



# WITHHOLDING TAX IN SINGAPORE

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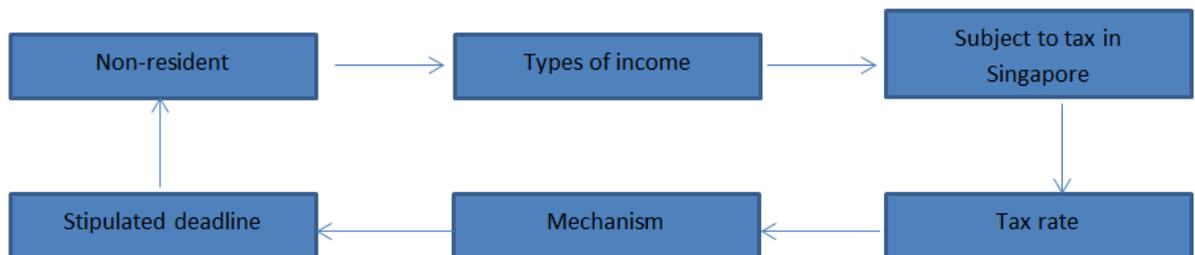
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## Concept of withholding tax

When income is paid to a non-resident of a country, it is usual for the country to collect tax from the non-resident; the payee is required to withhold tax before paying the net amount to the non-resident. It is a tax subsidised by a non-resident on income derived or deemed to be derived from Singapore. This tax is deducted at source which means that it is taken when an income arises and payment made.

Due to the nature of having to file for withholding tax and adhere to deadlines, it is sometimes referred to as a mechanism by which the tax on certain types of income of a non-resident is deducted at source, at a rate dependant on the income by the payer and forwarded to the Comptroller within a specified deadline.



The following questions should be asked to determine whether a payment is subject to withholding tax:

- Was the payment made to a non-resident?
- What type of income was it?
- Is the income subject to tax in Singapore?
- At what rate would the income be subject to tax?
- When will the withholding tax be payable?



## Scope of taxation

Singapore adopts a quasi-territorial concept of taxation; this means that income accrued in or derived from Singapore<sup>1</sup> is taxable. Similarly income sourced outside Singapore but is remitted or deemed received into Singapore is liable to pay tax in accordance with Singapore legislation.

## System of taxation

Non-residents<sup>2</sup> who are trading and have income sourced in Singapore are required to file a tax return. The responsibility lies with the payer of the income to deduct tax at the rate specified in the ITA. **Section 45** relates to interest income, but also applies to other payments under **Sections 45A** to **45H**.<sup>3</sup>

Withholding tax is calculated according to the gross payment made to the non-resident unless there are concessions given by the Inland Revenue Authority of Singapore (IRAS). The amount of withholding tax under Section 45 is not final tax, as any expenses incurred whilst deriving the income are not permitted to be deducted from the gross amount being subject to tax. Any withholding tax which is lower than 17% is the final tax amount. The non-resident responsible for the withholding tax can file for the tax return in Singapore and also claim for a deduction of any expenses incurred. For example, service fee is not classed as final tax as it is 17% and therefore non-residents can reclaim any expenditure accrued against the service income.

## Income subject to withholding tax

The following types of income are subject to withholding tax:

- Interest.
- Management fees.
- Technical service fees.
- Income from rent.
- Royalties.

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<sup>1</sup> “Accrued in or derived from Singapore” is commonly referred to as “sourced in Singapore or Singapore Sourced”. A non-resident will be subject to tax if they have income sourced in Singapore. **Section 12 of the Income Tax Act (ITA)** deems certain types of income to have a source in Singapore.

<sup>2</sup> An individual who is employed or physically present in Singapore for less than 183 days during the basis period is considered a non-resident in Singapore.

<sup>3</sup> Section 45A of the ITA governs the system of withholding tax where the tax is payable on income sourced in, or deemed sourced in Singapore, under Section 12(6) or 12(7).



- Payments for know-how.
- Unit trust & REIT distribution.
- Proceeds from the sale of property.
- SRS withdrawals. (Only for banks with non-residents opening SRS accounts).

## Non compliance

- To ensure that the Form C is accurately completed.
- To avoid non-compliance and maintain a good record with IRAS. This is because penalties snowball and penalties are imposed each month.
- Reduce tax liability in situations where the payer is required to bear the withholding tax. For example if withholding tax is \$100, the payee can recalculate the payment to be \$111.
- For MNEs with inter-company transactions, manage the effective tax rate at group level.
- Subsidising withholding tax in one country and not claiming from the other country.
- Usage of tax treaty or domestic concession to lower the withholding tax.

## Importance of understanding withholding tax

- To ensure that the Form C is accurately completed.
- To avoid non-compliance and maintain a good record with IRAS. This is because penalties snowball and penalties are imposed each month.
- Subsidising withholding tax in one country and not claiming from the other country.
- Usage of tax treaty or domestic concession to lower the withholding tax.

## Concept of permanent establishment

Under **Section 2 of ITA** the definition of permanent establishment is a fixed place where a business is entirely or partly conducted, including a place of management, a branch, an office, a factory, a warehouse, a building or work site or a construction, installation or assembly project.

A person shall be deemed to have PE in Singapore if that person carries out supervisory duties in Singapore related to a building, work site or construction, installation or assembly project. There are no limitations, even if only for one day, it is deemed as having a PE; if the non-resident has an agent in Singapore who has authority to conclude contracts; keeps stocks or merchandise in order to deliver on behalf of the non-resident; or consistently secures orders for the non-resident.

### Relationship between permanent establishment and withholding tax

The existence of PE does not affect the applicability of withholding tax on payments made to non-residents but it has an effect on the rate of withholding tax. The prevailing corporate tax rate of 17%



(currently) shall apply in situations where the income derived by the non-residents is connected with a permanent establishment in Singapore.

The responsibility resides with the payer of the income/payment to ascertain if the non-resident recipient has a PE in Singapore. The payer is also required to disclose this in the Form IR37 if the non-resident has a PE in Singapore.

## **Withholding tax on interest**

Whether a payment is considered “interest” depends on the substance of the transaction. The intrinsic nature of said interest is compensation for not being able to use or the delayed payment of money by another. The interest must be charged against a primary sum of money which must be owed to the person entitled to the interest.

**Section 45A (1)** applies to the payment of any income referred to in **Section 12(6)** or **(7)** by any person to another person not known to him to be resident in Singapore. **Section 12(6)** refers to interest deemed to be sourced in Singapore. Therefore withholding tax is applicable on the interest income of a non-resident that is deemed to be sourced in Singapore.

a. Any interest, commission, fee or other payment connected with any loan or indebtedness, or with any arrangement, management, guarantee or service (related to services) relating to any loan or indebtedness

i. Borne directly or indirectly by a Singapore resident or permanent establishment in Singapore except in respect of any business conducted outside Singapore through a permanent establishment outside Singapore or any immovable property situated outside Singapore. (e.g. A Singapore company has a branch in Indonesia, a permanent establishment outside Singapore and the company takes a loan to finance Indonesian permanent establishment and headquarters pays interest. No withholding tax comes into play as the permanent establishment is outside Singapore.) or;

ii. Deductible against any income accruing in or derived from Singapore (e.g. If a Singapore company claims expenses against income then it is necessary to pay withholding tax. Most of the time this happens and therefore the interest income gets caught under this provision); or

b. Any income derived from loans where the funds provided by such loans are brought into or used in Singapore.



## Types of interest payments subject to withholding tax

### Swap payments

Withholding tax is not charged to payments exchanged or made in respect of non-financial derivatives if the conditions set by IRAS are met:

- The derivative does not effectively give rise to the creation of any loan or indebtedness,
- The payment is not, or is not effectively, a return for the use of money or provision of credit, and
- The payment made is at arm's length.

Interest on **overdue trade accounts and interest on credit terms** paid to a non-resident supplier are subject to withholding tax.

Payments made under a **securities lending or repurchase arrangement** by a transferee, who is a PE or resident in Singapore, to a transferor who is a non-resident of Singapore:

a. Any distribution of interest in respect of transferred securities;

b. And compensatory payment in place of:

(i) Any distribution of income derived from outside Singapore,

(ii) Any dividend derived from Singapore from which tax has been deducted under **Section 44**, or

(iii) Any interest (other than interest derived from qualifying debt securities).

## Withholding tax on royalties

### What is Royalty?

Royalty is the consideration for the use of, or the right to use any copyright of literacy (Software), or any artistic or scientific work. It consists of patent, trade mark, design or model, secret formula, information or process which is usually a secret and not commonly available in the public domain. Information (know-how which is not registered) concerning industrial, commercial or scientific experience.



Definition under **Section 3 of Economic Expansion Incentives Act (EEIA)**: “royalties or technical assistance fees” includes:

- a.) Any royalties, rental or other amounts paid as consideration for the use of, or the right to use, copyright, scientific works, patents, designs, plans, secret processes, formulae, trademarks, licences or other like property or rights;
- b.) Income derived from the alienation of property or information mentioned in paragraph (a).

### **Royalty payments subject to withholding tax**

**Section 45A (1)**: Section 45 shall apply in relation to payment of any income referred to in Section 12(6) or 12(7) by any person to a non-resident. Section 45 will impose withholding tax payments on **Sections 12(6) or 12(7)**.<sup>4</sup>

### **Withholding tax under a double tax agreement**

**The OECD Model Tax Convention 2010 Article 12** states:

1. Royalties arising in a Contracting State, such as Singapore and beneficially owned by a resident of the other country shall be taxable only in that other State (which is different from a Treaty).
2. The term “royalties” as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literacy, artistic or scientific work including cinematography films, any patent, trade mark, design or model, secret formula, process, or for information concerning industrial, commercial or scientific experience.

## **Withholding tax on software & digitised goods**

### **Software**

Any payment made for software is usually considered royalty and subject to withholding tax. There are four types of software payments made by end-users where exemption is granted. To qualify for

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<sup>4</sup> Section 12(7) (a): Royalties and other lump sum payments received by non-residents for the use of, or the right to use, movable property deemed to be derived from Singapore.

First part of Section 12(7) (b): Payments received by non-residents for the use of scientific, technical, industrial, or commercial knowledge or information.



the exemption, the buyer should not have the right to make copies of, or perform any kind of modification on the software.

### Digitised goods

Payment for the use or right to use digitised software or information is considered royalty/know-how and subject to withholding tax.

A ten year exemption is granted on payments made by end-users to non-residents for income accruing in or derived from Singapore on or after the 28<sup>th</sup> of February 2003.

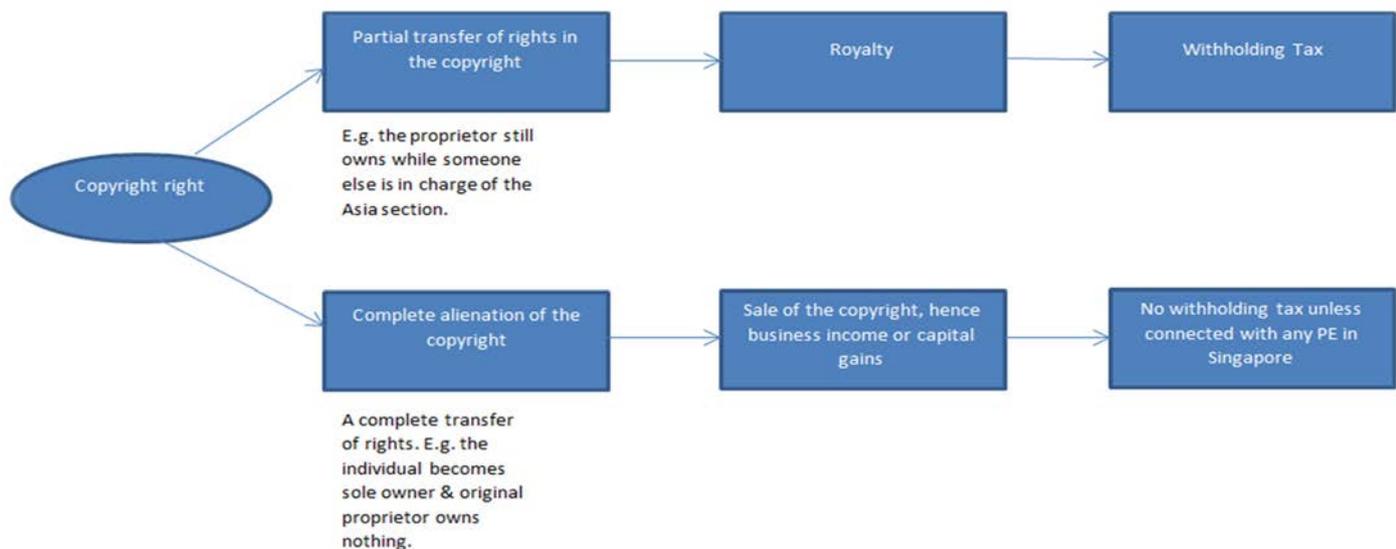
To qualify for this exemption, the end-users must use it for their personal consumption or use within business operations. Also the copyright of information should not be exploited in any way.

### Copyright right

The payer is allowed to “commercially exploit” the software. This involves making any kinds of modification, reproduction or adaptation to the software. Nor can the payer distribute any of the software, information or digitised goods; nor prepare underlying works based on the copyrighted software program, information and digitised goods for distribution.

### Copyrighted article

Rights are limited to enable the payer to operate or use the information or digitised goods, for personal consumption or for use within any personal business operations.





### Tax treatment on copyright right with effect from February 28<sup>th</sup> 2013

Payment for a copyrighted article does not constitute a royalty as per **Section 45A** as it does not fall under **Section 12(7)**. Withholding tax does not take effect unless the payments have come from a business carried out by the non-resident person in Singapore or connected with any PE in Singapore. Payments for other additional services are not within the scope of the rights-based approach. Withholding tax is charged on the service fees attributable to work done in Singapore only. For example a vendor provides training, and the software upgrade falls under the exemption.

### Rental income subject to withholding tax

Under **Section 12(7) (d)**, rent or other payments under any agreement or arrangement for the use of any movable property shall be deemed derived from Singapore if they are:

- Borne by a person, resident or a PE in Singapore; OR
- Deductible against any income accruing in or derived from Singapore.
- Rental of immovable properties are not covered in **Section 12(7) (d)**.
- Classed as immovable property. Under the Interpretation Act immovable property includes land, benefits to arise out of land and things attached to the earth or permanently fastened to anything attached to the earth.
- A payment made to a non-resident for rental of furniture and apartment; withholding tax is usually applicable but by concession IRAS is not prepared to impose withholding tax if the rental of furniture is incidental of the rental of premises.

### Withholding tax on management fees

#### Income derived from Singapore

Under **Section 12(7) (c)**, payment for the management or assistance in the management of any trade, business or profession that are:

- Borne by a person resident or a PE in Singapore; OR
- Which are deductible against any income accruing in or derived from Singapore.
- There is no statutory definition of management or assistance in the management of any trade, business or profession.
- According to a press statement, sales and purchasing commissions paid to non-residents are usually not considered under **Section 12(7)(C)**.

From the 29<sup>th</sup> of December 2009:



A Management fee is not deemed to be derived from Singapore if the management services are rendered outside Singapore by a non-resident who:

- a) Is not incorporated, formed or registered in Singapore,
- b) Does not carry on a business in Singapore, and
- c) Does not have a PE in Singapore.

If the non-resident who is rendering the management services conducts a business or has a PE in Singapore, the management fee will not be deemed derived in Singapore, or the service is not performed through that business carried out in Singapore, or PE in Singapore. This is provided the non-resident is not incorporated or registered in Singapore.

## Withholding tax on services

**Section 12(7)(b)** deals with payments for the use or the right to use scientific, technical, industrial, or commercial knowledge or for the rendering of assistance and services in connection with the application or use of such knowledge or information that are:

- a) Borne, directly or indirectly, by a Singapore resident or permanent establishment in Singapore except in respect of any business conducted outside Singapore through a permanent establishment outside Singapore; or
- b) Deductible against any income accruing in or derived from Singapore.

The first part of **Section 12(7) (b)** relates to royalty (10% rates apply) and the second part relates to services:

Rendering of assistance or service in connection with the application or use of scientific, technical, industrial or commercial knowledge or information.

### Royalty or services

- Provision of technical training, where there is no Intellectual Property and no rights to use the Intellectual Property is classed as a payment made for service.
- Provision of a customer list, (dependant on whether it is customer based and intangible) can be classed as payment made for service.
- Payment for use of a logo on the website is classed as payment for royalty.
- A company contracting a foreign recording artist to produce a special jingle to market its restaurants in Singapore. If the company pay the artist \$20,000 for the recording, a payment would be made for royalty.



## Services

Categorising of income is crucial. It is important to distinguish palpably if the payment is a royalty or a technical fee.

When know-how is being supplied, very little services are performed. Regarding the supply of services, the supplier has to spend time and money, and has to apply skills and expertise in the performance of the work being completed, but will not entail a transfer of such skills and knowledge. It is also advisable to split the contracts for work completed in and outside Singapore.

To understand what creates a PE in Singapore under the relevant tax treaty and take proactive steps to avoid a PE so as to mitigate the withholding tax.

## Withholding tax on other payments

### Distributing unit trust to its holders

Withholding tax at 20% should be withheld from approved unit trusts **Section 13B** distributed to a non-resident with a PE in Singapore and where the gains or profits have not been taxed in the hands of the unit trust.

Withholding tax at 20% should be withheld from distributions by a unit trust designated under Section 35 where the distribution is made to a non-resident person (other than an individual) that is not a foreign investor. Distributions made by designated unit trusts and approved CPF unit trusts on or after the 28th of February 1998 will not be subject to withholding tax.

### Distributions by REITS (Real Estate Investment Trusts).

A withholding tax of 10% applies to any distribution made from the 18th of February 2005 to the 31st of March 2015 by a trustee of any REIT listed in the Singapore exchange to the following: (as per **Section 45G**.)<sup>5</sup>

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<sup>5</sup> To any person not known to the trustee to be resident in Singapore to whom section 43(3B) applies; or

To any other person not known to the trustee to be:

- (i) An individual;
- (ii) A company incorporated and resident in Singapore;



## Real property transactions

Firstly, lawyers have to determine if the company is in the business of rental property. **Section 45(D)** applies to payments made to a non-resident person with respect to the disposal of any real property by that non-resident, if that non-resident person's income arising from the disposal of that real property is chargeable to tax under **Section 10(1)(a)**.

15% of the gross income paid to the non-resident seller by a designated person for the purchase of the property and not the net profit the non-resident seller makes. By applying the badges of trade, we can determine if the seller is a property dealer. The non-resident seller must be carrying on a trade of buying and selling properties. Designated person refers to Advocate or Solicitor who act on behalf of the buyer of the property.

## Other payments

Under **Section 45(E)**, when withdrawals from SRS accounts are made by a foreigner or Singapore PR, a 20% withholding tax applies.

Under **Section 45(H)**, when payment of any commission or other payments by any person to a licensed international market agent not known to him to be a resident in Singapore for organising or conducting a casino marketing arrangement with a casino operator in Singapore.

## When to file and pay withholding tax

Any person who withholds tax from interest, royalties, management fees, Directors' remuneration or other payments paid to a non-resident person must complete and submit the IR37 form to the Comptroller together with the relevant amount of tax withheld. The following information must be provided:

- The particulars of the local payer.
- The nature of payment. (e.g. interest, royalties, directors' fees, charters fees, etc.)

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(iii) A branch in Singapore of a company, incorporated outside Singapore that has obtained the Comptroller's approval for distributions to be made by the trust to it without deduction of tax; or

(iv) A body of persons incorporated or registered in Singapore, including a charity registered under *the Charities Act (Cap. 37)* or established by any written law, a town council, a statutory board, a co-operative society registered under *the Co-operative Societies Act (Cap. 62)* or a trade union registered under *the Trade Unions Act (Cap. 333)*.



- The particulars of the non-resident payee, including country of residence.
- The date of payment.
- The period of payment or deemed payment.
- The gross amount.
- The rate of tax and the amount of tax deducted and;
- The amount of penalty (if any) for late payment of withholding tax to the Comptroller.

### Forms

- Form IR37: Must be completed and submitted to the IRAS when making payment such as interest, management fees, or royalty etc.
- Form IR37A: Payments to foreign property traders for the disposal of real property.
- Form IR37B: Withdrawals made by Supplementary Retirement Scheme (SRS) members who are foreigners or Singapore Permanent Residents.
- Form IR37C: Payments to individual foreign professionals or foreign firms.
- Form IR37D: Payments to foreign public entertainers.<sup>6</sup>

### Timing of payment

**Under Section (45)(8)(D)**, even if interest is not actually paid by a person to another person it will be deemed paid if it is reinvested, accumulated, capitalised, carried to any reserve or credited to any account or otherwise dealt with on behalf of the other person.

Tax should be withheld and paid at the earliest of the following dates:

- When payment is due and payable based on the agreement/contract. In the absence of a contract or agreement, the date of invoice would be the deemed date of payment;
- When payment is credited to the account of the non-resident (re-invested, accumulated, capitalised or carried to any reserve) or any other account however designated (considered as deemed payment); or
- The date of actual payment.

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<sup>6</sup> The IR586 form must be completed and submitted with the IR37 form to the IRAS for payments made to non-resident professionals with a reduced tax rate claimed under tax treaty. With effect from the 1<sup>st</sup> of April 2009, the IR37 form can be consolidated every six months and submitted every 15 June and 15 December when tax exemption under a tax treaty has been claimed. Certificate of Residence must be furnished to IRAS by the 31<sup>st</sup> of March by the following year. This must be submitted within 3 months from the date of submission of Form IR37 if the claim is for preceding year(s).



As for Director's fee the date of payment is the date they are voted and approved at the company's Annual General Meeting.

The filing of Form IR37/A/B/C/D and payment of withholding tax must be made to the IRAS by the 15<sup>th</sup> of the second month from date of payment to the non-resident. For example if the payment is withheld in April, the withholding tax must be filed by the 15<sup>th</sup> of June.

Confirmation of Payment letter (CP) will be issued within 21 days from the receipt of payment and Form IR37/C/D. If not received, the IRAS should be contacted and informed as soon as possible.

## Penalties

As per **Section 45(4)**, if the withholding tax is not paid to the Comptroller:

- a) By the 15<sup>th</sup> day of the second month from when the interest from the tax is to be deducted is paid, a sum equal to 5% of such amount of tax shall be payable; and
- b) Within 30 days after the time specified in paragraph (a), an additional penalty of 1% of such amount of tax shall be payable for each completed month that the tax remains unpaid, but the total additional penalty under this shall not exceed 15% (maximum cap) of the outstanding tax amount.

The above applies for payments made to the non-residents on or after 1<sup>st</sup> April 2003. i.e:

$$5\% + 15\% = 20\% \text{ (maximum penalty for withholding tax)}$$

Under **Section 45(5)**, where a company withheld tax but failed to notify the Comptroller within the stipulated time that the tax has been withheld from a payment made to a non-resident will be guilty of an offence and, on conviction, may be liable for a penalty equal to three times the amount of tax withheld as well as a maximum fine of \$10,000 or to imprisonment for up to three years, or to both a fine and imprisonment.

As per **Section 45(6)**, where an individual has been convicted for three or more offences under this section the imprisonment he shall be no less than six months.

## Recommendations

- In order to pay withholding tax on a timely basis, keep track of all payments to non-residents.
- Note all foreign parties' contract for:



- a) Timing of payment and amount.
- b) Nature of payment.
- c) Whether treaty rates apply.
- d) Whether tax exemptions apply.
- e) The party bearing the withholding tax.
  - Conduct periodic/yearly review to detect non-compliance and make voluntary disclosures if necessary.
  - Keep proper documentation of withholding tax payments e.g. payment vouchers.
  - Hire a tax consultant or obtain clarification from IRAS if in doubt whether withholding tax applies to a payment.



## Summary of rates

Type of Payments to Non-Residents	Withholding Tax
Interest, commissions, fees and other payments in connection with any loan or indebtedness.	15%
Royalty for the use of movable property.	10%
Know-how payments for the right to use scientific, technical, industrial or commercial knowledge or information.	10%
Rent or other payments for the use of movable property.	15%
Management and technical services fees.	17%
Distributions made by a Trustee of any listed real estate investment trust.	10%
Proceeds from any sale of real property where the non-resident seller is a real property trader.	15%
Non-resident Directors' remuneration or fees.	20%
Non- resident entertainers.	10%
Professional fees.	15% to 20%



## About Publisher



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