

UNDERSTANDING OUR DTAs

INTRODUCTION

There is an increasing trend of Singapore businesses as well as Singaporeans venturing overseas. When these businesses and individuals derive income from a foreign jurisdiction, their income may be subject to tax both in the foreign jurisdiction and Singapore, i.e., the income are subject to international double taxation.

International double taxation results when the same income is being taxed twice: once in the State where the income arises (Source State) and another time in the State where the income is received (Residence State).

HOW INTERNATIONAL DOUBLE TAXATION MAY ARISE

International double taxation arises because each jurisdiction has its own sovereign right to tax income and own set of tax rules. The areas in which two jurisdictions' tax systems could differ include:

- The scope of taxation
Some jurisdictions are on the territorial system (e.g. Singapore) whereas others have adopted a worldwide taxation basis (e.g. Australia).
- Source rules for income
The source rules determine whether income is sourced in the state where income arises, or in the state where the income is received. Conflict of source rules can result in an income having a source in both jurisdictions.
- Rules for determining the tax residence of an individual or a company.
- Measures provided for under a jurisdiction's domestic laws to relieve double taxation.

Double taxation invariably increases the burden of tax on foreign income. This has a negative impact on cross-border movements of investment, technology and expertise.

WHAT IS A DTA?

To mitigate the effects of double taxation on its residents deriving income from outside its own national boundary, one measure that a jurisdiction can take is to conclude an Agreement for the Avoidance of Double Taxation ("DTA") on a bilateral basis with other jurisdictions.

The DTA is an agreement usually entered into between two jurisdictions seeking to avoid double taxation. The main objective of a DTA is to provide certainty regarding when and how tax is to be imposed in the jurisdiction where the income-producing activity is conducted or payment is made. In a DTA, the taxing right of each jurisdiction is defined and there are provisions for one of the jurisdictions to give tax credit or exemption to eliminate double taxation.

Under a DTA, the taxation rights over income derived by a resident of one jurisdiction from the other jurisdiction can be allocated in any of the following ways:

- i. full rights to tax only in one jurisdiction, i.e., the other jurisdiction exempts the income. The full rights may be allocated either to the Source State or Residence State;

- ii. full rights to tax by both jurisdictions but with tax in the Source State limited to no more than a specified level and the Residence State giving a credit for tax paid in the Source State. This form of allocation normally results in a sharing of tax between the two jurisdictions;
- iii. full rights to tax by both jurisdictions without limitation and the Residence State giving a credit for tax paid in the Source State.

Although an item of income may be deemed to be sourced in a particular jurisdiction under that jurisdiction's domestic laws, that jurisdiction could give up totally or partially the source taxation by agreeing to share the rights to tax with the DTA partner.

SINGAPORE'S TAX TREATY NETWORK

Singapore has concluded two types of DTAs: (1) comprehensive DTAs which cover all income flows and (2) limited DTAs which cover only shipping and/or air transport income.

The full text of Singapore's tax treaties are available on IRAS' website at www.iras.gov.sg (select "Tax Treaties" under the "Quick Links" section). On our website, the treaties are divided into 4 categories, namely, Comprehensive DTAs, Limited DTAs, Exchange of Information Arrangements and Agreements which are signed but not ratified (i.e., not in force).

CONTENTS OF COMPREHENSIVE DTAs CONCLUDED BY SINGAPORE

The DTAs concluded by Singapore typically covers the following aspects:

- Definition of the scope of the DTA
- Definition of taxing rights for all types of income or gains
- Methods of eliminating double taxation
- Special provisions

A DTA is divided into Articles. As the specific provisions (terms of the respective DTAs) in each DTA are different, we will only highlight the general principles of the key Articles of a typical DTA that Singapore normally concludes with another jurisdiction. If you derive income from a particular jurisdiction with which Singapore has concluded a DTA, please refer to the relevant DTA for the specific provisions.

Definition of Scope

Persons Covered Article

The scope of our DTAs is always limited to residents of Singapore and that of the treaty partner. Non-residents of either jurisdiction do not qualify for the concessionary treatment provided under the DTA.

Taxes Covered Article

This Article states that the provisions of the DTA shall apply only to taxes on income. Therefore, taxes like GST, customs and excise duties are outside the scope of our DTAs.

General Definitions Article

Various terms commonly used in the DTA are defined in this Article. If a term is not defined in the DTA, it would normally assume the meaning that it has under the domestic tax laws of the jurisdictions.

Permanent Establishments (“PE”) Article

The PE concept is used mainly to determine whether there exists in one jurisdiction a fixed place of business through which the business of the enterprise is carried on.

The definition of what constitutes a PE in a jurisdiction is important, as business profits attributable to that PE is taxable in that jurisdiction.

Under our DTAs, the term “Permanent Establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on, and normally includes a place of management, a branch, an office, a factory, a workshop and a place of extraction of natural resources, etc.

Certain activities carried out in one jurisdiction may also constitute a PE, notwithstanding that there is no fixed place of business established in that jurisdiction. Such activities are:

- A building site or a construction, assembly or installation project
 - the activity will be considered a PE if it lasts for more than a specified number of months or days (period test). The period tests stipulated in our DTAs range from 6 months to 12 months.
- Supervisory activities connected with the building site or construction project
 - The activities will likewise be considered a PE if the activities are carried out in a jurisdiction exceeding a certain period stipulated under the DTA.
- Furnishing of services (including consultancy services) by an enterprise through employees
 - In some of our DTAs, a period test is used to determine whether a PE exists in a jurisdiction when an enterprise renders services in that jurisdiction.
- Presence of an agent
 - The presence of an agent in a jurisdiction who has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of the enterprise could constitute a PE of the enterprise in that jurisdiction.

Definition of Taxing Rights

Income from Immovable Property

Income from immovable property, such as rental income from real estate, is usually taxed both in the Source State (where the property is situated) and Residence State of the recipient. In such circumstance, the Residence State will have to allow a credit for the tax paid in the Source State. The term “immovable property” is defined in this Article.

Business Profits Article

If a Singapore resident carries on business in a jurisdiction with which Singapore has a DTA, the profits derived from the business will not be subject to tax unless the business is carried

on through a PE in that jurisdiction.

However, if business is carried on through a PE, the treaty partner (i.e., the Source State) has the full right to tax all profits directly attributable to the PE as if it were an independent enterprise. In arriving at the taxable profit, the enterprise is allowed to deduct expenses which are reasonably attributable to the PE.

When the business profits are remitted by the Singapore resident and taxed here, Singapore (as the Residence State) will give a tax credit in respect of the foreign income.

Shipping and Air Transport Article

This article generally provides for either full or partial exemption of airline or shipping profits derived by an enterprise of one jurisdiction from the other jurisdiction. Where full exemption is provided for, this means that the air transport or shipping income will be taxed in the enterprise's Residence State only.

Such exemptions or reduced rate of tax is only applicable where the profits are derived from the operation of aircraft or ships in "international traffic". The term "international traffic" is normally defined under our DTAs to mean any transport by a ship or aircraft operated by an enterprise of a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State.

Another point to note is that the provisions of this Article apply only to enterprises engaged in international operation of ships and aircrafts. Hence, the income derived by enterprises engaged solely in the leasing of aircrafts and ships do not fall within the scope of this Article.

Dividends Article

The source of dividends is defined in this Article. The source rule for dividends generally provides that the source is in the jurisdiction where the company paying the dividends is resident.

The tax rate on dividends provided in the Dividends Article refers to the withholding tax on dividends which is a feature of a classical system corporate taxation¹. Singapore does not levy dividends tax under both the imputation system and the new one-tier corporate tax system. The reduction of the tax rate provided for in the Dividends Article in our DTAs is therefore applicable only to the other DTA jurisdictions with a classical system of taxation. Singapore residents deriving dividends from such jurisdictions will enjoy a withholding tax rate lower than that imposed under the treaty partners' domestic laws.

Interest Article

The DTA resolves the problem of conflict of source rules on interest by defining the jurisdiction in which the interest arises. The source of interest is typically the jurisdiction of the payer, but the DTA may give the right to tax the interest to both jurisdictions.

To mitigate double taxation, the jurisdiction of the payer will reduce the rate of tax or provide exemption on the interest. For Singapore's DTAs, a compromise is usually adopted by reducing Singapore's domestic tax rate from 15% to either 5% or 10%. In certain DTAs, the interest is exempt by the Source State if it is paid to the Government of a state, a bank or a financial institution of the treaty partner.

¹ Under the classical system, a withholding tax is imposed on dividends in addition to the corporate tax on the company's profits.

Royalties Article

As in the case of interest, the Royalties Article defines the State where the royalties arise and provides for a reduced tax rate on royalties in the Source State. Under the DTAs Singapore have concluded, the rate on royalties have typically been reduced to 5% or 10%.

Royalties in our DTAs are usually defined to include the use or right to use copyright, patent, trademark, industrial commercial or scientific equipment, information concerning industrial, commercial or scientific experience, etc.

Capital Gains Article

This Article deals with the income from the disposal or sale of capital assets, such as immovable properties.

The right to tax gains arising from the sale of immovable property and gains from sale of shares are defined in this Article. As the rules vary from DTA to DTA, you may wish to refer to the relevant DTA for the detailed provisions.

Independent Personal Services

This Article establishes the general rule as to the taxation of income of an individual from the provision of professional services or services of an independent character to be that in the jurisdiction in which the services are performed subject to certain conditions.

Examples of individuals rendering services of an independent character include physicians, lawyers, engineers, architects, dentists, accountants, etc.

Under most of our recent DTAs, an individual rendering services of an independent character would be exempt from tax in the jurisdiction in which he is performing the services if both of the conditions are satisfied:

- a the individual must not have a fixed base in the jurisdiction in which he is performing the services (A fixed base is similar in concept to a PE); and
- b the individual is not present in the jurisdiction in which he is performing the services for a stipulated time period (please refer to the specific DTAs for the time period).

Dependent Personal Services

This Article provides for the source rules for income from employment (other than pensions, director's fees and remuneration for government services). The source is where the employment is exercised, or where the services are provided.

However, where the duration is for short-term purposes, and for the facilitation of movement of qualified personnel, exemption of tax is granted by the Source State if certain conditions are met. In many of our DTAs, these conditions which must be satisfied concurrently are:

- a The recipient is present in the Source State not exceeding a certain period (you may wish to refer to the specific DTAs for the time period); and
- b the services are rendered for, or on behalf of a person, who is a resident of the Resident State; and
- c the remuneration is not borne by a PE, or fixed base which the employer has in the Source State.

Note: Normally, there are separate Articles spelling out the tax treatments for cross-border Director's Fees, income derived by Artistes & Athletes (Sportsmen), income derived from Government Service, income derived by Students & Trainees. You may wish to refer to the relevant DTAs for the detailed provisions.

Methods of Eliminating Double Taxation

Elimination of Double Taxation Article

Within the framework of co-operation under a DTA, the Residence State would usually agree to either give credit to its residents for income which is taxed at reduced rates, or exempt such income from tax. The credit or exemption granted by the Residence State is one way whereby double taxation is eliminated on foreign income derived by its residents. In a DTA, the provisions to bring about avoidance of double taxation is normally found in the Elimination of Double Taxation Article.

The exemption and credit methods of avoiding double taxation can be applied in more than one form. The various forms are:

Exemption Method

- a Full Exemption. The income in question may be left out altogether, so that the State concerned is not entitled to take that income into consideration, when determining the rate of tax to be imposed on the rest of the income.
- b Exemption with progression. This form can only apply where tax in the Residence State is computed using graduated rates. Here, although tax is not imposed by the Residence State on the income in question, it is however taken into account for the purpose of determining the effective rate of tax to be applied on other income taxable in that jurisdiction.

Credit Method

- a Ordinary credit. The tax credit allowed by the Residence State is restricted to its own tax on the income derived from the Source State. Therefore, if the tax suffered in the Source State is higher than the tax in the Residence State, complete relief is not available.
- b Full credit. The tax paid in the Source State is allowed as a credit in full. Under this form, if the tax in the Source State is higher than the tax in the Residence State, it results in the Residence State giving up its tax on other income.

The method of eliminating of double taxation usually follows that which is provided in the domestic tax legislation. The Singapore laws provides for the ordinary credit method to eliminate double taxation for residents of Singapore², i.e., a credit is allowed, in respect of foreign tax paid against Singapore tax payable on the same income, but the credit is restricted to the lower of the foreign tax and Singapore tax payable on the same income.

² There are also provisions under Singapore's domestic laws to exempt certain foreign-sourced income. As announced in Budget 2003, foreign-sourced dividend, foreign branch profits and foreign-sourced service income received in Singapore on or after 1st June 2003 will be tax exempt subject to certain conditions. The tax exemption regime has been extended in Budget 2004 to all foreign-sourced income received by resident individuals in Singapore on or after 1 January 2004. For further information on the Foreign-Sourced Income Exemption regime, please refer to the e-Tax guide – Tax Exemption for Foreign Sourced Income, published on 6 Sep 2011 available on IRAS' website at www.iras.gov.sg.

In the case of dividends, Singapore usually agrees, as a policy to encourage direct investments, to take into account the foreign corporate tax paid on the profits of the dividend-paying company (this is referred to as “underlying tax credit”) if the minimum shareholding requirement specified in the DTA is met. Under our domestic laws, underlying tax credit is allowed by Singapore where the shareholding is at least 25%. In most of our DTAs, this minimum percentage is reduced to 10%.

The method adopted under a DTA by our treaty partner to eliminate double taxation of income derived by its own residents depends on that jurisdiction’s domestic tax laws. It can either be the credit method (with or without underlying tax credit) or the exemption method (with or without progression) or a combination of both, depending on the current tax system of that jurisdiction.

Tax Sparing Credit

Under a DTA, tax credit is usually available in the Residence State only if the income has been taxed in the Source State. Tax sparing credit is a special form of credit whereby the Residence State agrees to give a credit of the tax which would have been paid in the Source State but was not, i.e., “spared”, under special laws in that jurisdiction to promote economic development.

The tax sparing credit provision is usually found in DTAs between a developing jurisdiction which offers tax incentives to attract foreign investment and a developed jurisdiction which is capital exporting. The credit is given by the capital-exporting jurisdiction under its laws to promote investments.

Special Provisions

Mutual Agreement Procedure (MAP) Article

This Article sets out the rules governing the mutual agreement procedure to be followed, where differences of opinion, or other difficulties arise as to the application of the DTA. The Article provides a mechanism for resolving difficulties arising from the application of the provisions of a DTA.

The taxpayer may use his right under the Article, to address himself to the taxation authority of the State in which he is a resident to resolve issues relating to the application of the DTA.

Entry into Force Article

This Article specifies when the provisions of the DTA become effective. The actual provision may differ from DTA to DTA, depending on the national laws of the Contracting States concerned.

Termination Article

The provisions in this Article deal with how and when the DTA would cease to have effect.

Some States consider it an advantage for the Agreement to remain in force for a fixed minimum period, and thereafter, to continue indefinitely, subject to a power to terminate on prior notice. It is open to the Contracting States to decide upon the earliest year during which such notice can be given, or even to agree not to fix any minimum period, as they so desire.

CONCLUSION

Global transactions across international boundaries have given rise to international double taxation. To mitigate international double taxation, Singapore has concluded DTAs with more than 50 treaty partners.

Although the general principles underlying Singapore's DTAs are similar, the provisions in each DTA may differ. This is because every DTA is the result of a series of negotiations between two jurisdictions which have their own sets of national objectives, policy and technical considerations, and each jurisdiction may have to make various compromises in order to conclude the DTA. Therefore, in order to understand the tax treatment of a specific income derived from a treaty partner, it is necessary to refer to the relevant DTA. The full text of the DTAs that Singapore has concluded are available at www.iras.gov.sg (select "Tax Treaties" under the "Quick Links" section).