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Non-taxation of foreign-sourced income - EU review outcome

Singapore, along with Malaysia and Hong Kong, was recently subject to a review by the European Union's (EU) Code of Conduct Group (COCG) and endorsed by the EU Economic and Financial Affairs Council (ECOFIN). The focus of the review was the non-taxation of foreign-sourced income (FSI) by selected jurisdictions, specifically the processes and rationale that exempted such income from taxation. The review was undertaken to assess compliance with the EU and Organisation for Economic Co-operation and Development (OECD) rules on fair tax competition and tax transparency. Jurisdictions found to be non-compliant with EU and OECD tax standards have been listed on an EU tax haven blacklist.

Background

On December 5, 2019, the ECOFIN approved a list of FSI exemption regimes to be investigated from the following jurisdictions: Botswana, Costa Rica, Hong Kong, Maldives, Malaysia and Labuan Island, Namibia, Nauru, Panama, Qatar, Singapore, Eswatini, Uruguay and Samoa.

Review criteria

Overall, there were five criteria used to assess whether the exemption of FSI was considered to be harmful. These were:

Criteria 1 and 2 – Targeting non-residents and ring-fencing: "whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents" and "whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base"

Criterion 3 – Substance: "whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages"

Criterion 4 – Internationally accepted principles: "whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD"

Criterion 5 – Transparency: "whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way"

Outcome

The General Secretariat of the Council of the European Union announced their findings in relation to Singapore's taxation of FSI on 24 November 2021.

Broadly speaking, the EU concluded that the taxation of FSI on a territorial basis is not, in and of itself, problematic. In fact, exempting foreign income profits is acceptable and even recommendable in certain cases to prevent double taxation. The EU review noted that problems will arise when such regimes not only prevent double taxation, but also create situations of double non-taxation. In summary, the non-taxation of FSI by Singapore has been reviewed and cleared by the EU.

In relation to Malaysia and Hong Kong, the EU concluded that the non-taxation of FSI in these jurisdictions is in certain circumstances harmful.

Taxation considerations

The conclusion of the EU review process on the taxation of FSI and their acceptance of Singapore's tax rules based on the concept of territoriality underscores the stability and reliability of Singapore as a regional hub for financial and intellectual property planning. Importantly, the use of real economic substance in Singapore was a key factor that underpinned the EU's conclusions.

Furthermore, the OECD's Global Anti-Base Erosion (GloBE) rules will include allowable adjustments for temporary timing differences. The allowance for temporary timing differences should therefore accommodate Singapore's territoriality basis of taxation. Taxpayers will however need to consider the impact of the OECD's proposed Subject to Tax Rule (STTR) and how these rules may be applied to payments made to Singapore in certain situations. But if the FSI is subject to tax at rates above 9% in Singapore, or if already subject to rates of withholding tax above 9% (at source), the STTR would not apply.

For more information on the implications of these rules, please reach out to your local KPMG representative or to Dean Rolfe for further details on this matter.

About Tax Alert

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