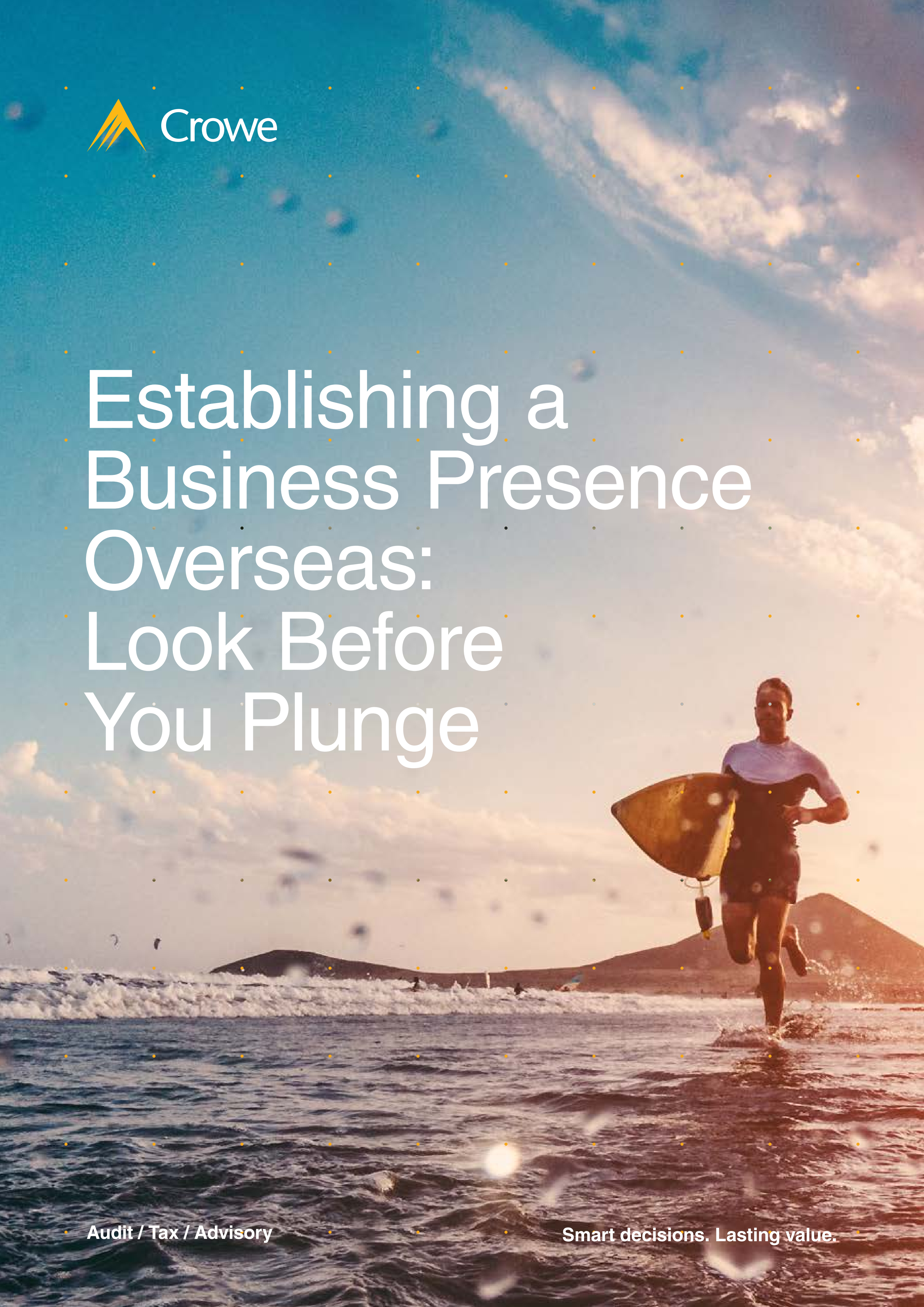

Crowe

Establishing a Business Presence Overseas: Look Before You Plunge

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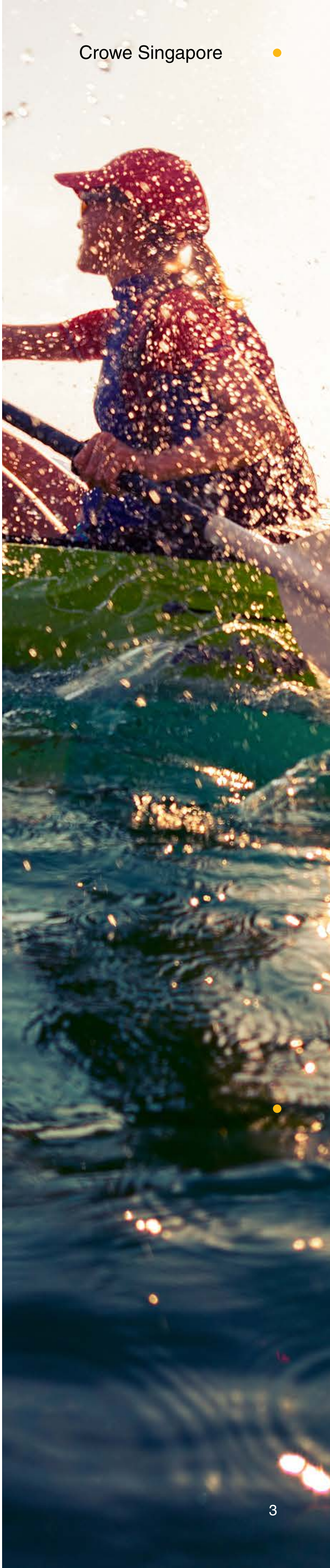
“Upfront planning can prevent a downstream tax disadvantage”

Going global can be a significant driver of growth. However, the first step to going international can be daunting as you will be faced with an overwhelming number of regulatory, legal and tax issues. There is no cookie-cutter approach due to the fluid nature of tax and legal issues in the foreign countries. However, by taking a life cycle approach, you can address and manage such issues in a step-by-step manner.

A life cycle approach is a systematic process of identifying and managing the regulatory issues at each phase of a business entity’s life, namely, the pre-establishment, start-up, growth, investment, profit & asset repatriation and exit phases.

As a first step, companies must decide exactly how they plan to do business abroad. In the pre-establishment phase, depending on the type of activities that are planned to be carried out in the foreign jurisdiction, it may be mandatory to set up a legal presence in that jurisdiction. Such legal presence could be in the form of a branch, company limited by shares, partnership, sole-proprietorship, etc. In some jurisdictions it is even possible to carry on a business through a trust.

Given the choices in the type of entity that can be established, companies would want to identify the most appropriate corporate structure considering tax and non-tax factors. This article looks at a few broad tax issues to be considered by a Singapore company in evaluating the different foreign entity structures or legal presence.



Corporate Taxation in the Overseas Jurisdictions

If different entity structures are taxed at different rates in a particular jurisdiction that a Singapore company is looking to do business in, it will make sense to plan upfront in choosing the right entity structure for that jurisdiction.

In some situations, the difference in tax rates is due to tax residency. For example, the basic corporate tax rate in India, excluding surcharges, for a non-resident company is 40% and for a resident company is 30%[1]. A branch in India will generally be treated as a non-resident and hence, the 40% rate shall apply. If a company is resident in India, the 30%[1] rate applies.

In some countries, both a resident and a non-resident company are taxed at the same rate but the basis of taxation may differ. For example, a resident company will be taxed on its worldwide income whilst a non-resident is taxed only on income having a source in that country.

As such, the choice of entity may have an impact on the residency status and thereby determining the tax rate and/or the basis of taxation. It also means that the on-going requirements to maintain tax residency, if it is advantageous to do so, need to be considered in determining the entity type.

Beyond comparing the tax rates of different entity types, it is worthwhile to look at whether the jurisdiction in question offers tax incentives. If tax incentives are available, the rules for the application of such incentives can be examined to see if certain entity types are precluded from enjoying the incentives, for example, in certain countries a company may be preferred to a branch for the purpose of granting tax incentives. Upfront planning will prevent a downstream tax disadvantage arising from choosing an inappropriate entity structure.

Withholding Tax on Profit Repatriation

While businesses should look to lowering the effective corporate taxes suffered on their foreign businesses, they should also consider whether any foreign withholding taxes on profits repatriated to Singapore has a bearing on the type of entity structure.

Some jurisdictions, by way of their domestic tax law, impose withholding tax on outbound remittance of profits by way of dividends or branch profits to non-residents. For example, in China the withholding tax on dividends paid to non-residents is 10%.

Under Singapore's Avoidance of Double Taxation Agreements (DTA) with over 80 foreign jurisdictions, it may be possible to reduce the withholding tax rates on certain income derived by Singapore residents from those jurisdictions. For example, withholding tax rates on dividends may be reduced under an applicable DTA if certain conditions, such as whether the recipient and payer of the dividends are tax residents of the respective countries that are parties to the DTA and whether the recipient is a beneficial owner of the dividend received, are met. In addition, the reduced rate of withholding tax for dividends under a DTA may also depend on the percentage of shareholding that the Singapore parent company has in the foreign subsidiary.

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[1]As proposed in the Budget 2019, a 25% tax rate applies where gross turnover in FY 2017-18 does not exceed Rs.4,000 million. This has not been enacted as of the date of this article.

Let's say the repatriation of profits in the form of dividends will result in the lowest withholding tax in a foreign jurisdiction. It, therefore, follows that in order to enjoy a reduced rate of withholding tax on dividends, the type of entity set up by a Singapore company in the foreign jurisdiction must be able to distribute profits that qualify as dividends as defined in the relevant DTA and all the conditions for applying the reduced rate are met.

In this regard, the questions to address are:

1. Are there differences in the domestic withholding tax rates on the different types of income repatriation?
2. Will the proposed entity type in the foreign jurisdiction allow for the use of a valid tax treaty between Singapore and that foreign jurisdiction to further reduce the withholding tax on the profits repatriated?
3. Considering the above, will the proposed entity type in the foreign jurisdiction allow for the repatriation of profits with the least withholding tax?

Taxation of Foreign-Sourced Income

When income derived from a business carried on through an entity established outside Singapore (also referred to as foreign sourced income) is repatriated to Singapore, the issue of double taxation needs to be addressed.
Where taxes are suffered in both Singapore and the foreign jurisdiction on the foreign sourced income, a tax credit for the foreign tax suffered can be claimed against the income tax payable in Singapore on the same income if the recipient of the income is a Singapore tax resident and certain other conditions are met. This is provided for under the DTAs. Where there is no DTA between Singapore and a particular country, Singapore allows unilateral tax credits on all types of foreign-sourced income received in Singapore by Singapore tax residents.

In general, for a Singapore resident company, the entity type in the foreign jurisdiction will not be a factor in claiming foreign tax credits in Singapore either under a DTA or through the unilateral tax credit mechanism.

However, the entity type in the foreign jurisdiction will play a role if the Singapore company wants to claim a tax exemption on the foreign sourced income. This is because only dividends, service income and branch profits are granted tax exemption, provided all the following qualifying conditions under Section 13(8) of the Income Tax Act are met:

1. The foreign income had been "subject to tax" in the foreign jurisdiction from which they were received.
2. The highest corporate tax rate of the foreign jurisdiction from which the income is received is at least 15% at the time the foreign income is received in Singapore; and
3. The Comptroller of Income Tax is satisfied that the tax exemption would be beneficial to the person resident in Singapore.

Hence, if the foreign entity structure is a partnership or trust, the foreign income exemption under Section 13(8) will not apply.

Exit Strategy

Businesses that are growing and expanding overseas will rarely think of divestment strategies upfront. Sometimes even with the best of intentions to be in a country for the long haul, a change in circumstances may require exiting from a location.

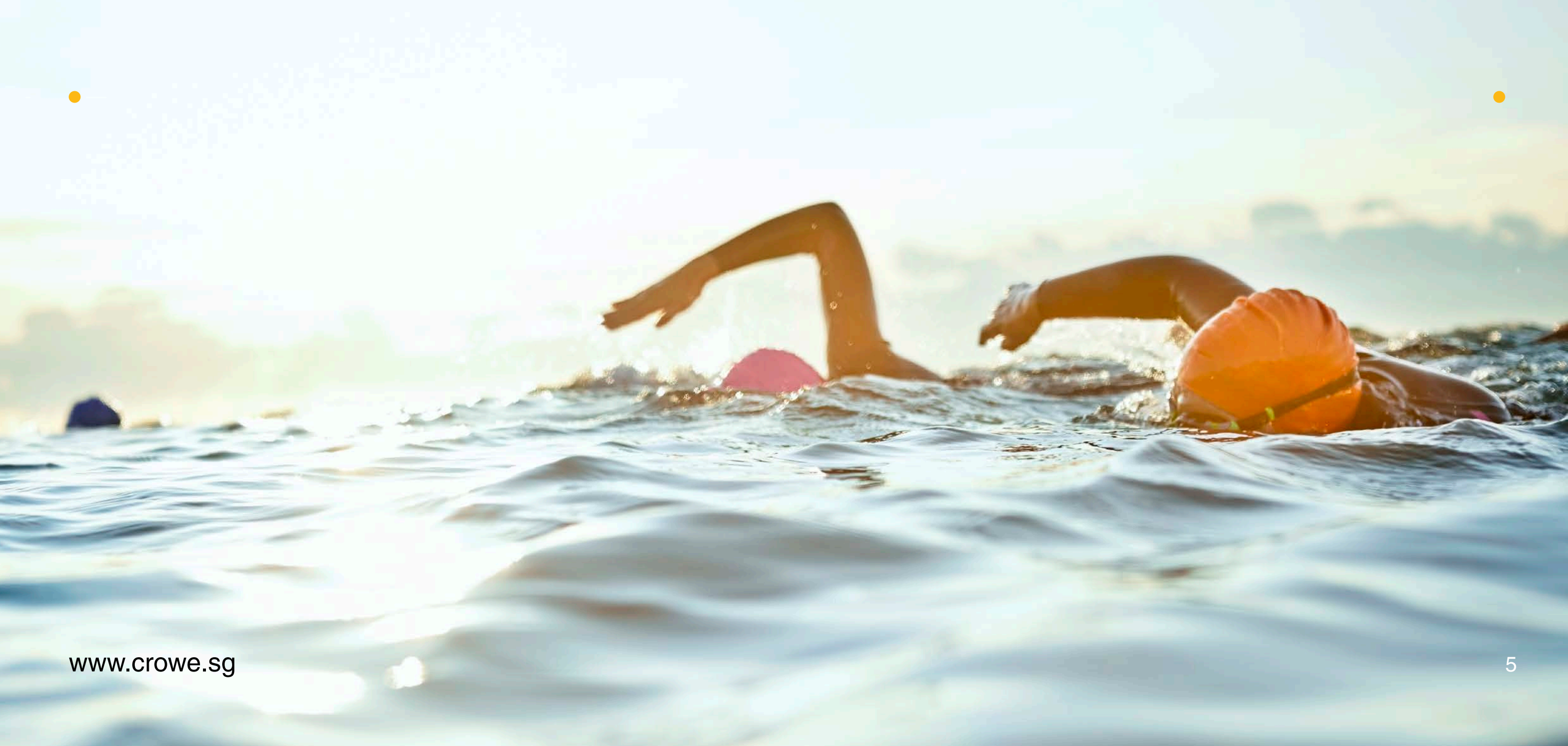
Should businesses choose to wind up or sell their overseas investments, the exit tax is something that needs to be considered as some countries impose capital gains or asset transfer taxes.

How does choosing the right entity impact the exit tax? Here are a few considerations:

1. Is there a difference in the transfer taxes (such as stamp duty) imposed on a transfer of shares vis-à-vis a transfer of assets? The answer may favour a company over a branch or vice-versa.
2. Will there be a difference in the tax implications of liquidating a company versus closing down or de-registering a branch or other type of entity structures?
3. Will there be any difference in the tax implications relating to the repatriation of residual profits after closing down, de-registering or liquidating the different types of entity structures?
4. If the country in question allows re-domiciliation of companies with minimal tax impact, is this an issue to be considered in determining the entity structure?

Concluding Remarks

This article has provided a glimpse of some of the many tax issues to be considered in structuring an overseas business or legal presence. It is by no means an exhaustive list of all tax issues to be considered. In reality, depending on the jurisdiction concerned, the issues could be far ranging and complex that requires a detailed analysis. Of course, tax is only one facet of the decision-making process. Non-tax issues stemming from corporate law, labour law, investment regulations, licensing regulations, etc are also important considerations in determining the appropriate entity type for doing business in a particular country.



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