Technical Group Discussion

May The Source Be With You

26 August 2011, Friday

Accredited Tax Advisory (Income Tax) Mr David Sandison shared his insights on the deceptively simple word of 'source' with tax professionals.

In a lively discussion, Mr David Sandison, Accredited Tax Advisor (Income Tax) and Tax Partner at PricewaterhouseCoopers Services LLP, explained the different approaches tax authorities have taken in determining the source of profits and offered parting insights on where this issue may be heading.

Mr Sandison kicked off the session with an explanation of what the Hong Kong and Singapore legislations state with regards to this issue. While differing words such as 'arising in', 'accruing in' and 'derived from' may be used in the various legislative documents, it was deemed that there is no material difference in the meaning.

Participants were also given an overview of various case laws in Hong Kong and Singapore involving the source of profits and an analysis of the resulting conclusions. The below are some of the issues covered in the discussion.

Treatment of Business Activity

In Hong Kong, a business activity may be carried out in the country but it is not automatically deemed that the income is accrued in or derived from Hong Kong. Profits may, as such, be considered as foreign sourced.

In contrast, a business activity may be split according to whether it was carried out in Singapore or overseas. Apportionment is a recognised concept and income is subjected to tax to the extent where business is carried out in Singapore. In addition, where the business is carried out overseas, profits are subjected to taxes only when the profits are received in Singapore.

Difference in Approaches

Based on the Hong Kong case laws, Hong Kong seems to be taking an 'all or nothing' approach. A company could be carrying out its business in Hong Kong but profits are not considered as being sourced in Hong Kong if the transactions, in relation to its assets, are executed outside of Hong Kong.

This is different from what is done in practice in Singapore.

If income arises from outside of Hong Kong, the income, in its entirety, will not be taxed. The attribution of value is ignored. This is contrary to general tax treaty principles and transfer pricing concepts where business operations are divided and profits attributed and taxed accordingly. In countries like Singapore, the United Kingdom and Australian, apportionment of income is contemplated when determining the source.

It was also noted that in Singapore, the determination of whether business operations are carried out in Singapore is largely a question of fact and degree. If the bulk of activities are carried out largely in Singapore with elements carried out overseas, it is not sufficient to consider the profits as being sourced overseas.

In addition, the place of execution and completion of the transaction are taken into consideration in Hong Kong. The focus is on the completion of transaction rather than what led to it. In contrast, it can be inferred that the activity involved in negotiating or securing contracts may create a source in the Singapore context. This is even if the business is executed outside of Singapore. The key consideration is where the originating thought that gave rise to the business is. Execution and finality of the business transaction are not material.

Implications of Permanent Establishments Mr Sandison also explained that where a business sets up a permanent establishment in Singapore, the profits from the business are considered as Singapore-sourced, unless specific activities may be isolated that are attributable to operations carried out outside of Singapore.

Reliefs
The discussion also included key elements of Section 50A(1) which covers unilateral reliefs. One aspect was that management fees and technical service fees were regarded as Singapore sourced if services were performed here. These fees are still Singapore sourced if performed elsewhere which is an anomaly.

Conclusion
Overall, looking ahead, it was shared that the Inland Revenue Authority of Singapore had indicated that it generally will consider factors such as the nature of the taxpayer’s business, what it has done to earn the income and where such activities are performed to determine the source of an income.

Thus, while Hong Kong may be taking a very clean cut ‘all or nothing’ approach, Singapore’s approach seems to take into consideration apportionment, transfer pricing allocation rules and attributable value concepts amongst other factors.

In addition, the principles underlying tax treaties and transfer pricing could also be used and applied universally on other tax areas.

Overall, there could be further clarity from the authorities on this issue of source.

As the session came to a close, participants were appreciative of the enlightening presentation that was peppered with interesting discussion and analogies.

A big thanks to Mr David Sandison!