

IRAS CIRCULAR

INCOME TAX TREATMENT OF TRUSTS



**INLAND REVENUE
AUTHORITY
OF SINGAPORE**

Published by
Inland Revenue Authority of Singapore

Published on 30 November 2006

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INTRODUCTION

Several new provisions relating to trusts have been included in the Income Tax (Amendment) Bill 2006¹ that is currently pending approval by Parliament. This Circular explains the significance of the pending changes and summarises the income tax treatment of trusts as provided in the pending legislation.

2 Currently, the Singapore Income Tax Act (“ITA”) has specific provisions that deal with the tax treatment of the following types of trusts:

- (a) Real Estate Investment Trusts (“REITs”)
- (b) Designated Unit Trusts and CPF Approved Unit Trusts;
- (c) Approved Unit Trusts²
- (d) Trust Funds (Foreign Investors)³
- (e) Foreign Trusts⁴
- (f) Philanthropic Purpose Trusts⁵
- (g) Prescribed Locally administered Trusts⁶
- (h) Registered Business Trusts⁷

The tax treatment of these types of trusts will continue to be governed by the existing provisions in the ITA and is unaffected by the pending legislation.

CURRENT TAX TREATMENT

3 At present, Section 35(11) of the ITA provides that the income of a trust is the statutory income of the trustee and is chargeable to tax on the trustee.

4 Where a beneficiary is entitled to the trust income or a share of it, the beneficiary may be taxed on the entitlement, and allowed a credit for tax already imposed at the trustee level⁸. The Comptroller may also agree not to charge the trustee with any tax on the trust income to which the beneficiary is entitled, and subject the beneficiary to tax on the distribution received (also known as the “tax transparent treatment”).

5 Questions have been raised concerning the tax treatment to be accorded to trust income under different circumstances. In this regard, there were requests for greater certainty on the tax treatment under each circumstance. There were also requests to consider extending concessions and exemptions currently available to

¹ Presented in Parliament for First Reading on 8 November 2006.

² Section 10B of ITA.

³ Section 13C of ITA.

⁴ Section 13G of ITA.

⁵ Section 13O of ITA.

⁶ Section 13Q of ITA (introduced in Income Tax (Amendment) Bill 2006).

⁷ Section 36B of ITA. For tax purposes, registered business trusts are treated like companies.

⁸ Section 46(1)(b) of ITA (before the changes made in the Income Tax (Amendment) Bill 2006).

various income types derived directly by taxpayers to trust distributions received by beneficiaries where the distributions are made out of the same income types.

6 At the same time, since trusts are increasingly being employed as vehicles to carry on trade or business, it is necessary from a policy viewpoint, to harmonise the tax treatment of trusts used for such purposes with that of a company.

CHANGES TO TAX TREATMENT OF TRUSTS

7 Three main changes to the tax treatment of trusts are introduced in the Income Tax (Amendment) Bill 2006 with the aim to achieve the outcomes reflected in paragraphs 5 and 6 above.

8 Before the proposed changes, distributions received by beneficiaries of a trust would be treated as not being of the same nature as the underlying trust income. Hence, any concessions, exemptions and foreign tax credits that would have been applicable to the underlying income would not be available to the distributions received by the beneficiaries. The first change (i.e. the proposed new Sections 13T, 43X and 50B) will now enable beneficiaries, who are residents of Singapore and entitled to the trust income, to be accorded the concessions, exemptions and foreign tax credits as if the beneficiaries had received the trust income directly.

9 With these new sections, the distributions received by such beneficiaries will be deemed to have retained the nature of the underlying trust income for the purpose of claiming the concessions, exemptions and foreign tax credits by the beneficiaries. At the same time, for these beneficiaries (i.e. residents of Singapore who are entitled to the trust income), the Comptroller will also accord the tax transparency treatment under Section 43(2). No tax will be imposed at the trustee level and the beneficiaries are subject to tax on the distributions received. The treatment set out in this paragraph and paragraph 8 above shall not apply to income derived from a trade or business carried on by the trustee which is dealt with in paragraph 11 below.

10 It is important at this point to highlight that whether or not a beneficiary is entitled to the trust income is a question of fact. One would have to examine the trust deed to determine if the beneficiaries of the trust are indeed entitled to the trust income. However, where the trust income is distributed to the beneficiaries within the same year in which the trust income is derived, the Comptroller will treat the beneficiaries as being entitled to income distributed.

11 The second change (i.e. the proposed new Sections 43(2A)(b) and 35(16)(b)) ensures that the income from a trade or business carried on by the trustees will be subject to a final tax at the trustee level. Distributions made out of such income are in the nature of capital and will not be subject to any further tax in the hands of the beneficiaries. The same treatment applies to trust income to which the beneficiaries are not entitled and trust income to which non-resident beneficiaries are entitled.

12 With the bringing in of the two changes set out in the preceding paragraphs, there will be no case where a beneficiary will be subject to tax on any distribution from a trust which has also been subject to tax at the trustee level. In this regard, Section 46(1)(b) which is to provide for beneficiaries to claim a credit of the tax imposed at the trustee level where the beneficiaries are taxable on the distribution has become redundant. Section 46(1)(b) of the principal Act has therefore been amended. This is the third salient change to the tax treatment of trusts included in the Income Tax (Amendment) Bill 2006.

13 Where the trust income is subject to a final tax at the trustee level (i.e. scenarios in paragraph 11), the trustee is regarded as a body of persons for tax purposes notwithstanding that the trustee may have legal personality in its own right i.e. it is a company or an individual etc.

14 The changes concerning the tax treatment of trusts included in the Income Tax (Amendment) Bill 2006 take effect from Year of Assessment 2008. A table summarising the tax treatment of trusts pursuant to these changes is attached at Annex A.

ENQUIRIES

15 For general enquiries or clarifications on this Circular, please call 1800-3568622.

Inland Revenue Authority of Singapore

ANNEX A

Trustee derives trade or business income	Trustee derives income other than trade or business income		
	Beneficiaries are entitled to trust income		Beneficiaries are not entitled to trust income
	Resident Beneficiaries	Non Resident Beneficiaries	
<p>No tax transparency is possible [Sections 43(2A)(b) and 35(16)(b)].</p> <p>Tax at trustee level is final [Section 35(11)].</p> <p>Trustee is to be treated as a body of persons for purposes of tax and claim for relief, concessions, and exemptions.</p> <p>Distributions received by beneficiaries are capital.</p>	<p>Tax transparency will be accorded. Hence, tax will not be applied at trustee level [Section 43(2)].</p> <p>Beneficiaries are entitled to trust income. Hence, distributions are deemed to have retained the nature of the underlying trust income for the purpose of claiming concessions, exemptions and foreign tax credits [Sections 13T, 43X and 50B].</p>	<p>Tax transparency will not be accorded.</p> <p>Tax at trustee level is final [Section 35(11)].</p> <p>Trustee is to be treated as a body of persons for purposes of tax and claim for relief, concessions, and exemptions.</p> <p>Distributions received by beneficiaries are capital.</p>	