TED: Grasp: PE Seize: The World

Be on Top of Permanent Establishment as You Internationalise

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Facilitated by:
Accredited Tax Advisor (Income Tax) Mr Sivakumar Saravan

"Supporting our companies to internationalise is a key strategy to help them grow revenues," Deputy Prime Minister and then-Minister for Finance Tharman Shanmugaratnam commented during his Budget 2015 speech.

As more and more Singapore companies echo the government's call and ready themselves for internationalisation, it is timely for them to sit back and consider the myriad of challenges that may arise from overseas ventures. With their focus on strategic growth issues, the last thing companies need is to be caught unaware abroad, tripping over tax issues such as permanent establishment (PE).

At a recent *Tax Excellence Decoded* session jointly organised by the Singapore Institute of Accredited Tax Professionals (SIATP) and IE Singapore, Accredited Tax Advisor (Income Tax) Sivakumar Saravan, Head of Tax Services at Crowe Horwath First Trust, took the audience on a journey through internationalisation and explained how companies could tackle PE issues head-on. Besides gaining knowledge on PE, the audience also learnt more about the support available to companies venturing overseas as Tan Ee Loo, Senior Manager at IE Singapore, walked the participants through the essentials of the Double Tax Deduction Scheme for Internationalisation (DTDi).

Permanent Establishment

The way each country determines how the income of a non-resident derived from carrying on a business in that country should be taxed may sometimes lead to double taxation. Under tax treaties, the concept of PE can be seen as a means to allocate business profits between countries in order to avoid double taxation.

Let's take the example of a Singapore company that carries out business activities in Country A, and the income attributable to those activities are taxable under Country A's domestic law. If there is a comprehensive tax treaty between Singapore and Country A, the Singapore company's business profits can be taxable in Country A only to the extent such profits are attributable to a business carried on through a PE in Country A.

PE as an allocation rule is relevant to the extent the income of the Singapore company that is taxable under Country A's domestic law falls within the Business Profits Article of the tax treaty.

PE generally refers to a fixed place of business through which the business of an enterprise is wholly or partly carried on.[1]

[1] Article 5(1) of the OECD Model Tax Convention on Income and Capital, 9th edition, 2014 (OECD Model Convention)

Reasons For PE Management

Using the earlier example, if the Singapore company carries on a business through a PE in Country A, whether its income is taxable in Country A will depend on Country A's domestic law. Assuming it suffers tax in Country A, it may claim a credit for the foreign tax suffered against its Singapore tax payable on the same income under the tax treaty.

If creating a PE in a foreign country does not necessarily lead to double taxation, why should companies be concerned over the creation of PE outside of Singapore?

There are various reasons for mitigating foreign tax. Given that Singapore's corporate tax rate is one of the lowest in the region, foreign taxes suffered may lead to an increase in the overall effective tax rate even if tax credits are claimed. Similarly, a Singapore company in a tax loss position will see an increase in its effective tax rate due to the inability to carry forward the unutilised foreign tax credits.

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Going International

In a typical scenario, a Singapore company looking to internationalise may first seek out opportunities by attending overseas trade fairs, participating in overseas trade mission trips or meeting up with potential suppliers. If the company is interested in a particular market, it may set up a representative office in that country to conduct in-depth market research. Positive findings may prompt the company to advertise its products and finally set up overseas trade offices to sell its products in the foreign market.

Almost all of Singapore's tax treaties provide for a list of activities (the "exception list") where a PE will not be deemed to have arisen if a place of business is used solely for such activities. The exception list typically covers preparatory or auxiliary activities. For example, the maintenance of a fixed place of business by an enterprise solely for the purpose of collecting information for that enterprise would usually fall under the exception list in Singapore's tax treaties.

Hence, the setting-up of an office in a foreign country to conduct market research is unlikely to create a PE. Similarly, the attendance at overseas trade fairs to merely provide information on one's products or services should be seen as being preparatory or auxiliary in nature.

However, taking into consideration Action Plan 7 of the Organisation for Economic Cooperation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) project, activities that are within the exception list but nevertheless constitute core functions of the enterprise may be seen as not being preparatory or auxiliary in nature. For example, a procurement activity that is an essential and significant part of an enterprise's overall business activity may lack the preparatory or auxiliary character to be exempted outright from the definition of a PE. Therefore, it is important for companies to monitor the developments concerning the implementation of the BEPS Action Plans and to review their activities overseas on an on-going basis.

The Singapore company should pay closer attention when it starts to market and sell its products overseas as such activities are likely to have PE implications now or in the future due to emerging trends. Let us consider the following scenarios:

MARKETING ACTIVITIES

A Singapore company engages Company B in Country B to advertise its products and provide information to potential customers in Country B. Company B does not conclude contracts with customers. Interested customers are required to contract directly with the Singapore company.

Generally, the Singapore company should not have a PE in Country B even if Company B is a dependent agent provided it does not have explicit nor implied authority to conclude contracts on behalf of the Singapore company.

However, the BEPS Action Plan 7 recommendations, which are primarily directed at updating the OECD Model Convention, when implemented, will lead tax authorities to also consider whether Company B plays a principal role leading to the conclusion of contracts without material modifications by the Singapore company when assessing the Singapore company's PE status.

Facilitating a fully-booked session, Accredited Tax Advisor (Income Tax) Sivakumar Saravan, Executive Director at Crowe Horwath First Trust, shared insights on tackling PE issues.

E-COMMERCE

A Singapore company engages Company C, an unrelated company in Country C, for website hosting services. The Singapore company sells its products through its website. The website is hosted on Company C's servers situated in Country C.

As a website is intangible, the Singapore company does not have a place of business in Country C. The servers are also not at the Singapore company's disposal. On this account, assuming it does not carry out any other activities, the Singapore company should not have a PE in Country C.

However, using the same example, if the Singapore company owns the server on which the website is hosted and the server exists for a long-enough period in Country C, it is possible that the server may create a PE in Country C for the Singapore company. This is even if the Singapore company does not employ any personnel in Country C to carry on a business.

DOUBLE TAX DEDUCTION FOR INTERNATIONALISATION

As Singapore companies venture overseas, the government is also doing its part to support their internationalisation efforts. The DTDi, which allows businesses[2] to claim a 200% tax deduction on qualifying expenditure incurred on qualifying market expansion and investment development activities, was extended in Budget 2016 for four years to 31 March 2020.

DTDi covers 14 internationalisation activities, ranging from activities relating to market preparation and market exploration, to activities relating to market promotion and market presence. While many would know that expenses relating to overseas business development trips are eligible for DTDi, companies should also be aware that expenses incurred for other internationalisation activities, such as product certification, production of corporate brochures for overseas distribution and investment feasibility studies, are also eligible for DTDi.

[2] The DTDi is applicable for Singapore-registered company or companies that have a PE in Singapore with the primary purpose of promoting the trading of goods or provision of services.

Companies may automatically claim DTD in their tax filing on the first $100,000 of eligible expenses for four qualifying internationalisation activities:

(i) Overseas business development trips and missions;
(ii) Overseas investment study trips and missions;
(iii) Overseas trade fairs, and
(iv) Local trade fairs approved by IE Singapore or Singapore Tourism Board (STB).

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For expenditure above $100,000 of these four qualifying activities, as well as for the remaining 10 internationalisation activities, companies are required to submit an online application via the DTD incentive portal for each trip or project prior to the project start date. It is good to note that companies are not required to wait for the approval before starting the project. If approved, the companies will be given a Letter of Support to accompany their tax claims. The online application should take no longer than 10 minutes to complete.

Plan properly; tread carefully. As you venture into overseas markets, know that you are not alone. Get valuable advice from accredited tax professionals to avoid overseas tax traps, and while you are at it, remember to log on to the DTD incentive portal[3] before you spend on internationalisation activities.

This technical event commentary is written by SIATP's Head of Tax, Felix Wong. This article is based on SIATP's Tax Excellence Decoded session facilitated by Accredited Tax Advisor (Income Tax) Sivakumar Saravan, Head of Tax Services, Crowe Horwath First Trust, and Ms Tan Ee Loo, Senior Manager, IE Singapore.

For more tax insights, please visit https://www.siatp.org.sg.

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[3] https://incentives.iesingapore.gov.sg/Pages/CompanyLogin.aspx