SVCA Singapore Venture Capital & Private Equity Association

#07-02A Far East Finance Building* 14 Robinson Road* Singapore 048545* Tel: (65) 6224 7001* Fax: (65) 6224 6772* UEN No. S92SS0118E

ENHANCEMENTS TO THE ENHANCED-TIER FUND TAX INCENTIVE SCHEME

A. Introduction

1 The Enhanced Tier Fund Tax Incentive scheme, or the section 13X scheme, was first introduced in the 2009 Budget in order to provide Singapore-based fund managers with a greater flexibility in the sourcing of mandates. Prior to the introduction of the section 13X scheme, tax exemption at the fund level was only granted if the fund complied with the so-called "30-50" rule (which imposes a restriction on the amount of investments that could be made by Singapore investors). But with the introduction of the 13X Fund, this restriction was relaxed. The section 13X scheme was also introduced to accommodate fund structures with limited partnerships, such that the requirements for tax exemption would not be too onerous for them to comply with. Since then, the section 13X scheme has been further improved at least twice. For instance, to accommodate the fund structures common to private equity and hedge fund structures, the scheme was expanded to include Master-Feeder fund structures. To accommodate real estate, infrastructure funds and private equity funds, the minimum fund size requirement was also amended to include the concept of committed capital.

2 The introduction of the section 13X scheme and its subsequent enhancements is a good example of the Singapore Government's commitment to the fund management industry, and its willingness to accept and implement changes that are useful for the growth of the industry. The success of the section 13X scheme is a testament to what can be achieved when both industry and government work together.

3 In the spirit of working together with the Singapore Government to further grow the fund management industry in Singapore, the Committee has drawn up a list of recommendations to improve the section 13X scheme, which we have set forth below in this paper.

RECOMMENDATIONS

A. <u>Amendments to the criteria for SPVs in master-feeder-SPV structures under section 13X</u>

Changing the economic conditions for SPV

4 Under the present scheme, the fund structure can submit a consolidated tax incentive application and meet the sum of the economic commitments expected from each fund entity collectively. The enhanced scheme is extended to both master-feeder-SPV and master-SPV fund structures.

5 Most fund managers structure their portfolio holdings under one or more SPVs. This, among other things, facilitates ring-fencing of liabilities and potentially eases exit processes (allowing for sale of the SPV rather than sale of the portfolio company directly). Requiring each SPV to separately meet the financial tests makes it that much more challenging for small managers. As long as the main fund and manager meet the 13X thresholds, there seems no reason to impose additional requirements on purely structural SPVs.

Changing the requirement for the SPVs to be a company

6 While most SPVs are companies, there are managers who use limited partnerships (or other types of entities) below the main fund. There are a variety of drivers for this, including documentation, ease of governance and US tax issues. It is not clear what the policy imperative is for requiring SPVs to be companies, but it certainly ties a manager's hands in terms of structuring flexibility. To facilitate structuring flexibility, it would be good if this requirement is relaxed or broadened.

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Changing the requirement for the Master Fund in Master-SPV structure to be Singapore incorporated/constituted/registered entity and regarded as Singapore tax resident.

7 Promoting the use of Singapore vehicles/tax residents is understandable, but the fact is the global funds industry has adopted (and is very much use to) off-shore structures. Requiring the use of a Singapore vehicle to qualify for the SPV exemption makes the SPV exemption largely unusable by most managers with international investors. There may come a time when the use of Singapore vehicles is more common (in particular with the availability of the SVACC), but we are not there yet. As such, to deepen the expertise of the fund management industry in Singapore, and facilitate its development, this requirement should be relaxed.

Changing the requirement for the SPV to be wholly-owned by the Master Fund

8 Many managers bring co-investors into portfolio investments. In fact, many investors are now demanding access to co-investment as a condition to their making an investment in the main fund. Such co-investment is almost always structured through one or more SPVs below the fund. As such, the requirement for an SPV to be wholly owned by the fund means some of the funds SPVs could qualify for 13X, while any co-invested SPV would not. As long as the fund maintains a meaningful stake and controlling stake on the overall portfolio investment, there does not seem to be any reason for the requirement that an SPV be wholly owned.

Allowing for an increase in the number of SPVs that may be included as part of the 13X fund

9 Limiting the number of tiers of SPVs that can qualify for 13X to two also seems unnecessarily restrictive. It is not uncommon for a portfolio holding structure to have more than two tiers of SPVs. For example there might be an SPV directly above the portfolio company that takes on the debt in a leveraged deal. This SPV might be owned by another SPV where the co-investors come in, and that SPV might then be partially owned by another SPV that is 100% owned by the fund itself.

B. <u>Reviewing the economic commitments for 13X</u>

10 Under the present 13X scheme, the fund must employ at least a minimum of 3 investment professionals. Such investment professionals refer to portfolio managers, research analysts, and traders who are earning more than $3,500 per month and must be engaging substantially in the qualifying activity. Further, the fund must have a minimum fund size of S$50 million. Further, the fund must incur at least S$200,000 in local business spending (such as, but not limited to, expenses paid for remuneration, management fees and other operating costs) in each basis period relating to any year of assessment. Such economic commitments are unrealistic for most first-time funds, and in particular, venture capital funds. Thresholds of $10m and 2 investment professionals and $200,000 of spending (not restricted to local business spending) would still ensure that the fund manager was "real" (and making a genuine contribution to the fund ecosystem). In particular, with respect to the requirement for local business spending of $200,000, it remains unclear to the industry why the spending for section 13X funds is limited to Singapore expenses, unlike the conditions for section 13R funds. If the intention is for both funds to have "substance" in Singapore, it is not necessary to confine the spending threshold to Singapore expenses. We would thus urge the MAS to review this condition as well.

C. <u>Helping the section 13X fund when it fails to meet its conditions</u>

11 At present, under the section 13X scheme, if the fund fails to satisfy the specified conditions for any basis period, the fund will not enjoy the tax exemption on specified income derived from designated investments for that basis period concerned. The fund cannot rely on the lower threshold schemes like section 13CA or section 13R either, to continue with the tax exemption. Instead the fund will "lose" the tax exemption until it is able to satisfy the conditions again; in which case the fund can enjoy the tax exemption in any subsequent period during the life of the fund, if it is able to satisfy the specified conditions in that subsequent period. It is recommended that this limitation be removed.

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12 Separately, if a fund transits into Section 13X status in mid-year, it can be impractical to meet the $200,000 of Singapore business spending. It is hereby recommended to allow a 1 year grace period (from date of application) for funds to meet the economic conditions under section 13X. Alternatively, if this is not possible, we understand that the current practice of the MAS may be to allow for pro-rating of the economic commitments in the first year on a case-by-case basis. However, to provide upfront certainty, we would recommend that such pro-rating mechanism should be hardcoded into the Section 13X award

Conclusion

13 When section 13X was first introduced in 2009, it was recognized as an "enhanced" scheme because it appeared to be more liberal than the other fund management schemes in the market. As such, in "exchange" for such requirements, the policy thinking may have been to impose more stringent conditions. While this was a valid consideration at that point in time, we would urge the Singapore Government to recognize that times have changed. Many jurisdictions (besides HK) are stepping up their game and offering attractive arrangements for fund managers be stationed there. As such, to remain as a competitive and relevant scheme, the section 13X scheme must be changed. We should not regard the changes as "enhancements" *per se* (which would suggest an element of choice), but simply, necessary for Singapore to stay ahead of the game.