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Will Global Tax Change Singapore's Value Proposition?

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Speaker

Edmund Leow S.C.
Senior Partner
Dentons Rodyk & Davidson LLP
D +65 6885 3613
E edmund.leow@dentons.com

Edmund is a senior partner heading up the firm's Tax practice with three decades of experience in advising multinational organisations on cross-border tax planning, transfer pricing and tax disputes. He also advises on international trade issues such as customs, WTO and free-trade agreements.

Edmund was invited by the government to serve as a Judicial Commissioner at the Supreme Court and served from 2013 to 2016. On stepping down, he was appointed Senior Counsel in 2017, making him the first and only Tax and Trust lawyer to be given this accolade nationwide.

Prior to his appointment to the Singapore judiciary in 2013, Edmund was named a Tier 1 lawyer by *The Legal 500 Asia Pacific* for Tax in 2012. His views on tax and wealth management were widely sought and publicised in the media, such as Bloomberg, BBC, Channel NewsAsia, Reuters, The Financial Times and The Straits Times. He was also a founding partner of a Singapore law firm that was associated with an international law firm, where he headed up the Tax and Wealth Management practices in Singapore.

Edmund is the President and an honorary member of the Singapore Trustees Association (STA). He is a co-founder of the STA, and previously served as its President from 2004 to 2008, then as Vice President from 2008 to 2013. The STA represents the interests of trust companies in Singapore.

In addition, he has been appointed Deputy Chairman of the Income Tax Board of Review, which is a statutory tribunal which hears income tax disputes between the Inland Revenue Authority of Singapore and taxpayers.

Agenda

- Introduction to the global tax reforms
- OECD/G20 Inclusive Framework on base erosion and profit shifting (“**BEPS 2.0**”)
  - Background to BEPS 2.0
  - Pillar One – nexus and profit allocation rules
  - Pillar Two – global minimum tax rate
- Impact of the global tax reforms
- Impact of the global tax reforms on Singapore’s value proposition

Introduction to the Global Tax Reforms

Introduction to the Global Tax Reforms

- G7 Ministers discussed global tax reforms proposed by the Biden Administration at the G7 Summit 2021
- Builds on the two-pillar approach outlined in the OECD/G20 Inclusive Framework on base erosion and profit shifting
  - Aims to address the tax challenges arising from the digitalisation of the economy
  - Pillar One: Profit allocation and nexus
  - Pillar Two: Global minimum tax rate
- Important step towards reaching an international agreement on global tax reforms

BEPS 2.0

Background to BEPS 2.0

- Tax challenges arising from globalisation and digitalisation of the economy
    - Impact of globalisation
        - US$240 billion lost annually due to profit shifting by MNCs
    - Impact of digital economy
        - Emergence of digitalisation erodes utility of traditional definitions of a PE
        - Newer business models operate through online platforms instead of traditional ‘brick and mortar’ structures
        - Flexibility to choose where their substantial business activities take place and shift existing functions to remote locations away from the market jurisdiction
        - Digital businesses not subject to income tax despite having a digital ‘presence’ in that country through remote digital participation

Background to BEPS 2.0

- Tax challenges arising from globalisation and digitalisation of the economy
  - OECD’s proposals to tax digital businesses (BEPS Action 1)
    - Expansion of PE status through removal of exemption of preparatory or auxiliary activities
    - Withholding tax on digital sales
    - ‘Significant digital presence’ nexus
    - ‘Virtual permanent establishment’
  - None of the proposals adopted as internationally agreed standards

Background to BEPS 2.0

- Increasing number of jurisdictions taking uncoordinated and unilateral actions, e.g. implementation of unilateral digital services tax
  - Potential increase in damaging tax, trade disputes and tax uncertainty
- COVID-19 Pandemic
  - Accelerates trend of digitalisation of the economy and increases prominence of the tax challenges arising from digitalisation
  - Budgetary constraints and increased fiscal pressure faced by Governments
  - Government support during the crisis reduces public tolerance of tax avoidance by MNCs

BEPS 2.0 – Pillar One

- Pillar 1: Profit allocation and Nexus
  - Align taxing rights more closely with local market engagement e.g. residual profit taxed in the jurisdiction where the user/customer is located
  - Consider fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction
- Proposal to eliminate double tax
  - Step 1: Identification of paying entity (through activities, profitability, market connection priority and connection with market jurisdiction)
  - Step 2: Exemption or credit method

BEPS 2.0 – Pillar One

- Digital Services Tax ("**DST**")
  - OECD endorses a unified approach, but several countries have implemented unilateral DSTs
    - France: 3% tax on revenues deemed generated in France by digital companies
    - Spain: 3% tax on digital services developed by MNCs with users located in Spain
    - UK: 2% tax on revenue of social media platforms, search engines and online marketplaces linked to UK user 'participation'
  - Growing support from developing countries, e.g. India
    - India: 6% equalisation levy on online advertisement services and 2% equalisation levy on e-commerce sales of goods and services provided by foreign operators to Indian customers
  - Provides a source of corporate tax revenue as DSTs not covered by double tax treaties
  - Results in double taxation, e.g. dual source

BEPS 2.0 – Pillar Two

- Global minimum tax
  - Prevent profit shifting of intangibles to tax havens by MNCs
  - Creates a level playing field and reduces harmful tax competition
  - All MNCs pay a minimum level of tax regardless of source jurisdiction and physical presence
  - E.g. Top-up tax payable where profits are taxed below internationally agreed minimum tax rate or source jurisdiction can deny deductions or apply withholding tax to “top-up” tax if interest, royalties or service fees subject to no or low tax
  - Apple’s Ireland tax deal provides the impetus for a global minimum tax in Europe
    - European Commission ordered Ireland to recover €13 million of unpaid taxes and interest from Apple in 2014
    - Decision annulled by the EU General Court in July 2020

G7 Summit – Pillar One of BEPS 2.0

- Reallocation of profits and taxing rights
  - G7 Ministers agreed to allocate new taxing rights to market jurisdiction of at least 20% of profit exceeding a 10% margin for the 'largest and most profitable multinationals'
  - The Biden Administration expanded the scope of application of the Pillar One rules to the top 100 MNEs
    - OECD proposal only applies to digital and consumer-facing businesses
    - Some big tech companies not captured under this rule (E.g. Amazon's profit margin was 6.3% in 2020), prompting further discussions on a 'segmentation' approach
  - G7 Ministers also agreed to repeal digital services taxes and other relevant similar measures
  - Further details to be discussed at the G20 Finance Ministers meeting

G7 Summit – Pillar Two of BEPS 2.0

- Global minimum tax
  - G7 Ministers backed the creation of a 15% global minimum tax rate
    - OECD previously proposed a 12.5% global minimum tax rate
    - Biden Administration proposed a 21% global minimum tax rate but later compromised on a 15% global minimum tax rate
  - OECD proposed a €750 million annual revenue threshold and a global minimum tax calculation methodology
  - Potential renegotiation of existing tax treaties between parties to incorporate the new rules

Singapore's Response to BEPS 2.0

Then Finance Minister Heng Swee Keat, Budget 2021 Speech:

"*…our tax system must remain resilient to withstand shocks. We are mindful of international tax developments, and the downside risks to our revenues.*

There are ongoing discussions to revise international tax rules under the Base Erosion and Profit Shifting, or BEPS 2.0 project. These proposals will adversely impact our corporate income tax revenues. As I have mentioned in this House previously, we are actively involved in these talks.

If and when these international tax rules are changed, we will consider if adjustments are required to our corporate tax system accordingly, in consultation with the industry."

Impact of the Global Tax Reforms

Impact of the Global Tax Reforms

- Balances effective rate of corporate income and employment income
  - Global minimum tax requires countries to impose higher tax on companies
- Increases global tax revenues
  - Global debt risen to US$289 million in Q1 2021 due to COVID-19 pandemic
  - OECD estimates that the Pillar One rules would increase global corporate tax revenues by 0.2%–0.5% (approximately US$5 billion to US$12 billion)
  - OECD estimates that the Pillar Two rules would increase global corporate tax revenues by 1.6%–2.8% (approximately US$42 billion to US$70 billion)
  - Supports domestic resource mobilisation in developing countries
  - But some countries do not need to raise tax revenue

Impact of the Global Tax Reforms

- Encourages relocation of investment in low-tax jurisdictions
  - But OECD estimates only a small negative effect on global investment
    - Proposed pillars mostly affect highly profitable MNCs whose investments are less sensitive to taxes
    - Increases importance of non-tax factors in the investment location decisions of MNCs
- Erodes tax sovereignty and increases homogeneity of tax systems
- Reduces ability of governments to use tax incentives to pursue specific policy objectives and encourage good behaviour (E.g. green energy, reduction of emissions, philanthropic activities)
- Shift of incentives from income tax to other non-profit based taxes (E.g. property tax, custom duties)

Impact of the Global Tax Reforms on Singapore’s Value Proposition

Impact of the Global Tax Reforms on Singapore's Value Proposition

- Implications of Pillar One: Reduction of Singapore's tax base
  - Singapore's geographical location ideal for MNCs to set up hubs to enter the Asia-Pacific market
  - Part of the profits from hub operations in Singapore may be re-allocated to the market jurisdiction
- Implications of Pillar Two: Neutralises Singapore's tax incentives and contributes to profit leakage of Singapore's corporate tax revenue
  - Tax incentives in Singapore brings effective tax rate below 15%
  - SMEs potentially impacted by measures introduced to prevent profit leakage (E.g. capital gains tax, withdrawal of tax incentives)
  - Government may impose more stringent requirements to qualify for tax incentives

Impact of the Global Tax Reforms on Singapore's Value Proposition

- Only large MNCs affected by global minimum tax rate
  - Majority of companies benefiting from Singapore tax incentives are SMEs
  - MNCs still attracted to Singapore's non-tax factors (E.g. political stability and safety, rule of law, infrastructure, connectivity, education)
  - Singapore Government needs to accelerate Singapore's "X-factors" and provide other incentives to attract investment (E.g. Capital grants, enhanced support for innovation and training)
  - Could lead to different sets of rules for small and large companies
- Domestic companies not subject to global minimum tax rate
- May still benefit from the exodus of companies from offshore centres

Singapore's Response to the Global Tax Reforms

Finance Minister Lawrence Wong on the global tax reforms:

> "…*We will continue to support a multilateral consensus-based solution that is anchored on sound economic principles, promotes tax certainty, and ensures a level playing field across all jurisdictions...The new rules should not inadvertently weaken the incentives for businesses to invest and innovate. Otherwise, countries will all be worse off, fighting over our share of a shrinking revenue pie.*"

> "…*We will continue to ensure that our tax system is compatible with international norms, while managing the administrative and compliance burden on businesses.*"

> "…*Our overall competitiveness has never been based on taxation alone. It's about ensuring a conducive environment for businesses and entrepreneurs to thrive. ...Trust, reliability and integrity are ultimately what makes Singapore an attractive place for substantial economic activities*…."