SINGAPORE BRIEFING

Private Client Tax Update for Year 2025

December 2024

With the year drawing to a close, it is a good time to take stock as well as to plan ahead. There are some Singapore tax changes that will take effect from year 2025.

We highlight the following changes coming into effect from 1 January 2025 that could impact Private Clients in particular:

1. Transfer Pricing Requirements – *domestic related party loans now need to be at arm's length.*
2. Economic Criteria for Section 13O & 13U funds – *some changes impact current incentive holders*
3. Extension of tax incentives for Trusts structures – *extended until 31 December 2027*
4. Certificate of Residence ("COR") application for a foreign-owned investment holding company – *increased requirements*

1. Transfer Pricing Requirements

What has changed?

The Inland Revenue Authority of Singapore (the "IRAS") updated the Transfer Pricing Guidelines on 14 June 2024. The full guide is available here.

In particular, Private Clients should note the change concerning domestic related party loans.

At present the IRAS allows, as a concession, interest expense restriction as a proxy for domestic related party loans (i.e. from one Singapore entity to another Singapore entity). This effectively restricts the tax deduction available to the lender that is attributable to the amount of interest-free domestic loans granted to related parties.

Following a policy review, this concession will no longer apply on related party domestic loans granted from **1 January 2025** onwards. Loans granted before 1 January 2025 will not be impacted, however, such loans may be seen as a "new loan" if it is refinanced after 1 January 2025.

Going forward, Singapore entities who are not in the business of borrowing or lending can choose to:

- Apply the IRAS indicative margin (updated annually) for domestic loans; or
- Apply an arm's length rate of interest.

With the change, it is important to note that granting of interest-free loans may result in adverse tax implications as it can be challenging to argue that interest-free loans are at arm's length. Penalties and surcharges may be imposed by the IRAS on non-arm's length transactions.

What is the impact?

It is very common for Private Client structures to have related party loans – either via Trust and/or corporate vehicles. A common example is having a Trust (funded by a settlor) lend to a wholly owned subsidiary to fund the acquisition of assets or investments.

For such funding, loans are generally preferred over equity as there is greater flexibility should a return of funds be required. More often than not, such loans are interest-free and do not have a stipulated date of repayment. As such, these loans tend to have more features of equity (akin to an injection of shareholder funds) than a loan (debtor-creditor relationship).

From 1 January 2025, the distinction between loans and equity becomes important. The former (being a loan) requires an arm's length rate of interest to be charged while the latter (being equity) does not.

What should Private Clients do?

The first is to review if the borrower and lender are considered to be related – i.e. does one have control over the other or are both controlled by a common person. This may be a complicated exercise depending on the complexity of the structure and if there is a Trust within the structure - the terms of the Trust deed could influence the outcome.

Next, having a properly crafted agreement between related parties is important. The contractual terms in the agreement should be carefully reviewed to demonstrate the intention – if the funding is intended to be debt or equity? If the intention of funding is to provide quasi-capital; the terms should be clearly worded to that effect. Ambiguity of terms in the loan agreement or not having any agreement drawn up is clearly disadvantageous. The documentation should be maintained to support the intent of funding and may be called upon by IRAS when requested.

2. Funds relying on Section 13D, 13O & 13U tax incentives

What has changed?

On 1 October 2024, the Monetary Authority of Singapore ("MAS") issued updated requirements in respect of tax incentives for funds managed in Singapore. We have prepared a detailed write-up here. Economic criteria for existing funds managed by a Single-Family Office ("SFO") remains unchanged, however they may be impacted by the change in AUM calculation.

Important changes include:

- Assets under management ("AUM") is currently computed as the net asset of the fund (total assets minus total liabilities). From 1 January 2025, AUM will be defined as the total value of designated investments for all 13O and 13U Funds.

- Economic criteria for existing & new funds managed by non-SFOs have increased:

  - A Section 13O fund will require an AUM of SGD5 million and be managed by a fund manager with 2 investment professionals.

  - Local business spending requirement for both Section 13O and 13U fund will now be tiered with a minimum of S$200,000.

  - Section 13D fund needs to be managed by a fund manager with at least 1 investment professional by the financial year ending 2027.

- A Singapore company that had already made investments may now apply for Section 13O tax incentive.

What is the impact?

The AUM of a fund which utilizes shareholder loans or leverage as a source of funding will likely see an increase in AUM following the change in the way AUM is calculated.

SFO managed funds that received incentive approvals after 18 April 2022 have business spending requirements that are tied to the AUM. An increase in AUM could mean that higher spending may be required in order to enjoy the tax-exemption. Private Clients in such situations should ascertain the impact of the increase in AUM on spending requirements.

What should Private Clients do?

As investment values fluctuate, the monitoring of AUM and local businesses spending (now tiered) is important so as to ensure that such requirements are met. The key values of AUM for non-SFO managed funds to keep a lookout are S$250 million and S$2 billion – since the tiered local business spending requirements increases when the AUM exceeds these values.

3. Extension of tax incentives for Trusts

The existing tax incentives – Qualifying Foreign Trust ("QFT") and Prescribed Locally Administered Trust ("LAT") have been extended to 31 December 2027.

The scope of tax exemption for LAT has been expanded – all foreign-sourced income received by the LAT, and its wholly owned subsidiary, in Singapore is now tax-exempted (unless income was derived through a partnership in Singapore).

It is important to note that these schemes may not be extended indefinitely. However, once a Trust structure is in place on or before 31 December 2027, it will continue to enjoy the tax incentive even if the tax incentive is not subsequently renewed so long as the stipulated conditions continue to be met annually.

4. COR application for a foreign-owned investment holding company

An investment holding company (i.e. does not carry on any business activities) where 50% or more of its shares are beneficially held by foreign companies or individuals often face difficulties when applying for a COR. The level of difficulty will be further increased from 2025.

A COR is a certification issued by the IRAS confirming that the taxpayer is considered to be a Singapore tax resident for a particular tax year. This allows the taxpayer to enjoy benefits accorded under tax treaties signed between Singapore and its treaty partners – typically used to enjoy reduced withholding tax on foreign income and to avoid double taxation.

Prior to 1 January 2025, the foreign-owned investment holding company needs to demonstrate that strategic business decisions are made in Singapore. In practice this means holding board meetings in Singapore. Going forward the company must also have:

- At least 1 executive director based in Singapore;
- At least 1 key employee (C-suite level) based in Singapore or
- Is managed by a related company in Singapore.

With these changes, a foreign-owned investment holding company that is part of a wider group but has no other operations in Singapore will unlikely be able to obtain a COR.

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