DFDL Tax Alert: Singapore and Lao PDR sign much anticipated DTA

Highlights of DTA between Lao PDR and Singapore

The much anticipated double taxation agreement ("**DTA**") between the Lao People's Democratic Republic ("**Lao PDR**") and Singapore was signed on 21 February 2014. The DTA is currently awaiting ratification. Lao PDR now has concluded DTAs with 13 countries, with the most recent being Indonesia and Luxembourg in 2012. Eight of the 13 DTAs are currently in effect.

The DTA burnishes Singapore's reputation as an attractive holding company jurisdiction for investments into the surging economies of the Mekong region as it puts Singapore in the short list of jurisdictions to locate a holding company for Lao PDR investments.

In this article, we highlight the key provisions under the DTA, including permanent establishment ("**PE**"), furnishing of services, dividends, interests, royalties and capital gains.

PE and furnishing of services

Article 5(2) of the DTA defines PE to include the usual fixed places of business (i.e., branch, office, factory, workshop, oil/gas well). Considering the Lao PDR investment profile, it is worth noting that Article 5(2) also includes a farm or plantation in the definition of PE. In addition, Article 5(3) states that a PE may be constituted by the following:

- (a) a building site, a construction, installation or assembly project, or supervisory activities connected therewith, but only where such site, project or activities lasts for more than 12 months;
- (b) the furnishing of services, including consultancy services, by an enterprise of a Contracting State through employees or other personnel engaged by the enterprise for such purpose, but only where activities of that nature continue (for the same or a connected project) within the other Contracting State for a period or periods aggregating more than 300 days within any 12-month period.

It is interesting to note that Article 5(3) deviates from the UN Model Treaty with respect to the time requirement. Under the UN Model Treaty, the time requirement for Article 5(3)(a) is 6 months, whereas under the Lao PDR-Singapore DTA is 12 months. With respect to the furnishing of services provision, the time requirement under the UN Model Treaty is 6 months, whereas under the Lao PDR-Singapore DTA, the time requirement is 300 days.

The furnishing of services provision is therefore favorable for a Singapore service provider, in that the service provider may perform services in Lao PDR for a significant part of the year without being deemed to have a PE.

Dividends

With respect to dividends, Article 10(2) of the DTA provides that the maximum withholding tax ("**WHT**") rate to be as follows:

- *(a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 10 per cent of the capital of the company paying the dividends;*
- *(b) 8 per cent of the gross amount of the dividends in all other cases."*

In other words, the DTA will limit the WHT with respect to dividends to 5% if the beneficial owner holds at least 10% of the capital, and to 8% in all other cases. Note that dividends paid to a governmental entity (as defined under the DTA) are exempt.

Since the default dividends WHT under Lao PDR tax law is 10%, the DTA will benefit Singapore shareholders with the WHT reduction.

Interest

With respect to interest, Article 11(2) provides as follows:

"…such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 5 per cent of the gross amount of the interest.

In other words, the DTA will limit the WHT rate to 5% for interests paid to a beneficial owner. Under Lao PDR's domestic tax law, a WHT rate of 10% is applicable for interest payments to a foreign lender. Therefore, application of the DTA will benefit Singapore lenders with this significant reduction. Note that interest paid to a governmental entity (as defined under the DTA) are exempt.

Royalties

With respect to royalties, Article 12(2) provides as follows:

"…such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties is a resident of the other Contracting State, the tax so charged shall not exceed 5 per cent of the gross amount of the royalties."

The 5% treaty rate on royalties does not improve upon the current 5% WHT rate under Lao PDR tax law.

Capital gains on sale of shares

Perhaps the most significant provision of the DTA is Article 14(4) which provides as follows:

"Gains from the alienation of any property other than that referred to in paragraphs 1, 2 and 3, shall be taxable only in the Contracting State of which the alienator is a resident."

Note that Paragraphs 1, 2 and 3 of Article 14 relate to gains on the sale of immovable property, movable property forming part of the business property of a PE or fixed base, and transportation items (i.e., vehicles, aircrafts and ships).

Therefore, with respect to the sale of shares, Article 14(4) provides that capital gains may only be taxed in the jurisdiction where the transferor is a resident. In other words, if a Singapore resident sells shares in a Lao PDR company, the capital gains may only be taxed in Singapore. This allows a Singapore shareholder to avoid the 10% Lao PDR capital gains tax. Note that Singapore does not impose a tax on capital gains.

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