

RELEVANT TO ACCA QUALIFICATION PAPER F6 (SGP)

Understanding withholding tax rules in Singapore

In a nutshell, withholding tax is an efficient mechanism to collect corporate income tax from certain groups of non-residents. Normally the tax liability rests with the non-resident who earns the income, unless this is otherwise provided in a contract, whereby the payer chooses to undertake this tax burden. On the other hand, the onus of tax reporting and payment is shifted from the non-resident to the payer and the tax is collected upfront. Under this system, the payer has the legal obligation to withhold tax at source before making certain payments to another person who is not known to be a resident of Singapore. The tax withheld – which is based on a prescribed percentage of the gross payment – would then have to be paid over to the Inland Revenue Authority of Singapore (IRAS). As the obligation to withhold tax does not apply to payments to residents, it is important that the tax status of the recipient be ascertained.

This article starts by looking at the various payments that are subject to withholding tax in Singapore, and the applicable withholding tax rates. It then focuses on the compliance obligations of the payer and the penalties for failing to discharge these responsibilities. Turning to the non-resident, it then looks at how his interest can be taken care of in cases where certain payments that are ordinarily subject to withholding tax may be exempted either under existing legislation or administrative concessions.

Payments subject to withholding tax

Generally, a person has to withhold tax when he makes payments of the following nature to a non-resident person:

- Interest, commission, fee in connection with any loan or indebtedness. Under Section 12(6) of the Singapore Income Tax Act (SITA), any interest, commission, fee or any other payment in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service relating to any loan or indebtedness is deemed to be sourced in Singapore if it is borne directly or indirectly by a person resident in Singapore, or a permanent establishment in Singapore, or the payment is a deductible expense to the payer. These deemed source rules also apply to any income derived from loans where the funds provided by such loans are brought into or used in Singapore.

However, the Minister of Finance has, since 1977, clarified that any commission, fees or any other payments in connection with any arrangement, guarantee, management or service relating to any loan or indebtedness where such activities are performed by a non-resident outside Singapore will not be caught under Section 12(6)(a) – ie they are not deemed to be derived from Singapore under Section 12(6)(a). This is provided that the relevant transactions are at arm's length and not

entered into with the intention to siphon off Singapore income. It should be noted that this ruling does not cover interest payments. This Ministerial concession was given legislative effect when Section 12(6A) was introduced in December 2009.

- Royalty or other payments for the use of or the right to use any movable property.
Under Section 12(7)(a) of the SITA, any royalty or other payments in one lump sum or otherwise for the use of or the right to use any movable property is deemed to be sourced in Singapore if it is borne directly or indirectly by a person resident in Singapore, or a permanent establishment in Singapore, or the payment is a deductible expense to the payer.

It is important here to distinguish between outright sale of the movable property (eg software or intellectual property) and royalty-type payments that grant the payer the right to use such movable properties. The former is not subject to withholding tax while the latter is.

- Payment for the use of or the right to use scientific, technical, industrial or commercial knowledge or information.
Under the first limb of Section 12(7)(b) of the SITA, any payment for the use of or the right to use scientific, technical, industrial or commercial knowledge or information is deemed to be sourced in Singapore if it is borne directly or indirectly by a person resident in Singapore, or a permanent establishment in Singapore, or the payment is a deductible expense to the payer.

As far as Singapore tax is concerned, this payment has the same consequences as royalty payments.

- Payment for the rendering of assistance or service in connection with the application or use of scientific, technical, industrial or commercial knowledge or information.
- Under the second limb of Section 12(7)(b) of the SITA, any payment for the rendering of assistance or service in connection with the application of scientific, technical, industrial or commercial knowledge or information is deemed to be sourced in Singapore if it is borne directly or indirectly by a person resident in Singapore, or a permanent establishment in Singapore, or the payment is a deductible expense to the payer.

The Minister has also clarified since 1977 that payments for the assistance or service in connection with the application or use of scientific, technical, industrial or commercial knowledge or information will not be caught by Section 12(7)(b) where the services are performed

wholly outside Singapore – ie they are not deemed to be sourced in Singapore. The concession is subject to the relevant transactions being conducted at arm's length and not entered with the intention to siphon off Singapore income. This ministerial concession was also given legislative effect when Section 12(7A)(a) was introduced in December 2009.

- Management fee.
Under Section 12(7)(c) of the SITA, any payment for the management or assistance in the management of any trade, business or profession is deemed to be sourced in Singapore if it is borne directly or indirectly by a person resident in Singapore or a permanent establishment in Singapore or the payment is a deductible expense to the payer.

The Minister has clarified since 1977 that payments to related parties, which are for the reimbursement or allocation of costs as well as payments to unrelated parties for management services, will also not be caught by Section 12(7)(c) provided that the payments are at arm's length, and all the services are performed outside Singapore, and there is no intention to siphon profits from Singapore.

From 29 December 2009, this cost reimbursement requirement was removed for management services paid to related parties, when Section 12(7A)(b) was introduced to give legislative effect to this concession. With this new legislation, all payments of management fees to both related and unrelated parties are not deemed to be sourced in Singapore so long as the services are performed wholly outside Singapore. For payments to related parties, the arm's length requirement must be met.

- Rent or other payments for the use of any movable property.
Under Section 12(7)(d) of the SITA, any rent or other payments under any agreement or arrangement for the use of any movable property is deemed to be sourced in Singapore if it is borne directly or indirectly by a person resident in Singapore, or a permanent establishment in Singapore, or the payment is a deductible expense to the payer.

It is important here to distinguish between rent or other payments for the use of movable property from those concerning immovable property. The former is subject to withholding tax while the latter is not.

- Payment of any remuneration to a non-resident director.
- Payment for the purchase of real property from a non-resident property trader.
- Payment to non-resident professionals, including consultants, trainers, coaches, etc.
- Payment to non-resident public entertainers, including artistes, musicians, sportsmen, etc.

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- Distribution of real estate investment trust (REIT).
- Withdrawals from Supplementary Retirement Scheme (SRS) Account by foreigners and Singapore permanent residents.

The tax to be withheld is based on a certain percentage of the gross income depending on the nature of the income. The taxes to be withheld for the various payments are as shown below:

Nature of income	Tax rate
Interest, commission, fee or other payment in connection with any loan or indebtedness	15% ¹
Royalty or other lump sum payments for the use of movable properties	10% ^{1,2}
Payment for the use of or the right to use scientific, technical, industrial or commercial knowledge or information	
Technical assistance and service fees	Prevailing corporate tax rate ³
Management fees	Prevailing corporate tax rate ³
Rent or other payments for the use of movable properties	15% ¹
Directors' remuneration/directors' fee	20%
Proceeds from sale of any real property by a non-resident property trader	15%
Non-resident professionals	15%, 20% if non-resident opts to be taxed on net income
Non-resident public entertainers	15% (10% during the period 22 Feb 2010 to 31 Mar 2015)
Distribution of taxable income (except distribution out of Singapore dividends from which tax is deducted or deductible under Section 44) made by REIT to unit-holder who is a non-resident (other than an individual)	10% ⁴
Withdrawals from SRS Account by foreigners and Singapore permanent residents	20% ³

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Table footnotes

1. The withholding tax at 15% or 10% on the gross payment is a final tax. No deduction for expenses incurred in the production of the income will be granted. These rates apply provided that the income is not derived by the non-resident person through its operations carried out in or from Singapore. For operations carried out in or from Singapore, the tax rates applicable on the gross payment are as follows:

Non-resident person (other than individuals): Prevailing corporate tax rate
Non-resident individuals: 20%

2. The reduced withholding tax rate of 10% applies to payments due and payable on or after 1 January 2005. Prior to this date, the rate was 15%.

3. For payments made to non-resident individuals, tax is to be withheld at 20% on the gross payment. For payments to non-resident companies, the prevailing corporate tax is 17% with effect from the year of assessment 2010. The tax is not final and the non-resident is able to file a tax return for the income to be taxed on a net basis – ie after claiming all tax-deductible expenses and, in the process, seek a refund for tax withheld in excess of the eventual tax liability.

4. The reduced withholding tax rate of 10% applies to distributions made during the period from 18 February 2005 to 31 March 2015. With effect from 16 February 2007, withholding tax shall not apply to any distribution made by the trustee of the REIT where tax has been paid by the trustee of the trust on the income from which the distribution is made (Income Tax (Amendment) Act 2007 refers).

The above are domestic withholding tax rates. Where a double tax agreement is applicable, the rates specified in the agreements of the respective countries would apply.

Compliance obligations of the payer

Before making payments that are subject to withholding tax to non-residents, the payer is required to withhold the relevant tax and remit the amount withheld to the IRAS by the 15th of the month following the date of payment.

For example, if the payer is liable to make an interest payment to the non-resident person on 1 April, he has to notify the comptroller and remit the tax withheld to IRAS by 15 May. Even if the date of payment falls on 30 April, the deadline to IRAS will still be by 15 May.

When withholding tax is due and payable

The date of payment is based on the earliest of the following dates:

- When the payment is due and payable based on agreement or contract (or date of invoice in the absence of agreement or contract).

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- When the payment is credited or deemed credited to the account of the non-resident.
- Date of actual payment.

In the case of director's fees, the date of payment is the date the fees are voted and approved at the company's annual general meeting.

Penalties

Penalties will be imposed on failure to withhold tax, failure to notify IRAS of tax withheld and late payment of tax withheld.

(a) Penalties for failure to withhold tax

Section 45(1) of the Act provides that any tax amount deducted shall be a debt due from him to the government and shall be recoverable in the manner provided by Section 89 of the Act. In addition, Section 45(3) of the Act provides that where the payer fails to make a deduction of tax that he is required to make under Section 45(1) of the Act, the amount of withholding tax shall be recovered from him.

(b) Penalties for failure to notify IRAS of tax withheld

If the payer has deducted the withholding tax due from the non-resident, but did not submit the relevant form IR37 and/or remit the amount deducted to the IRAS, the payer shall be guilty of an offence. On conviction, the payer will have to pay a penalty equal to three times the amount deducted and will be liable to a fine not exceeding \$10,000, or imprisonment for a term not exceeding three years, or both.

(c) Penalties for late payment of tax withheld

Where taxes withheld are not paid by the due date, late payment penalties (up to a maximum of 20% of the withholding tax due) would be imposed. This comprises an immediate 5% penalty if the withholding tax is not remitted to the IRAS by the due date plus an additional 1% penalty for each completed month that the tax remains unpaid from the date it is due, up to a maximum of 15% additional penalties.

Exemptions from withholding tax

Although withholding tax may generally apply for certain payments, there may be instances where certain payments are exempted from withholding tax.

Several categories of payments have been exempted from withholding tax and these include:

Specified software payments

Generally, software payments are construed as royalty payments for tax purposes. As such, software payments are subject to withholding tax at 10% (15% prior to 1 January 2005) unless reduced or exempted by an applicable tax treaty.

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The following software payments are, however, exempted from withholding tax subject to certain conditions:

- shrink-wrap software
- downloadable software by end-users
- site licences
- software bundled with computer hardware
- use of or the right to use scientific, technical, industrial or commercial knowledge or information, and digitised goods by end-users (for the period from 28 February 2003 to 27 February 2013 – both dates inclusive).

Generally, to qualify for these exemptions, the buyer must not have obtained any right granted to either commercially exploit the copyright of the software; or to duplicate, reverse engineer and modify the software, information or digitised goods.

Payment for satellite capacity

Payments made to a non-resident person for the leasing of capacity on a space satellite will be exempt from the 15% final withholding tax for the period from 11 July 1997 to 10 July 2012.

Payments for the use of international submarine cable capacity, including payments for Indefeasible Rights of Use (IRUs)

Any payments for the use of or the right to use international submarine cable capacity (including payments for an IRU) are subject to withholding tax at 15%, or such reduced rates as provided under an applicable tax treaty.

Tax exemption has been granted to such payments made to non-residents for payments accruing in or derived from Singapore during the period from 28 February 2003 to 27 February 2013 (both dates inclusive).

Conclusions

Withholding tax is an area that continues to be overlooked by individuals and entities, as many mistakes continue to be made. As there are hefty penalties levied on the payer for failing to discharge his legal obligations, individuals and entities operating in Singapore should be aware of their compliance obligations so as to avoid unwarranted tax costs. As the burden of the withholding tax rests on the non-resident, the non-resident should be acquainted with the possible exemptions under existing legislation as well as administrative concessions. Where withholding tax is unavoidable, the non-resident should be aware of the possibility of filing a tax return for the income to be ultimately assessed on a net basis for cases where withholding tax is imposed at the prevailing corporate tax rate. All these will go a long way to minimise the tax burden and optimise the cashflow positions of the non-resident.

Simon Poh is examiner for Paper F6 (SGP)