The impact of BEPS on tax incentives in ASPAC and Singapore

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Across the Asia Pacific (ASPAC) region, many countries offer a range of tax incentives to attract foreign investment and to drive the development of local infrastructure. However, the introduction of a global minimum tax raises questions about the future of such incentives.

KPMG is pleased to provide a summary of the results of our ASPAC regional survey of tax incentives. This survey and detailed commentary can be accessed via this link.

Introduction

On 8 October 2021, the Organisation for Economic Co-operation and Development's (OECD) Inclusive Framework (IF) announced that it had reached majority agreement on the building blocks and key rates for a new global tax framework, which is currently supported by 136 out of 140 IF members.

Our recent KPMG publication gives a fuller explanation of the 8 October 2021 statement.

Impact of a global minimum tax rate on ASPAC tax incentives

In a recent survey, we found that more than 40 tax incentive regimes, across the ASPAC region, had the potential to be impacted by the Pillar Two measures, although the number grows considerably when sector-specific variations of these incentives are factored in.

It is important to note that Pillar Two is not like some of the other BEPS measures, which simply will not affect a country that chooses not to adopt them domestically. Top-up tax can apply under Pillar Two (typically at the ultimate parent company level) to neutralise tax incentives enjoyed elsewhere in the group.

The question then arises: How likely is it that countries will continue offering generous tax concessions (at a cost to their tax revenue) if another country can claw back that benefit (to benefit their tax revenue)?

Potential policy responses

With the potential neutralisation of their tax incentives under Pillar Two and no grandfathering of existing incentives, some countries in the region have already started to explore alternative options:

- It is likely that the most generous tax incentives will be unwound, or else rates increased. However, with the benefit of jurisdictional blending with higher-rate income or entities, it may be that incentive rates of below a certain threshold (say, 10%) do not survive, but those at or above do.
- Some jurisdictions in the region are also exploring an alternative minimum tax concept for in-scope multinational groups. This would allow for incentives to be maintained for out-of-scope taxpayers, whilst ensuring that any top-up tax to get to an effective tax rate (ETR) of 15% is collected locally rather than in another jurisdiction.
- Move towards encouraging investment by way of grants and qualifying refundable tax credits, which have less of a reduction to the ETR than non-refundable tax credits under the current proposals.
- Other alternative non-tax incentives might include things like payroll incentives or a reduction of regulatory burdens.

One thing is clear: Governments need to respond quickly to these measures, as uncertainty can make medium- to long-term business planning very challenging and could dampen investment activity.

Mitigating factors

There are some aspects of the measures which could lessen the impact on multinational groups:

- Jurisdictional blending allows for the ETR to be calculated on an aggregated basis for all group entities in the same jurisdiction (blending high-tax and low-tax entities). Centralising operations can optimise the advantages of jurisdictional blending.
- The formulaic substance-based exclusion for a 10% fixed return on payroll costs and 8% fixed return on tangible assets may also reduce the impact (tapering to 5% over 10 years), particularly for manufacturing operations or headcount-dependant incentives.
- For Ultimate Parent Entities that benefit from incentive rates, the delay of the Undertaxed Payment Rule start date to 2024 is helpful. Groups with limited overseas operations will have an additional 5 years before it applies.

Impact on Singapore profit pools

Singapore offers a range of tax incentives, which primarily result in reduced tax rates for qualifying activities for a fixed number of years (usually 5 years). These might include the Finance and Treasury Centre Incentive (8%), Regional Headquarter Incentive (0–10%) or the Intellectual Property Development Incentive (5–10%). These temporary tax rate reductions are below the agreed 15% global minimum tax rate.

In addition, foreign-sourced income (e.g. interest and royalties) is only taxed in Singapore when remitted onshore. This will impact ETR calculations, where such income is included in financial statements but not subject to tax in the same tax year, and also lead to other considerations for certain cross-border-related party payments.

Singapore also exempts certain classes of income which may have the income inclusion rule (IIR), undertaxed payments rule (UTPR) or subject to tax rule (STTR) impacts. On the other hand, the Pillar Two Global Anti-Base Erosion (GloBE) rules allow for a substance carve-out on tangible assets and payroll costs which will be beneficial to groups with substantial activities located in Singapore.

Opportunities may, however, arise to relocate operations from foreign jurisdictions with high-taxed profits into Singapore so as to blend with any pre-existing low-taxed profit pools. This might result in simplified group structures or transaction flows, while preserving pre-existing Singapore tax incentives benefits.

This is especially relevant given that the OECD average corporate income tax rate in 2021 was 22.9% according to the OECD's Corporate Tax Statistics: Third Edition.

Pillar One rules will also impact ETR calculations for some very large Singapore taxpayers due to the reallocation of profits to market jurisdictions. This will likely increase ETR calculations for Singapore-based profit pools as the reallocation of profits under Pillar One is likely to result in higher levels of overall corporate taxation and might, in part, offset some of the impact of Pillar Two.

In summary, the jurisdictionally blended ETR calculation requirement, under GloBE rules, needs to accommodate these issues, as well as many other timing and permanent differences. Relevant transitional rules (e.g. carryforward losses) also need to be considered. Modelling the impact of these rules will be important to identify likely taxation costs, which will lead to financial statement and market disclosure considerations.

For completeness, we note that proposed changes to US tax rules may also require consideration.

What should multinationals be thinking about?

With the expected release of the detailed rules in late November 2021, the pressure is on for quick adoption of the measures and a proposed start date in 2023.

This leaves very little time for multinationals to work out how the measures may affect them and to reassess their group structure, intellectual property holdings, financing arrangements and global supply chains given the potential neutralisation of existing tax benefits. Local consultation to get certainty on incentives and other policy responses will be important.

How we can help

Your KPMG team can support you with impact assessments, scenario modelling, lobbying support, group structure planning and holistic data solutions.

About Tax Alert

KPMG Tax Alert highlights the latest tax developments, impending change to laws or regulations, current practices and potential problem areas that may impact your company. As certain issues discussed herein are time sensitive it is advisable to make plans accordingly.

To uncover more insights on the global tax implications of COVID-19, read our COVID-19 Global Tax Developments Summary
Read more of our insights and perspectives at the KPMG in Singapore Webpage

[2] The fixed input tax recovery rate from 1 April 2021 to 31 March 2022 is 74% for a full-licensed bank.

Author

Dean Rolfe
Partner
Head of International Tax, Asia Pacific
T: +65 6213 3199
E: deanrolfe@kpmg.com.sg

Contact us

Ajay K Sanganeria
Partner
Head of Tax
T: +65 6213 2292
E: asanganeria@kpmg.com.sg

BANKING & INSURANCE

Alan Lau
Partner
T: +65 6213 2027
E: alanlau@kpmg.com.sg

REAL ESTATE & ASSET MANAGEMENT

Teo Wee Hwee
Partner
T: +65 6213 2166
E: weehweeteo@kpmg.com.sg

Agnes Lo
Partner
T: +65 6213 2976
E: agneslo1@kpmg.com.sg

Anulekha Samant
Partner
T: +65 6213 3595
E: asamant@kpmg.com.sg

Leonard Ong
Partner
T: +65 6213 2038
E: leonardong@kpmg.com.sg

Stephen Banfield
Partner
T: +65 6213 3399
E: stephenbanfield@kpmg.com.sg

Pearlyn Chew
Partner
T: +65 6213 2282
E: pchew@kpmg.com.sg

Evangeline Hu
Partner
T: +65 6213 2597
E: evangelinehu@kpmg.com.sg

ENERGY, TECHNOLOGY, MEDIA & TELECOMMUNICATION

Gordon Lawson
Partner
T: +65 6213 2864
E: glawson1@kpmg.com.sg

Larry Sim
Partner
T: +65 6213 2261
E: larrysim@kpmg.com.sg

Harvey Koenig
Partner
T: +65 6213 7383
E: harveykoenig@kpmg.com.sg

Mark Addy
Partner
T: +65 6508 5502
E: markaddy@kpmg.com.sg

INFRASTRUCTURE, GOVERNMENT & HEALTHCARE

Chiu Wu Hong
Partner
T: +65 6213 2569
E: wchiu@kpmg.com.sg

Dean Rolfe
Partner
T: +65 6213 3199
E: deanrolfe@kpmg.com.sg

CONSUMER & RETAIL

Tan Chee Wei
Partner
T: +65 6213 2470
E: cheeweitan@kpmg.com.sg

CORPORATE TAX PLANNING & COMPLIANCE

Mak Oi Leng
Partner
T: +65 6213 7319
E: omak@kpmg.com.sg

Pauline Koh
Partner
T: +65 6213 2815
E: paulinekoh@kpmg.com.sg

Contact us

PERSONAL TAX & GLOBAL MOBILITY SERVICES

Anna Low
Partner
T: +65 6213 2547
E: alow@kpmg.com.sg

Lee Yiew Hwa
Principal Advisor
T: +65 6213 2866
E: yiewhwalee@kpmg.com.sg

TAX – DEALS, M&A

Adam Rees
Principal Advisor
T: +65 6213 2961
E: adamrees@kpmg.com.sg

INDIRECT TAX

Lam Kok Shang
Partner
T: +65 6213 2596
E: kokshanglam@kpmg.com.sg

Gan Hwee Leng
Partner
T: +65 6213 2813
E: hweelenggan@kpmg.com.sg

Shirley Shen
Partner
T: +65 6213 3288
E: shirleyshen@kpmg.com.sg

TRANSFER PRICING CONSULTING

Felicia Chia
Partner
T: +65 6213 2525
E: fchia@kpmg.com.sg

Lee Jingyi
Partner
T: +65 6213 3785
E: jingyilee@kpmg.com.sg

R&D & GRANTS CONSULTING

Harvey Koenig
Partner
T: +65 6213 7383
E: harveykoenig@kpmg.com.sg

PROPERTY TAX & DISPUTE MANAGEMENT

Leung Yew Kwong
Principal Advisor
T: +65 6213 2877
E: yewkwongleung@kpmg.com.sg

See Wei Hwa
Partner
T: +65 6213 3845
E: wsee@kpmg.com.sg

INDIA TAX SERVICES

Bipin Balakrishnan
Partner
T: +65 6213 2272
E: bipinbalakrishnan@kpmg.com.sg

US TAX SERVICES

Daniel Joe
Partner
T: +65 6213 2626
E: danieljoe@kpmg.com.sg

Curtis Ottley
Partner
T: +65 6213 3611
E: curtisottley@kpmg.com.sg

TAX GOVERNANCE

Pauline Koh
Partner
T: +65 6213 2815
E: paulinekoh@kpmg.com.sg

FAMILY OFFICE & PRIVATE CLIENTS

Stephen Banfield
Partner
T: +65 6213 3399
E: stephenbanfield@kpmg.com.sg

GLOBAL COMPLIANCE MANAGEMENT SERVICES

Cristina Alvarez-Ossorio
Partner
T: +65 6213 2688
E: cristinaalvarez@kpmg.com.sg

TAX TECHNOLOGY & TRANSFORMATION

Jenny Clarke
Partner
T: +65 6213 3123
E: jennyclarke@kpmg.com.sg

Catherine Light
Partner
T: +65 6213 2913
E: catherinelight@kpmg.com.sg

KPMG
16 Raffles Quay #22-00
Hong Leong Building
Singapore 048581
T: +65 6213 3388
F: +65 6220 9419
E: tax@kpmg.com.sg

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