KPMG

Tax Alert

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G7 consensus on international tax reforms and considerations for Singapore

Introduction

On 5 June 2021 the Group of Seven (G7) issued a statement which gives significant momentum to the negotiations between the 139 jurisdictions in the Inclusive Framework on BEPS (base erosion and profit shifting), led by the OECD and the Group of Twenty (G20). The G7 includes the United States, Japan, Germany, France, the United Kingdom, Canada and Italy, and their resolution of several long-standing disagreements removes key obstacles to the ultimate global agreement. The intention is to reach a global agreement on updated international tax rules for release at the G20 Finance Ministers meeting in early July.

If agreement is achieved, this would be the culmination of many years of work to seek global compromise and would arguably represent the biggest change to international tax rules in over 100 years.

Structure of the proposed rules

Two core issues are addressed with two sets of rules. The first set, the Pillar One rules, involve the reallocation of taxable profits of the largest multinationals to 'market jurisdictions'. The second set, the Pillar Two rules, seek to set a global minimum effective tax rate for large multinationals operating around the world. The idea is that the location chosen for business activities cannot be used to achieve more desirable (lower) tax outcomes.

It is important to also highlight that the proposed Inclusive Framework Pillar Two rules are different to the existing US global minimum tax rules. Further to recent US tax reform proposals, there is likely to be an alignment of sorts between proposed Inclusive Framework rules (applicable to non-US multinationals) and the US domestic tax rules (applicable to US multinationals).

Pillar One and its unresolved issues

The essential trade-off in Pillar One is that market jurisdictions will give up their right to introduce Digital Services Taxes or similar taxes on the so-called digital economy, in exchange for greater taxing rights over the global profits of the largest multinational taxpayers.

There are three key issues still to be negotiated and many smaller technical issues that will have a significant impact on how the rules will be implemented.

The first main Pillar One issue concerns the size of the multinationals that will be impacted. A considerable range has been mooted from the scope from only covering the top 100 companies to covering more than 2,000 companies. This means that the multinational group revenue threshold could be set as high as EUR20 billion or as low as EUR750 million.

The second main issue, which impacts many developing and resource-rich countries, concerns potential exclusions from the rules. It is likely, but not certain, that there will be a carve-out for natural resources and commodities. Previously, carve-outs for financial institutions, real estate, infrastructure, airlines and shipping have been discussed, but it is not yet clear whether they will be within the scope of final rules.

The third main issue is the level of profit that will be reallocated to market jurisdictions under Pillar One. The G7 release says that it will be at least 20 percent of the profit of a multinational group above a nominated profit threshold of 10 percent. This, could mean, for example, that a multinational with over EUR20 billion of global revenues would allocate 20 percent of its global annual profits (exceeding a 10 percent return on sales) to market jurisdictions. The agreed reallocation percentage will have a significant impact on the size of the pie to be reallocated to market jurisdictions and is a key consideration for many of the 139 Inclusive Framework members.

Global Minimum Tax

For Pillar Two, the main issue is the negotiation of the Global Minimum Tax rate amongst the 139 Inclusive Framework members. The G7 statement seeks an effective tax rate of at least 15 percent and that this rate should be calculated on a country-by-country basis and not on a global or entity basis. This means that multinational operations in each country will be assessed separately to see if the minimum tax rate is met – if not then a 'Top-Up' tax will be applied. This will mean that countries with low corporate tax rates or which offer generous tax incentives will be impacted by this rule.

There are many technical issues on the calculation of the rate, how it is imposed, the size of companies that will be impacted and the interface with other international tax rules.

Consequences for Singapore

Singapore's current statutory tax rate is 17 per cent and so exceeds the indicated global minimum tax rate. Furthermore, these proposed rules will only apply to the very largest taxpayers. The so-called global minimum tax will therefore only have an impact for taxpayers who are above the nominated revenue thresholds (say EUR750 million) and only when the effective tax rate here in Singapore is below the agreed minimum threshold (say 15 per cent). Accordingly, multinationals who currently pay tax above 15 per cent in Singapore will not be impacted. Small, medium and many large taxpayers who fall below the nominated global revenue threshold (even if they pay tax below 15 per cent) will not be impacted either.

However, very large taxpayers who exceed the agreed global revenue threshold of say EUR750 million and who have benefited from tax incentives in Singapore (resulting in an effective tax rate below 15 per cent) may end up paying top-up tax in the jurisdiction of their ultimate parent entity. This means, that the benefit of Singapore's tax incentives may be impacted in certain situations.

That said, the diversity of Singapore's market gives play to a special feature of the proposed rules that may, for certain multinationals, protect the value of Singapore's tax incentives. This feature, referred to as 'jurisdictional blending', lets the tax burdens of all local companies, both high taxed and incentivised, be aggregated together when calculating an effective tax rate for Singapore. Accordingly, multinationals may find, in many instances, that they can still enjoy the benefits of Singapore's tax incentives despite the rollout of the global minimum tax. It is therefore extremely unlikely that Singapore will make any changes to existing tax incentives as a short-term response. Even if a Top-Up tax is levied, a 15 per cent tax rate may still be considerably lower than the tax rate paid by the Ultimate Parent Entity, thus providing an overall tax saving to the multinational group. Furthermore, it is possible that Singapore may look at providing other forms of support including cash grants, as opposed to providing tax rate reductions, in future.

Separately, current Pillar One proposals suggest that for the largest 100 global multinationals (say with global revenue above EUR10 billion), there will also be a reallocation of 20% of their global profits. While it is not yet clear how these rules will operate, based on the earlier public drafts issued by the OECD, there may be cases in which the Singapore-based multinational profits are allocated to (other) market jurisdictions. This would decrease the tax paid in Singapore by such groups. Whether Singapore, in net terms, gets more or less tax revenue under Pillar One will depend on the where these 100 largest global multinationals already book their profits under existing transfer pricing rules.

Leaving aside the taxation consequences of these rules, Singapore's many other commercial advantages will ensure Singapore remains an attractive place for regional economic activity.

Consequences for large multinational taxpayers

The G7 position is generating substantial interest in how individual multinationals will be affected by the final rules.

For most large multinationals, this will not be a simple answer and early preparation will be critical for timely communications to boards and senior management. This will include consideration of accounting and tax systems that need to be put into place to collect information to comply with the rules. Multinationals will need to evaluate whether existing group structures and intra-group transactional arrangements are still appropriate or need to be restructured.

Furthermore, the financial impact of these proposed rules is not easy to calculate for individual multinationals given complex taxpayer facts and circumstances. KPMG has developed a modelling tool to assist with this impact analysis. This tool can also assist with determining how jurisdictional tax footprints will change and thereby help with the identification of likely new tax compliance considerations.

There are still many steps along the path to agreement, but given the political will shown by the G7 in the 5 June 2021 communique, consensus may be reached sooner than one might have envisaged. That said, there are still significant challenges to meeting the demands of other Inclusive Framework members. This includes the G7 statement requiring the roll-back of all unilateral tax measures designed to target particular industries, sectors or commercial activities, which remains a point of contention with developing countries.

Readers should monitor these developments closely.

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