



What's The Deal With Withholding Tax? Complexities Of Withholding Tax In Business Scenarios

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KEY TAKEAWAYS

- Companies are expected to examine and consider relevant factors holistically (for example, location of Board of Directors' meetings to ascertain where control and management is exercised, or the company's address where information on control and management is not practically known, especially in third party scenarios) to determine tax residency.
- Withholding tax is only applicable to certain types of income of a non-resident person that is sourced in Singapore or deemed to be sourced in Singapore.
- A Certificate of Residence, duly endorsed by the Tax Authority in the non-Singapore resident payee's country, must be submitted to IRAS in order to apply reduced withholding tax rate or exemption under the Double Tax Agreement (DTA).

“Is software payment regarded as royalty for withholding tax purposes?”

“How do you determine whether the payee is a Singapore resident or non-Singapore resident?”

“Is there a difference between making a payment to a foreign company and the Singapore branch of the foreign company?”

These were some of the withholding tax issues that were addressed by Yap Hsien Yew, an Accredited Tax Advisor (Income Tax) and Business Tax Partner from Deloitte Singapore, and Swati Gupta, an Accredited Tax Advisor (Income Tax) and International Tax Director from Deloitte Singapore, at a recent webinar organised by the [Singapore Chartered Tax Professionals](#).

WITHHOLDING TAX IN SINGAPORE

Despite its name, withholding tax is not a different type of tax. It is in fact a collection mechanism to collect income tax from non-residents by putting the onus (to withhold tax and remit it to the authorities) on the Singapore payer. Where certain payments are made to another person not known to him to be resident in Singapore, the Singapore payer is obliged to deduct tax at the applicable rate.

“A Singapore payer may withhold tax if there are reasons to believe that the payee is a non-Singapore resident even if he may not be completely sure,” explained Mr Yap.

“On the other hand, if the Singapore payer decides not to withhold tax on certain payments to non-residents, he should be confident about the technical position taken and be ready to defend it should the need arise.”

To comply with their withholding tax obligations and avoid compliance errors, Singapore companies need to be clear on whether withholding tax is applicable on the payments they made to non-residents and if so, how much to withhold and when to file and pay the withholding tax.

TO WITHHOLD OR NOT TO WITHHOLD, THAT IS THE QUESTION

TAX RESIDENCY OF PAYEE

As withholding tax does not apply to payments made to Singapore residents, the first question that the Singapore payer should ask is whether the payment is made to a non-Singapore resident.

In Singapore, the tax residency of a company is determined by where “control and management” is exercised. The term “control and management” is, however, not defined in the Income Tax Act 1947 (ITA).

Conventionally, the location of Board of Directors’ meetings where strategic decisions are made has generally been accepted as the place where “control and management” of a company is exercised.

Technological advancements and changing business norms have, however, challenged this notion. The prevalence of video-conferencing and virtual Board meetings has, for example, made pinpointing the location of Board meetings difficult.

Companies are expected to examine and consider relevant factors holistically (for example, location of Board of Directors’ meetings to ascertain where control and management is exercised, or the company’s address where information on control and management is not practically known, especially in third-party scenarios) to determine tax residency.

PAYMENTS SUBJECT TO WITHHOLDING TAX

Assuming that the payee is determined to be a non-Singapore resident, the next questions to ask are whether the payment made is subject to withholding tax as set out in the relevant sections in the ITA (for example, Sections 45, 45A to H of the ITA), and whether such income is sourced or deemed to be sourced in Singapore.

Essentially, withholding tax is only applicable to certain types of income sourced in Singapore or deemed to be sourced in Singapore (such as interest, royalties, licence fees, technical service fees, management fees, and rental of movable properties) paid to a non-resident person.

Proper characterisation of the payment is crucial in determining whether it is subject to withholding tax, and also the rate at which withholding tax applies.

CONSIDER EXEMPTION OR REDUCED RATE UNDER THE DTA

After it has been determined that a particular payment is subject to withholding tax, the Singapore payer may consider 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 a DTA is available and subject to meeting the relevant conditions, the Singapore payer may be able to apply a lower withholding tax rate or exemption on the payment made to the non-Singapore resident.

A Certificate of Residence (COR), duly endorsed by the Tax Authority in the non-Singapore resident payee’s country, must be submitted to the Inland Revenue Authority of Singapore (IRAS) in order to apply reduced withholding tax rate or exemption under the DTA.

COMMON WITHHOLDING TAX QUESTIONS

1) DOES A SINGAPORE PAYER NEED TO WITHHOLD TAX ON PAYMENTS MADE TO A SINGAPORE BRANCH OF A FOREIGN COMPANY?

A Singapore branch of a foreign company is not a separate legal entity from the foreign company and is essentially an extension of the foreign company.

While the Singapore branch is prima facie a non-Singapore resident, there is no requirement to withhold tax on payments made to the Singapore branch of foreign companies as such payments have been legislatively exempted from withholding tax since 21 February 2014.

2) IF THE MALAYSIA BRANCH OF A SINGAPORE COMPANY MAKES INTEREST PAYMENT TO A MALAYSIA BANK, IS THE INTEREST PAYMENT SUBJECT TO SINGAPORE WITHHOLDING TAX?

The interest payment relates to a business carried on outside Singapore through a permanent establishment (PE) outside Singapore, that is, the Malaysia branch. The interest expense is not deductible against income accruing in or derived from Singapore.

Assuming that the income derived from the loan where the funds provided by the loans are not brought into or used in Singapore, the interest payment made by the Malaysia branch to the Malaysia bank is not subject to Singapore withholding tax under Section 12(6) of the ITA.

3) IS SOFTWARE PAYMENT REGARDED AS ROYALTY FOR THE PURPOSES OF WITHHOLDING TAX?

Singapore adopts a rights-based approach to characterise payments for software and payments for the use of or the rights to use information and digitised goods.

Payments for copyright rights which allow the Singapore payer to commercially exploit the copyrights are considered royalties within the scope of Section 12(7) of the ITA, and withholding tax is applicable unless exemption applies.

On the other hand, payments for copyrighted articles limit the usage to personal consumption or within the business operations only, under the aforementioned rights-based approach. Such payments are generally characterised as business income outside the scope of Section 12(7) of the ITA and are not royalties for the purposes of withholding tax.

4) WHAT HAPPENS IF A SINGAPORE COMPANY FILES A WITHHOLDING TAX RETURN BASED ON THE REDUCED RATE UNDER A DTA BUT IS UNABLE TO OBTAIN THE COR FROM THE NON-SINGAPORE TAX RESIDENT?

The Singapore payer may be liable for penalties from IRAS. The amount of the penalty will depend on the actual circumstance but may be up to 20% of the shortfall between the tax withheld and tax that should have been withheld absent the DTA benefit.

Conclusion

Withholding tax issues can be complex and unclear at times. Businesses can do themselves a favour by not adding another layer of uncertainty to these issues.

“The lack of clarity in contracts, particularly in related-party situations, can make withholding tax issues more contentious than they need to be,” observed Ms Gupta. “For the purpose of withholding tax compliance, businesses would appreciate well-drafted contracts that leave little or nothing to interpretation – the nature of payment is clearly defined; the date of payment for withholding tax purposes can be clearly determined, and the party who bears the withholding tax liability is explicitly stated.”

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