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Singapore tax treaties: the end of limitation of relief?

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What is limitation of relief?

Here is an actual illustration: A client in Singapore has loans to a Spanish SOCIMI, a real estate investment company equivalent to a REIT. Spain requires tax to be deducted at source when interest becomes payable even if in fact the interest is not actually paid. Spanish withholding tax on interest is 20 – 21% (depending on the year in which the interest is payable) whereas with the benefit of the treaty between Spain and Singapore the withholding tax is 5%.

However, the treaty contains a proviso, the limitation of relief, that the 5% tax rate only applies if the interest is remitted to Singapore. In the example, 20 – 21% tax was deducted in Spain, notwithstanding the treaty between Spain and Singapore, because the interest was not in fact paid when it was payable and, as such, no money had been remitted (and there was no money to be remitted) to Singapore when it was time to pay Spanish withholding tax on the interest.

Subject to tax

Most of Singapore's tax treaties make the elimination or reduction of tax at source conditional upon the income in question being remitted to and subject to tax in Singapore. The reason for it is the territorial nature of Singapore income tax: income sourced outside Singapore is beyond the scope of income tax until and unless it is received in Singapore. Remittance was made a condition for treaty relief since foreign-sourced income is subject to tax only when and if it is remitted to Singapore.

Income tax in Singapore is fundamentally a charge on income as such. It is a true or direct tax on income, as distinct from a tax on persons. The starting point is that all income earned in Singapore or remitted to Singapore from outside Singapore is subject to tax. Prima facie, tax is payable on all such income, whoever it belongs to. The charge of income tax does not distinguish Singaporeans from foreigners, or residents from non-residents. The key question is whether or not the income, rather than the taxpayer, is within the jurisdiction. The flip side of the coin is that no tax is payable on any income that is sourced outside Singapore, even if the income belongs to Singapore persons or Singapore residents.

So far as Singapore is concerned, then, limitation of relief in a treaty is provided for our benefit. That is to say, many tax practitioners and, not least, the IRAS will say that it was put into the treaties at Singapore's request. Whenever taxing rights to foreign-sourced income was allocated to Singapore in a treaty, the territorial nature of the tax system made it necessary to require that the income be remitted in order to be subject to Singapore tax. Unless and until the income was remitted, Singapore was unable to collect its tax under its domestic law.

Foreign-sourced income exemption

Over the years, economic policy in Singapore has changed. The previous policy was to encourage taxpayers to repatriate foreign-sourced income. Since 2004, the policy is for local businesses to venture abroad and increase their business operations and presence in foreign markets. Consequently, treaties no longer carry the requirement to remit and subject foreign-sourced income to tax in Singapore. Singapore has also decided that it is in its economic interest to exempt certain foreign-sourced income from tax altogether.

Interesting questions of treaty interpretation for its treaty partners arise when a country exempts foreign-sourced income:

1. Are treaties meant to enable double non-taxation, or must income be taxed at the destination to qualify for treaty relief at source?

2. Should relief at source under the treaty still depend on remittance to the destination, or is limitation of relief simply a dead letter?

A First-Tier Tribunal in the UK, the Norwegian Royal Ministry of Finance and an Oslo court have each had a different interpretation of whether income that is exempt from tax is nonetheless 'subject to tax.'

Weiser v HMRC

In 2012, a UK First-Tier Tribunal considered the meaning of 'subject to tax' in the Israel-UK treaty. Under the treaty, certain income arising in the UK was exempt from UK tax if the income was subject to tax in Israel.

Weiser was tax-resident in Israel and for that reason the income was formally or nominally within the scope of Israeli income tax, but it enjoyed a specific tax exemption in Israel. In essence, Weiser's argument was that it would not have been necessary to exempt the income if it was not 'subject to tax' in the first place. In this argument, the income was subject to tax in Israel for the purposes of the treaty, although exempt there locally.

The tribunal, however, ruled that in-principle liability to taxation in the other country was insufficient. It held that the words 'subject to tax' was intended to ensure that tax was actually paid in one country or the other: '[T]he allocation of taxing rights as between the UK and Israel [is] to obviate double taxation… Its purpose is not to enable double non-taxation of the relevant income.'

Anticipating Weiser

With all respect to HM Rvenue & Customs, I think it is fair to say, however, that when a country exempts a foreign-sourced income, the country intends to benefit its taxpayers rather than its treaty partners. But in the Weiser tribunal's interpretation, the tax that one treaty partner forgoes should benefit the other treaty partner, not the taxpayer. Indeed, if the tax rate at source is higher than at the destination, the taxpayer could be worse off with the foreign-sourced income exemption than without it. The Inland Revenue Authority of Singapore was alive to the possibility that limitation of relief and exemption could unintentionally interact in this way to undermine the tax position of Singapore residents. One approach would have been for the IRAS to clarify the construction of 'subject to tax' with each treaty partner. However, it could not be assumed that every country would share Singapore's interpretation. Indeed Weiser demonstrates this possibility.

Instead of taking up the matter with a large number of countries and risking unwelcome results, the IRAS took a gradual approach. Limitation of relief was omitted from treaties with new partners; and it was deleted from existing treaties when the occasion permitted as and when these were renegotiated. In 2012, the UK and Singapore signed a protocol which, among other things, removed the limitation of relief article from the UK-Singapore treaty (although a close reading of the treaty will show that not every instance of the words 'subject to tax' was deleted from the treaty). The protocol came into effect in 2013.

Until limitation of relief is done away with completely, any inappropriate response from a treaty partner to tax-exemption in Singapore is addressed by a condition attached to the exemptions. The condition is that foreign-sourced income is exempt only if 'the Comptroller is satisfied that the exemption would be beneficial' to the taxpayer. At first blush, this condition is puzzling: how or why wouldn't tax exemption be beneficial to a taxpayer? The answer, as the UK showed in Weiser, is when it gives rise to more tax abroad than the exemption saves onshore.

How the condition operates in practice is that a taxpayer may volunteer tax to the IRAS if the source country's response to tax exemption in Singapore is to deny the taxpayer exemption or reduction under the treaty. If tax has to be paid, it is generally cheaper to pay it in Singapore since the Singapore corporate income tax rate is lower than in many other countries.

Norwegian Royal Ministry of Finance

Not all tax authorities interpret limitation of relief in the same way as HM Revenue & Customs. In 2013 and 2014, we were involved in a court case in Norway where the issues were the limitation of relief under the treaty and the Singapore remittance regime.

Under the treaty, tax rates were reduced in Norway on income which was remitted and subject to tax in Singapore. Since the treaty was signed, however, Singapore had made the income exempt from tax on remittance, subject to the domestic condition, mentioned previously, that the Comptroller had to be satisfied that the exemption was beneficial to the taxpayer.

The taxpayer's case was that limitation of relief did not apply — ie, it was not necessary to remit the income — because there was no tax to pay whether the income was brought back to Singapore or not.

Unlike the UK, Norway's Royal Ministry of Finance did accept that, for the purposes of the treaty, Norwegian-sourced income was 'subject to tax' in Singapore on remittance notwithstanding that it was now exempt from tax. The Norwegian tax authority did not mind that the income from Norway was exempt in Singapore and that the taxpayer had not paid tax in Singapore. However, Norway took the view that, in order to benefit from treaty, it was still necessary for the taxpayer to have remitted the income to Singapore in compliance with the letter of the treaty.

The Norwegian case was that remittance was required for treaty relief because foreign-sourced income was not subject to tax in Singapore as demanded by the terms of the treaty unless and until it was remitted. The actual amount of tax (if any) in Singapore was beside the point. Where income had been received in or remitted to Singapore, Norway would regard the income as subject to Singapore tax. Conversely, where income had not been remitted to Singapore, then it was not subject to tax in Singapore. In such a situation, there would be no relief at source under the treaty, and Norway's usual domestic tax rates should apply.

The taxpayer's diametrically-opposed case was that exemption in Singapore rendered limitation of relief irrelevant. Some part, although not all, of the income had in fact been brought back to Singapore but, according to this argument, proof of what or how much had actually been remitted was beside the point.

Oslo City Court

The Norwegian Royal Ministry of Finance claimed that limitation of relief in the Norway-Singapore treaty was a unilateral provision intended to protect the Norwegian tax base. But this was not corroborated by the IRAS, whose point of view, as mentioned above, was that limitation of relief was a general feature of Singapore's treaties at Singapore's instance and that Singapore, after the introduction of its domestic exemptions, asked Norway about the possibility of removing limitation of relief from the treaty.

As for the Singapore remittance regime, the Norwegian Royal Ministry of Finance claimed that the taxpayer was obliged to remit the income to Singapore, declare it to the IRAS, and obtain a formal statement exempting the income from Singapore tax. However, as a matter of fact and practice, exemption under the Singapore remittance regime does not involve any formal grant of exemption by the IRAS.

The income in question was dividends from a Norwegian company. And the facts of the case were that most of the money representing the dividends never left the bank account of the company distributing the dividends because the dividends were set off against debt owed by the shareholder to the company.

The case was heard in Oslo in September 2014. The Oslo City Court subsequently gave a decision agreeing with the taxpayer that, when there was no tax in Singapore whether or not the income was remitted, the limitation of relief article in the treaty was irrelevant.

Spain

Finally, I return to the example mentioned at the beginning of this article. To recap, withholding tax was payable in Spain on interest due to a Singapore lender. Tax was withheld at four times the rate specified in the Singapore-Spain treaty due to limitation of relief because the interest had not yet been paid to lender.

This application of limitation of relief seems to be rather severe. To begin with, Singapore withholding tax works in the same way as Spanish withholding tax. That is to say, tax must be withheld and paid to the IRAS so long as the interest is due to the non-resident lender, even if the payment to the lender is delayed. So payment of withholding tax without concurrent payment of the income in question to the non-resident is not unfamiliar to the IRAS. Where a treaty is involved, the IRAS will issue a certificate of residence for the purpose of claiming treaty benefit for a specified income on an undertaking or promise to remit the income. The taxpayer is asked to estimate when it expects to receive the income in Singapore; it does not have to show that the income has actually been received. In other words, we interpret the limitation of relief article as permitting tax to be withheld at the treaty rate so long as the lender pledges to remit the income to Singapore and to pay the tax (if any) at such time as the income is actually paid.

Conclusion

In summary, our experience is that the exemption of foreign-sourced income in Singapore:
1. revives tax at source; or
2. has no adverse impact on treaty relief at source so long as the income is remitted; or
3. makes remittance irrelevant

as the case may be. This tells us that when it comes to interpreting a treaty it might be prudent to take advice in both countries because one cannot be certain that two countries will read their agreement in the same way.

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