

Dear Clients & Friends

MAS Circular: Changes Pertaining to Tax Incentive Schemes for Fund Management

The previous tax exemption regime for funds managed by fund managers in Singapore required (inter alia) not more than 20% of the total value of the issued securities of the fund company or total value of the trust fund to be beneficially owned, directly or indirectly, by persons who are citizens of Singapore or resident in Singapore (excluding certain designated persons). This is often referred to as the "80:20 rule".

It was announced in the Singapore Budget Statement 2007 delivered on 15 February 2007 that the above tax exemption scheme would be liberalised and that accordingly the "80:20 rule" described above will be removed to "give certainty of tax exemption to foreign investors whose funds are managed in Singapore, and also provide fund managers based in Singapore with greater flexibility in sourcing for mandates from investors". The removal of the "80:20 rule" was to be subject to conditions to be announced.

The Monetary Authority of Singapore (the "**MAS**") recently released a circular FDD Cir 04/2007 dated 31 August 2007 (the "**MAS Circular**") entitled "Changes Pertaining to Tax Incentive Schemes for Fund Management" to clarify the details of the removal of "80:20 rule" and the new tax exemption regime for funds managed by fund managers in Singapore (the "**New Regime**").

The New Regime took effect from 1 September 2007 and applies to new and existing funds. New funds set up on or after 1 September 2007 come under the New Regime. Existing funds set up prior to 1 September 2007 can choose to come under the New Regime from 1 September 2007 or from the beginning of the relevant fund's next financial year after 1 September 2007. (Hence, a fund will have to elect to move to the New Regime from 1 September 2007 or from the beginning of its next financial year, but cannot continue under the 80:20 regime beyond this timeframe).

Qualifying Fund

Under the New Regime, the fund being managed by a Singapore fund manager* must be a "qualifying fund" which is defined in Paragraphs 4 and 5 of the MAS Circular as follows:

- (a) an individual that is neither resident in nor a citizen of Singapore;
- (b) a company not resident in Singapore, and where the value of issued securities of the company is not 100% beneficially owned, directly or indirectly, by investors in Singapore

(including investors who are resident individuals, resident non-individuals and permanent establishments in Singapore), and where the company:

- (i) does not have a permanent establishment in Singapore (other than a fund manager);
and
 - (ii) does not carry on a business in Singapore; or
- (c) a trust administered by a trustee not resident in Singapore, and where the value of the fund is not 100% beneficially held, directly or indirectly, by investors in Singapore (including investors who are resident individuals, resident non-individuals and permanent establishments in Singapore), and where the trustee of the trust:
- (i) does not have a permanent establishment in Singapore (other than a fund manager);
and
 - (ii) does not carry on a business in Singapore.

Qualifying Investors

In addition to the requirement that the fund must be a “qualifying fund”, all the investors in the qualifying fund must also be “qualifying investors” (as determined on the last day of the qualifying fund’s financial year), failing which a proportion of the income derived by the fund and attributable to non-qualifying investors may be subject to tax in the hands of the non-qualifying investors based on a specified formula.

A “qualifying investor” is defined in Paragraph 6 of the MAS Circular to be:

- (a) an individual investor;
- (b) a “bona fide non-resident non-individual investor” (which is referred to in the MAS Circular as an entity “which carries out substantial business activities for genuine commercial reasons and had not as its sole purpose the avoidance or reduction of tax”) and which:
 - (i) does not have a permanent establishment in Singapore (other than a fund manager) and does not carry on a business in Singapore; or
 - (ii) carries on an operation in Singapore through a permanent establishment in Singapore but does not use funds from its operation in Singapore to invest in the qualifying fund;
- (c) a designated person;** or
- (d) an investor other than those listed in (a), (b) and (c) above and:
 - (i) where the qualifying fund has less than 10 investors and such an investor, alone or with its associates, beneficially owns not more than 30% of the total value of issued securities of the qualifying fund (being a company) or the total value of the qualifying fund (being a trust fund), as the case may be; or
 - (ii) where the qualifying fund has 10 or more investors and such an investor, alone or with its associates, beneficially owns not more than 50% of the total value of issued securities of the qualifying fund (being a company) or the total value of the qualifying fund (being a trust fund), as the case may be.

For the purpose of determining whether an investor of a qualifying fund is an associate of another investor of the fund, the two investors shall be deemed to be associates of each other if:

- (a) at least 25% of the total value of the issued securities in one investor is beneficially owned, directly or indirectly, by the other; or
- (b) at least 25% of the total value of the issued securities in each of the two investors is beneficially owned, directly or indirectly, by a third entity.***

As mentioned above, an investor of the qualifying fund who is not a “qualifying investor” will be required to pay a “financial amount” (the “**Financial Amount**”, i.e. a proportion of the income derived by the qualifying fund and attributable to the non-qualifying investor based on a specified formula) to the Singapore Comptroller of Income Tax (the “**Comptroller**”) and to declare this Financial Amount in its Singapore income tax return for the relevant year of assessment. The status of whether an investor of a qualifying fund is a qualifying investor will be determined on the last day of the qualifying fund’s financial year.

An investor that is not a qualifying investor (under paragraph (a), (b) or (c) above in the definition of a qualifying investor) as at the last day of the qualifying fund’s financial year could be granted by the Comptroller a grace period of up to one month from the last day of the qualifying fund’s financial year to reduce its percentage of ownership in the qualifying fund to meet the allowable investment limits under paragraph (d) of such definition of qualifying investor. The investor will be granted the grace period if the investor can prove to the Comptroller that the investment limits were exceeded for reasons beyond the reasonable control of the investor. If the grace period is granted and the investor fails to reduce its percentage of ownership in the qualifying fund to such allowable investment limits within the grace period of one month, the investor will be liable to pay the above Finance Amount (computed based on his proportion of issues securities in the qualifying fund as at the last day of the qualifying fund’s financial year).

Reporting Obligations

Under the New Regime, the fund manager also has certain reporting obligations. In respect of each financial year of the qualifying fund, the fund manager of the qualifying fund will have to issue an annual statement to each of its investors, showing:

- (a) the profit of the qualifying fund for that financial year as per the audited financial statement;
- (b) the total value of issued securities of the qualifying fund (being a company) or total value of the qualifying fund (being a trust fund), as at the last day of the qualifying fund’s financial year;
- (c) the total value of issued securities of the qualifying fund (being a company) or total value of the qualifying fund (being a trust fund) held by the investor concerned as at the last day of the qualifying fund’s financial year; and
- (d) whether the qualifying fund has less than 10 investors as at the last day of the qualifying fund’s financial year.

The fund manager is also required to submit a declaration to the Comptroller if, for any particular financial year of the qualifying fund, there are non-qualifying investors (as determined on the last day of the qualifying fund's financial year) and furnish the Comptroller with the details of such investors based on a specified format annexed to the MAS Circular. As mentioned above, a non-qualifying investor of a qualifying fund will then have to declare and provide for the Financial Amount in its Singapore income tax return for the relevant year of assessment.

Financial Sector Incentive-Fund Management ("FSI-FM") Award

Fund managers who have been granted the FSI-FM award should also note that the concessionary tax rate of 10% under such scheme will apply to fee income derived from managing qualifying funds for the purpose of any "designated investments" or providing investment advisory services to qualifying funds in respect of "designated investments". However, if any of the investors of the qualifying fund is not a qualifying investor**** (as determined on the last day of the qualifying fund's financial year), the concessionary rate of 10% under the FSI-FM scheme would not be applicable to the fund manager of the qualifying fund for the full year of assessment relating to that financial year of the qualifying fund.

Other Relevant Issues

The tax exemption under the New Regime applies to "specified income" from "designated investments" as per the earlier "80:20 regime", and as defined in the Income Tax (Income from Funds Managed for Foreign Investors) Regulations 2003.

The MAS has also confirmed in the MAS Circular that the New Regime would apply to qualifying Singapore-resident funds under Section 13R of the Income Tax Act (Cap. 134).

The MAS Circular also states that certain anti-avoidance measures would apply under the New Regime, as follows:

- (a) a qualifying fund under the New Regime will exclude a fund where the assets held under the fund have been transferred to the fund from any business carried on in Singapore in relation to any investments by any person and income derived by that person from that business in Singapore was not or would not be (as the case may be) exempt from tax, unless such assets have been so transferred by way of a sale on market terms and conditions; and
- (b) the New Regime will not apply to funds set up with the sole purpose of abusing the tax incentives under the New Regime.

* The fund manager for this purpose means a company that holds a capital markets services licence under the Securities and Futures Act (Cap. 289) for fund management or that is exempted under that Act from holding such a licence.

** For this purpose, a "designated person" means (1) the Government of Singapore Investment Corporation Pte. Ltd., (2) any statutory board in Singapore or (3) any approved company which is wholly owned, directly or indirectly, by the Minister for Finance of Singapore in his capacity as a body corporate established under the Minister for Finance (Incorporation) Act (Cap. 183).

*** This second limb does not apply where the investor is an independent listed entity and does not have a 25% or more shareholding interest in any other investor in the qualifying fund.

**** For this purpose, the fund manager must trace and identify the beneficial owner if such investor invests in the qualifying fund through a nominee entity.

Should you have any further queries as to how this may affect your business, please do not hesitate to get in touch with your usual contact at Allen & Gledhill LLP or any of the following:

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