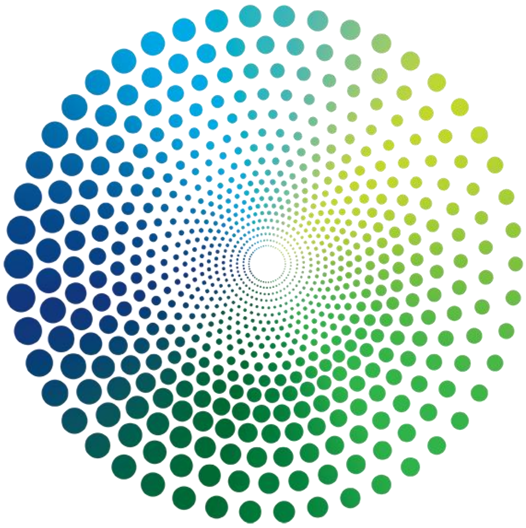

Singapore Business Tax developments
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Organisation for Economic Cooperation and Development (OECD) proposal: "Unified Approach" to address tax challenges arising from digitalisation of the economy—A Singapore's perspective

On 9 October 2019, the OECD released for comment a Public Consultation Document ("Consultation Document") containing a Secretariat Proposal for setting a "Unified Approach" under Pillar One. This follows on from the Programme of Work issued on 31 May 2019, and seeks to harmonise aspects of the three initial proposals under user participation, marketing intangibles and significant economic presence in order to develop a possible new approach. It is important to note that it does not at this stage, have consensus political support from the more than 130 governments participating in the Inclusive Framework.

Unified approach proposed by the OECD Secretariat

In putting forward a proposal for a unified approach, the OECD Secretariat has drawn on the commonalities of the three proposals identified in the May program of work:

- Reallocating taxing rights in favor of the user/market country, unconstrained by a physical presence;
- Envisaging a new nexus rule not dependent on physical presence in the user/market country;
- Going beyond the arm's length principle and departing from the single entity principle; and

- Searching for simplicity, stabilisation of the tax system and increased tax certainty in implementation.

The proposal from the OECD Secretariat is designed to attract enough governmental support to lead to consensus. It is set at a high level to include key features but will require further detailed work.

Scope

The scope of the new rules will cover highly digital business models but also goes wider, focusing on consumer-facing businesses, broadly defined, e.g., businesses that generate revenue from supplying consumer products or providing digital services that have a consumer-facing element. It is considered that these businesses are likely to derive meaningful value from interactions with consumers/users in markets without a traditional physical presence. Significant technical work would need to follow, to distinguish precisely between consumer facing businesses and other businesses.

Further work will be done on scope and possible exclusions or carve-outs. Size limitations, such as the €750 million revenue threshold used for country-by-country reporting requirements, will be considered. The document sets out that extractive industries are assumed to be out of scope. Further discussion should also take place as to whether other sectors (e.g., financial services) should also be carved out, taking into account the policy rationale.

New nexus rule

The new rules will create a nexus for in-scope businesses that is not dependent on physical presence but instead on sustained and significant involvement in the economy of a market. The simplest way of operating the new rule would be to define a revenue threshold in the market (the amount could be calibrated to reflect the size of the market jurisdiction and their economies). The aim is not to disturb the existing system in bilateral treaties and therefore the measure would be designed as a new self-standing treaty provision (in addition to the existing permanent establishment article).

New and revised profit allocation rules going beyond the Arm's Length Principle (ALP)

New profit allocation rules are proposed that will apply to in-scope businesses irrespective of whether marketing and distribution activities in country are done by group entities or through third party distributors. It will allocate profits to the market/user jurisdiction irrespective of physical presence, as otherwise it would be impossible to use the existing ALP rules to allocate profits to this new nexus where no functions are performed, no assets are used, and no risks are assumed in the market jurisdiction.

Accordingly, the new rules go beyond the ALP and proposes a formula-based approach to deliver an amount of profit to the market jurisdiction in a simplistic manner to reduce disputes between governments and increase tax certainly in the contentious area of residual profits from marketing intangibles and distribution returns in market jurisdictions.

Three tier mechanism

The unified approach proposes three possible types of taxable profit that may be allocated to a market jurisdiction:

Amount A—new taxing right

A new taxing right, which allocates a portion of deemed residual profit to market jurisdictions, irrespective of local physical presence, using a formulaic approach.

The starting point is proposed to be the total profits in the group's consolidated accounts and consideration is being given as to whether this should be analysed on a business line or regional segmentation basis. In the next step, the residual profit would be calculated as the profit that remains after excluding a deemed routine profit amount. The deemed routine profit seeks to allocate profits to routine activities and could be calculated based on an agreed fixed percentage.

The residual profit would be:

i. Allocated to market jurisdictions on the basis of being attributed to marketing intangibles (known as the deemed residual profit)—a fixed percentage formula for this will be explored; and
ii. Allocated to other factors such as trade intangibles (innovative algorithms, software etc.), capital and risk etc.

The deemed residual profit computed in (i) above would then be split among eligible market jurisdictions according to an agreed allocation key (e.g., sales).

It is important to note that the deemed routine profit calculation is purely a formula for calculating profits attributable to the new nexus and should not affect the actual allocation of profits to routine activities under the group's existing transfer pricing policies.

Amount B—fixed return for marketing and distribution functions

Amount B provides a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction. This could continue to be based on existing transfer pricing rules; however given the large number of tax disputes in this area, a fixed percentage return should also be explored.

Amount C—additional return based on transfer pricing analysis

Amount C recognises that any such approach for a "fixed return" in Amount B may not deal with all the activities in the market jurisdiction. Therefore, an effective and binding dispute resolution mechanism is being explored to deal with situations where the source country looks to tax additional profit for the additional functions in the market jurisdiction under existing transfer pricing principles.

Pending key questions

A number of areas have been identified as needing further work including but not limited to:

- The possibility of using different mechanisms for different business models to reflect the degree of digital differentiation;
- The definition of activities under Amount B;
- Political agreement on scale or amount of profit to be allocated to market jurisdictions;
- Approaches to eliminate double taxation that could result through double counting of the three types of taxable profit (Amounts A, B and C);
- The treatment of losses; and
- Implementation and administration issues regarding enforcement and collection, and the changes required to double tax treaties.

Deloitte Singapore's views

Ramifications of the "unified approach" and its potential impact on Singapore

The OECD has taken the rare step of publishing a proposal for a "unified approach" to help facilitate the step of gaining political consensus among the more than 130 members of the Inclusive Framework by the end of 2020. In the recent OECD webcast, it was stated that the Secretariat Proposal has been designed to provide elements to serve conflicting interests of the countries in the Inclusive Framework in a way which countries could agree on the outline of the architecture of the unified approach by January 2020, as significant technical work would then need to follow on the open key questions by the end of 2020.

In the preliminary economic analysis and impact assessment performed by the OECD, it has been indicated that low and middle-income economies will gain relatively more tax revenues from Pillar One than advanced economies, although larger market jurisdictions would likely gain more in absolute tax revenues. Investment hubs are expected to experience significant losses in taxable profits from the combined effect of Pillars One and Two[1]. In addition, the greatest impact would be on businesses in digital-orientated and intangible-intensive sectors under both pillars.

What does this mean to a small and open economy like Singapore?

In line with the recommendations in the 2015 Base Erosion Profit Shifting (BEPS) Action 1 Report (Tax Challenges arising from the Digital Economy), Singapore has already decided to apply Goods and Services Tax (GST) to imported services with effect from 1 January 2020. This comprised two measures:

- The reverse charge regime for Business-to-Business supplies of imported services such as consultancy and marketing services; and
- Overseas vendor registration regime for Business-to-Consumer (B2C) supplies of imported digital services for businesses with annual global turnover exceeding S$1 million and B2C supplies of digital services to customers in Singapore exceeding S$100,000.

Both of these measures are considered to be in line with the OECD Value Added Tax/GST guidelines. The intention of the measures is to level the playing field between local businesses which are GST-registered and foreign-based businesses which are not.

In addition, Singapore has implemented the four minimum standards under the initial BEPS project in relation to Action 5 (Harmful Tax Practices), Action 6 (Tax Treaty Abuse); Action 13 (Country by Country Reporting); and Action 14 (Mutual Agreement Procedures).

Singapore also supports the work led by the OECD in developing a consensus based solution and is committed to work with members of the BEPS Inclusive framework towards a consensus-based solution. Singapore is supportive of jurisdictions working together at an international level to achieve consensus in order to avoid unilateral actions, which would lead to a disproportionate cost on global businesses in the form of significant compliance costs and an increased risk of double taxation. Accordingly, Singapore will be keen to see that any improvements to the international tax framework remain supportive of cross-border trade and do not put a disproportionate cost on businesses operating in the digital/consumer facing sector industries.

In her opening address to the 2019 Digital Tax Conference jointly organised by the International Fiscal Association and Tax Academy in Singapore earlier this month, Minister in the Prime Minister’s Office and Second Minister for Finance and Education, Ms Indranee Rajah, made publicly clear the Singapore Government’s position. Ms Indranee remarked that a global consensus solution should be based on two principles and must continue to, (i) support global economic growth and innovation, (ii) give room for jurisdictions to pursue their own policy mix appropriate to their circumstances and development needs.

The allocation of profit in taxation has historically been tied to production and value creation by the business based on the location of associated functions, assets and risks of the business. Pillar One as currently proposed seeks to allocate more profits to the market jurisdiction; however, the size of the market should not be the only consideration for profit allocation as this may weaken the incentives for businesses and governments to invest in innovation and building of capabilities such as a skilled workforce. Accordingly, it will be important to objectively evaluate what value is in fact created by the business in the market jurisdictions. This is important for smaller economies such as Singapore that continuously invest in its infrastructure, systems and governance so as to be able to attract global enterprises to be based in Singapore and make and execute decisions that lead to profits for such enterprises.

[1] Pillar Two is focused on addressing remaining BEPS risk of profit shifting to entities subject to no or very low taxation.

Next steps

Comments on the consultation document are invited by noon on 12 November 2019. A public consultation meeting will be held on 21 and 22 November 2019 at the OECD in Paris.

The OECD continues its work in respect of the global anti-base erosion proposal (Pillar Two) of the Programme of Work. A consultation document is expected to be released in November, followed by a separate public consultation meeting in Paris in December 2019.

The OECD hopes that political agreement on the architecture of both the Pillar One new nexus and profit allocation rules and the Pillar Two global anti-base erosion rule can be reached by June 2020.

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Companies should assess and evaluate the potential impact of these proposed changes. Please contact either the listed contacts below, or any member of the [Singapore Tax & Legal team].

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