparent vehicles in Singapore and income derived by a partnership is not subject to tax at the partnership level but at the partner level on his share of partnership income. The June Circular clarifies that tax exemption would be granted to partners (assuming they are foreign investors as defined) when the partnership derives specified income from designated investments. This clarification essentially seeks to confirm that an investment in a partnership will be treated as a designated investment as long as the underlying investments are designated investments.

While this has clarified the treatment on the investments side, it also serves to reinforce another issue – if a fund were to be set up as a partnership, the tests to be applied in respect of the tax exemption scheme for offshore funds would not be applied at the partnership level, unlike corporate fund vehicles. This makes the use of a partnership fund vehicle more cumbersome than alternatives available, even though it is a relatively common form of fund vehicle.

Other updates

- **Financial Sector Incentive – Extension of expiry dates**

The MAS issued a circular on 28 December 2006 extending the expiry dates of certain Financial Sector Incentive (FSI) awards, including the FSI-Fund Manager Incentive, to 31 December 2008. This is relevant to companies which enjoyed the Approved Fund Manager award before the FSI award came into being.

Companies currently enjoying the above extension are required to continue to meet the conditions set out under their existing awards.

Other updates (continued)

- **Tax Treaties**

Singapore recently signed and entered into the following tax treaties/amendments to treaty protocols.

Tax treaty with:	Relevant aspects:
Belgium	New tax treaty signed on 6 November 2006. The provisions of the existing tax treaty will cease to apply once the new treaty is ratified.
Brunei	Treaty ratified and entered into force on 14 December 2006, covering income derived on or after 1 January 2007.
China	New Tax Treaty signed on 11 July 2007 (not ratified yet), providing for: • A reduction in withholding tax rates for dividends from 7% (at least 25% shareholding) and 12% to 5% and 10% respectively. • Gains on the disposal of shares not taxed in China unless the alienator holds at least 25% of the share capital at any time in the 12 months before disposal.
Estonia	Tax treaty signed on 18 September 2006. However, it has not been ratified and therefore does not have the force of law.
Germany	New treaty ratified and entered into force on 12 December 2006, replacing the one signed on 19 February 1972. It reduces the withholding tax rate on interest from 10% to 8%, but increases the withholding tax rate on royalties from nil to 8%.
Morocco	Tax treaty signed on 9 January 2007. However, it has not been ratified and therefore does not have the force of law.
New Zealand	The Third Protocol to the tax treaty was ratified and entered into force on 17 August 2006, covering income derived on or after 1 January 2006.
Qatar	Tax treaty signed on 28 November 2006. However, it has not been ratified and therefore does not have the force of law.
Republic of Fiji Islands	Treaty ratified and entered into force on 28 November 2006 covering income derived on or after 1 January 2007.
Ukraine	Tax treaty signed on 26 January 2007. However, it has not been ratified and therefore does not have the force of law.

How PricewaterhouseCoopers (PwC) can help you

PwC is a global market leader for tax services with 23,000 dedicated tax professionals in over 140 countries. Our tax practice is among the largest in Singapore. With more than 250 tax professionals and directors, we help individuals and businesses with tax strategy, planning and compliance, while also delivering a wide range of business advisory services. From fund management, treasury, transfer pricing to international tax planning, our team of Investment Management tax experts provides you with the ideal tax solutions.

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MICA (P) 210/07/2007 Co. Reg. No.: 199902830D

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