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Tax

Implications of the G-7 Global Minimum Corporate Tax for Singapore

Singapore has long been known for its attractive corporate tax rates, but this tax advantage may be whisked away once the landmark tax agreement by the Group of Seven ("**G-7**") comes into effect.

The G-7 represents a huge proportion of global gross domestic product (GDP) and global net wealth, being comprised of the seven countries of Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States. On 5 June 2021, the G-7 sent ripples worldwide when it reached a deal to implement two sets of rules, namely (a) reallocating taxable profits of the largest multinational enterprises ("**MNEs**") to "market jurisdictions" where their customers are located, and (b) a global minimum tax rate of 15% for large MNEs.

The agreement has multiple aims, ranging from modernising tax laws for the digital economy, to avoiding a "race to the bottom" with countries offering progressively lower tax rates to attract MNEs, to closing cross-border tax loopholes.

While there is no clear indication on when this agreement might come into play and what the specific rules will entail, it will have far-reaching implications beyond the borders of the G-7 countries. The G-7 agreement may further set the stage for similar deals, such as amongst the Group of 20 ("**G-20**") or the more than 130 countries under the Organization for Economic Cooperation and Development Inclusive Framework. However, China as a member of the G-20 has already voiced objections to a global minimum corporate tax rate.

We examine the implications of this agreement below, and specifically what it might mean for Singapore.

Key Aspects

There are two key aspects to the agreement, namely (a) the global minimum corporate tax rate, and (b) the taxation of the digital economy.

Global minimum corporate tax rate

Increasingly, companies have booked income from intangible sources such as drug patents, software and royalties in jurisdictions where they pay little or no tax. The global minimum tax rate targets MNEs that design their international group structures to achieve reductions in their overall tax rate. In essence, the global minimum tax rate aims to prevent businesses from achieving better tax outcomes through conducting their business activities in a particular jurisdiction. While jurisdictions retain the rights to levy

whatever corporate tax rate they choose, an MNE with a customer base in a G-7 jurisdiction – despite lacking a physical presence there – will have to pay a "top-up" tax to such jurisdiction.

In effect, the MNE will pay at least 15% tax, split between the jurisdiction from which they operate and paying the balance tax to the G-7 jurisdiction. This eliminates any tax advantage a low-tax jurisdiction can offer an MNE.

The 15% rate will likely be assessed on a country-by-country basis, rather than a global or entity basis.

Taxation of the digital economy

Currently, technology giants are able to sell their services remotely, attributing much of their profits to intellectual property rights in jurisdictions with low corporate tax rates. This leads to an erosion of tax base for such companies' traditional home countries.

In recent years, several countries have moved ahead with unilateral measures to tax the digital economy. As these taxes mainly impact US companies, the US has responded with retaliatory threats. This has given rise to a confusing global tax landscape with increasingly prohibitive costs of achieving compliance. The agreement will see the G-7 countries giving up their right to introduce taxes on the digital economy but gaining greater taxing rights over the global profits of the largest MNEs. It is unclear what threshold will be set to determine which MNEs will be captured by this agreement, but market countries are likely to be awarded taxing rights on at least 20% of profit exceeding a 10% margin for such MNEs.

Other details to be hammered out are whether some sectors such as investment funds and real estate investment trusts may be excluded.

Implications for Singapore

Although Singapore's corporate tax rate stands at 17%, the effective tax rates of many businesses in Singapore may fall below the 15% global minimum rate as a result of tax incentives and the non-taxation of capital gains and foreign sourced income. Accordingly, this would place Singapore in the category of low-tax jurisdictions which risk losing their tax advantages over high-tax jurisdictions. In a worst-case scenario, some US MNEs may move certain functions currently performed in Singapore back home or to another jurisdiction.

However, not all is gloomy. While the agreement principally benefits high-tax jurisdictions, Singapore too stands to reap some benefits. In the short term, Singapore is likely to do away with some tax incentives, resulting in increased corporate income tax revenue. Second, jurisdictions with tax rates lower than Singapore's will also lose their tax advantages over Singapore, allowing Singapore to potentially benefit from the exodus of companies from tax havens such as the British Virgin Islands,

Cayman Islands and Bermuda. Third, small and medium-sized enterprises ("**SMEs**") will not be affected by the new rules, noting that SMEs represent the majority of economic activity in many jurisdictions.

In the long term however, Singapore will need to shift away from its traditional reliance on low tax rates to continue to attract MNEs to its shores. Singapore may maintain its competitive edge by exploring other strategies such as assisting MNEs in the form of capital grants and other incentives which are not taxable. Further, Singapore will need to capitalise on its non-tax strengths which include its:

1. economic and political stability;
2. robust infrastructure;
3. educated workforce;
4. strong intellectual property ("**IP**") laws; and
5. a focus on minimising compliance burden for businesses, which was recently highlighted by the Minister for Finance in a parliamentary reply in May 2021.

It is worth noting that Singapore's legal infrastructure has recently been in the spotlight, having tied with London as the most preferred seat of international arbitration in a first for Singapore. Another natural advantage is Singapore's convenient geographical location, leading to its being deemed a "gateway to Asia".

Concluding Remarks

Despite the G-7 agreement presenting an undeniable challenge to Singapore's ability to attract businesses, Singapore continues to shine in many areas that make it an attractive option to MNEs. Apart from the strengths set out above, its handling of the COVID-19 pandemic also earned it the top spot on Bloomberg's "Covid Resilience Ranking" in April 2021.

With the agreement likely taking years to implement, the effect on Singapore remains to be seen. However Singapore’s value proposition has never rested on taxation alone. Singapore's other strengths such as its strong rule of law, integrity of its institutions, adaptability and conducive business environment provide a measure of reassurance that Singapore will be able to weather the changes wrought by the G-7 agreement and maintain its competitive advantage in the ever-changing international business landscape.

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