

## Tax perspectives on the Singapore Variable Capital Company (S-VACC) Consultation Paper



The Monetary Authority of Singapore (MAS) has recently issued a consultation paper on a legislative framework for a new corporate structure, S-VACC, that is tailored for collective investment schemes (CIS). The S-VACC will also allow for the segregation of assets and liabilities of sub-funds established under a single legal entity.

In this issue, we share our thoughts and perspectives on the S-VACC. We envisage engaging with the MAS on these aspects in due course.

Of particular interest is the comment in Paragraph 2.6 of the Consultation Paper indicating that the MAS is in the process of studying the tax regime which should apply to the S-VACC.

### General observations

Firstly, we would like to raise a couple of structural issues which feed into the tax analysis.

### Investment Management

Paragraph 7.5 of the Consultation Paper notes that the fund manager will carry out the investment activities of the fund. We need to reconcile this requirement with the fact that internationally, the various sub-funds are often managed by specialist investment managers who would make investment decisions without input from the fund manager of the overall platform.

This becomes very relevant when we consider how the various sub-funds are taxed where they operate and are being managed out of foreign countries.

### Quarantining Sub-funds

Section 4 of the Consultation Paper discusses segregation of assets and liabilities and the need to avoid cross-contagion of the sub-funds. Laws to this effect can be drafted in Singapore but that does not guarantee that these rules will be respected in foreign countries, as acknowledged in the Consultation Paper.



As such where debt is a factor, we would still expect that investors might want to ring-fence that debt in the various countries and indeed against individual assets. This makes us wonder whether a foreign lender can only seek recourse from the specific sub-fund or the overall S-VACC under a financing arrangement governed under the laws of the foreign lender.

This would provide a natural limit to S-VACC's direct investment in real estate and infrastructure that is perhaps consistent with the CIS limitation which MAS is proposing. On the other hand, this reduces possible tax complexity of characterising such investments.

### **Net Asset Value (NAV)**

Another important issue is the impact of the tax position (i.e. underlying foreign tax, see below) on the calculation of NAV. The S-VACC must be able to properly evaluate the impact of foreign taxes (especially in respect of any unrealised positions) on the calculation of NAV. Otherwise, the impact of these taxes is potentially passed from an exiting investor to the investors who are there when the income is realised, thus resulting in an effective value shift between investors.

### **Collective Investment Vehicles (CIV)**

The MAS briefing paper stated that the S-VACC needs to be a Collective Investment Scheme, which could be interpreted as covering both retail and institutional CIS.

Interestingly, the definition in the Securities and Futures Act specifically excludes most closed ended funds which seems to contradict the intent of the S-VACC. We also wonder how the definition of CIS sits with private equity styles funds with portfolio companies and the like.

Nevertheless, let us stick to tax here. It would seem that the S-VACC could be a CIV (widely held, regulated and with a diversified portfolio of securities) or a non-CIV (all other funds) for tax purposes. Before moving on to the Base Erosion and Profit Shifting (BEPS) analysis, we need to work through the application of the existing treaty rules.

If the S-VACC is a CIV which is fully tax exempt and does not make distributions, some countries may see the combination of tax exemption and opportunities for deferral (i.e. no current tax in the hands of the ultimate investors) as a basis for denying treaty benefits. A close inspection of the relevant treaties would be required and these outcomes may impact on the attractiveness of the S-VACC as a vehicle for foreign investors.

If the S-VACC is a non-CIV, the tax treaty outcomes could be even more uncertain under the current BEPS climate. This means that the principal purposes test and anti-treaty shopping issues need to be carefully considered.



## Taxation of investors

### Singapore investors

If the S-VACC, its investors and the sub-funds are all based in Singapore, the tax outcomes are relatively easy to understand. The only issue is whether Singapore investors (individuals or non-individuals) will benefit from a tax exemption in these circumstances and whether the usual designated investments limitations will apply to the Fund in relation to the fund exemption. Things get a lot more interesting when you move into the international sphere.

The actual design of the fund exemption is going to be interesting. When you look at international comparatives, there are generally blanket exemptions covering every aspects of tax including GST. Of course, as we will read in the article below, exemption from Singapore taxes is not necessarily the end of the tax story for foreign investments made by the S-VACC and/or foreign investors in the S-VACC.

### Non-Singapore investors

If the S-VACC Fund has US investors, they will want to understand the characterisation of these vehicles and whether it results in any attribution and/or reporting requirements in the US. For investors from other countries including the UK, the S-VACC may need to provide a detailed breakdown of the income from which dividends, returns of capital and or redemptions are made so that the investor can complete their local tax return.

This could easily extend to providing a detailed analysis of the income arising from the underlying sub funds in which they have invested.

For example, if an investor receives a distribution of S\$200 from an S-VACC which is funded out of unrealised profits but in respect of which there is a mark-to-market accounting profit, the question is whether that payment is a dividend. On the other hand, if there was no mark-to-market accounting profit, the characterisation of the payment would also be a question.

## Taxation of the Fund

### Sub-fund

We need to consider the position of sub-funds operating in foreign countries. Under the traditional tax analysis of these activities, there should be no permanent establishment in the foreign country and thus no taxable presence. This often depends on tax treaty outcomes and will need to be tested and understood in each country in which the S-VACC wishes to invest. A lot of time then goes into withholding tax management especially around dividends arising from the underlying investments which is often handled by custodians and other agents on behalf of the fund.

Of course, this exercise will be focused on reducing the cash impact of these taxes as it is unlikely that foreign tax credits will flow to underlying investors in the S-VACC.



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### BEPS

There are a number of BEPS-related changes which might alter some of these tax outcomes. This includes changes to the definition of permanent establishment, holding period rules to qualify for preferential withholding rules under tax treaties and look-through rules for land-rich entities. The outcome of all of these proposed changes is not clear and the application will not be uniform.

Above all, there will be a need to consider the anti-tax treaty shopping rules (most likely in the form of the principal purposes test) as they apply between the S-VACC and the various entities in which the sub funds might invest. This testing will require some further thought regarding the substance that S-VACCs are required to have in Singapore in order to maintain treaty outcomes in respect of underlying income flows.

### Looking forward

The draft framework in the S-VACC consultation paper is a step forward in developing Singapore as a centre for both fund management activities and investment fund domiciliation.

As tax is a key consideration in any fund structuring discussion, the tax aspects of the S-VACC framework would have an impact on the eventual implementation of the scheme. While it is important that the tax regime for S-VACCs should be aligned to the goals and objectives that MAS has for the S-VACC structure, the tax regime should also take into account the prevailing commercial practices in the funds industry as well as international tax developments.

### How we can help

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