SCTP Singapore Chartered TAX PROFESSIONALS

Figuring Out FSIE in Singapore and HK

Foreign-Sourced Income Exemption In Singapore And Hong Kong

Comparing The FSIE Regimes Amid Recent Changes

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Facilitated by:
Accredited Tax Advisor (Income Tax) Mr Loh Eng Kiat and Mr Chung Yiu Hong

KEY TAKEAWAYS

- Singapore may introduce a "economic substance" concept through the proposed Section 10L to impose tax on gains from the sale of foreign assets received in Singapore.
- Singapore's FSIE regime covers foreign-sourced dividend, branch profits and service income, while Hong Kong's FSIE regime covers dividend, interest, disposal gains on equity interests and IP income.

While Singapore and Hong Kong's tax regimes are both attractive to investors, there are fundamental differences between the two regimes, such as how foreign-sourced income is treated for tax purposes. Unlike Singapore which generally imposes income tax on all foreign-sourced income received in Singapore unless specifically exempt, Hong Kong has historically adopted a territorial basis of taxation where offshore profits are generally not subject to tax.

This changed following a review in 2021, when Hong Kong was placed in the European Union's (EU) "watchlist" of non-cooperative jurisdictions for tax purposes. Hong Kong has since implemented its foreign-sourced income exemption (FSIE) regime on 1 January 2023, but the buzz continued as a new consultation paper was issued shortly after, on proposed refinement to expand the scope of disposal gain.

Diving into and dissecting all that was happening in Hong Kong, comparing the new FSIE regime in Hong Kong with Singapore's very own, and analysing what all these mean for businesses were what Accredited Tax Advisor (Income Tax) Loh Eng Kiat, Tax Partner and Sports Business Tax Leader, Deloitte Singapore, and Chung Yiu Hong, Tax Director, Deloitte China, did at a recent Singapore Chartered Tax Professionals webinar.

Background

Singapore

Under Singapore's FSIE regime, specified classes of foreign-sourced income (including dividend, branch profits and service income) received in Singapore by a Singapore tax resident company can be exempt from tax if certain conditions are met.

Late in 2022, the European Union (EU)'s Code of Conduct Group issued updated guidance on FSIE to require all types of passive income (including capital gains) to be subject to the economic substance requirement as a prerequisite for non-taxation. To align Singapore's tax regime with EU's guidance, the Ministry of Finance has proposed to introduce a new Section 10L into the Income Tax Act 1947 (ITA) to impose tax on gains from the sale of foreign assets that are received in Singapore by businesses without economic substance in Singapore.

If passed, the legislative effect would take place on or after 1 January 2024.

"Introducing an economic substance concept into the ITA for Section 10L purposes may bring about uncertainty to taxpayers since "substance" may be in the eye of the beholder. It would be interesting to see if the Inland Revenue Authority of Singapore (IRAS) proactively embraces "economic substance" advance rulings for taxpayers keen to seek certainty for future transactions, like their counterparts in Hong Kong," said Mr Loh.

Hong Kong

Unlike Singapore, offshore profits are generally not subject to tax under Hong Kong's territorial basis of taxation.

In October 2021, the EU added Hong Kong to its watchlist of non-cooperative jurisdictions for tax purposes following its period review of FSIE regimes.

In its effort to be taken off EU's watchlist, Hong Kong introduced its FSIE regime on 1 January 2023. Despite its efforts, Hong Kong has remained on EU's watchlist. Further amendments to the FSIE regime, in particular, to expand the scope of disposal gain, are expected to address the specific issues raised by the EU.

An Analysis of the Two FSIE Regimes

SCOPE OF FSIE REGIME

Singapore

Singapore tax resident companies may enjoy tax exemption on foreign-sourced dividend, branch profits and service income under Section 13(8) of the ITA, subject to Section 13(9) conditions (such as whether the foreign income has been subject to tax, the foreign headline tax rate concerned is more than 15%, and if the tax exemption is beneficial to the Singapore tax resident).

Certain foreign-sourced income which do not meet the conditions for tax exemption under Section 13(8) of the ITA may be granted tax exemption under Section 13(12) of the ITA under specified scenarios, subject to conditions.

Hong Kong

One unique aspect of Hong Kong's new FSIE regime is that it only applies to multinational enterprise (MNEs) entities.

Under Hong Kong's regime, certain foreign-sourced income (including dividend, interest, disposal gains on equity interests, and intellectual property (IP) income) accrued to an MNE entity carrying on a trade, profession or business in Hong Kong, will be deemed to be sourced from Hong Kong and chargeable to profits tax when it is received in Hong Kong.

These specified foreign-sourced income, however, will continue to be exempt from profits tax if the economic substance requirement, participation requirement or nexus requirement (as the case may be) is satisfied in the year of assessment in which the income accrues to the MNE entity. If the MNE entity fails all exceptions, the foreign-sourced income will be subject to profits tax in the year of assessment in which such income is received by the MNE entity in Hong Kong.

Exceptions from the Deeming Provision in Hong Kong

(a) Economic substance requirement (for interest, dividend and disposal gain)

Foreign-sourced interest, dividend or disposal gain received in Hong Kong by an MNE entity would be exempted from profits tax if the economic substance requirement is met for the year of assessment in which the income accrues.

There are no minimum thresholds to determine whether the adequacy tests are satisfied for the purpose of the economic substance requirement. Instead, several relevant factors, such as the adequacy of qualified employees in Hong Kong and the adequacy of operating expenditures in Hong Kong in relation to the specified economic activities, are taken into account to ascertain whether the economic substance requirement is met.

(b) Participation requirement (for dividend and disposal gain)

The participation requirement provides an alternative pathway for an MNE entity which receives foreign-sourced dividend or disposal gain in Hong Kong to claim tax exemption.

An MNE entity may qualify for participation exemption if it has continuously held not less than 5% of equity interests in the investee entity for a period of not less than 12 months immediately before the foreign-sourced dividend or disposal gain accrues subject to specific anti-abuse rules.

(c) Nexus requirement (for IP income)

A nexus requirement is in place to determine the extent of foreign-sourced IP income to be exempt from profits tax. Essentially, only income from a qualifying IP asset can qualify for preferential tax treatment. This is based on a nexus ratio which is the qualifying expenditures as a proportion of the overall expenditures that have been incurred by a taxpayer to develop an IP asset.

Double Taxation Relief

Hong Kong

Hong Kong resident persons who fail to meet the exemptions conditions but has paid taxes in a foreign jurisdiction in respect of the specified foreign-sourced income may obtain double taxation relief through a tax credit mechanism. The amount of tax credit is capped at the lower of foreign tax paid and the profits tax that would have been payable on the same income.

In the case of foreign-sourced dividend, tax credits may be allowed in respect of not only the foreign tax paid on the dividend but also the foreign tax paid on the investee entity's underlying profits out of which the dividend is paid, provided that the MNE entity has held at least 10% equity interests in the investee entity when the dividend is distributed.

Singapore

Similar to Hong Kong, corporate resident taxpayers in Singapore who are taxed on the same foreign-sourced income in foreign countries may have flexibility to claim tax credits locally in lieu of Singapore's FSIE regime to relieve themselves from double taxation.

KEEPING FOREIGN-SOURCED INCOME "OFFSHORE"

While the concept of keeping foreign-sourced income "offshore" is not necessarily new to some Singapore companies, it is something that Hong Kong companies did not have to think about previously, given Hong Kong's territorial basis of taxation.

Following the introduction of the FSIE regime in Hong Kong, certain foreign-sourced income would now be deemed to be sourced from Hong Kong and chargeable to profits tax when it is "received in Hong Kong". It is therefore timely for MNE entities operating in Hong Kong to evaluate whether they are affected by the new FSIE rules and if so, consider the necessary adjustments to be made in relation to their foreign-sourced income. Some relevant questions to ask include:

- Whether there is a need for the MNE entity to set up a dedicated overseas bank account to receive foreign-sourced income to avoid being "received in Hong Kong";
- Whether the MNE entity's existing systems and processes are adequate in tracking its foreign-sourced income for compliance purposes;
- How the MNE entity may redeploy its foreign-sourced income in the longer term without such income being regarded as "received in Hong Kong".

FOREIGN TAX CREDIT POOLING

Singapore tax residents may in some situations elect for the foreign tax credit pooling system when claiming foreign tax credit on income for which they paid foreign tax, giving them more flexibility and reducing their Singapore tax payable on remitted foreign-sourced income. There is currently no equivalent foreign tax credit pooling concept in Hong Kong.

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Facilitators

Mr Loh Eng Kiat
Tax Partner & Sports Business Tax Leader
Deloitte Singapore
Accredited Tax Advisor (Income Tax)

Email: ekloh@deloitte.com

Mr Chung Yiu Hong
Tax Director, International Tax Services
Deloitte Hong Kong

Email: yhchung@deloitte.com.hk

This technical event commentary is written by SCTP's Tax Head, Accredited Tax Advisor (Income Tax) Felix Wong and Tax Manager, Joseph Tan. For more insights, please visit https://sctp.org.sg/Tax-Articles.

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