

# Tax Alert

SINGAPORE

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In this issue, we examine the implications of a recent case where a taxpayer successfully applied for leave to quash the decision of the Comptroller of Income Tax (CIT). CIT had held the position that under interest rate swap agreements, withholding tax should be applied to payments made to its overseas subsidiaries. In the second part of this Alert, we highlight the recent announcement by the CIT on the withholding tax waiver for partnerships with non-resident partners.



## ACC v CIT [2009] SGHC 211

In the above case, the High Court granted a taxpayer, ACC leave to apply for order to quash the decision of the Comptroller of Income Tax (CIT) who held the position that withholding tax applies to payments made by ACC to its overseas subsidiaries under interest rate swap arrangements.

Under the Income Tax Act, any payments made to non-residents that fall within the ambit of section 12(6)(a) as “interest ..... or any other payment in connection with any loan or indebtedness or with any arrangement, management, guarantee or services relating to any loan or indebtedness.....” are deemed to be sourced in Singapore and subject to withholding tax requirements under section 45. Under the withholding tax mechanism, the payer is responsible to withhold the tax and account it to the CIT. Failure to do so rendered a payer non-compliant and subject to late payment penalties.

### Background

The taxpayer, ACC made payments to its overseas subsidiaries under interest rate swap agreements and wrote to the CIT to seek confirmation that such payments should not be subject to withholding tax. However, the CIT took the position that the swap payments fall within the ambit of section 12(6)(a) of the Income Tax Act. Unless ACC could successfully overturn the CIT’s decision, it would be legally obliged to comply with the withholding tax requirements and account to the CIT the amount of tax it should have withheld.

In the Income Tax Act, there is no provision of an avenue for the taxpayer or the recipient of the payment to object to the decision of the CIT. Hence, ACC sought leave from the High Court to apply for order to quash the CIT’s decision.



Before the High Court can grant leave to apply for the quashing order, the Court needs to be satisfied that the application is not groundless, trivial or misguided. Hence, the Court would need to consider the following: -

- whether the matter complained of is susceptible to judicial review
- whether the applicant has sufficient interest in the matter
- whether the case is arguable.

#### Decision

On the facts and materials presented, the Court found that the above requirements were fulfilled in ACC's case. On the first requirement, the Court is of the view that the CIT's decision is susceptible to judicial review since its source of power to assess and collect stems from a statute, that is, the Income Tax Act. On the second requirement, although the withholding tax is not a tax liability of ACC but that of its subsidiaries, ACC has sufficient interest in the matter as it will be liable to pay penalties if it is found that withholding tax is applicable on the swap payments since it did not withhold tax on the payments. Above all, the Court also found that the case to be arguable as the crux of the issue is on the construction of section 12(6)(a), that is, whether the swap payments fall within the ambit of the deemed source provision .

In the process of the review, the Court examined what was involved in the swap transactions between ACC and its subsidiaries and concluded that neither party to the swap made a loan to the other that would give rise to a payment of 'interest' as there was no underlying loan or indebtedness between the parties.

It is interesting to note that in arriving at the preliminary conclusion, although not to be taken as a substitute for a determination at the full hearing of the application for a quashing order, Justice Andrew Ang commented in paragraph 37 of the case report " that an interest rate swap agreement does not give rise to a payment of 'interest' from one party to another as there is no underlying loan or indebtedness between the parties. Therefore, swap payments are not interest paid in connection with any loan or indebtedness, but rather a swapping of anticipated cash flows." Justice Ang also considered whether the swap payments fall within 'any other payment' but concluded that to qualify as 'any other payment' within section 12(6)(a), they would have to be made in connection with 'any loans or indebtedness' which did not arise in the swap payments made by ACC to its subsidiaries. Furthermore, this is not a payment that is connected to any 'arrangement, management, guarantee or service relating any loan or indebtedness'.

On the basis of the above findings, the High Court granted ACC leave to apply for a quashing order against the decision of the CIT.

#### KPMG Comments

Although the case is for the High Court to decide whether leave should be granted to ACC to apply for a quashing order and not to determine whether the swap payment falls within the ambit of section 12(6)(a) of the Income Tax Act, the preliminary analysis made by the High Court has certainly brought to light a grey area that has been the subject of disagreement between taxpayers and the CIT.

The important points that are relevant to this case are as follows:

- Should interest rate swap payments be regarded as 'interest' or 'other payments made in connection with any loan or indebtedness'? This question is not that straightforward and definitely, more thoughts would need to be put into the deliberation process.
- Whether gain or loss arising from interest rate swap be regarded as capital or revenue? The issue is whether such gain or loss should be regarded as revenue in nature if the interest rate swap were not connected to a loan (capital) but is for a contractual swapping of cash flow as the swap is for fixed or floating interest rate. In this regard, depending on the facts of the underlying transaction, whether the gain or loss arising from the swap is revenue in nature is not entirely clear.



## Application for a waiver of withholding tax for non-resident partners

Partnerships with non-resident partners are subject to withholding tax requirements on certain payments received from payers in Singapore. The Inland Revenue Authority of Singapore (IRAS) recently announced that payments to such partnerships may be granted withholding tax waiver.

### Reasons for withholding tax requirement for partnership

Under the Income Tax Act, certain payments to non-residents are deemed sourced in Singapore and the payer is legally obliged to withhold the tax and account it to the CIT. In the case where such payments are made to a partnership with non-resident partners, withholding tax would apply because a partnership is not a legal person and payments made to a partnership are regarded as being paid to the non-resident partners through the partnership.

### Withholding tax waiver

The IRAS acknowledges that it may not be feasible to strictly impose withholding compliance for payments to partnerships with non-resident partners as such requirements would increase compliance costs and impose cash flow difficulties since the withholding tax has to be paid upfront. Notwithstanding the withholding tax requirements, all partnerships that are doing business in Singapore are still required to file yearly tax returns in which all income has to be declared.

In view of the yearly tax return filing made by partnerships, the IRAS announced that with effect from 5 November 2009, all payments to partnerships with at least one resident partner would be granted waiver on withholding tax requirements under section 45. However, should the one resident partner withdraws from the partnership and the partnership becomes one with only non-resident partners, the partnership would need to submit a letter from its head office to undertake to pay any outstanding tax arising from the waiver in the event of a default of tax payment by any non-resident partners before it can continue to enjoy the waiver.

For existing partnerships where all partners are non-residents, the IRAS requires the above mentioned letter of undertaking from their head office and that letter has to be submitted to the IRAS by 31 December 2009 before the withholding tax waiver can be granted.

From 1 January 2010, new partnerships with all non-resident partners that wish to enjoy the withholding tax waiver are required to file the letter of undertaking from their head office immediately upon commencement of business in Singapore. The CIT reserves the right to review and revoke any waiver granted.

### KPMG Comments

Partnerships would certainly welcome the withholding tax waiver as this would place partnerships (with non-resident partners) in line with foreign branches where subject to conditions, the IRAS had already granted such waiver. However, it is important for the IRAS to provide more details on the requirement to submit an undertaking from the head office of the partnership in Singapore.

'Head office' is a commonly known concept in the context of a branch of a company. Generally, it refers to the corporate headquarter where most, if not all, of the important functions of the company are coordinated, taking full responsibility in managing all business activities, including those of the branch. A partnership is an association of two or more persons (individuals or companies) formed for the purpose of making a profit. Unlike a branch, the business of a partnership is managed and run by the partners, often jointly, but in certain instances, such responsibilities may rest with a single partner or few partners, with others acting as 'sleeping' partners.

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In this regard, it is appropriate to consider the requirement under the following situations:

**a) A Singapore partnership with partners which are non resident companies and non resident individuals**

Do we just focus on the corporate partners to select one company for which its head office would need to provide the letter of undertaking, regardless of the corporate partners' level of contributions made to the partnership (which may be small as compared with the contributions made by the non resident individual partners)?

If so, what should be the criteria for selecting the corporate partner in a case involving more than one corporate partner? What if all the corporate partners are companies with no corporate shareholders or have corporate shareholders which do not have substantial shareholding in the company?

**b) Limited partnership**

Would the above considerations be different in the context of a limited partnership in view that it has general partners and limited partners? Do we just focus on the general partners for this purpose? What if there is no corporate general partner?

Perhaps, the IRAS would need to provide more information concerning the requirement to submit an undertaking from the head office of a partnership in Singapore.

### **KPMG Tax Services can help**

As a committed tax advisor to our clients, we welcome any opportunities to discuss the relevance of the above matters to your business.

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KPMG's Tax Alert highlights the latest tax developments, impending change to laws or regulations, current practices and potential problem areas that may have an impact on your business. As certain issues discussed herein are time sensitive, it is advisable to make plans accordingly.

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