



MINISTRY OF REVENUE & CUSTOMS: INCOME TAX Public Ruling02/2020

Income Tax: Technical and Independent Services

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Protection Label

! This Ruling provides you with the following level of protection:

This publication (excluding any appendices) is a public ruling for the purposes of section 50 of the *Revenue Services Administration Act 2002 (RSAA)*.

A public ruling is an expression of the Minister's opinion about how the revenue law applies, or would apply, to persons generally or to a class of persons in relation to a particular arrangement or transaction or a class of arrangements or transactions.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that

is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any under-paid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the revenue law applies to you.

Introduction

1. This ruling is with reference to section 4, section 6, section 60 (3), (4) and (13) and section 79 (2) and (3) of the Income Tax Act 2007 (herein referred to as the Act), as amended.
2. Non-residents are persons who are not residents in Tonga for tax purposes under section 4 of the Act.
3. Non-resident persons earning Tongan sourced technical service fee are subject to a non-resident withholding tax of 15%.
4. Non-resident persons earning Tongan source business income for rendering of independent services are subject to a non-resident withholding tax of 10%.
5. Tongan sourced income is generally any payment made by a resident person to a non-resident person.
6. The ruling is to provide a clear distinction between technical services and independent services.
7. Technical service fee is clearly defined as the consideration for the rendering of managerial, technical, or consultancy services.
8. Independent service is not defined in the Act however in the ordinary meaning of the term would include professional services.
9. Professional service is not defined in the Act but in the normal dictionary would include lawyers, architects, accountants, financial advisers, engineers and consultants. Basically, they can be any profession that offers customized, knowledge based services.
10. Given that both technical and independent service definitions may overlap in terms of the word professional, this ruling looks is to clearly determine when a professional service is technical service therefore subject to 15% NRWHT and when a professional service is an independent service therefore subject to the lower rate of 10%.

What this Ruling is about?

Class of person/Arrangement or transaction

11. This Ruling applies to non-resident persons earning Tongan sourced technical service income or business income for rendering independent services.

12. Tongan sourced income is basically any payment made by a resident person to a non-resident person.
13. The Tongan resident counterpart of the non-resident is obligated to withhold tax from the gross amount due to be paid to the non-resident.
14. The Tongan resident counterpart will then be provided a non-resident withholding tax certificate to confirm payment of tax.
15. The tax will then be a credit to be claimed by the non-resident at their place of residence for tax purposes.

The Law

16. The Act defines technical services fee in section 2, *“means an amount, however described, whether periodical or lump sum, as consideration for the rendering of any managerial, technical, or consultancy services, including the services of technical or other personnel, but does not include employment income”*.
17. The words technical, managerial and consultancy are not defined in the Act but common definitions are;
 - i) Technical: services requiring professional skills. Professionals would normally be providing advice similar to consulting services
 - ii) Managerial: services related to control or administration
 - iii) Consultancy: services involving the provision of advice
18. The definition above renders these services to refer to services that can be performed by the non-resident person to its permanent establishment or services provided within the same organisation.
19. Nature of technical services include:
 - i) The service provided is effectively connected to the permanent establishment of the non-resident (arm’s length test);
 - ii) The service is related to the business activity of the resident person;
 - iii) Knowledge based/professional skills required;
 - iv) Normally provided on a regular basis;
 - v) Passive or not much physical involvement from the non-resident person.
20. Nature of independent services:
 - i) The non-resident has no connection to the resident person;
 - ii) The non-resident services is not connected to the business activity of the resident person;

- iii) There is active involvement or material physical participation by the non-resident;
- iv) Labour intensive services.

Ruling

21. For a service to be a technical service, it must satisfy EITHER ONE of the following elements.
- i) Managerial, technical or consultancy service;
 - ii) Any other service but the non-resident person and the resident person are related parties;
OR
 - iii) Any other service and non-resident and the resident persons are not related but the service provided is directly related to the business activity of the resident person.

Examples –

- Legal fees paid by YY Ltd to Legal Eagles Fiji (consultancy service)
- Services fees paid by XXL Tonga to XXL NZ for fixing atm machine (non-technical but related)
- Fees paid by Mechanical Tonga Ltd to an unrelated mechanic in Fiji for fixing a car (not technical service and auto Mechanical Tonga Ltd and mechanic in Fiji are not related but the business activity of the resident and the non-resident is the same which is fixing cars)

22. For a service to be an independent service, it must satisfy ALL of the following elements.
- i) Not managerial, technical or consultancy service;
 - ii) The non-resident and the resident are not related parties; AND
 - iii) The service is not connected to the business activity of the resident person (parties have different business activities).

Examples –

- Service fees paid by Sea Shipping Ltd to Ships Services Ltd (Fiji) for servicing their ship [service is not technical service, the parties are not related, and business activity of the resident is transportation of passengers while business activity of the non-resident is servicing of ships].

Date of effect

23. This Ruling is effective on the 1st July 2020.

24. This Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of this Ruling.

Minister of Revenue & Customs