

Variable Capital Company 101

1. WHAT IS THE VARIABLE CAPITAL COMPANY? WHAT KIND OF FUNDS CAN IT BE USED FOR?

The variable capital company ("VCC") is a new corporate structure for all types of collective investment schemes ("CIS") in Singapore. Each VCC may comprise of one or more CIS, which can be open-ended or closed-ended funds. The VCC will be regulated under the Variable Capital Companies Act 2018 ("VCCA"), which has not come into force as at August 2019, as well as various proposed items of subsidiary legislation that have not been passed. However, it is expected that the VCC framework will be operational in Q4 2019. The introduction of the VCC is intended to further enhance Singapore's appeal as an international fund management centre.

The VCC can be used for all types of investment funds, including mutual funds, hedge funds, private equity and real estate funds. The VCC also be used to re-domicile foreign corporate entities set up as funds, provided the relevant conditions are satisfied. The VCCA does not contemplate the conversion of existing Singapore fund vehicles such as a unit trust or company to a VCC nor is there any concept of amalgamation into a VCC.

2. HOW CAN I USE A VCC TO SET UP AN INVESTMENT FUND?

The VCC can be structured either as a single standalone fund, or as an umbrella fund with two or more sub-funds. Each sub-fund can hold different assets. To incorporate an umbrella VCC, the umbrella VCC can first be incorporated, and any sub-funds that are subsequently set up must then be registered within 7 days of forming the sub-fund.

3. WHAT ARE THE KEY BENEFITS OF USING THE VCC STRUCTURE OVER OTHER EXISTING STRUCTURES IN SINGAPORE?

While the existing CIS structures (i.e. unit trusts, companies incorporated under the Companies Act, limited partnerships) will continue to be available in Singapore, there are benefits to choosing the VCC over the existing structures when setting up a fund.

First, a fund using the VCC structure will enjoy flexibility in the distribution and return of its capital, as the VCC will be permitted to freely redeem shares and pay dividends using its net assets/capital. Property of the VCC must be measured on a fair value basis so the net asset value of a VCC should be reflective of its fair market value. The VCCA provides that the value of the paid-up capital of a VCC is at all times deemed to be equal to the net asset value of the VCC and the

shares of the VCC can be issued, redeemed or repurchased at a price equal to the proportion of the net asset value of the VCC represented by each share at the relevant time. This price may be adjusted by adding or subtracting (as the case may be) fees and charges in accordance with the constitution of the VCC. The VCCA further provides that where the VCC has redeemed or repurchased its own shares (which must be fully paid), these shares are to be cancelled and the amount of the issued share capital must be reduced by the amount of consideration paid.

In contrast, under the Companies Act, a company may generally only repurchase 20% of its shares during any period up to the next annual general meeting unless it follows a capital reduction procedure, which requires a solvency statement to be made by all the directors, as well as a creditor objection period of 6 weeks to lapse before a capital reduction can be effected. A solvency statement by the directors is also required for the redemption of redeemable preference shares ("RPS") and one has to be careful about RPS being treated as debt for accounting purposes. The Companies Act also stipulates that dividends may only be paid out of the profits of a company. These provisions hinder the normal operations of a CIS, which require flexibility to redeem shares out of capital when investors exercise their redemption rights.

Second, the VCCA also mitigates the risk that the creditors of a poorly performing or insolvent sub-fund will reach into the assets of other sub-funds within the same umbrella fund, as the VCCA provides for the segregation of the assets and liabilities of each sub-fund of a VCC. Under the VCCA, each sub-fund's assets and liabilities may only be allocated to and used to discharge the liabilities of that particular sub-fund, and cannot be used to discharge any liability of the umbrella VCC or any other sub-fund of the VCC. However, it should be noted that there are potential conflict of laws questions which may arise if a judgment is awarded in a foreign court against a VCC in respect of liabilities of a sub-fund and that foreign court enables recovery in bankruptcy against assets of another sub-fund of the same VCC.

A third key benefit is that the umbrella VCC structure is more cost efficient compared to standalone funds, since administrative functions within an umbrella VCC can be consolidated. Further, as a VCC can have a single shareholder or hold a single asset, it also has the flexibility of being used as part of a Master-Feeder structure.

4. WHAT DO I NEED TO INCORPORATE A VCC?

To incorporate a VCC, the proposed shareholders

must submit the constitution of the proposed VCC, the name of the manager and the directors, the last day of the first financial year of the proposed VCC, payment of the prescribed fee as well as such other information and documents as may be prescribed.

Directors: A VCC must have at least one Singapore resident director for non-authorised schemes and at least three directors for authorised schemes. At least one director must be a director of the fund manager or a qualified representative of the fund manager. All directors must also be "fit and proper persons".

On 30 April 2019, MAS released a consultation paper relating to the proposed framework for VCCs and the proposed amendments to the Code on Collective Investment Schemes ("**CIS Code**") and the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005 ("**SFR(CIS)**"). One proposed amendment to the CIS Code requires at least one director of authorised schemes that are constituted as VCCs to be independent of any business relationships involving the VCC, the fund manager of the VCC and its related corporations, the custodian of the VCC, as well as the substantial shareholders in the VCC.

Manager: A VCC will need to appoint an investment manager or adviser that is registered, licensed or exempted by the MAS to manage the assets of the VCC. Single family offices, immovable assets managers and related corporations are excluded from the class of permissible exempt fund managers. The MAS specifically note that they may expand the list of permissible exempt fund managers in the future.

Custodian: A custodian may or may not need to be appointed depending on the type of fund that is being established. Pursuant to the consequential amendments to the Securities and Futures Act (Cap. 289) ("**SFA**") as set out in the VCCA, VCCs that are authorized schemes will need to appoint a custodian that is a trustee approved under section 289 of the SFA.

However, different requirements will apply to VCCs that are restricted schemes, or private equity or real estate funds. VCCs that are restricted schemes need only maintain their assets with prescribed entities, which include licensed or approved banks, custodians, finance companies or depository agents. Private equity and venture capital funds need not appoint a custodian, subject to certain conditions including disclosing to the investors and obtaining their acknowledgement that there are no custodial arrangements for their assets.

Audit and accounting requirements: The MAS has released a consultation paper on the proposed subsidiary legislation, the VCC (Prescribed Accounting Standards) Regulations 2019, which set out the accounting standards to be used by a

VCC to prepare its financial statements. A VCC must be subject to audit by an accounting entity approved under the Accountants Act. A VCC that is not an authorised scheme must present its financial statements in accordance with the Singapore Financial Reporting Standards (SFRS), the Singapore Financial Reporting Standards (International) (SFRS(I)), the International Financial Reporting Standard (IFRS) or the Generally Accepted Accounting Principles in the United States (US GAAP). A VCC which is an authorised scheme must prepare its financial statements using the Statement of Recommended Accounting Practice 7 (RAP 7). An umbrella VCC must use a single accounting standard across all sub-funds.

Other requirements: A VCC must have its registered office in Singapore and must appoint a Singapore-based company secretary. A VCC must have at least one shareholder.

A VCC has no minimum capital requirements and its capital is deemed to be equal to its net asset value.

5. WILL THE REGISTER OF A VCC BE MADE PUBLIC?

The register of shareholders of a VCC will not be required to be disclosed to the public but will have to be disclosed to the MAS, the Accounting and Corporate Regulatory Authority and other public authorities for regulatory, supervisory and law enforcement purposes.

6. CAN FUND MANAGERS DELEGATE THEIR DUTIES TO THIRD PARTIES?

MAS has clarified that the fund manager of a VCC can delegate fund management activity and operational duties to another party provided that (i) the other party is regulated as a fund manager in another jurisdiction, and (ii) the fund manager ultimately retains overall responsibility for the fund management duties and must mitigate any conflicts of interests that may arise.

7. WHAT ARE THE AML/CFT REQUIREMENTS APPLICABLE TO A VCC?

It is intended that VCCs will be subject to Anti-Money Laundering/Countering the Financing of Terrorism ("**AML/CFT**") requirements. On 30 April 2019, MAS released a Consultation Paper on the Proposed Notice on Prevention of Money Laundering and Countering the Financing of Terrorism for VCCs ("**AML/CFT Notice**").

The proposed AML/CFT Notice includes the requirement that VCCs shall engage an eligible financial institution (which is defined to include a regulated fund manager) to conduct the necessary checks and perform the measures in order to comply with the AML/CFT Notice. However, the VCC will remain ultimately responsible for compliance with AML/CFT requirements.

Paragraph 10 of the proposed AML/CFT Notice specifically requires the VCC to ensure that the eligible financial institution it engages will only rely on a third party to perform customer due diligence measures if that third party is an approved financial institution (and subject to other conditions).

8. WHAT ARE THE MEASURES TAKEN TO MITIGATE THE RISK OF CROSS-CELL CONTAGION?

One key measure addressing the risk of cross-cell contagion is that the VCCA expressly provides for the segregation of the assets and liabilities of sub-funds within an umbrella VCC. The VCCA further provides that (i) any provision inconsistent with such segregation of assets and liabilities of sub-funds is void to the extent of its inconsistency, and (ii) in documents referring to sub-funds and dealings on behalf of sub-funds, a VCC must disclose the sub-fund's name, registration number and the fact that the sub-fund has segregated assets and liabilities.

As stated above, MAS has released a consultation paper on the proposed amendments to the CIS Code and SFR(CIS). Some of the amendments relate to the mitigation of the risk of cross-cell contagion.

Pursuant to the proposed amendments to the CIS Code, an authorised VCC or an authorised sub-fund may invest in assets located in jurisdictions that do not have a cellular structure only after taking reasonable measures to mitigate cross-cell contagion risk. Examples of such measures can include ensuring that the agreements that each sub-fund enters into and which govern the sub-fund's overseas assets, are governed by the laws of jurisdictions that recognise cellular structures and uphold the segregation of assets and liabilities across sub-funds. This can help to mitigate the risk of the creditors of an insolvent sub-fund successfully recovering their debt from the assets of a solvent sub-fund in a jurisdiction which does not recognise cellular structures or which does not uphold the segregation of assets and liabilities within an umbrella VCC.

In addition, the proposed amendments to the SFR (CIS) require VCCs that are restricted schemes to disclose the risk of cross-cell contagion to shareholders of the VCC, and VCCs that are authorised schemes to describe and explain the risk of cross-cell contagion to shareholders of the VCC.

9. WHAT IS THE TAX TREATMENT OF A VCC? ARE THERE ANY TAX INCENTIVES FOR VCCS?

The proposed tax treatment of VCCs is addressed in the Variable Capital Companies (Miscellaneous Amendments) Bill, which was moved for First Reading in Parliament on 5 August 2019. In summary, the VCC (Miscellaneous Amendments) Bill will amend the Income Tax Act, the Goods and

Services Tax Act and the Stamp Duties Act to provide for the tax treatment of VCCs.

For income tax purposes, the VCC will be treated as a company and a single entity. For umbrella VCCs, tax residence will be determined at the umbrella fund level and a single corporate income tax return can be filed with the Inland Revenue Authority of Singapore for the entire umbrella fund structure including all its sub-funds. However, in terms of the computation of chargeable income for an umbrella VCC, the Bill contemplates that tax deductions and allowances will be applied at the sub-fund level, and the resulting chargeable income of each sub-fund will then form the total chargeable income of the umbrella VCC.

For goods and services tax ("GST") purposes, the umbrella VCC will perform GST registration, accounting and reporting on behalf of its sub-funds. However, each sub-fund is required to assess its GST registration liability based on the value of taxable supplies made. GST-registered sub-funds are also required to file separate GST returns. The collection and enforcement of GST will be conducted at the sub-fund level based on the GST returns filed by the respective GST-registered sub-funds.

Stamp duty treatment will be applied at the sub-fund level.

In terms of tax incentives, tax incentives will be applied at the umbrella fund level for umbrella VCCs (and not the sub-fund level). VCCs can enjoy the following tax incentives:

(a) Income from designated investments for eligible funds may be tax free if the VCC qualifies for the Enhanced Tier Fund Scheme or the Singapore Resident Fund Scheme. These schemes are provided for under sections 13X and 13R of the Income Tax Act, respectively, and can apply to a VCC in a similar manner as to a Singapore company.

(b) There are also tax incentives under the Partial Tax Exemption and Start-Up Tax Exemption pursuant to the Income Tax Act. Should the VCC satisfy the qualifying conditions, the VCC can enjoy the Start-Up Tax Exemption for the first three years of assessment from its date of incorporation.

(c) Singapore-resident VCCs can enjoy the benefit of and rely on the various tax treaties Singapore has concluded with other countries. The potential to combine in-country fund management with the pooling of investors into the VCC itself looks helpful in enabling access to treaty benefits. The commercial benefits associated with using a VCC potentially make this vehicle less susceptible to attack by a source country on the basis of the principal purpose test.

(d) GST remission will also be extended to eligible VCCs, which will be able to reclaim GST charged by Singapore registered suppliers such as fund managers and administrators at a fixed recovery rate set by MAS.

The application of the US check the box rules are a potentially important part of the implementation of a VCC having prospective US investors. The VCC will have the greatest level of flexibility, particularly as a consolidated feeder vehicle, if elections may be made in relation to individual sub-funds.

Fund managers will also enjoy tax incentives. The 10% concessionary tax rate under the Financial Sector Incentive – Fund Management Scheme will be extended to approved fund managers managing an incentivised VCC, subject to the qualifying conditions. An application needs to be made to the MAS for the grant of this award and the award of the concessionary tax rate is subject to MAS's discretion.

10. ARE THERE ANY OTHER UPCOMING CHANGES TO THE VCC FRAMEWORK?

There are other upcoming changes proposed to the VCC framework. On 24 July 2019, the MAS released a third Consultation Paper relating to the proposed framework for VCCs. This Consultation Paper focuses on the proposed subsidiary legislation relating to the insolvency and winding up of a VCC and its sub-funds. The MAS announced that the proposed subsidiary legislation will come into force together with the VCCA, but will ultimately be replaced by the subsidiary legislation to the Insolvency, Restructuring and Dissolution Act 2018 ("IRDA") once the IRDA is passed and comes into force.

On 5 August 2019, the Variable Capital Companies (Miscellaneous Amendments) Bill 2019 was moved for First Reading in Parliament. This Bill

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seeks to amend the VCCA's provisions on insolvency and winding up, as well as amend the Income Tax Act, the Goods and Services Tax Act and the Stamp Duties Act to address the tax treatment of VCCs. The Bill also includes other amendments such as clarifying that a VCC should have at least one member (to align with the minimum number of shareholders for companies under the Companies Act), requiring a directors' resolution for amendments to the constitution that do not require a members' resolution to be lodged with the Registrar for proper records, and correcting certain referencing errors, such as references to a branch office, or a VCC being registered as a member of itself.

If you wish to have further information on this update or wish to discuss how it may potentially have an impact on your business, please feel free to contact the following:



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