

## **Technical Excellence Decoded**

### **Crossing Borders. Perplexing Transactions.**

*Understanding Cross-Border Transactions*

15 May 2014, Thursday



**I**n a little red dot as Singapore is sometimes referred to, many local businesses spearhead growth through overseas ventures or various offshore activities to achieve greater heights.

Just as much as vast opportunities abound, risks are aplenty too. Peeling away layers of complexities pertaining to cross-border transactions was Accredited Tax Advisor (Income Tax) Linda Foo, Tax Partner, Deloitte Singapore.

*Accredited Tax Advisor Ms Foo provided clarity in her no-holds-barred insights and patiently shared her expertise as she addressed the wide range of queries.*

At a packed *Tax Excellence Decoded* session organised by the Singapore Institute of Accredited Tax Professionals (SIATP), the session was peppered with a generous dose of questions from the participative audience from the industry, consultancies and financial institutions.

#### **Crossing Borders**

Starting with the bare basics, companies extending their footprint beyond Singapore and are Singapore tax residents must first be mindful of any double tax agreement (DTA) Singapore has with the country they are venturing into as DTAs take precedence over the domestic tax legislation.

Secondly, companies will also need to be familiar with the rules of Permanent Establishment (PE). It is imperative to consider such tax issues upfront at the strategic planning stage as a reactive hindsight approach may result in unnecessary higher tax obligations and worse, be faced with unnecessary queries from the tax authorities both in Singapore and overseas.

In understanding PE, one must be familiar with the various types found in a typical DTA.

#### **Physical PE**

In determining if a company has a physical PE, businesses have to determine if the place of business has some permanence and is at the disposal of the company. It does not need to be a venue that the Singapore company owns or rents; it could even be a space within the customer's premises which the Singapore company uses at its disposal. Some of the examples provided in the Model Convention are a branch, factory, mine and oil or gas well. The list is not exhaustive.

### **Construction PE**

A construction PE does not solely refer to a building or a road, it also refers to any installation of equipment. A construction PE is created if a project lasts for more than 12 months. However, companies should be mindful to take reference from the specific DTA as it may state a different time frame.

### **Service PE**

Service refers to the furnishing of services, including consultancy services, by a business through its employees or other personnel engaged by the company for such purpose. The term 'personnel' refers to a natural person, be it the venturing company's employee or an individual engaged by the company.

A service PE may be created if the above activity (for the same or a connected project) continues within a specific overseas jurisdiction for a period or periods aggregating more than six months within a 12- month period. Again, companies must take reference from the specific DTA with regard to the timeframe as it may vary across different DTAs.

### **Substantial Equipment PE**

Some DTAs, such as the DTA with Australia, include a provision for a substantial equipment PE. This refers to companies with substantial equipment installed in another country. This equipment is leased to the client. This arrangement may create a PE for the Singapore company.

### **Agency PE**

Where a Singapore company has a person acting on its behalf overseas and habitually exercises an authority to conclude contracts in its name, the Singapore company shall be deemed to have a PE in that country in respect of the activity which that person undertakes for the enterprise.

A person could be an individual, a company or any body of persons, other than an agent of an independent status. Again, businesses should refer to the specific DTA for the specific technicalities on the definition of 'agency'.

### **Subsidiary and PE**

It should be noted that an overseas subsidiary, unlike a branch, does not automatically indicate that the subsidiary is a PE for the venturing company as the overseas subsidiary is a separate legal entity. However, if subsidiary performs activities that may constitute it as a dependent agent of the Singapore company, it may then create a PE for Singapore company.

### **Profits attributable to PE**

After determining if there is a PE overseas, companies also need to take into consideration the profits attributable to the PE. If the project is a one-off activity, it may be feasible to simply pay the taxes overseas on the profits attributable to the PE.

It is also advisable to engage the services of a local tax consultant familiar with the domestic tax laws as tax authorities may have different interpretations of various definitions stipulated in DTAs. A local tax agent may provide insight into the local tax authority's interpretation.

It should also be noted that business profits are defined differently across DTAs, thus it is important to refer to the definitions section of each DTA.

### **Avoiding a PE scenario**

A PE potentially results in additional tax costs. One way to avoid a service PE is to consider staff secondment as opposed to having staff travel overseas from the Singapore entity for the provision of services. By seconding a staff to the overseas entity, the staff would be rendering the services as an employee of that local company and not as an employee of the Singapore company, thus avoiding a service PE for the Singapore company.

In contracting arrangements, the project may comprise offshore and onshore activities where part of the activities is rendered in the home country and the remainder in the overseas jurisdiction. In such cases, where possible, it may be advisable to perform the onshore portion by the local entity and offshore by the Singapore company so that the Singapore company does not create a PE through the physical presence of its own employees overseas.

Besides PE, companies branching overseas come head-on with withholding tax.

### **Withholding Tax**

When a company in Singapore makes payments to an overseas entity which is not a Singapore tax resident, the overseas entity may have a tax liability to the Inland Revenue Authority of Singapore (IRAS) on the income they received from Singapore. However, it is often not practical for the IRAS to collect taxes from the overseas entity which has no presence in Singapore.

The payer, typically a Singapore company, thus bears the tax compliance obligation when it is making certain types of payments to non-residents, such as interest, royalties, know-how, show-how, technical assistance fees, management fees or rent for the use of movable property. They are required under the tax law to withhold tax and remit the tax amount to IRAS. The various withholding tax rates are provided in the Income Tax Act. Such rates may be reduced under a relevant DTA if the payee is tax resident in a country that has a DTA with Singapore. A flowchart on when a withholding tax obligation incurs is available in the IRAS website.

Companies need to ensure that withholding tax obligations are met as non-compliance may result in hefty fines and even a jail term. If there is a lapse in this area, companies should submit a voluntary disclosure before this is discovered by IRAS.

As observed, a plethora of tax issues and risks lurk when companies tread beyond local shores and venture overseas. *Carpe diem* (seize the day) but certainly not with eyes wide shut. Do seek professional advice.

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### **About SIATP's Technical Discussions**

SIATP's technical discussions have continually been very well received by accredited tax professionals. Unlike the run-of-mill Continuing Professional Educational courses which typically cover tax fundamentals, SIATP's interactive technical discussions are designed to cover tax issues that do not have clear-cut solutions or situations that may have different interpretations. Over time, these discussions contribute in boosting the overall tax standards in Singapore.

### **About Ms Linda Foo**

***Tax Partner, Deloitte Singapore  
Accredited Tax Advisor (Income Tax)***

T: +65 6530 5562

E: lfoo@deloitte.com

Linda, a Tax Partner at Deloitte Singapore, has over 25 years of tax experience serving multinational and local companies including their expatriate employees in Singapore. A graduate of the Accountancy degree and Master of Business Administration programmes from the National University of Singapore, Linda has, over the years, acquired extensive experience in personal and company tax compliance as well as Singapore and international tax consultancy and planning in the area of corporate restructuring, tax due diligence, cross-border payments, supply-chain planning, mergers and acquisitions and permanent establishment issues.

*This technical event commentary is written by SIATP's Assistant Director, Joanna Wong.*