

Withholding tax update

More than three decades ago, a collection mechanism in the form of withholding tax was introduced to facilitate the collection of taxes from certain groups of non-resident service providers. The withholding tax system places the responsibility of withholding and paying over the tax to the Inland Revenue Authority of Singapore (IRAS) on the Singapore payer. Although the tax is strictly the non-resident's liability unless otherwise contractually provided for, the IRAS will look to the local payer to recover any shortfall in the tax withheld even if he is unable to recover those taxes from the non-resident. Late payment penalties can be up to 20% of the unpaid tax, therefore the cost of getting it wrong for the local payer can be extremely high.

Recognising taxpayers' concerns and in their efforts to provide a business-friendly environment, the Ministry of Finance (MOF) and the IRAS have, over the years, tweaked the tax regime to provide greater clarity to taxpayers and to ease the administrative and compliance processes.

In the wake of recent changes to both the scope and administration of the withholding tax system, it is perhaps timely to attempt a round-up of where we currently are in this complex area.

Recent changes

Management services

Currently, payments for technical and management services performed by non-residents (excluding non-resident professionals and public entertainers, details of which are discussed below) are subject to withholding tax at the prevailing corporate tax rate of 17%.

To address concerns and avoid confusion on the scope and interpretation of the withholding tax provisions, the MOF clarified in a 1977 press statement that services performed offshore and charged at arm's length are not caught under the withholding tax system.

However, in the case of management service fees paid to related parties, there was an additional condition. The fees for services rendered must be charged on a cost reimbursement basis, with no profit mark-up.

The incongruence of this requirement with the accepted transfer pricing rules has been highlighted repeatedly to the authorities over the years but to no avail. Multinationals compelled by home country transfer pricing rules to transact at arm's length often face difficulties in meeting this condition, and, if no treaty relief is available (more details on the relief mechanism is explained below), they will be subject to withholding tax on their gross income.

As the 17% tax withheld is not a final tax (it is merely tax paid on account of the final liability), the overseas service provider may claim a deduction for expenses incurred to provide the services by filing a tax return. Any excess tax withheld will then be refunded to the service provider. In practice, the IRAS has simplified the process of claiming the refund by requiring only copies of certified accounts and tax computations. However, this remains an administrative burden and cost for the overseas person.

It is therefore a welcome change that the MOF is finally proposing to remove the cost-reimbursement requirement with the Income Tax (Amendment) Bill 2009, which was released on 14 September 2009.

A reason for this change may be the increasing focus of the IRAS on transfer pricing and an acceptance of the illogicality of their previous position. In addition, a circular issued by them earlier this year stipulates that related party services must be charged on an arm's length basis. This means that a profit mark-up is generally expected in most circumstances. It is important to note however, that the removal of the cost reimbursement requirement will only take effect when the amendments to the Income Tax Act are gazetted, which we expect will take place soon.

Non-resident professional services

In 2002, a final withholding tax regime was introduced for non-resident professionals (NRPs)ⁱ. Fees for services which are performed by the NRPs in Singapore are subject to a 15% withholding tax on gross income from services performed in Singapore. Gross income includes all cash (allowances, per diem, etc.) and non-cash payments (e.g. accommodation, airfare, transport, meals, etc. that are provided by the Singapore payer). The 15% final tax rate is intended to approximate the effective tax rate of the NRP who is not expected to incur substantial expenditure to perform the services.

However, recognising that certain NRPs may have different expense to income ratios, the IRAS decided to allow NRPs to opt to be taxed on a net income basis, i.e. taxed at the prevailing rate of 20%—the non-resident individual tax rate—on the net income. Under this option, NRPs can claim tax deductible expenses against their fees. In addition, as an administrative concession, the costs of airfare and accommodation (provided for 60 days or fewer in a calendar year) are exempt where they are borne by the local payer.

To enable the local payer to withhold tax on net fees, NRPs must make an election either before the tax is withheld and remitted to the IRAS, or within 45 days from the date of paymentⁱⁱ, in which case they can claim a refund for any excess tax paid through withholding by the local payer. It is important to note that the election is irrevocable. The net basis of taxation will then apply to all income from the same engagement.

Another change, introduced to help reduce the administrative burden for local payers, is the ability for local payers to consolidate and remit the relevant tax to the IRAS by the 15th of the month following the last date of paymentⁱⁱ of the fees under the multiple payments concession. The concession is applicable when the payer makes multiple payments to the same NRP for the same engagement, and the interval between the first and the last payment does not exceed 60 days.

Non-resident public entertainers

With effect from 1 January 2008, local payers are required to withhold tax at the rate of 15% from gross fees paid to non-resident public entertainers (NRPEs) for performances staged in Singapore. Previously, the local payer's obligation to withhold tax arose only when the IRAS appointed him as an agent to collect the relevant tax. The obligation of the local payer to withhold tax is now immediate under the withholding tax system.

As with the tax treatment for NRPs, NRPEs may take advantage of the multiple payments concession, i.e. the payer can choose to consolidate and remit the tax to the IRAS by the 15th of the month following the last date of paymentⁱⁱ of the fees, subject to the conditions mentioned above.

Unlike NRPs, however, the NRPE may exclude the costs of airfare and accommodation (provided for 60 days or fewer in a calendar year) borne by the local payer from his gross income.

Double taxation agreements (treaties) do not normally give protection for income of the NRPE unless his visit to Singapore is substantially funded by the government of his home country.

Use of double taxation agreements

In determining the relevant amount of tax to withhold, the local payer should consider the following points:

- **Whether treaty exemption is available**

Singapore has signed treaties with more than 60 countries. Where there is a treaty with the home country of the non-resident person, exemption may be available. The legal form of the non-resident person, whether it is an incorporated entity or a non-incorporated entity (e.g. a partnership), may determine the relevant article to apply.

ⁱ Including foreign firms, i.e. unincorporated partnerships of two or more persons whose principal place of business is outside Singapore.

ⁱⁱ Refers to the earlier of

(a) the contractual due date or the date of invoice in the absence of a contractual date, or
 (b) when the fees are credited to the account of the non-resident person, or
 (c) the actual date of payment of the fees.

In most cases, treaty exemption would be available under the Business Profits Article so long as the non-resident person does not have a permanent establishment in Singapore. However, before applying the exemption, local payers must ensure that the services (particularly technical and management services) rendered by the non-resident are not excluded from the scope of the business profits exemption. Even if the income is not specifically excluded, complications may still arise as the IRAS may interpret the treaty rules differently. Also, there is some confusion as to whether one should apply the Business Profits or Independent Services Articles where the services are rendered by an unincorporated entity.

- ***Relevant certification for treaty exemption***

It is important to note that a copy of the non-resident person's Certificate of Residence (duly endorsed by his home country's tax authorities) must be submitted to the IRAS for him to enjoy the exemption or reduced rates under the treaty. Failing this, the IRAS may issue a Demand Note to the local payer requiring him to pay the relevant withholding tax and any late payment penalties. More details on the filing procedures are provided in the Appendix.

Administration

- ***Date of payment***

In most cases, withholding tax collected by the local payer must be paid to the IRAS by the 15th of the month following the date of paymentⁱⁱ. The date of paymentⁱⁱ may however be deemed to be an earlier date than the physical payment date under certain circumstances. It is therefore crucial that the date of paymentⁱⁱ is determined correctly. Failure to do so may trigger costly late payment penalties of up to 20% of the tax remaining unpaid.

- ***Applicable withholding tax rate***

Depending on the facts of the case, local payers may apply either the rate prevailing at the time the services were rendered or at the date of payment.

There are of course other forms of payment which are subject to withholding tax. While the purpose of this article is not to cover all such payments, a summary of some of the more common payments which fall within the ambit of withholding tax is provided in the Appendix for your easy reference.

Please call your usual PricewaterhouseCoopers contact if you require more detail or have any questions on the withholding tax system.

Appendix: Overview of withholding tax rates and filing requirements

This table provides a summary of some common payments made to non-resident persons which are subject to withholding tax and the relevant filing procedures. Please note that the rates indicated may be reduced or exempted under the relevant treaties.

Nature of payment	Tax rate (%)	Withholding tax forms	Filing deadlines ⁵
Interest and related payments, rent or payments for the use of movable property	15 ¹	Form IR37 and where applicable, Certificate of Residence	<p>To be submitted by the 15th of the month following the date of payment. Multiple payments concession may be available for payments made to non-resident directors. See below for details of the concession.</p> <p>With effect from 1 April 2009, where treaty exemption applies, the filing of the form may be consolidated and submitted twice a year, on 15 June and 15 December of each year.</p> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p>Important note</p> <p>Where the treaty exemption or treaty rates apply, the local payer must submit a Certificate of Residence (duly endorsed by the non-resident's home country tax authorities):</p> <ul style="list-style-type: none"> • by 31 March of the following year for current year claims; or • within three months from the date of submission of the relevant withholding tax form for back-years' claims. </div>
Charter fees	1 to 3		
Royalties	10 ¹		
Copyright royalties in respect of literary, dramatic, musical or artistic work or approved invention or innovation	17 or 20 ²		
Technical and management fees	17		
Director's remuneration ³	20		
Professional service fees	15 ⁴	Form IR37C and where applicable, Form IR586	<p>To be submitted by the 15th of the month following the date of payment.</p> <p>Multiple payments concession may be available. Payments to the same person for the same engagement may be consolidated and remitted to the IRAS by the 15th of the month following the last date of payment, provided that the interval between the first and the last payment does not exceed 60 days.</p> <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p>Important note for payments to NRPs</p> <p>The election to be taxed on a net basis should be made by completing the relevant section of the withholding tax form. A letter of authority may be required where the election is made by the payer (on the NRP's behalf).</p> <p>Where treaty rates or exemption apply, Form IR586 must be completed and submitted together with the relevant withholding tax form. Details of the number of days in which the NRPs are physically present in Singapore for both the current and prior calendar years must be provided.</p> </div>
Public entertainer fees	15	Form IR37D	

¹ These are final tax rates which apply unless the income is derived by the non-resident person through a trade, business, vocation, or permanent establishment in Singapore, in which case, the income will be subject to tax at the prevailing corporate rate or non-resident individual tax rate.

² The higher rate applies where the non-resident person is an individual. In addition, where the individual files a tax return, the maximum taxable income is 10% of gross income.

³ Under certain circumstances, executive directors' remuneration fall outside the ambit of withholding tax. The date of payment for directors' remuneration is the date they are voted on and approved at the company's Annual General Meeting.

⁴ NRPs may elect to be taxed at 20% on net income.

⁵ The IRAS will issue a letter to the Singapore payer confirming the withholding tax payment within 14 days of receipt of the relevant form(s) and tax payment. However, the IRAS will not issue the letter if the relevant form(s) is incomplete or the withholding amount is less than \$10.

Important note on penalties

Tax remaining unpaid by the stipulated deadlines will be subject to late payment penalties of up to 20%. In addition, the local payer may be convicted of an offence under the Income Tax Act where they fail to pay taxes withheld to the IRAS. A penalty equal to three times the amount of withholding tax and a fine not exceeding \$10,000 and/or imprisonment for a term not exceeding three years may be imposed.

With the introduction of the voluntary disclosure programme, taxpayers who have not correctly withheld tax in the past may consider taking advantage of the programme. A one-time waiver of the usual penalties may be available if the taxpayer voluntarily discloses the error within a year of the statutory filing deadline. Disclosures made after the one-year concession may be subject to a reduced penalty of 5% of the tax underpaid.

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