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Organisation for Economic Co-operation and Development (OECD) Pillar Two proposal: Global Anti-Base Erosion (GloBE) Proposal—A Singapore perspective

On 8 November 2019, the OECD released for comments a Public Consultation Document (“Consultation Document”) on the GloBE proposal—Pillar Two. This follows on from the Programme of Work issued on 31 May 2019 and is designed to strengthen countries’ ability to tax profits where income is locally subject to a low effective rate of tax. The consultation document contains limited additional details on the proposal itself but rather seeks comments on the key technical design aspects.

At this stage, the consultation document does not have consensus political support from the more than 130 countries participating in the G20/OECD Inclusive Framework.

GloBE proposal

The GloBE proposal would enable countries to tax profits that would otherwise be taxed at an effective rate, which is below a “minimum rate”. The GloBE proposal will operate as a top-up to the minimum rate; however, the minimum rate has not yet been agreed on, and the consultation document mentions that it will be agreed at a later stage. The GloBE proposal consists of two inter-related elements, which includes four components:

- Income inclusion:
 - An **income inclusion rule** that would tax the income of a foreign-controlled entity or branch if that income was subject to a low effective tax rate; and
 - A **switch-over rule** that would turn off the benefit of exemption (in favour of a credit method) in the case of profits attributable to exempt foreign branches or income derived from foreign immovable property subject to an effective tax rate below the minimum rate.
- Tax on base-eroding payments:
 - An **undertaxed payments rule** that would deny a deduction, or impose source-based taxation (including withholding tax), for a payment made to a related party unless those payments were subject to tax at a minimum effective rate; and
 - A complementary **subject to tax rule** that would subject a payment to withholding or other taxes at source and deny treaty reliefs otherwise available to undertaxed payments.

Comments are welcomed on all parts of the proposal as set out in the program of work.

Three technical design aspects have been identified with comments requested: on the use of financial accounts as a starting point; on the blending of low-tax and high-tax income; and on possible carve-outs and thresholds.

1. Tax base determination: The use of financial accounts as a starting point for determining the tax base under the proposal

Consideration is given as to whether using financial accounts, subject to agreed adjustments, could provide an appropriate base for measuring income and could simplify and reduce the compliance costs of the proposal. Views are sought on the use of the accounting standard of the ultimate parent entity instead of the local Generally Accepted Accounting Principles of each entity, and on the acceptability of different standards. Consideration also would need to be given to cases where consolidated financial statements are not prepared for any other purpose.

Recognising that accounting profits may differ significantly from taxable profits, the Consultation Document considers adjustments to accounting profits that could be required.

Views are sought on these two aspects:

Permanent differences	Types of material “permanent differences” between financial accounting income and taxable income that may need to be removed from the tax base.
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Temporary differences	<p>"Temporary differences"—such as differences between the timing of accounting depreciation and tax relief on capital expenditure, or the carry forward of losses—have distortive effects on effective tax rates that typically reverse in future years. Three basic approaches are described that could address the effects of temporary differences:</p> <ul style="list-style-type: none"> • Carry-forward of excess taxes and tax attributes; • The use of deferred tax accounting; and • Multi-year averaging. <p>Comments are sought on the advantages and disadvantages of each approach.</p>
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2. Blending: The extent to which a business can combine low-tax and high-tax income when calculating its effective tax rate/rates

Blending could be done on a narrow or broad basis and three approaches are briefly described:

Worldwide blending approach	Requiring a business to aggregate its total foreign income and total foreign tax. Where the tax on the total foreign income was below the minimum rate, additional tax would be due.
Jurisdictional blending approach	Requiring businesses to aggregate amounts on a jurisdiction-by-jurisdiction basis, paying additional tax in respect of the income in those jurisdictions effectively taxed below the minimum rate.
Entity blending approach	Requiring the calculation of income, taxes and effective tax rates of each individual group entity (and foreign branch).

The Consultation Document also describes the possibility of "local group blending"—a variation of the entity blending approach that would allow for the results of entities within a local tax consolidation or local group relief regimes to be aggregated.

Each approach has different policy implications and implementation challenges, and views are sought on the interactions between each approach and managing effective tax rate volatility; obtaining the required level of financial accounts data; allocating income between branches and head offices; the treatment of tax transparent entities (e.g.,

partnerships); crediting taxes arising in other jurisdictions (e.g., tax arising under controlled foreign company (CFC) rules); and the treatment of dividends and other distributions.

3. Carve-outs and thresholds

Carve-outs to be considered include those for regimes compliant with standards of Base Erosion and Profit Shifting (BEPS) Action 5 on harmful tax practices and other substance-based approaches, a return on tangible assets and for controlled corporations with related party transactions below a certain threshold. Carve-outs may be based on a qualitative overall evaluation of the facts and circumstances or based on more quantitative objective criteria—e.g., based on formulas.

Other related matters under consideration include using thresholds based on the size of the group, de minimis thresholds to exclude smaller transactions or entities and the appropriateness of carve-outs for specific sectors or industries. Views are sought on which options should be adopted or avoided.

Deloitte Singapore comments

The Consultation Document considers some of the challenges and complexities originally discussed in the public consultation meeting held in March 2019.

It is clear that many significant issues have yet to be resolved. While some of the challenges are explored further (such as the need to identify a common tax base and consideration of the use of accounting information to achieve this), there is limited detail on how the GloBE proposal will be developed. The consultation document acknowledges that many of the technical and design aspects remain dependent on policy choices to be agreed by the more than 130 countries that make up the G20/OECD Inclusive Framework.

The Consultation Document's focus on complexities highlights the difficulty of including such rules on a global basis in a manner that is not distortive and that does not require disproportionate efforts in terms of compliance and administration. The rules that deal with the denial of deduction for payments are particularly problematic from a practical perspective. The challenges highlighted around the tax base raise the question as to whether the focus should be on the income inclusion rule instead.

A further public consultation document is expected once a clearer outline of the undertaxed payments rule and the subject to tax rule has been developed.

What does this mean for Singapore?

Singapore has been closely monitoring the development of the GloBE proposal as a fixed minimum tax rate may have a significant impact on how Singapore formulates its tax policies. It is worth noting that no agreement has yet been reached on the minimum tax rate. While some examples in the Consultation Document use a rate of 15 percent, the OECD Secretariat makes it clear that this rate is for illustrative purposes and no inference should be drawn as to the rate that will ultimately be agreed.

A silver lining remains if BEPS Action 5 compliant incentives could be excluded from the GloBE proposal. All of Singapore's tax incentives are BEPS compliant and their exclusion from the GloBE proposal will be a boon for Singapore; however, the consultation document also notes that such carve-out for BEPS Action 5 compliant incentives would undermine the policy's intent and effectiveness of the proposal, and as such may not be favoured by all countries.

A minimum tax rate for all businesses operating internationally may also have an adverse impact on the quasi-territorial tax regime in Singapore. Under the current system, Singapore effectively allows for taxes on foreign-sourced income to be deferred until such income is remitted into Singapore. Certain types of foreign-sourced income may also be tax exempt in Singapore. The GloBE proposal may result in such income to be subject to additional taxes outside Singapore. The ultimate impact on Singapore will depend on the outcome of the technical issues discussed in this consultation document.

The proposals under Pillar One and Pillar Two represent a fundamental overhaul of the architecture of the international tax system. However, the proposals are at the early stages of development and much of the technical work remains to be done before the rules are finalised.

Next steps and anticipated developments

Comments on the consultation document should be submitted by 2 December 2019. A public consultation meeting will be held on 9 December 2019 at the OECD in Paris.

It is anticipated that an additional public consultation will be issued in respect of the mechanics and operation of the undertaxed payment rule, and the nature and scope of the subject to tax rule once the G20/OECD Inclusive Framework has developed a clearer outline of these rules.

The OECD hopes that political agreement on the architecture of both the Pillar One and Pillar Two can be reached by June 2020.

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