

## **Australasian Tax Teachers Association Conference 2016**

### **Unpacking the “direct benefit” requirement for zero-rating exports of services in section 21(3)(j) of Singapore’s GST Act**

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#### **Abstract**

When does a service directly benefit someone other than the person contracting for it? The answer determines whether a service can be zero-rated under section 21(3)(j) of Singapore’s GST Act. This article unpacks what it means to “directly benefit” from a service, and proposes some principles to determine who exactly “directly benefits” in a given situation.

## I. Introduction

1 Assume USCo, a corporation incorporated in the US, sells software solutions to customers in Asia, including Singapore. A Singapore customer purchases the software from USCo, and it is delivered to him via the internet. The supply is an import of services,<sup>1</sup> which does not trigger any GST<sup>2</sup> consequences.<sup>3</sup>

2 Later on, the Singapore customer encounters issues with the software. He contacts the customer service helpline for advice. This helpline is run by SingCo, a wholly-owned Singapore-incorporated subsidiary of USCo. SingCo does not charge the Singapore customer for the advice. Instead, under an agreement with USCo, SingCo is paid a service fee by USCo to perform this technical assistance service for the Singapore customer. USCo cannot perform this service by itself because it has no operations or employees in Singapore.

3 Does the service fee qualify for zero-rating? Why does this matter? If the fee does not qualify for zero-rating, SingCo has to charge 7% GST on the service fee; (a) USCo incurs irrecoverable GST, since it is not GST-registered; and (b) the Singapore customer cannot claim this GST amount as input tax – besides the obvious point that he did not pay the service fee including the GST on it, there is probably a supply of service made by SingCo to USCo but not to the Singapore customer<sup>4</sup> (although, extraordinarily, under an administrative

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<sup>1</sup> Supplying software is a supply of service. Section 10(2) provides that, subject to the Second Schedule and orders made by the Minister, anything which is not a supply of goods but is done for consideration (including the granting assignment or surrender of any right) is a supply of services. Software is a service because (a) it is not tangible, moveable and visible (*ie*, it is not a good); and (b) neither the Second Schedule nor any order made by the Minister changes this treatment.

<sup>2</sup> Henceforth, a reference to “GST” refers to Singapore GST, unless the context suggests that (a) it refers to GST in the general sense (*ie* as a system of taxation worldwide); or (b) the GST or equivalent tax of a different jurisdiction.

<sup>3</sup> Section 14 provides for the Minister to make regulations prescribing services that will be subject to the reverse charge mechanism. No such regulations have been prescribed.

<sup>4</sup> The GST amount on the service fee can be claimed as input tax only if (amongst other conditions), there is a supply “to” the Singapore customer: s 19(3)(a). There are views in the context of non-Singapore GST regimes that in such situations (*ie* where X contracts with Y, under which X is paid by Y to perform a service for Z), X has made a supply to Y, not Z. Singapore having no case law directly on point, will likely endorse these views, not least because, given that either Y or Z should be entitled to claim input tax (since we assume neither are end consumers), it is far less difficult to administer a tax regime where the person who is invoiced the GST amount (*ie* generally Y, since he contracted with X) claims the same as input tax.

For some views in the context of non-Singapore GST regimes: see (1) *Customs and Excise Commissioners v Redrow Group plc* [1999] STC 161 (“*Redrow*”) at 165 and 171 (where Y is GST-registered, it can claim input tax credits because (amongst others) it pays for the service – since GST is meant to be a tax on the final consumer and not businesses and Y is a business, denying Y input tax credits is contrary to the purpose of GST); (2) Edmundson, Peter (2001) “An Analysis of GST and Third Party Consideration”, *Revenue Law Journal*: Vol. 11: Iss 1, Article 4; and James, Caroline and STACEY, Paul “The GST Treatment of Tripartite Arrangements”. *Australian Tax Review*. 31.4 2002. 192 – 232 (considering, in the context of the Australian GST regime, whether X is making a supply to Y or Z); and (3) the ATO’s GSTR 2006/9 (20 August 2014 Consolidated Ruling) at paras 130 - 154 (considering *Redrow* and the subsequent related UK and New Zealand

concession the Singapore customer can possibly claim the input tax).<sup>5</sup> If the fee qualifies for zero-rating, SingCo does not charge GST on the service fee, and no one incurs irrecoverable GST.<sup>6</sup>

4 The zero-rating conditions applicable to this scenario are found in s 21(3)(j). Under that section, the service fee that SingCo charges USCo can be zero-rated if all the following conditions are fulfilled (with each condition called “Condition (a)”, “Condition (b)”, “Condition (c)” and “Condition (d)” respectively, and collectively, the “Section 21(3)(j) Conditions”):

- (a) the service is supplied under a contract with a person who belongs outside Singapore;
- (b) the service directly benefits a person who belongs outside Singapore;
- (c) the person who directly benefits is outside Singapore at the time the service is performed; and
- (d) the service is not (I) the supply of a right to promulgate, or the promulgation of, an advertisement;<sup>7</sup> or (II) directly in connection with land in Singapore, or goods in Singapore that are not for export<sup>8</sup>.

5 In our scenario, Condition (d) is fulfilled, so we will consider the remaining three conditions. First, Condition (a). To fulfil it, SingCo must supply the service under a contract with a person who belongs outside Singapore. Does USCo belong outside Singapore? Section 15 provides two rules (which I will call Rule 1 and Rule 2, and collectively the “Rules”) for determining the belonging status of a person who receives the service:

Rule 1: If the person is an individual who receives the service otherwise than for his business purposes, he belongs outside Singapore if his usual place of residence is not Singapore.

Rule 2: If the person does not fall under Rule 1, he belongs outside Singapore if:

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cases, and concluding that there is a supply made by X to Y (contractual flow) that X provides to Z (actual flow)).

<sup>5</sup> Recognising that the irrecoverable GST outcome may affect the international competitiveness of Singapore suppliers in SingCo’s position, as an administrative concession, the Inland Revenue Authority of Singapore (“IRAS”) allows the Singapore customer to claim the GST charged by the Singapore supplier, if prescribed conditions are fulfilled. This is discussed further at *infra* note 81.

<sup>6</sup> Further, a zero-rated supply is a taxable supply: s 21(2), so input tax credits are available to SingCo.

<sup>7</sup> Section 21(4B). The zero-rating of such services is separately provided for under s 21(3)(u).

<sup>8</sup> Section 21(4C). Zero-rating under s 21(3)(g) is available for services that are directly in connection with goods for export and supplied to a person not belonging in Singapore at the time the services are performed.

- he has a fixed establishment or some other business establishment<sup>9</sup> outside Singapore and no such establishment elsewhere; or
- he has no such establishment in any country but his usual place of residence is outside Singapore (further, a company's usual place of residence is its country of incorporation); or
- he has such establishments both in Singapore and outside Singapore and (i) the establishment that most directly uses the service is outside Singapore; or (ii) the service is most directly used for the purposes of the establishment that is outside Singapore.

6 Condition (a) in our scenario is fulfilled if the service (*ie* the technical assistance service for the Singapore customer) is supplied under a contract between a person who belongs outside Singapore. The service is supplied under a contract between SingCo and USCo. USCo, as a US-incorporated corporation (and which we assume has no fixed or business establishment in Singapore), is a person who belongs outside Singapore under Rule 2. Therefore Condition (a) is fulfilled.

7 We are left to consider Condition (b) and Condition (c). Does the service directly benefit someone who belongs outside Singapore and who is outside Singapore at the time the service is performed? This turns on who directly benefits from the service. If it is USCo, then Condition (b) and Condition (c) are fulfilled, since we have already established that USCo belongs outside Singapore,<sup>10</sup> and it is obviously outside Singapore at the time the service is performed.<sup>11</sup> If it is the Singapore customer, then Condition (b) and Condition (c) will not be

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<sup>9</sup> Section 15(6) provides that a person carrying on a business through a branch or agency in any country shall be treated as having a business establishment there.

<sup>10</sup> The Rules tell us to whom a supply is "made" but not who directly benefits from a supply: the word "made" is used in s 15(4) and s 15(5). Section 15(2) calls this person the "recipient" (in our scenario, that person is USCo). However, it is reasonable to use the Rules to determine if, under Condition (b), a person who directly benefits from the service belongs outside Singapore, because the Rules are the only provisions in the Act that tell us how to determine the belonging status of anyone who is not a supplier of the service (and we are obviously not concerned with the belonging status of the supplier here).

<sup>11</sup> Where Rule 2 is applied (*eg* to companies), Condition (c) probably does not add anything to the other three zero-rating conditions in s 21(3)(j), because (i) in every case where Condition (b) is fulfilled; Condition (c) will also be fulfilled, since if the entity does not belong in Singapore, there is no basis to say that it is in Singapore at the time the service is performed; and (ii) the four Section 21(3)(j) Conditions are cumulative (*ie* all four have to be fulfilled). Condition (c) is probably meaningful only when Rule 1 is applied (*ie* to individuals who receive the service otherwise than for business purposes).

fulfilled, because the Singapore customer belongs in Singapore and is not outside Singapore at the time the service is performed.<sup>12</sup>

8 In short, a service can be zero-rated under s 21(3)(j) only if the person who directly benefits from the service belongs outside Singapore and is outside Singapore at the time the service is performed (the “DB Requirement”). So, we need to identify who directly benefits from the service (the “Direct Beneficiary”).

## II. Who is the Direct Beneficiary?

### *Parliament’s intention and the structure of the zero-rating provisions*

9 Section 9A of the Interpretation Act<sup>13</sup> requires statutes to be interpreted purposively; *ie* effect must be given to Parliament’s intention in enacting the statute in question. Therefore, the natural starting point in determining the identity of the Direct Beneficiary is to figure out what Parliament meant by “directly benefit”. The words “directly benefit” were added when s 21(3)(j) was amended in 2004.<sup>14</sup> Prior to that, zero-rating under s 21(3)(j) was allowed if (a) the service was supplied for and to a person who belonged outside Singapore; (b) that person was outside Singapore at the time the service was performed; and (c) the service was not directly in connection with land in Singapore, or goods in Singapore that were not for export.

10 The 2004 amendment to s 21(3)(j) removed the requirement that the service be supplied for and to a person who belonged outside Singapore, and replaced it with Condition (a) and Condition (b) – *ie* the service must be supplied under a contract with a person who belongs outside Singapore, and the service must directly benefit a person who belongs outside Singapore. Parliament’s intention in making the amendment was not to introduce

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<sup>12</sup> What if the service directly benefits both a person who belongs in Singapore and another person who belongs outside Singapore? The wording in s 21(3)(j) does not explicitly exclude zero-rating in that case. However, it would be unreasonable to insist that the entire service can be zero-rated where there are only 10 “qualifying beneficiaries” (*ie*, direct beneficiaries who belong outside Singapore and are outside Singapore at the time the service is performed) and 1000 “non-qualifying beneficiaries” (*ie* direct beneficiaries who are not “qualifying beneficiaries”). It is far more reasonable to imply that the service cannot be zero-rated to the extent that there is a non-qualifying beneficiary (and conversely, the service can be zero-rated to the extent that there is a qualifying beneficiary). Singapore’s administrative practice of allowing apportionment in such a case is in line with this interpretation: see *infra* note 56.

<sup>13</sup> Cap 1, 2002 Rev Ed.

<sup>14</sup> Goods and Services Tax (Amendment) Act 2004 (No. 50 of 2004) at s 3.

anything new; rather, it was to clarify that, to enjoy zero-rating under s 21(3)(j), the service must be made contractually to and beneficially for an overseas person.<sup>15</sup>

11 That the amendment was described as a clarification<sup>16</sup> suggests that the words “for and to” were always intended to mean contractually to and beneficially for. It has been suggested<sup>17</sup> that the clarification was necessary because of the New Zealand case of *Wilson & Horton Ltd v CIR*.<sup>18</sup> There, it was held that “for and to” a person (in the context of New Zealand’s equivalent of s 21(3)(j)) referred only to the service being made contractually to that person, so it was unnecessary to consider who the service benefited.<sup>19</sup> On this view, the 2004 amendment was intended to prevent any potential application of *Wilson* in interpreting s 21(3)(j).<sup>20</sup>

12 After determining that Parliament intended the DB Requirement to ensure that the service is beneficially for an overseas person, the next step is to study how the DB Requirement fits within the structure of the provisions that zero-rate services in the Act. The aim is to interpret the Direct Benefit Requirement in a way that is consistent with the underlying rationale behind zero-rating services. The provisions that zero-rate services are found in the sub-paragraphs of s 21(3); and s 21A, s 21B and s 21C (collectively, the “Zero-Rating Provisions”). The Zero-Rating Provisions can be explained on the basis that each of them has any one of three distinct overseas elements: (a) the property in connection with the service is overseas; (b) the service is performed overseas; or (c) the recipient is overseas (with (a), (b) and (c) known as “Overseas Element 1”, “Overseas Element 2” and “Overseas

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<sup>15</sup> *Singapore Parliamentary Debates, Official Report* (17 November 2004) vol 78 at col 1216 (Mr Raymond Lim Siang Keat, Acting Second Minister for Finance).

<sup>16</sup> See also the Explanatory Statement to the Goods and Services Tax (Amendment) Bill (Bill No. 59/2004): “Clause 3 amends section 21(3)(j), (k) and (s) to clarify that the services to qualify thereunder as international services are those supplied under a contract with a person who belongs outside of Singapore and which directly benefit a person who belongs outside Singapore.”

<sup>17</sup> Leung Yew Kwong and Ong Sim Ho, ‘Zero-Rating of ‘International Services’’ (*Law Gazette*, September 2004) <<http://www.lawgazette.com.sg/2004-9/Sep04-col2.htm>> accessed 5 January 2016.

<sup>18</sup> (1994) 16 NZTC 11,221 (1994) TRNZ 792 (“*Wilson*”).

<sup>19</sup> The New Zealand Court of Appeal reasoned that the GST regime was concerned only with the contractual supply of services, and so it was unlikely that non-contractual benefits affecting a wide and indeterminate group of New Zealanders were intended to affect whether a service could be zero-rated.

<sup>20</sup> Likewise, New Zealand introduced section 11A(2) of its Goods and Services Tax Act 1985 to counteract the effect of *Wilson*. Briefly, this provides that zero-rating will not apply to a supply of services under an agreement that is entered into with person A who is a non-resident if (a) the performance of the service is received in New Zealand by person B (who may be an employee or director of person A); and (b) it is reasonably foreseeable when the agreement was entered into that person B will not receive the performance of the services in the course of making taxable or exempt supplies.

Element 3” respectively; and all three collectively known as the “Three Overseas Elements”).<sup>21</sup> This is shown in the first three columns of the table below.

<b>Zero-Rating Provision by section number</b>	<b>Description of service</b>	<b>Overseas Element</b>	<b>Use is overseas because...</b>
21(3)(a), (b) and (c)	Transportation of goods or people which takes place substantially outside Singapore, including ancillary services like insurance, arranging such transport and the loading/unloading/handling of the goods.	<b>Overseas Element 1</b>  <b>Non-fluid service</b> <sup>22</sup> <b>performed overseas</b>	As the transportation is substantially outside Singapore, <sup>23</sup> the transportation service is used overseas.
21(3)(i)	Certain non-fluid services that are performed outside Singapore.		These non-fluid services are used where the service is performed. <sup>24</sup>
21(3)(d),	(a) The supply of certain things used		For (a): As the

<sup>21</sup> The Three Overseas Elements that justify the zero-rating of services were given in Parliament when the first of the Zero-Rating Provisions were introduced: *Singapore Parliamentary Debates, Official Report* (19 March 1993) vol 60 at col 1543 (Dr Richard Hu Tsu Tau, Minister for Finance). Also see paragraph 28 of the *Select Committee Report*. Although these two sources referred to zero-rating based on the “recipient” without elaborating, this must mean the recipient belongs outside Singapore: see Charles Lim Aeng Cheng, ‘Synopsis of GST Bill 1993’ (1993) 5 SAcLJ 121 at 126, which interpreted “recipient” to mean the residence status of the service recipient (before the *Select Committee Report* recommended using the Rules instead of residence to define an overseas recipient of the service, a recommendation which was adopted). Over time, new provisions were added and existing ones amended, but we can still rationalize most of the Zero-Rating Provisions according to the Three Overseas Elements, as shown in the table below.

<sup>22</sup> I added the word “non-fluid” as it more accurately describes the types of services that are performed overseas and zero-rated. A non-fluid service is one which is used where it is performed. The OECD’s *International VAT/GST Guidelines* (November 2015) at paras 3.114 and 3.117 call these “on-the-spot” supplies and lists as examples hairdressing, massage, accommodation and theatre performances etc. See *infra* note 24.

<sup>23</sup> Thus, the Act was amended in 2010 to zero-rate a “cruise to nowhere” (*ie*, one that leaves Singapore and returns to Singapore without calling at an overseas port), on the basis that the cruise ship is substantially outside Singapore: see *Singapore Parliamentary Debates, Official Report* (16 August 2010) vol 87 at col 913 (Mrs Lim Hwee Hua, Second Minister for Finance).

<sup>24</sup> These non-fluid services are cultural, artistic, sporting, educational, exhibition or convention services. The non-fluid feature is a safeguard against tax planning and round-tripping: *Select Committee Report* at para 31; *Singapore Parliamentary Debates, Official Report* (12 October 1993) vol 61 at col 581 - 582 (Dr Richard Hu Tsu Tau, Minister for Finance). Thus, a consultant who performs a fluid service cannot zero-rate his service by deliberately going to a neighbouring country to perform his work on a laptop.

<p>(o), (x), (v)</p> <p>S 21(3)(l), (m), (n), (p), (t), (w)</p>	<p>exclusively overseas: vehicles, ships and things on ships,<sup>25</sup> aircraft and aircraft parts<sup>26</sup>; and containers which are used for the international transportation of goods on ships or aircraft.</p> <p>(b) Services in connection with ships, aircraft and international trade: pilotage, salvage or towage; services within port/airport areas; use of the Portnet.com IT system for logistics in connection with the handling and storage of goods carried in a ships or aircraft; surveying of ships; classification of ships or aircraft; the repair, maintenance broking or management of ships or aircraft; the repair; providing an electronic system for applying for approvals for the import and export of goods;<sup>27</sup> maintenance or</p>	<p><b>Overseas Element 2 Property in connection with service is overseas</b></p>	<p>vehicles, ships, aircraft (and aircraft parts) and containers are used exclusively overseas,<sup>28</sup> the service (being the supply of the vehicle, ship, aircraft or container)<sup>29</sup> is used overseas.<sup>30</sup></p> <p>For (b): the service is used overseas because it is so closely related to the thing in (a), and since all things in (a) are exclusively used overseas, the service</p>
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<sup>25</sup> Approved marine customers can purchase or rent goods and enjoy zero-rating automatically if the goods are used on commercial ships that are wholly for international travel (*ie*, their suppliers do not have to maintain export documentation): s 21B.

<sup>26</sup> The supply of ship parts was probably not zero-rated because unlike aircraft parts, it was practically difficult to ensure that the parts end up on ships: see *Singapore Parliamentary Debates, Official Report* (16 August 2010) vol 87 at col 918 - 919 (Mrs Lim Hwee Hua, Second Minister for Finance).

<sup>27</sup> Section 21(3)(t). The electronic system relates to trade declarations for the import and export of goods via road, rail and mail. Portnet.com (the supply of which is zero-rated under s 21(3)(l)) is the equivalent electronic system for the import and export of goods via sea and air.

<sup>28</sup> Section 21(3)(o) zero-rates the supply (including the letting on hire) of any ship or aircraft. That these aircraft and ships are exclusively used overseas can be deduced from the definitions of “aircraft” and “ship” in s 21(4)(a), and the fact that Singapore is a tiny country; so practically all aircraft and ships supplied in Singapore are for international use.

<sup>29</sup> Ordinarily, these may be supplies of goods instead of services. A supply of goods is zero-rated only if the goods are exported, but this is subject to s 21, s 21A, s 21B and s 21C: s 21(1). As the supplies under s 21(3) are described as “international services”, s 21(5) clarifies that where the supply referred to in a sub-paragraph of s 21(3) is a transaction which would not otherwise be a supply of service, it would nevertheless be treated as a supply of service for the purposes of the Act. No such issue arises for supplies under s 21A, s 21B and s 21C.

<sup>30</sup> The underlying rationale of ensuring that the use of the thing supplied is outside Singapore may be seen in s 21(4)(c). This provides that a supply of ships or aircraft under s 21(3)(o) excludes services under an aircraft or ship charter which consist of (i) transport of passengers; (ii) accommodation; (iii) entertainment; (iv) catering of food or beverage; or (v) education, where these services are substantially performed in Singapore. This is to deter acts like deliberately having a seminar on a ship instead of in a hotel to enjoy zero-rating. But it also shows that the policy intention is to zero-rate the use of ships or aircraft outside Singapore.

	management of containers which are used for the international transportation of goods.		is taken to be used overseas as well.
21(3)(e), (f), (g), (h)	Services directly in connection with (i) land outside Singapore; (ii) goods outside Singapore when the service is performed; (iii) goods for export outside Singapore where the contractual recipient does not belong in Singapore and is outside Singapore at the time the service is performed; and (iv) prescribed financial services in relation to the goods in (ii) and (iii).	<b>Overseas Element 2</b> <b>Property in connection with service is overseas</b>	The service is used overseas because it is so closely related to land or goods that are used overseas that it is taken to be used overseas as well.
21(3)(j)	Services (a) where the contractual recipient belongs outside Singapore; (b) that directly benefit a person who belongs outside Singapore at the time the service is performed; and (c) that are not directly in connection with land in Singapore or goods in Singapore at the time the service is performed other than goods for export.	<b>Overseas Element 3</b>	This is the argument: we can identify the person who directly benefits from the service (whom we have called the Direct Beneficiary in the context of s 21(3)(j)) as the person who
21(3)(k)	Prescribed services where (a) the contractual recipient is contracting in his business capacity; and (b) in that capacity belongs outside Singapore, and that directly benefit a person wholly in his business capacity and who in that capacity belongs outside Singapore. <sup>32</sup>	<b>Recipient of service is overseas</b>	
21(3)(s)	Services supplied (a) where the		

<sup>32</sup> See the Second Schedule of the Goods and Services Tax (International Services) Order. The prescribed services include (amongst others) the services of lawyers, engineers and other similar consultancy services that are not directly in connection with land in Singapore or goods in Singapore at the time the services are performed other than goods for export and ships. Accommodation and entertainment services are expressly excluded.

	contractual recipient belongs outside Singapore; (b) which directly benefit a person who belongs outside Singapore; and (c) which relate to the co-location in Singapore of computer server equipment belonging to the person in (a) or (b). <sup>33</sup>	<b>Overseas Element 3</b>  <b>Recipient of service is overseas</b>	uses the service, because the use of a service overseas underlies all the other Zero-Rating Provisions. <sup>31</sup>
21(3)(y)	Prescribed services that are directly in connection with storing prescribed high value goods like art, antiques and gold in specialised storage facilities in Singapore, (a) where the contractual recipient belongs outside Singapore; and (b) which directly benefit a person belonging outside Singapore.		
21C	Grant or assignment of lease, tenancy or licence to occupy land which is part of an approved warehouse <sup>34</sup> , (a) where the contractual recipient belongs outside Singapore; and (b) which directly benefits a person belonging outside Singapore.		
21(3)(r)	Services in relation to a foreign trust.		

*\*Note that the table above excludes three of the Zero-Rating Provisions which are harder to explain by reference to the Three Overseas Elements; however, they may still be explained on the basis that they are used outside Singapore.<sup>35</sup>*

<sup>33</sup> Co-location is defined as providing a physical environment for the operation of the computer server equipment: s 21(4a).

<sup>31</sup> Regarding s 21(3)(r), in substance, the contractual recipient and direct beneficiary of such services belong outside Singapore, because a “foreign trust” is generally a trust that does not have a settlor or beneficiaries in Singapore. See also *Singapore Parliamentary Debates, Official Report (22 November 2000) vol 72 at col 1214* (Dr Richard Hu, Minister for Finance), where the Minister stated that a cardinal principle underlying GST is that it is a tax on domestic consumption of goods and services, and zero-rating services that fall under s 21(3)(r) is consistent with this principle because the recipients of such services are the beneficiaries and settlors who are foreigners, so there is no domestic consumption.

<sup>34</sup> An approved warehouse is the specialised storage facility for storing prescribed high value goods referred to under the “Description of Service” for s 21(3)(y).

<sup>35</sup> The three provisions are described below.

13 In explaining the Zero-Rating Provisions according to the Three Overseas Elements, we discover that the three elements are manifestations of one underlying rationale. The underlying rationale is this: as explained in the fourth column of the table, (a) the service is zero-rated because the use of the service is overseas; and (b) the service is used overseas because (i) the service is non-fluid and performed overseas; or (ii) the property in connection with the service is overseas; or (iii) the recipient of the service is overseas.

14 There are many other reasons for saying that the underlying rationale of the Zero-Rating Provisions is the use of the service overseas. For one, this is implicit in the express wording in Rule 2,<sup>36</sup> which provides that the service recipient is determined, in certain defined circumstances, according to which of his multiple establishments most directly “uses” the service. More importantly, the policy intention is to zero-rate services that are consumed outside Singapore: the GST White Paper states that Singapore intends to zero-rate services that are exported, which implicitly means services that are consumed outside Singapore.<sup>37</sup> What does consumption outside Singapore mean? The plain ordinary meaning of “consume” is to “use”. To consume a service is thus to use it.

15 Lastly, to say that the underlying rationale of the Zero-Rating Provisions is the use of the service overseas is consistent with international guidelines. Thus, the OECD’s *International VAT/GST Guidelines* (November 2015) promotes the implementation of the

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(a) Section 21(3)(q) zero-rates prescribed services comprising the provision of any means of telecommunication that is not transmitted from and to a place in Singapore (see the Fifth Schedule of the Goods and Services Tax (International Services) Order). Such services are used overseas because they are closely related to international business and trade.

(b) Section 21(3)(u) zero-rates the supply of a right to promulgate or the promulgation of an advertisement by means of any medium of communication, where the advertisement is intended to be substantially promulgated outside Singapore (such advertising services are expressly taken out of the ambit of s 21(3)(e), (f), (g) and (j): s 21(4B)). The policy intention is to zero-rate the supply of advertising services based on their nature instead of the subject of the particular advertisement: *Singapore Parliamentary Debates, Official Report* (22 November 2000) vol 72 at col 1214 (Dr Richard Hu, Minister for Finance). These services are used outside Singapore because they are the provision of advertising space to circulate advertisements that are used overseas. It has been noted that Singapore’s approach, by focussing on place of promulgation instead of the customer’s location, differs from other jurisdictions and “runs counter to the cost element principle”: Millar, Rebecca (2008) *The Impact of GST and VAT on Cross-Border Transactions. Commercial Practice in a Global Economy 2008: Commercial Law Association of Australia / Ross Parsons Centre of Corporate, Commercial and Taxation Law* at p 36 <<http://taxboard.gov.au/files/2015/07/Millar-submission.pdf>> accessed 21 January 2016.

(c) Section 21A zero-rates the supply of prescribed tools and machinery retained in Singapore to manufacture goods for export to an overseas customer, and services directly in connection with such tools and machinery. The services that are directly in connection with such tools and machinery are used overseas in the sense that the machines, although in Singapore, are merely business inputs to manufacture goods for export (*ie*, the use of the service is overseas because the service is identified with the goods which are meant for overseas use).

<sup>36</sup> See *supra* para 5.

<sup>37</sup> White Paper titled “The Goods and Services Tax” (first published February 1993), Appendix I at para 16. The implication arises because while there is no explanation of what an export of services entails, it is mentioned (also at para 16) that an export of goods means the consumption of goods outside Singapore, and thus an export of services should likewise mean the consumption of services outside Singapore.

destination principle: GST is ultimately levied only on the final consumption that occurs within the taxing jurisdiction. In other words, the Zero-Rating Provisions allow zero-rating because the services they describe are consumed or used overseas. By way of example, Australia uses a concept of “effective use or enjoyment” in its equivalent of s 21(3)(j). Item 3 of section 38-190 of A New Tax System (Goods and Services Tax) Act 1999 allows zero-rating of a supply if (i) it is made to a recipient who is not in Australia when the thing supplied is done; (ii) the “effective use or enjoyment” of the supply takes place outside Australia; and (iii) the supply is not (A) work physically performed on goods in Australia when the thing supplied is done; or (B) directly in connection with Australian land. The requirements in (i) and (iii) correspond to Condition (a) and Condition (d) of the Section 21(3)(j) Conditions respectively. Likewise, the requirement in (ii) also corresponds to Condition (b) and Condition (c).

16 In short, we can identify the Direct Beneficiary as the person who uses the service, because this is consistent with the underlying rationale of all the Zero-Rating Provisions. Indeed, the Australian legislation highlighted above supports this conclusion.<sup>38</sup>

### **III. Principles for identifying the Direct Beneficiary**

17 We have seen that we can identify the Direct Beneficiary as the person who uses the service. But how do we do that exactly? After all, there is no Singapore case law on this point. In this section, I propose a set of (non-exhaustive) principles for doing so.

18 *Principle 1: Even if there is no tax avoidance, the Direct Beneficiary can be someone other than the contractual recipient of the service.*

Some may argue that the Direct Beneficiary is always the same as the contractual recipient of the service unless there is tax avoidance, because the DB Requirement serves an anti-avoidance function only.<sup>39</sup> After all, it is perfectly plausible that the contractual recipient

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<sup>38</sup> See ATO’s GSTR 2007/2 (17 April 2013 Consolidated Ruling) at para 41 (the supply is made to a recipient and provided to another entity known as the providee entity if in the performance of a service the actual flow of that supply is to an entity that is not the contractual recipient); para 68 (the providee entity is the relevant entity for determining where “effective use or enjoyment” of the supply takes place; the Direct Beneficiary will thus correspond to the providee entity); and paras 45 and 89 (“effective use or enjoyment” takes place outside Australia if there is provision of the supply to the providee outside Australia; for services, there is provision of the supply outside Australia if the service is performed outside Australia). In short, the Australian legislation requires the providee entity to be outside Australia when the service is performed, while the DB Requirement requires the Direct Beneficiary to be outside Singapore at the time the service is performed.

<sup>39</sup> The tax avoidance concern is that, if a service can be zero-rated solely on the basis that the contractual recipient is overseas, parties may interpose an overseas entity between a Singapore supplier and Singapore customer to avoid GST. Without the overseas entity, the Singapore supplier has to charge the Singapore

obtains some kind of benefit for the service; *eg*, the discharge of a pre-existing contractual obligation to a third party; otherwise why would he pay for it? Proponents of this argument will point to the statement in Parliament (in relation to the 2004 introduction of the DB Requirement) that the “amendment, which reinforces the policy intent that only services consumed by overseas persons can be zero-rated, acts as a safeguard against round tripping and tax avoidance”.<sup>40</sup>

19 The implication of this argument is that, so long as there is no tax avoidance, the contractual recipient is always the Direct Beneficiary. Thus, in our earlier scenario (let’s call it the customer helpline scenario), USCo and not the Singapore customer is the Direct Beneficiary, since USCo is the contractual recipient of the service and there is no tax avoidance. There is no question of tax avoidance because this arrangement was (a) not to avoid tax; and/or (b) carried out for *bona fide* commercial reasons and had not tax avoidance as one of its main purposes.<sup>41</sup> USCo did not structure the arrangement to avoid GST. It engaged SingCo to provide technical assistance to Singapore customers at large because of commercial necessity: it had to provide such assistance in a different time zone (*ie*, Singapore), but had no operations or employees in Singapore.

20 I will now show why the DB Requirement does not have a tax avoidance function only, and so the Direct Beneficiary can be someone other than the contractual recipient of the service even if there is no tax avoidance.

21 First, as discussed above,<sup>42</sup> the DB Requirement is meant to ensure that the service (for which zero-rating is sought under s 21(3)(j)), is beneficially for (and not just made contractually to) an overseas person. Thus, the DB Requirement implicitly recognises that someone other than the contractual recipient may directly benefit from the service. Indeed, s

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customer GST. However, after interposing the overseas entity, the first supply by the Singapore supplier to the overseas entity is zero-rated, and the second supply by the overseas entity to the Singapore customer has no GST consequences, because Singapore does not have in force a reverse charge mechanism.

<sup>40</sup> *Supra* note 15.

<sup>41</sup> This tracks the language in s 47, which is the general anti-avoidance provision. While there are no reported cases considering s 47, the Singapore Court of Appeal in *Comptroller of Income Tax v AQQ* [2014] 2 SLR 847 (“*AQQ*”) interpreted s 33 of Singapore’s Income Tax Act (Cap 134, 2014 Rev Ed.), which is Singapore’s general anti-avoidance provision for income tax and is *in pari materia* with s 47. Briefly, the court in *AQQ* stated that the Comptroller’s powers to disregard or vary an arrangement under s 33 would be triggered if (1) looking objectively at the effects of an arrangement and the steps used to implement it, the court could infer that the arrangement was implemented in that way to avoid tax; unless (2) subjectively, the taxpayer carried out the arrangement for *bona fide* commercial reasons and did not have tax avoidance as one of his main purposes; or the tax advantage arose from the use of a specific provision in the tax law that was within its intended scope and Parliament’s contemplation and purpose.

<sup>42</sup> Paras 9 - 10.

21(4A), which the 2004 amendment also introduced, puts the matter beyond doubt: it explicitly clarifies that the overseas person and the Direct Beneficiary may be the same person or different persons. If the DB Requirement is intended to only prevent tax avoidance, we would have expected s 21(3)(j) and s 21(4A) to state that the contractual recipient is the Direct Beneficiary unless there is tax avoidance. But that is not the case.

22 Secondly, if the DB Requirement serves an anti-avoidance function only, we will be forced to identify the contractual recipient as the Direct Beneficiary in all cases unless there is tax avoidance, and this will sometimes be a very unnatural thing to do. For example, suppose an overseas-based father pays a Singapore school to give classes to his Singapore-based son in Singapore (let's call this the generous father scenario). There is no tax avoidance here, but we will find it very difficult to say that the father is the Direct Beneficiary, instead of the son who receives the education.

23 For completeness, it is worth considering: can the father be the Direct Beneficiary because he receives a promise that the Singapore school will provide classes to his son?<sup>43</sup> This is unconvincing. For one, it is an artificial characterisation of what the father is really paying for. The father is paying for something valuable; *ie* the education service. If we say that he is only paying for a promise that the Singapore school educates his son, this means that he is paying for a mere right to sue the school if something goes wrong, which is far less valuable. Further, it is unhelpful to characterise any supply to do something as a promise to do that something, because that tells us nothing about the nature of the supply. Many things can be re-characterised as promises to do something: *eg* a sale of goods can become a promise to sell the goods. Instead, supplies are (rightly) characterised by their nature: *eg* a sale of goods.<sup>44</sup>

24 Lastly, to assert that the words “directly benefit” in s 21(3)(j) are meant to do more than prevent tax avoidance is not inconsistent with the fact that those same words probably have a larger anti-avoidance function when they appear in the other Zero-Rating Provisions that possess Overseas Element 3. The words “directly benefit” appear in ss 21(3)(k), (s), (y) and s 21C. These provisions are much narrower than s 21(3)(j), because they describe the

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<sup>43</sup> This reasoning is found in Edmundson, Peter (2001) “An Analysis of GST and Third Party Consideration”, *Revenue Law Journal*: Vol. 11: Iss 1, Article 4 at 3 – 6.

<sup>44</sup> See also *WHA Limited and Viscount Reinsurance Company Limited v Customs and Excise Commissioners* [2004] EWCA Civ 559 (it is better to view *Redrow* as involving a supply of real estate services, not a supply of rights).

particular service which enjoys zero-rating,<sup>45</sup> while s 21(3)(j) is phrased broadly and is of general application.<sup>46</sup> There is no inconsistency because the words should be read in the context of the specific provision in which they appear.<sup>47</sup>

25 *Principle 2: Even if there is a good reason for the overseas person to pay the Singapore supplier, this does not mean that the overseas person is the Direct Beneficiary.*

This principle flows naturally from Principle 1: because the DB Requirement is not solely to prevent tax avoidance, the Direct Beneficiary can be someone other than the contractual recipient of the service; *ie* someone other than the overseas person. Thus, although USCo had to pay SingCo to provide the technical assistance service to its Singapore customers out of commercial necessity, this does not mean that USCo is the Direct Beneficiary.

26 Indeed, even if the overseas person had absolutely no choice but to pay the Singapore supplier to perform the service, this still does not mean that the overseas person is the Direct Beneficiary. Suppose an overseas financial institution contracts with a very wealthy individual based in Singapore, to provide brokerage services to that individual in relation to the trading of certain financial instruments listed on the world's major exchanges, including Singapore's. Further suppose that under Singapore law, only a Singapore-incorporated company with the relevant licenses can broker trades on the Singapore exchange. Therefore, the financial institution has to appoint a Singapore broker to broker trades by the wealthy individual on the Singapore exchange (let's call this the Singapore broker scenario). The Singapore broker's performance of his service discharges the financial institution's contractual obligation to perform the same for the Singapore individual. In this scenario, although the overseas person was compelled by regulatory requirements to appoint the Singapore broker to perform the service, this does not mean that he is the Direct Beneficiary.

27 *Principle 3: We can identify the Direct Beneficiary (ie, the person who uses the service), by asking the question, "What is the overseas person paying the Singapore supplier for?", and answering the question in a commonsensical way from the Singapore supplier's*

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<sup>45</sup> Section 21(3)(k) is a small exception, as it is closely related to s 21(3)(j). Section 21(3)(k) is meant to allow individuals who belong outside Singapore to enjoy zero-rated services in their business capacity while they are physically in Singapore (*eg* consultancy services). Such services cannot be zero-rated under s 21(3)(j) because Condition (c) would not be fulfilled.

<sup>46</sup> Subject to Condition (d).

<sup>47</sup> It would be inconsistent, for example, if the DB Requirement had absolutely nothing to do with tax avoidance, which is not the case.

*perspective. If after that we still cannot identify the Direct Beneficiary, we ask another “why”.*

The Direct Beneficiary is the person who uses the service. But how do we identify him? After all, there is no Singapore case law on this point. In this section, I propose that we can identify the Direct Beneficiary in a particular scenario by adopting a “Question Test”. The Question Test requires us to ask what Y is paying X for and answer this question in a commonsensical way from the Singapore supplier’s perspective. This will normally reveal who uses the service. If it does not, we ask another “why”.

28 It is best to see how the Question Test works through scenarios. The easiest scenarios are the customer helpline scenario, the generous father scenario and the Singapore broker scenario. In those three scenarios, the Singapore person is the Direct Beneficiary because we cannot avoid saying that the overseas person is paying for the Singapore supplier to perform a service that is used by the Singapore person; *ie* the person who actually uses the technical assistance, education, or broking service, as the case may be. Principle 1 and Principle 2 are already provided for in the Question Test, since in answering what the overseas person is paying for, we are concerned solely with describing the service, instead of (a) whether the purpose of the arrangement is to avoid tax; or (b) whether there is a good reason for the arrangement.

29 That the Singapore person is the Direct Beneficiary in our three scenarios is supported by guidance published by IRAS. In its e-Tax Guide titled “*GST: Clarification on “Directly in Connection With” and “Directly Benefit”*”,<sup>48</sup> the following scenario was given and explained:<sup>49</sup> where the overseas person (Y) pays the Singapore supplier (X) to maintain machinery that Y sold to the Singapore person (Z), such that if Z needs the maintenance service he contacts X (through Y), and X then dispatches engineers to Z’s premises to perform the maintenance service, then Z and not Y is the Direct Beneficiary because it receives the maintenance service directly from X.

30 At this stage, we pause to consider the relevance of direct contact between the Singapore supplier (X) who is paid by the overseas person (Y), and the Singapore person who

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<sup>48</sup> 2<sup>nd</sup> ed. Published 14 October 2015 (the “**DB e-Tax Guide**”). The DB e-Tax Guide does not have the force of law and taxpayers are free to depart from IRAS’ interpretation of the DB Requirement. Conversely, taxpayers who rely on that interpretation are technically not legally protected as a court may disagree with IRAS’ interpretation, but the practical risk of a dispute reaching the court when the taxpayer relied on IRAS’ interpretation is naturally lower.

<sup>49</sup> DB e-Tax Guide at p 13.

benefits from X's service in some way or another (Z).<sup>50</sup> One may think that direct contact between X and Z<sup>51</sup> or things owned by Z is a necessary and sufficient condition for Z to be the Direct Beneficiary. This is incorrect; it is neither necessary nor sufficient, as will be seen later. That said, we can say that if X's direct contact with Z is ordinarily a characteristic of the service, this is a strong indicator that Z uses the service and is thus the Direct Beneficiary. The qualifier "ordinarily" helps defeat a claim that Z is not a Direct Beneficiary where the overseas person is interposed between X and Z to act as a "post-box" that merely relays communications between X and Z. There may be genuine commercial reasons for interposing Y in this way. For example, if X and Y are unrelated, sometimes Y may not want X and Z to have direct contact for fear that this will encourage X and Z to bypass Y, with Z contracting directly with X for the service. In this case, Z still uses X's service because Y acting merely as a "post-box" means that (a) there is in substance direct contact between X and Z; and (b) Y did not add value to X' service, and so this is not an onward supply scenario.<sup>52</sup>

31 We now consider a more complicated scenario in the DB e-Tax Guide (let's call it the referral scenario)<sup>53</sup>. X performs marketing services for Y, which involves sourcing Singapore buyers of Y's products and handling the paperwork and logistics for delivery whenever such a buyer is found. There are thus two classes of Zs in this scenario: potential buyers who learnt about the products from X but did not buy the products, and actual buyers. In this referral scenario, IRAS will view Y as the Direct Beneficiary. It will not view Z as the Direct Beneficiary because (i) the potential buyers merely enjoy "spin-off" benefits; and (ii) with regard to the actual buyers who directly benefitted from the paperwork and delivery performed by X, (A) the paperwork and logistics are merely incidental to the service of sourcing Singapore buyers for Y (*ie* they are not aims in themselves); and (B) they do not have separate contracts with X. Consequently, since Y is the only Direct Beneficiary, the whole service can be zero-rated.

32 In the referral scenario, the Question Test gives us the same answer as IRAS: Y (and not Z) is the Direct Beneficiary. Answered from X's perspective, Y is paying X to help it get

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<sup>50</sup> Henceforth, in this article, the overseas person that belongs outside Singapore will be called "Y". Y contracts with a person who belongs in Singapore (who will be called "X"), under which X is paid by Y to perform a service that benefits in some way or another a person who belongs in Singapore (who will be called "Z").

<sup>51</sup> Z may be a single individual, as in the case of the son who receives the education and the very wealthy individual who uses the brokerage service; or a defined class of persons, as in the case of the Singapore customers who receive the technical assistance service through the customer helpline.

<sup>52</sup> See *infra* para 34. Obviously, if X and Y are related parties, interposing Y in this way looks like tax avoidance, so there is even more reason to say that Z is the Direct Beneficiary and there is no zero-rating.

<sup>53</sup> DB e-Tax Guide at p 8 – 9.

new Singapore customers.<sup>54</sup> While in the generous father scenario, Y pays X for Z to receive an education; here, Y is not paying X so that Z will have more knowledge about Y's products. Instead, Y ultimately wants Z to buy its products. This is also why the Question Test requires a commonsensical answer; to exclude answers like "Y is paying X so Z will gain more knowledge about Y's products"; or even: "Y is paying X for the promise that X will provide a service to Z" (which we have seen is an artificial and unhelpful characterisation)<sup>55</sup>. Separately, the referral scenario is also an example of how direct contact between X and Z (which is also ordinarily a characteristic of a referral service) is not a sufficient condition for Z to be the Direct Beneficiary.

33 One advantage of the Question Test is its versatility: it works for a whole range of services, including those where the service does not ordinarily involve direct contact between X and Z. Suppose Y is starting to consider whether its wholly-owned subsidiary Z should enter a new product market, and Y pays its lawyer X to advise on the legal implications of this. X communicates solely with senior officers of Y, and X does not have any direct contact with Z. The Question Test tells us that Z uses X's legal service because Y is paying X to provide advice on Z's business.<sup>56</sup> This makes sense because the risks and rewards of entering the new product market (or not) are borne by Z.<sup>57</sup> Separately, this scenario is also an example of how direct contact between X and Z is not a necessary condition for Z to be the Direct Beneficiary.

34 Another advantage of the Question Test is that it helps us filter out an onward supply scenario, where X's service forms a business input for Y to make a separate supply to Z. In other words, Z ultimately receives a service from Y (instead of X), after Y has done

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<sup>54</sup> We will expect the payment arrangements between X and Y to reflect this especially if X and Y are unrelated.

<sup>55</sup> See *supra* para 23.

<sup>56</sup> It might be said that the legal advice was used by Y to make a decision for Z's benefit. This shows us why the Direct Beneficiary is one who uses (*ie*, benefits from) the service.

<sup>57</sup> If X's legal advice affects Y's business as well (*eg* where Y will directly finance Z's entry into the new market, and Z implements such entry, with both parties having agreed that any gains or losses from the project will be divided evenly between them), the situation is more complex. To be consistent with the policy intention that s 21(3)(j) should be read narrowly (see *infra* paras 44 – 45), the starting position should be to deny zero-rating if Z uses the service in a non-negligible way. If both Y and Z use the service in non-negligence ways, it is reasonable to allow apportionment on a reasonable basis so that a part of the service fee can be zero-rated (and it is on the person asking for apportionment to justify the same and propose a reasonable basis). The theory behind apportionment here is different from that behind apportionment in the typical scenario discussed at *supra* note 12. Here, one service "stream" is used by both Y and Z. However, in the typical scenario, a distinct service "stream" is used by a distinct person; *ie* Z, or another overseas person (which may include Y). But the difference in theory is not a good reason to disallow apportionment definitively since (as mentioned at *supra* note 12) s 21(3)(j) does not explicitly exclude zero-rating where the service as a whole directly benefits both a person who belongs in Singapore and another person who belongs outside Singapore.

something to add value to X's supply.<sup>58</sup> Conversely, if Y does not add value to X's initial supply, Z is probably the person who uses X's supply, because X's supply flows to it "with no impediment";<sup>59</sup> *ie* X's supply benefits Z "directly"<sup>60</sup> (or Z is the person that uses the service). The same idea is captured in the ATO's statement that it is a strong indicator that Z instead of Y "effectively uses or enjoys" a supply, where Y has no further interaction with or participation in the provision of the supply received by Z beyond contracting and paying for the supply.<sup>61</sup> Indeed, a key characteristic of tax avoidance arrangements (which, as we have seen, is one but not the only thing that the DB Requirement is meant to prevent) is that Y does not add value to X's initial supply; *eg* a back-to-back license of intangibles, where X licenses the intangibles to Y which immediately licenses the same to Z. The Question Test helps us filter out onward supply scenarios because answering "what is Y paying X for" in a commonsensical way from X's perspective reveals that Y is paying X for a business input so that Y can make a separate supply to Z.

35 We now consider the case where the Question Test involves us asking another "why". Sometimes, we answer the question ("what Y is paying X for?") in a commonsensical way from X's perspective, and still do not know who uses the service. In that case, we need to ask another "why". The following scenario is taken from the ATO's guidance.<sup>62</sup> Suppose we perform the Question Test and the answer is that Y paid X to audit its related company Z. Without knowing the purpose of the audit, we cannot tell whether it is Y or Z who uses the

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<sup>58</sup> An arrangement is not an onward supply scenario only because, when contracting with X, Y had a pre-existing contract with Z to perform services for Z. After all, in many of our earlier scenarios like the customer helpline scenario and the Singapore broker scenario, Y also has a contract with Z, only that to fulfil an obligation under that contract it pays X. In fact, if in a business setting we see Y paying X to do something that benefits Z, we would expect that this is only because Z is also paying Y for that thing to be done. It should be noted that this conception of an onward supply scenario, where Y must do something to add value to X's supply, may be too narrow. In many sub-contracting scenarios, the sub-contractor's performance under its contract with the main contractor also completely fulfills the main contractor's contractual obligation to its hirer. The predominant view is that such scenarios are onward supply cases, if there is no tax avoidance. See the OECD's *International VAT/GST Guidelines* (November 2015) at paras 3.50 – 3.52; *Suzuki New Zealand Limited v Commissioner of Inland Revenue* [2001] NZCA 144 (the performance of one obligation under one contract can simultaneously fulfill an obligation under another); and the ATO's GSTR 2006/9 (20 August 2014 Consolidated Ruling) at paras 217 – 220.

<sup>59</sup> This is the language used in the DB e-Tax Guide: see para 4.9.5. The DB e-Tax Guide at p 9 – 10 provides the following scenario. X collates information for Y and Y publishes that information on its website and magazine, and Z pays Y to read that information on the website and magazine, Z is not the Direct Beneficiary of X's service even though he eventually gets to see the information on the website and magazine which was collated by X. There are in fact two supplies: Z providing the data collation service to Y; and Y publishing those findings on its website and magazine, which Z pays to read. Z directly benefits from the second but not the first supply because what he receives is the information published by Y.

<sup>60</sup> Thus, para 4.7.2 of the DB e-Tax Guide states that the Direct Beneficiary is one to whom the service confers not just benefits, but benefits in a direct manner.

<sup>61</sup> ATO's GSTR 2007/2 (17 April 2013 Consolidated Ruling) at para 66.

<sup>62</sup> ATO's GSTR 2007/2 (17 April 2013 Consolidated Ruling) at para 65.

service. So we need to know the purpose of the audit. If the purpose of the audit is to effect compliance with Singapore laws, then Z is the person who uses the service. Conversely, if the purpose of the audit is to comply with the laws of Y's home country, then Y is the person who uses the service. In other words, it is also incumbent on X in this scenario to ask another "why".

36 Finally, it is worth highlighting that one advantage of using the Question Test is that it is practical. A difficulty with the DB Requirement is that it requires X to look beyond the contractual recipient Y, and determine whether there is a Singapore person (Z) who is a Direct Beneficiary.<sup>63</sup> Obviously, this is not always easy to do. In this regard, because the Question Test is phrased and answered from X's perspective (*ie* what is Y paying me for?), and X is the one who has to decide whether to zero-rate his service, it is a useful method for implementing the DB Requirement in practice.

37 *Principle 4: If direct contact between X and Z is ordinarily a characteristic of the service, that is a strong indicator that Z is the Direct Beneficiary. But such direct contact is neither a necessary nor sufficient condition for Z to be the Direct Beneficiary.*

This is explained at paragraphs 30 - 33 above.

38 *Principle 5: If Z ultimately receives a service from Y after Y has done something to add value to X's initial service, Z is not a Direct Beneficiary of X's service.*

This is the onward supply scenario explained at paragraph 34 above.

39 *Principle 6: The Question Test is subject to this caveat: if the service can be described as one that is used in Singapore, either because (a) it is non-fluid and performed in Singapore; or (b) the property in relation to the service is in Singapore, the service should not be zero-rated.*

Consider this scenario<sup>64</sup>: Y sells residential properties in Singapore. Y's prospective customer, Z, needs to sell his existing home to free up funds to buy a residential property from Y. Therefore, Y appoints and pays X, a housing agent, to help Z (and people like Z) sell his existing home quickly. Y pays X if Z sells his existing home and buys Y's residential property. Applying the Question Test, we will say that Y is paying X to perform a service to

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<sup>63</sup> *Supra* note 17.

<sup>64</sup> This scenario is based on the facts of *Redrow*.

help Y sell more residential properties faster. However, because the service is also directly in connection with Singapore land as it involves X helping Z sell his home (*ie*, the property in relation to the service is in Singapore),<sup>65</sup> the service should nevertheless not be zero-rated. There are two reasons for this *Principle*.

40 Firstly, based on the structure of the Zero-Rating Provisions (as can be seen from the table at paragraph 12 above), fulfilling the DB Requirement is a weaker justification for enjoying zero-rating than fulfilling Overseas Element 1 or Overseas Element 2. Thus, if the service possesses the opposite of Overseas Element 1 or Overseas Element 2 (*ie*, the service is non-fluid and performed in Singapore; or the property in connection with the service is in Singapore), it should not be zero-rated. This needs some explanation.

41 The DB Requirement is a weaker justification for enjoying zero-rating than fulfilling Overseas Element 1 or Overseas Element 2 because:

- (a) if a service can be zero-rated because it possesses Overseas Element 1 or Overseas Element 2, it will remain so even if it does not fulfil the DB Requirement; and
- (b) if a service possesses the opposite of Overseas Element 1 or Overseas Element 2 (*ie*, the service is non-fluid and performed in Singapore or the property in connection with the service is in Singapore), it will still not be zero-rated even if it fulfils the DB Requirement.

42 We first look at the services that possess Overseas Element 1 and Overseas Element 2 in turn:

- (i) Overseas Element 1: For the services that are zero-rated because they are non-fluid and performed outside Singapore, there is no situation where the DB Requirement is not satisfied, because such services are used where they are performed. Thus, the transportation of goods or people substantially outside Singapore and services ancillary to the same are zero-rated because they are performed and used outside Singapore. The same reasoning applies to services that are zero-rated under s 21(3)(i).

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<sup>65</sup> The service cannot be zero-rated because it is directly in connection with Singapore land, and so Condition (d) is not fulfilled. That such a service is directly in connection with Singapore land is implied from s 21(4)(b)(ii), which states that the services of estate agents are directly in connection with land, albeit land outside Singapore. New Zealand would appear to come to the opposite conclusion: see *Malololailai Interval Holidays NZ Ltd v CIR* (1997) 18 NZTC 13,137 (marketing of land is not directly in connection with land because it merely facilitates a transaction that has direct effect on the land); and New Zealand's Public Ruling BR Pub 15/03 (legal services provided to non-residents relating to transactions involving land in New Zealand is zero-rated).

(ii) Overseas Element 2: The supply of certain things used exclusively overseas like vehicles, ships and aircraft, and services in connection with the same, is zero-rated. It is irrelevant where the person who is supplied that thing for exclusive overseas use belongs and where he is at the time the service is performed (*ie*, the DB Requirement need not be fulfilled).<sup>66</sup>

(iii) Overseas Element 2: The supply of services directly in connection with land and goods outside Singapore (and goods for export and financial services in relation to goods outside Singapore or for export) at the time the services are performed is zero-rated, and it is irrelevant where the owner of those things belong or where he is at the time the service is performed (*ie*, the DB Requirement need not be fulfilled).

43 We now turn to the services that possess the opposite of Overseas Element 1 or Overseas Element 2.

(i) Overseas Element 1: These non-fluid services are zero-rated because they are performed outside Singapore. If they are instead performed in Singapore, there is no situation where the DB Requirement is fulfilled, since the service will be used in Singapore. Thus, a transportation service that is substantially in Singapore is not zero-rated, regardless of who uses it. If an individual is transported, he uses the service while he is in Singapore, and the DB Requirement is not fulfilled. If goods are transported, there is no zero-rating even if the owner of the goods belongs overseas and is overseas at the time the service is performed, because the transportation is directly in connection with goods in Singapore at the time of the service (*ie*, Condition (d) is not fulfilled).

(ii) Overseas Element 2: For the supply of certain things used exclusively overseas like vehicles, ships and aircraft, removing Overseas Element 2 means that these things would be used exclusively in Singapore. Supplying them would be a supply of goods. The DB Requirement is concerned with a supply of services and has no application to a supply of goods. The supply of services in connection with these things will be analysed under (iii) below.

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<sup>66</sup> Thus, for example, s 21(3)(p) allows the zero-rating of maintenance, repair and broking of any ship or aircraft regardless of where the recipient of the service belongs, or even who that recipient is. Previously, such services had to be provided to the owner, operator or agent of the ship or aircraft, but this restriction was removed in 2005 with the apparently self-evident justification that these services were “directly related to ships or aircraft”: *Singapore Parliamentary Debates, Official Report* (21 November 2005) vol 80 at col 1921 (Mrs Lim Hwee Hua, Minister of State for Transport).

(iii) Overseas Element 2: For the supply of services directly in connection with land and goods outside Singapore (and goods for export and financial services in relation to goods outside Singapore or for export), removing Overseas Element 2 means that these things are in Singapore at the time the services are performed. Even if the DB Requirement is fulfilled, there is no zero-rating because Condition (d) is not fulfilled.

44 The second reason why a service that fulfils the Question Test should nevertheless not be zero-rated if it possesses the opposite of Overseas Element 1 or Overseas Element 2 is that s 21(3)(j) should be read restrictively. Singapore's GST regime is intended to be broad-based with few exceptions (*ie* it is intended that few goods or services would qualify for zero-rating or be exempted from GST<sup>67</sup>). Thus, when Parliament debated the introduction of GST back in 1993, the Minister highlighted that zero-rated supplies are confined "only to exports of goods and services".<sup>68</sup> Three reasons for a broad-based GST with few exceptions were provided<sup>69</sup>:

(a) to send a social message to the people that, if they wanted the government to increase social spending, they had to pay for it (and thus, for example, basic foodstuffs should not be exempted from GST);

(b) too many exceptions create distortions (*eg* if rice is exempted from GST, should wheat flour be exempted too? If wheat flour is not exempted, then rice is favoured over bread, but there is no good basis for the government to differentiate between the two); and

(c) too many exceptions create definitional disputes and encourage people to wrongly declare items to benefit from a better GST treatment, and this raises compliance and administrative costs.<sup>70</sup>

45 Section 21(3)(j) is worded in broad terms: it applies to any service (provided the Section 21(3)(j) Conditions are fulfilled), and a supply of service is a supply for consideration of anything that is not a good, including the granting, assignment or surrender of any right. So, we have to read this broadly-worded provision narrowly (we have to read it narrowly

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<sup>67</sup> An exempt supply is not a taxable supply: s 8(2A). Unlike zero-rated supplies which are taxable supplies, input tax attributable to exempt supplies is not claimable: s 20(2).

<sup>68</sup> *Singapore Parliamentary Debates, Official Report* (19 March 1993) vol 60 at cols 1540 - 41 (Dr Richard Hu Tsu Tau, Minister for Finance). The types of exempt supplies are also limited to supplies of residential property, financial services and (since 2012), the importation of investment precious metals.

<sup>69</sup> *Singapore Parliamentary Debates, Official Report* (19 March 1993) vol 60 at cols 1577 - 1582 (Mr S. Dhanabalan, Minister for Trade and Industry).

<sup>70</sup> The Minister related how (at *Supra* note 69 at col 1581 - 82) in other countries with GST, observers believed it was better to replace a regime with a high tax rate and many exceptions, with one where the tax rate was lower and there were fewer exceptions.

because Singapore's GST regime is intended to be broad-based with few exceptions). Naturally, we need a sufficient counterweight to the broad terms of s 21(3)(j). In this context, a counterweight would be to deny zero-rating if the service possesses the opposite of Overseas Element 1 or Overseas Element 2, even if the Question Test is fulfilled.

46 *Principle 7: The DB Requirement is more important than having an overseas contractual recipient.*

This *Principle* is probably superfluous in most cases, since Conditions (a), (b) and (c) are cumulative: s 21(3)(j) requires the service to be both contractually to and beneficially for an overseas person. But it is worth emphasising that the DB Requirement is more important than having an overseas contractual recipient. Having an overseas contractual recipient is not very important because contractual arrangements are usually highly malleable. So the mere fact that the contractual recipient is overseas without more is a very weak reason to zero-rate a service.

47 This can be readily demonstrated. Suppose an engineer, while engaged by an overseas person to test and certify some equipment located in Singapore, uses in Singapore an entertainment service provided by a Singapore supplier. The overseas person had earlier contracted with the Singapore supplier to provide the entertainment service to the engineer, and paid for the same. It would be very strange if the Singapore supplier can zero-rate his service just because it had contracted with an overseas person. In fact, this outcome is strange because this arrangement is actually a common reimbursement arrangement in disguise. This reimbursement arrangement may take one of two forms:

(A) The engineer contracts with the Singapore supplier for the entertainment service, and pays the supplier directly. The overseas person then reimburses the engineer the amount he paid the supplier.

(B) The engineer contracts with the Singapore supplier for the entertainment service. Under the contract, the engineer is obligated to pay for the service, but he arranges for the supplier to bill the overseas person. The overseas person pays the supplier on the engineer's behalf.

48 Whichever one of the two forms the reimbursement arrangement takes,<sup>71</sup> what is important (and obvious) is that the Singapore supplier will have to charge GST on its entertainment service. Therefore, the mere fact that the Singapore supplier contracted with the overseas person is a very weak reason for zero-rating, because contractual arrangements are highly malleable.

#### **IV. Additional clarifications regarding IRAS' interpretation of the DB Requirement**

49 Several points concerning IRAS' interpretation of the DB Requirement should be clarified. Firstly, it is stated in the DB e-Tax Guide<sup>72</sup> that IRAS will perform the following steps in determining the identity of the Direct Beneficiary. The first step is to look at the contract governing the supply of service. If it stipulates the recipients of the service to the exclusion of other persons (an example would be "X will supply IT support services to all of Y's subsidiaries in Southeast Asia and no one else"), IRAS will consider that only these stipulated persons are Direct Beneficiaries. It is only when the contract alone does not identify all recipients of the service that IRAS will proceed to the second step of examining the flow of benefits to identify all Direct Beneficiaries of a service.

50 The first step is unhelpful and should be removed.<sup>73</sup> Surely the second step of examining the flow of benefits to identify all Direct Beneficiaries must be done in all cases, even if the first step is fulfilled, because the contract may not accurately describe what is happening. And if the second step must always be done, the first step is unnecessary. Further, it is uncommon for contracts to include the "and no one else" language, so it is difficult to imagine how else a contract can stipulate the recipients of the service "to the exclusion of other persons".

51 Secondly, while we have focussed on identifying the Direct Beneficiary, the DB Requirement also requires that the Direct Beneficiary does not belong in Singapore and is outside Singapore at the time the service is performed. Suppose the Direct Beneficiary is an individual acting in a non-business capacity. Rule 1 tells us that this individual belongs outside Singapore if his usual place of residence is outside Singapore. But since individuals

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<sup>71</sup> The reimbursement leg will not be discussed in detail. Suffice to say that it follows the GST treatment of the primary supply (*ie*, the testing and certification service performed by the engineer for the overseas person): see IRAS e-Tax Guide "*GST: Guide on Reimbursement and Disbursement of Expenses*", published on 31 May 2013, at paras 3 - 6.

<sup>72</sup> DB e-Tax Guide at p 6 - 7.

<sup>73</sup> This first step also appears in the IRAS e-Tax Guide "*GST: Guide for Advertising Industry*", published 14 November 2014, at paras 4.3.4 - 4.3.5.

are mobile, an individual may belong outside Singapore and still be physically in Singapore at the time the service is performed. Therefore, Condition (c) states that the individual must also be outside Singapore at the time the service is performed. Without Condition (c), a foreign individual (whose usual place of residence is not Singapore) may, for example, use entertainment services GST-free while in Singapore.

52 However, there are instances where the need to fulfil all four Section 21(3)(j) Conditions unduly restricts zero-rating. This happens where (i) a foreign individual is in Singapore at the time the service is performed purely by coincidence;<sup>74</sup> or (ii) an individual whose usual place of residence is Singapore uses the service while he is outside Singapore.<sup>75</sup> To remedy this, IRAS could adopt guidance from the ATO and allow zero-rating, where:<sup>76</sup>

(i) an individual who belongs outside Singapore is physically in Singapore at the time the service is performed, but such presence in Singapore is purely coincidental (and not integral) to the provision of the supply; and

(ii) an individual who belongs in Singapore is physically outside Singapore at the time the service is performed and such presence is integral (and not coincidental) to the provision of the supply.

An individual's presence will be integral (and not merely coincidental) to the provision of the supply if the need for the supply arises from his presence at that location, or his presence at that location is integral to the performance, receipt or delivery of the service.<sup>77</sup>

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<sup>74</sup> Suppose Mr V, who does not belong in Singapore, engages a Singapore lawyer to draft his will. While the lawyer does the drafting, Mr V takes a vacation in Singapore. He has no communication with the lawyer while on vacation. The lawyer's service cannot be zero-rated because Condition (c) is not fulfilled. In New Zealand, zero-rating will apply because s 11A(3B) read with s 11A(1)(k) of its Goods and Services Tax Act 1985 allows zero-rating where the overseas individual who receives the service is (i) outside New Zealand at the time the service is performed; or (ii) in New Zealand at the time the service is performed, provided that presence is minor and not directly in connection with the supply.

<sup>75</sup> Suppose Mr W, who belongs in Singapore, is on vacation outside Singapore. While on vacation, Mr W falls sick and calls his personal doctor in Singapore to fly over and attend to him. The doctor's service cannot be zero-rated because Condition (a) and Condition (b) are not fulfilled.

<sup>76</sup> ATO's GSTR 2007/2 (17 April 2013 Consolidated Ruling) at paras 91 – 114.

<sup>77</sup> Indeed, IRAS already relaxes Condition (a) and Condition (b) in a specific instance: zero-rating applies to certain student insurance policies provided to students who belong in Singapore but are staying overseas during the period of coverage: see the IRAS e-Tax Guide titled "*GST: Guide for the Insurance Industry (Second edition)*", published on 14 November 2014, at para 3.3.4(B). Presumably, this is because the student's presence overseas is integral (and not merely coincidental) to the provision of the supply. So, for IRAS to adopt the ATO's guidance is not a radical step; it merely lays down a general principle that IRAS already seems to agree with in the specific case of the overseas student's insurance.

#### IV. Conclusion

53 We have seen that the Direct Beneficiary is the person who uses the service. We have also discussed some (non-exhaustive) principles that help us identify the Direct Beneficiary. However, there is an infinite range of services and business arrangements. Ultimately, this ensures that the DB Requirement can never be precisely defined, and so the principles discussed can never be absolute or exhaustive<sup>78</sup>.

54 Given the uncertainty in identifying the Direct Beneficiary, it is tempting to think of alternatives to the DB Requirement. One alternative is to follow New Zealand in allowing zero-rating so long as the Direct Beneficiary is, generally, a GST-registered business.<sup>79</sup> The basis could be that, since a local business that is a Direct Beneficiary can generally claim the GST charged as input tax under an administrative concession anyway,<sup>80</sup> we can afford to make it easier to zero-rate services. However, there would still be revenue loss because some local businesses that are Direct Beneficiaries would not have been able to claim the input tax in full (*eg* those making exempt supplies).

55 The second alternative is imposing GST on the importation of services. As mentioned, if in a business setting we see Y paying X to do something that benefits Z, we would expect that this is only because Z is also paying Y for that thing to be done. With a reverse charge, there will be GST collected on the fee Z pays Y. Further, the reverse charge mechanism effectively prevents round-tripping and tax avoidance because there is no GST advantage to interposing Y (since GST will be imposed when Z imports the service from Y anyway). However, imposing GST on the importation of services would be a significant change to Singapore's GST regime, with far-reaching consequences to the economy, and GST administration and compliance generally. Such a change should be driven by a host of policy considerations, and projections have to be done on things like the cost of living, the effect on

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<sup>78</sup> Indeed, the ATO has stated that it is not possible to create principles to be applied generally to determine the providee entity's identity (*ie*, the Direct Beneficiary): ATO's GSTR 2007/2 (17 April 2013 Consolidated Ruling) at para 68.

<sup>79</sup> Section 11A(2)(b) of New Zealand's Goods and Services Tax Act 1985 ensures that zero-rating is still available under section 11(A)(1)(k), where the Direct Beneficiary equivalent receives the service in the course of making taxable or exempt supplies. See *supra* note 20.

<sup>80</sup> In a scenario involving X, Y and Z (with Z as the Direct Beneficiary), IRAS by way of administrative concession allows Z to claim the GST charged by X if prescribed conditions are fulfilled. One of these conditions is that Z (a) pays GST on the portion of the standard-rated services received by him; and (b) retains documentation which can include (i) an invoice issued by Y which reflects the amount of the GST charge Y passed on to Z; or (ii) a tax invoice issued by X to Z for the relevant GST charge. This administrative concession is found in the DB e-Tax Guide at p 12.

the competitiveness of Singapore businesses, the Government's budget and general tax rates (including the GST rate).<sup>81</sup> Making this change solely to avoid the difficulties in interpreting the DB Requirement would be akin to using a sledgehammer to kill an ant.

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<sup>81</sup> Another reason to implement a reverse charge mechanism is found in the OECD's *International VAT/GST Guidelines* (November 2015), at paras 3.67 and 3.69: the reverse charge mechanism respects the destination principle and ensures that there is neither double taxation nor unintended non-taxation; in contrast, the tax authority in the supplier's jurisdiction should not tax a supplier based entirely on the fact that the supplier is directly providing a service there, but allow it to zero-rate the supply to the overseas customer identified in the business agreement (obviously, this is an implicit rejection of s 21(3)(j), if (and only if) one considers that the actual customer is the overseas person, which is the difficult but key issue). Separately, it should also be noted that implementing a reverse charge mechanism is only recommended for business-to-business supplies; the OECD's *International VAT/GST Guidelines* (November 2015) at para 3.131 recommends that for business-to-consumer supplies, the most effective and efficient approach is to require the overseas supplier to register and account for GST in the jurisdiction of taxation (*ie*, Singapore in our case). So, if Singapore imposes GST on an importation of services, two (and not one) collection mechanisms should be introduced.