



TED: Making Sense of Withholding Tax

Understanding the Intricacies and Pitfalls

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Business models have evolved.

Competitive pressures have increased. Global contracting, restructuring of supply chains, centralisation of corporate functions and seeking out relevant expertise internationally have increased cross-border transactions. Inevitably, corporations are exposed to withholding tax (WHT) risks.

Understanding WHT

WHT is a collection mechanism by which the tax on certain types of income of a non-resident person that is sourced in Singapore (or deemed to be sourced in Singapore) and subject to tax in Singapore, is deducted at source at a certain rate by the payer and subsequently remitted to the Comptroller of Income Tax within a stipulated deadline.

To ensure WHT compliance, companies should systematically go through the following thought process when making a payment:

- 1) Is the payment made to a non-resident person? If no, WHT is not applicable.
- 2) If yes to question 1, is the payment (that is, the non-resident's income) subject to WHT? For this, the following need to be considered:
 - (a) Does the income of the non-resident recipient fall within the ambit of the WHT provisions of the ITA such as sections 45A to 45H and section 10N(9)?

Against this backdrop, Accredited Tax Advisor (Income Tax) Sivakumar Saravan, Head of Tax Services, Crowe Horwath Singapore, shared his insights on the intricacies and pitfalls of WHT from a Singapore payer's perspective at a recent *Tax Excellence Decoded* session organised by the Singapore Institute of Accredited Tax Professionals.

- (b) Is the income sourced or deemed to be sourced in Singapore? It is necessary to establish this because the WHT provisions such as section 45 are not charging sections and they merely impose a liability on the payer to deduct tax from income that are taxable under the Income Tax Act (ITA).
 - (c) Is the income exempt from tax by way of tax incentives or concessions under domestic law?
 - (d) Is the payer exempted from complying with the WHT provisions in respect of certain payments made to certain non-residents?
- 3) If the payment is subject to WHT, the next step is to establish the applicable WHT rate. To do this, companies need to consider:
 - (a) Whether there is an Avoidance of Double Taxation Agreement (DTA) between Singapore and the country in which the recipient of the income is resident. If so, is the rate under the DTA lower than the domestic rate, and can the conditions to avail the lower rate be met?

(b) If there is no DTA between the two countries or there is a DTA but the benefits under the DTA are not available, consider whether:

(i) the non-resident has a permanent establishment (PE) in Singapore under domestic law, since the reduced WHT rates under section 43 of the ITA do not apply if the income derived by the non-resident is effectively connected with a PE in Singapore;

(ii) any concessions are applicable such that the WHT can be applied on the net income of the non-resident so as to reduce the effective WHT rate.

4) In applying the WHT rate determined in step 3, the payer needs to establish if it is required to bear the WHT such that a gross up computation is required.

WHT Analysis

The nature and the source of income are two important considerations in determining a payer's WHT compliance obligations due to Singapore's territorial basis of taxation and the fact that only certain income of a non-resident, as specified in the WHT provisions (example, section 45A), are subject to WHT.

NATURE OF INCOME

Different types of income attract different WHT rates. Take, for example, the various types of income covered in section 12(7) – the WHT rates for royalty and know-how payment is 10%, for rental payment is 15% and for service payment (including management services) is 17% respectively. It is, therefore, important to distinguish the nature of each payment to ensure correct compliance.

Generally, a “substance over form” approach should be taken in determining the nature of income. This means the true character of the income, and not its nomenclature, should decide its nature. For example, if a non-resident supplier charges its Singapore customer a penalty for an overdue trade invoice but the payment is effectively an interest in substance, such payment should be treated as interest and be subject to WHT if the requirements under section 45/45A are met. This is notwithstanding its classification in the accounts of the payer as a penalty.

Sometimes, the legal form of an income may differ from its accounting classification. For example, a redeemable preference share could be equity based on its legal rights and obligations but treated as debt under accounting rules. As such, the distribution to the shareholder will be treated as interest (WHT may apply) for accounting purposes and dividends (no WHT) from a legal perspective. In such cases, generally, the legal form should take precedence¹.



Accredited Tax Advisor (Income Tax) Sivakumar Saravan, Head of Tax Services, Crowe Horwath Singapore, shed light on the intricacies and pitfalls of withholding tax.

¹ For details, refer to the IRAS e-Tax Guide on Income Tax Treatment of Hybrid Instruments; https://www.iras.gov.sg/irashome/uploadedFiles/IRASHome/e-Tax_Guides/etaxguide_CIT_Income%20Tax%20treatment%20of%20Hybrid%20Instruments_2014-05-19.pdf

SOURCE OF INCOME

There is somewhat a relationship between nature and source as the source rules may be different for different types of income. Hence, if the identification of the nature of the income is wrong, then the incorrect source rules may be applied. To illustrate this, let us consider section 12(7) payments made to non-residents that are subject to WHT by virtue of section 45A.

Section 12(7) income is deemed to be derived from Singapore if the payment is borne directly or indirectly by a person resident in Singapore or a PE in Singapore (except in respect of any business carried on outside Singapore through a PE outside Singapore), or if the payment is deductible against any income accruing in or derived from Singapore.

If the payment relates to services under section 12(7)(c) or the second limb of section 12(7)(b), there is an exception to the above sourcing rule under section 12(7A) in that services rendered outside Singapore will not be deemed to be derived from Singapore if certain conditions are met.



Accredited Tax Advisor (Income Tax) Sivakumar Saravan, Head of Tax Services, Crowe Horwath Singapore, also discussed common misconceptions relating to the WHT compliance requirements of certain payments.

Consider the application of the above to software payments. Singapore adopts the rights-based approach for characterising payments for software. Essentially, such payments can be for the transfer of a “copyright right” or for the transfer of a “copyrighted article”. Payments for copyright right allows the payer to commercially exploit the copyright. On the other hand, payments for a copyrighted article limit the usage to personal consumption or within the business operations only.

As an example, the purchase of accounting software by a company for its internal use is a payment for a copyrighted article. However, if the payment allows the company to modify the accounting software, make copies and on-license the software, it would then be a payment for copyright right.

A payment for copyright right is treated as royalty and the WHT provisions under section 45A will apply if the royalty income is deemed to be derived in Singapore under section 12(7). A payment for a copyrighted article is treated as business income of the non-resident recipient. Hence, it does not fall within the ambit of section 12(7) and WHT is not applicable, unless the payment constitutes income derived from a trade or business carried on by the non-resident recipient in Singapore.

The application of the rights-based approach is premised on the fact that there is either a partial or full transfer of a movable property to enable the payer to use that property. The question then is whether the movable property is a copyright right and whether it is a partial transfer, in order to classify the payment for the use or the right to use that property as a royalty.

Increasingly, businesses are choosing to access data and software over the Internet, which is commonly referred to as “cloud computing”. For example, businesses subscribe to software applications that they access over the Internet without downloading and accessing the software on their computers’ hard drive. The issue in a cloud computing environment is whether there is a transfer of movable property. If there is no such transfer of property, the rights-based approach may not be the appropriate method for determining the character of the payment. The IRAS considers payments for cloud computing as payments for services falling within the ambit of the second limb of section 12(7)(b) and therefore, WHT will apply for such payments made to non-residents if the services are rendered in Singapore. It must be noted that there are differing opinions in relation to the characterisation of payments for cloud computing.

The above shows how the characterisation of an income will impact the application of the appropriate source rules. However, determining what is royalty, rental or service is not straightforward in the digital economy where the lines between the different types of payment may be blurred. In addition, ascertaining where services are rendered for digital transactions adds another layer of complexity to WHT compliance.

As cross-border digital transactions continue to grow, so too the need for businesses to understand the evolving technology and be on top of their WHT obligations. With hefty penalties of up to 20% for late payment, it certainly pays for companies to get their WHT filing in order and on time.

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