

Singapore: Sovereignty, Society, Substance, Success

White paper on Singapore's tax policy





Foreword

Singapore proudly celebrated its 50th birthday on 9 August 2015. It was an opportunity for the nation to reflect on the remarkable achievements of our small city state over what – at least measured against most other first world economies – is an incredibly short and successful first 50 years of life as a nation.

Why has Singapore been so successful in evolving into a globally significant first world country? There are, of course, many reasons. At its core, Singapore is successful because of a bold ambition for our nation which was steadfastly pursued by visionary, resolute leaders. Our nation was built on strong principles and our pioneer and successive generations making personal sacrifices to fuel the exponential growth.

This vision has manifested itself in a number of qualities that Singapore can, uniquely in our region, offer the world:

- Solid and reliable infrastructure;
- A strong rule of law which is applied consistently and fairly;
- A stable government;
- A safe and secure environment, with a low crime rate and low unemployment rate;
- Easy access to South East Asia and the Asia Pacific more broadly;
- A truly global community and economy;
- A competitive tax system.

It is time for Singapore to have a tax system that mirrors the desire to build a great entrepreneurial system. It must allow for greater choice and with less supervision. It needs to allow for Singapore entrepreneurs to exercise self-determination and self-control. This would allow Singapore to show how enterprises in Singapore can exercise self-governance and meet international demands while choosing to take advantage of the value Singapore offers. Such enterprises must be allowed to leverage attractive benefits from where it is rooted in substance – Singapore.

Singapore's key natural resource is its people. The world knows the value of its highly-trained and productive workforce. This has been built from within and from without. There is a need to build on a principle developed by our founding fathers when they decided that home ownership was a fundamental way to anchor the people to this young country. The tax system now needs to promote this in a similar way to get the people in Singapore to have greater participation in the equity of the nation. We must plant deeper roots. It must also focus on how Singapore can continue to be competitive to enhance this since the world is getting flatter and talent becomes more transient.

We hope readers will find this paper food for thought and a useful contribution to the nation. This paper must lead to more ideas as we participate in laying the ground work for our children and theirs to celebrate SG100. Majulah Singapura!



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Summary

Given the current global focus on the tax policies of multinationals, individuals and sovereign countries, the purpose of this paper is to consider the competitiveness of Singapore's tax system.

In reflecting on the effectiveness of Singapore's tax system over the first 50 years of its life, it would be difficult for anyone to argue against awarding it a resounding A+. ¹ The continued evolution of the Singapore tax system is, however, essential to preserve the remarkable foundation built thus far. The question we need to ask then, is whether the tax system that has served us so well to date needs to go through a revolution for the future?

Singapore has always decided what tax policies are right for Singapore – the tax system has been used to serve many purposes. At the risk of stating the obvious, tax is the key means for the Government to raise revenue so that it can meet the many needs of the nation. This requires a fine balance. Like the story of Goldilocks faced with porridge of varying temperatures, a tax system that is too aggressive may end up burning entrepreneurship and scaring away opportunities to help Singapore thrive. If the tax system is too mild and results in low tax collections, the Government may be unable to fund many initiatives, run into deficit position or deplete its reserves. In this regard, Singapore has always worked to make the tax system just right and has always maintained its sovereignty.

Global competition between countries to attract and retain multinationals will remain. But the global tax world is changing rapidly. Increasingly, concerns are being voiced about what the Organisation for Economic Co-operation and Development (OECD) and G20 have termed “Base Erosion and Profit Shifting” (BEPS) by multinational corporations, and various interest groups are questioning the appropriateness of legitimate tax structures. There are calls for increased corporate tax transparency and automatic exchange of information (AEOI) between countries. This is changing the global tax landscape and the underlying concerns cannot be ignored. A more

detailed discussion of this changing landscape can be found in Appendix 1.

Singapore's tax system has been effective in supporting the growth of the economy, and one reason for this is that tax policy constantly evolves to meet the changing needs of the country as well as the global economic environment. It is important that this continues – more so now than ever, given that BEPS may lead to some of the most significant changes in the international tax system in a 100 years. But a revolution seems more appropriate.

Singapore has been labelled by some as a tax haven. This is unfair. To those familiar with the system, Singapore is transparent and has economic substance. Singapore not only needs to refute any such labelling but grow with confidence using these attributes as the catalysts.

Each year, PwC and others publish a Budget wish list of initiatives we recommend the Government consider as it develops the coming year's budget. These wish lists are an important means for the Government to take the temperature of the business community and consider new ideas. However, the initiatives typically proposed in a budget wish list are often more about tweaking the tax system rather than reforming it.

In this paper, we make several more strategic recommendations on changes to the fundamentals of Singapore's tax system that the Government could consider to meet Singapore's future needs. We have applied the experience from working in the international tax system every day and speaking with senior executives of local and multinational enterprises about their tax affairs.

With the benefits of these insights, we make several recommendations:

- i. **Singapore should continue to use tax incentives** to attract the industries it believes will add value to the Singapore economy and society, where such incentives continue to be based on sound principles consistently applied and based on economic

¹ Singapore was ranked 5th in *Paying Taxes 2015*, and has been consistently ranked in the top five economies surveyed since 2006. Singapore's cost of tax collection for the 2012/2013 financial year, was only 0.79 cents per dollar of tax collected by IRAS (https://www.iras.gov.sg/IRASHome/uploadedfiles/IRASHOME/Publications/Tax%20Coll_Cost%20of%20Tax%20Coll_FY00-FY13.xls). The IRAS also stated in “IRAS. Taxes. Redefined”, published in 2012, that it has achieved one of the lowest costs of tax collection and the highest rates of voluntary compliance in the world (<https://www.iras.gov.sg/irashome/uploadedfiles/irashome/Publications/IRAS%2020th%20Anniversary%20Special%20Feature.pdf>).

substance being established in Singapore. It is necessary to strike a balance between promoting greater transparency, and preserving taxpayers' confidentiality and Singapore's competitiveness. But it is a new dawn and Singapore would benefit from publishing industry summary data about its incentive schemes, the broad requirements for it to apply, the number of taxpayers enjoying the incentives, the number of employees in Singapore and other relevant economic features.

- ii. **Companies which are granted a tax incentive in Singapore should be subject to higher standards of self-assessment.** It is a *quid pro quo*. If tax incentives (see below) are used as an economic tool, taxpayers need to do their part to justify the benefit derived: they **must** show the incremental contributions to Singapore's economy. Such a demonstration could come from having relevant controls to ensure compliance with international tax principles.
- iii. **Utilise tax incentives to increase Singapore's tax revenue** and apply them in the same way to local enterprises. New foreign direct investments continue to be targeted but certain high-growth, high-potential segments of the domestic economy may well be incentivised to grow further. Tax revenues can continue to expand where the economy continues to grow.
- iv. **Additional government revenue to fund social support and welfare programmes must be raised.** Given the ageing population, Singaporeans will come to need or expect more social support. Enlarging the economic pie, with the resulting broadening of the tax base, would no doubt be the preferred approach. We are mindful if the Goods and Services Tax (GST) rate is to be increased consideration should be given to compensatory arrangements, including enhancing the GST Voucher scheme, to reduce the higher marginal impact on those most affected.
- v. **Singapore should establish an Asian/ASEAN tax arbitration hub** by building on its position as a commercial judicial centre for Asia. This will help multinationals settle transfer pricing and other cross-border tax disputes in an equitable way.
- vi. **Singapore should agree transfer pricing safe harbour rates with other tax authorities.** The uncertainty faced by taxpayers when dealing with transfer pricing disputes is significant. One way to further deal with such disputes is through bilateral Advance Pricing Agreements (APAs). APAs provide taxpayers with certainty through a pricing model which is documented and agreed between revenue authorities upfront, thereby providing certainty. In particular, Singapore should encourage other tax authorities of main trading partners, starting with other members of ASEAN, to agree to a range of transfer pricing safe harbour rates to provide certainty for transfer pricing of common activities. This will save considerable time and cost for multinationals operating on a cross-border basis.
- vii. **Singapore should continue to expand its treaty network.** While Singapore has an extensive network of double tax agreements with other countries, that network needs to be expanded. Singapore has taken many steps over the years to continually modernise its tax treaties and this should continue as tax competition (including through new treaties being executed between other countries) is only intensifying. A double tax agreement with the United States (US) is something that the business community should continue to lobby for and Singapore should have a tax treaty ratified with the US as soon as possible.
- viii. **The Inland Revenue Authority of Singapore (IRAS) should publish sanitised versions of the private rulings it issues to taxpayers.** The IRAS considered this option recently and concluded that it would not publish sanitised rulings given taxpayer confidentiality could not be guaranteed even where the rulings are heavily sanitised. Most other countries have dealt with the issue of confidentiality and do publish versions of their rulings. In this regard, it is also relevant to note that the IRAS will be sharing rulings with other competent authorities.
- ix. **Singapore should be more appealing for research and development (R&D) and Intellectual Property (IP) management activities.** Tax reform can catalyse and propel Singapore's progress towards its objective of becoming a global IP management hub. A broader interpretation of R&D for tax purposes, a pre-claim framework for Singapore businesses to obtain upfront certainty on eligibility of projects for R&D claims, and a suite of tax incentives can boost Singapore's already beneficial fiscal regime for IP management activities.



Options for the future

We have the benefit of working in the international tax system every day and speaking with local and multinational groups about their tax affairs. Designing a tax system will necessarily involve different stakeholders including charities, unions, academia and others.

We believe that the changes that are happening – and those that are likely to happen – to the way the tax systems of all the major economies of the world interact present a tremendous opportunity for Singapore to reflect on its past success and adapt its tax system for the future. We make several observations and recommendations for discussion in this chapter in the following areas:

- I. Tax administration and transparency (with a focus on incentives)
- II. Intellectual property
- III. Transfer pricing and cross-border arbitration
- IV. Tax treaties
- V. Attracting talent
- VI. Future of Singapore's tax system

I. Tax administration and transparency

In the drive towards reducing Singapore's reliance on an entrepôt economy in the early days of its nation building, there was a real need for Singapore to promote investment in new industries and industrialisation, but attracting foreign investors and industrialists to its shores back then, was far from easy. Tax incentives (introduced for the first time in 1959)² presented a win-win solution: for foreign investors coming to Singapore, tax incentives helped offset the disadvantages of investing in Singapore and increased their financial return; for the then-young Government this accorded fiscal prudence as compared to cash subsidies.

Fast forward more than half a century later, Singapore's economic progress is undeniable and remains the envy of many (see Appendix 2 for an overview of the Singapore economy). Tax incentives have been one of several highly successful strategies employed by the Singapore Government to attract foreign direct investment relevant to the Singapore economy, and, in more recent years, directing it towards key value-added industries that would support the growth of the economy. As the country has developed over the years, tax incentives, while still a consideration, are not the main reason why multinationals set up operations in Singapore, which now boasts a highly educated workforce, stable and corruption-free political environment, world class transport and communications infrastructure and a first-world standard of living. Its geographical position at the heart of Asia also makes it an ideal regional headquarters location.

Singapore's tax incentives can be broadly put into two categories:

- Tax concessions or incentives that are given automatically to qualifying taxpayers and do not require prior approval. Qualifying conditions for these are enacted in the tax legislation. These incentives typically require the taxpayer to perform certain activities in Singapore (e.g. enhanced tax deductions are given for research and development (R&D) carried out in Singapore, and the qualifying debt securities incentive requires debt issues to be substantially arranged by certain financial institutions in Singapore).
- Tax incentives are specifically aimed at growing identified industry sectors, such as pharmaceuticals and biotechnology, financial services, maritime, aerospace, etc. These are intended for multinationals that are prepared to make significant investments and/or contribute to the economy or to

² The Pioneer Industries (Relief from Income Tax) Ordinance and Industrial Expansion (Relief from Income Tax) Ordinance were enacted in 1959.



the development of specific industries which Singapore wishes to promote. Such taxpayers must have substantive operations in Singapore and commit to certain headcount, local business spending and other substantive criteria which are spelt out in the specific terms of their awards.

These incentives are typically administered by the statutory body overseeing the relevant sectors and usually have specific and stringent minimum qualifying criteria, details of which may be circulated to interested parties (e.g. industry players, potential applicants, professional advisors), but which are otherwise not publicly available. The qualifying conditions specific to the taxpayer for this category of incentives are agreed after a negotiation process between the administering authority and the taxpayer. This process takes into consideration the taxpayer's business plans for Singapore and the region.

The administering authorities generally do not publish minimum qualifying conditions for these incentives. This approach has been highly successful in the past as it allows the incentives to be tailored to specific taxpayers based on their investment in Singapore and also to provide greater agility to deal with changes in global and regional economic conditions.

These incentives are accompanied by clear, measurable milestones to allow the administering authority to monitor the necessary transformation to be undertaken as part of the incentivised investments. This can relate to any transfer of intellectual property (IP) and/or other assets, funding, changes to the value chain, etc.

Those following international tax developments would be well aware that the OECD's BEPS initiative reports include recommendations for changing some international tax rules. Amongst

these is a (re)focus on “Harmful Tax Practices”, with a nagging concern for Singapore being the longer term viability of its tax incentives framework.

The OECD report pertaining to “Harmful Tax Practices” published on 5 October 2015 (“the 2015 report”), whilst focused on review of the regimes of OECD member and associate countries³ in the OECD/G20 Project on BEPS, can provide some useful insights for Singapore. For example, the reiteration that incentives designed to attract investment in plant, building and equipment are not targeted by the OECD bodes well for many of Singapore’s tax incentives which are designed to encourage investment in manufacturing, productive equipment and local infrastructure.

There is also likely some good news for Singapore’s maritime sector, which has historically been buoyed by an array of shipping tax incentives. The fact that some European countries’ shipping regimes (which bear similarities to Singapore’s) have been rated “not harmful” within the 2015 report, should reaffirm the Government’s approach in this area.

Also worthy of mention is the financial services sector which contributed to about 11% of Singapore’s GDP⁴ in 2012. In spite of the many tax incentives available to this sector, it accounted for 27% of total corporate taxes paid for the Year of Assessment 2013.⁵ In contrast, in 2014 in the UK, financial and insurance services contributed £126.9 billion in gross value added (GVA)⁶ to the UK economy, 8.0% of the UK’s total GVA.⁷ The financial services industry contributed an estimated £65.6 billion in taxes (in 2013/14 to the UK exchequer which represents 11.5% of total UK government tax receipts.⁸ Tax concession notwithstanding, it can be seen that the corporate tax contribution of the financial services sector in Singapore is by no means light, both in terms of its share of the overall economic output and relative to a developed economy with an established international financial centre.

Some might argue that Singapore’s tax incentive regime should be refined (or eliminated) in light of BEPS. It may, however, be observed that Singapore does not have the natural resources, land or population size of other countries, so is it not right to seek to attract particular activities to its shores through tax incentives which are based on sound principles, consistently applied and require economic substance? In addition, a quick comparison with neighbouring countries and other financial centres shows that they too employ incentive regimes to attract and anchor investment (see Appendix 3 – Comparison of tax regimes).

While the adage goes “if it ain’t broke, don’t fix it” these challenging times present an opportunity for Singapore to use its natural and real hub status for the region to drive its global growth for the next 50 years. It can concurrently help deal with the global pressure that will (not “may”) eventually question Singapore’s sovereign right to offer tax incentives based on substance. Singapore should therefore seek a renaissance for its tax incentives regime.



³ Singapore’s incentives and those of other non-OECD country regimes were not covered in the 2015 report but are set to be reviewed as part of a second phase.

⁴ Singapore Department of Statistics (SingStat) website, <http://www.singstat.gov.sg/statistics/visualising-data/charts/share-of-gdp-by-industry>;

⁵ Corporate Income Tax, Taxable Companies by Economic Sector, IRAS website, https://www.iras.gov.sg/IRASHome/uploadedfiles/IRASHOME/Publications/CIT_Taxable%20Coys%20by%20Econ%20Sector_YA04-YA13.xls

⁶ GVA + taxes on products – subsidies on products = GDP

⁷ Financial Services: contribution to the UK economy, last updated 26 February 2015, House of Commons Library, <http://researchbriefings.files.parliament.uk/documents/SN06193/SN06193.pdf>

⁸ The Total Tax Contribution of UK Financial Services, seventh edition, <http://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Pages/Total-tax-contribution-of-UK-financial-services-seventh-edition.aspx>. This research is a broader measure of tax contributions and corporation taxes, VAT, business rates and other taxes. It includes both taxes paid by the sector and taxes collected on behalf of the government.

(i) The incentives renaissance

Singapore has an array of tax incentives to encourage investment in the country. These initiatives have been highly successful, as evidenced by the number of globally renowned companies with headquarters in Singapore covering industries which have helped propel Singapore from a third world country to one with one of the highest GDP per capita in the world. These incentives are provided on the basis of the level of investment into the country, taking advantage of its global connectivity and infrastructure as well as the world class skill sets available in Singapore. With its small consumer base, it is well known that Singapore's key advantage is to function as a headquarters location from which multinationals strategise, manage and grow their regional businesses. As a result, Singapore's tax incentives have always been tied to substance-based criteria involving numbers of skilled professionals, capital investment, human capital development and R&D.



Thus, when OECD looked at harmful tax regimes under BEPS Action 5, Singapore's position has been that its regime is substance based and its beneficiaries do not engage in purely tax driven operations or arrangements. For a regime to be considered preferential, it must offer some form of tax preference in comparison with the general tax rules in the country which can include reduced tax rates. Factors that would render a preferential regime to be potentially harmful include:

1. Failure to adhere to international transfer pricing principles;
2. A negotiable tax rate;
3. Promotion of the regime as a tax minimisation vehicle;
4. Encouragement of operations or arrangements that are purely tax driven and involve no substantial activities.

What makes a regime "actually" harmful rather than "potentially" harmful requires an analysis of whether it has harmful economic effects including whether the activities in that country are commensurate with the amount of investment or income and whether the preferential tax regime is the primary reason for the relocation of the activity.

It is clear that Singapore follows international transfer pricing principles. Singapore's tax incentives are not promoted as a tax minimisation vehicle nor are they given if there is no substantial activity. Further, the lower rate(s) are legislated and pegged to the level of investment activity committed by taxpayers. However, the current environment requires appropriate management of the perceptions of the regime and communication of these key issues to the world at large – not only to taxpayers and advisers.

(ii) Make the criteria for the tax incentives more transparent

Given the international developments, it would further enhance Singapore's position if there was greater transparency of our incentive regime. While there have been and remain good reasons why conditions set by the Government have been kept confidential,⁹ such an approach breeds unwarranted suspicion. Certificates awarding the incentives to taxpayers set out the specific criteria and milestones to be met in order to qualify for reduced tax rates; however, these are confidential documents.

An approach to greater transparency could be to allow for potential investors to select from certain pre-determined criteria how they would contribute to the growth of the Singapore economy. This can be related to various indicators such as employment, capital investment and development of know-how in Singapore, etc. Broad conditions could be set according to each criterion and by industry. This can show to the world in clear and objective terms why such programmes are necessary to incentivise investors to fuel growth, and to allay suspicion that the rates are merely used to attract the shifting of profits across to Singapore.

In the future, certain minimum qualifying conditions should be published and a self-assessment framework could be implemented. The framework could require taxpayers to perform self-reviews of their compliance with the qualifying conditions to ensure the adoption of adequate controls and international standards (e.g. in transfer pricing). The ability to clearly demonstrate arm's length profit attribution and ensuing taxes would help substantiate that Singapore only rewards investments that comply with globally acceptable practices.

(iii) Need to safeguard the standing of our incentives

IRAS reiterated its long-standing requirement for Singapore taxpayers to prepare contemporaneous transfer pricing documentation in January 2015 – all taxpayers (subject to *de minimis* rules) are required to prepare transfer pricing documentation by their tax filing date. However, they are not required to file the documentation with the tax authorities, only to have it ready when asked. As outlined above, Singapore companies enjoying tax incentives will likely be under scrutiny from tax authorities, and potentially, the media.

Bearing in mind there is already a requirement for contemporaneous transfer pricing documentation, that higher level of scrutiny may result in the tax incentivised companies having to actually file their transfer pricing documentation with IRAS each year and for IRAS to review the documentation as part of the annual tax return filing. This additional scrutiny should not be seen as unduly onerous to the incentivised taxpayer because it is already a standard requirement of the incentive for their transactions to comply with the arm's length principle. This should be seen as part of the incentive requirements and normal compliance with contemporaneous documentation, in line with the rules and regulations of the country.

The required filing will have the following benefits:

1. Enable IRAS to assess whether the taxpayer has complied with the substance requirements of the tax incentive. This will be set out in the documentation of the functions, assets and risks undertaken.
2. Assess if the incentivised income is commensurate with the activities undertaken in Singapore. The income should be determined in accordance with international transfer pricing requirements, based on the substance requirements in the incentive.
3. In the future, there will likely be more information exchange between tax authorities to promote transparency between regimes and IRAS will likely want to be a participant as a principled tax authority. In this transparent environment, it would be beneficial for Singapore to have the information at hand and to have the benefit of analysing the information beforehand on the adherence to substance and international transfer pricing principles.
4. In the same way, country-by-country reporting requirements will be mandated in more countries and information on the effective tax rate, revenue, profitability and certain details supporting substance (such as headcount, etc.) of companies in Singapore, particularly incentivised companies should likely be collected by other tax authorities. The review of transfer pricing documentation as part of the annual tax return will allow early assessment of the tax affairs of the incentivised companies in a more holistic manner.

⁹ Among other things, this is necessary to protect taxpayers' confidentiality as incentives are tied to specific business plans of the award holders.



IRAS is already looking at the transfer pricing practices of companies to ensure that international transfer pricing rules are followed and the above recommendations should not increase the burden on their resources. However, having the firm requirement of an annual check and tax review of the transfer pricing documentation will help to deal with any incorrect perception of Singapore as a harmful preferential tax regime. Communication of a systematic review process implemented and enforced annually by IRAS with information collected at hand on the tax affairs of these incentivised companies will help to dispel and rebut any such incorrect allegations which may surface.

While there may be some concern that such additional burdens may erode Singapore's competitiveness, it will unlikely outweigh the ensuing reputational benefits.

In our experience, companies which enjoy tax incentives in Singapore are commercially driven to locate here and have a long history of adopting best practices in managing their tax affairs.

(iv) More flexible incentives that target growth

In the spirit of greater free enterprise to encourage businesses in Singapore to further expand we need to develop a self-assessment and more transparent incentive regime that further rewards incremental growth and certain behaviour.

The essence of the various current initiatives can be narrowed down to the following elements:

- It is administered by various agencies that have a mandate to grow elements of our economy. One agency is tasked to attract foreign investors to bring new investments into Singapore; another, the export of goods and services; others are to develop certain sectors such as the finance or shipping industries. The process of awarding is robust. Various benefits are pieced together.



- The common thread is growth. Enterprises are incentivised to increase certain headcount, spending in Singapore, export, focus on specific sectors, etc. Specific industries are targeted as an ecosystem is developed around various clusters.

It is therefore important to challenge what we have today:

- Can an incentive regime going forward be in a free form and allow the market of Singapore-based and Singapore-bound entrepreneurs to determine where and what it is to pursue so long as the elements to help Singapore grow are met?
- Can enterprises enjoy tax benefits so long as incremental revenue is achieved and key behaviours are demonstrated?
- Can enterprises be rewarded just because they grow? It should not mean a lower revenue collection where the basis is simply one theme - growth. While disproportionate growth in certain sectors may result in a misallocation of resources such concerns could be addressed by adding an element of tenure to allow for re-calibration of something that is more free form.

In the spirit of entrepreneurship, certain tax incentives should broadly be targeted at helping Singapore-based small and medium enterprises (SMEs) to grow. Candidates for these incentives could be companies that have been in Singapore for a certain period of time (say five years) and which have a certain track record of growth over that time. Such criteria are important to target enterprises with growth potential.

This is to encourage growth and certain behaviours. This is to reward the relevant successes based on predetermined conditions and without the need to apply to agencies. This is broadly similar to many incentives currently available but the availability would not be on an application basis but available to all relevant and qualifying enterprises in Singapore.

The incentives would lower corporate income tax burdens. Broadly, lower corporate tax rates would apply to incremental income brought to tax in Singapore from various activities. The rationale of such an approach would be to reward growth without the additional administration of an incentive application but would be governed by adequate self-assessment and controls.

Singapore tax collections should not be stressed but should increase since the lower taxes would apply to incremental profits. The normal corporate tax rate would continue to apply to the base profit level.

There are various activities that would give rise to qualifying incremental income, for example:

- Sales that are directly or predominantly contributing to a value chain that results in the export sale of goods where substantial value is added in Singapore or services performed predominantly in Singapore to enterprises outside Singapore should qualify as concessionally taxed incremental revenue. This would incentivise enterprises to seek greater growth from markets outside Singapore and reward the establishment of greater substance in Singapore.
- Attaining higher productivity – based on meeting certain productivity standards or ratios (e.g. improved income to employee number ratios)- that results in incremental income. This would encourage greater productivity through the use of more

technology and less reliance on human capital or more highly-skilled individuals who can provide better yield.

- Enterprises that attain better margins from improvements in people skills or certain human capital behaviours - such as the reduction of reliance on foreign workers or the hiring of older citizens – should also be rewarded where this results in incremental income.

Other similar expansionary activities that increase value added economic activities and relevant income in Singapore could similarly be encouraged.

The examples cited are meant to simply illustrate the point rather than exhaustively define the recommended regime, which needs to be more liberal than it has ever been before.

(v) Our recommendations

Tax competition between jurisdictions is significant, and Singapore has fared extremely well over many years by taking a principled, consistent approach to attracting multinationals to its shores while always playing the global tax competition game fairly.

While tax is only one reason enterprises consider moving to or investing further in Singapore, it is important that any reforms to the Singapore tax system take into account the potential impact on such potential greater investment. Singapore cannot risk losing its enviable position. Our recommendations are as follows:

- Singapore should not adopt one low flat tax rate for all taxpayers. A continuation of the principled and consistent approach to tax incentives is appropriate, provided requirements over economic substance and stringent adherence to transfer pricing requirements remain.
- It should be noted that the BEPS project “... aims to create a single set of consensus-based international tax rules...offering increased... predictability to taxpayers...” Complementing the themes of transparency and substance therefore, is the issue of predictability. Although a discretionary approach allows governments some flexibility and helps manage the allocation of (limited) resources, the qualifying criteria (with at least part thereof) for being granted and maintaining a tax incentive should be published in greater detail as Singapore has a good story to tell.
- Companies enjoying Singapore’s tax incentives should be held to a higher standard of compliance requirements to demonstrate adherence to transfer pricing rules.
- Complete tax holidays should be sparingly used - only for critical or novel sectors that support the ambition to grow such sectors for the betterment of Singapore residents. Otherwise it may be challenged and more importantly, it makes it difficult to engage other tax authorities in Mutual Agreement Procedure (MAP) discussions. Since no tax would be paid in Singapore, other authorities will be reluctant to entertain any MAP application from a Pioneer applicant.
- Consider providing more liberalised tax incentives under a self-assessment system that is growth focused to provide incremental profits and therefore taxes. It may not be on application but based on specific published guidelines.
- All rulings should be published in the interest of transparency. Citing taxpayer confidentiality as the key reason may be seen as going against the call for greater transparency; which will likely be an international norm in the near future. As a minimum, sanitised versions of the rulings issued to taxpayers, particularly those concerning arrangements which it sees as good commercial behaviour, could be published.

II. Intellectual property

(i) Innovation

Land and labour are both scarce and expensive commodities in Singapore. Hence, the Government has long recognised that Singapore needs to focus on growing activities at the top of the value pyramid if it wants to continue growing its economy. In short, it needs to innovate.

The R&D tax regime and Productivity and Innovation Credit (PIC) scheme provide incentives for taxpayers to innovate and act as a strategic means of helping businesses enhance innovation. However, the PIC (R&D) category take-up rate is comparative low – less than 3% according to IRAS Annual Report 2012/2013. The total number of active businesses in Singapore that made PIC claims has increased over the past two years but we understand that R&D continues to have a low take-up rate compared to the IT and automation equipment and training categories.

Based on the 2013 R&D survey conducted by the Agency for Science, Technology and Research (A*STAR), the growth in the number of research scientists and engineers (RSEs) was especially significant in the private sector – of the 1,800

new RSE jobs created, 1,100 were in the private sector. Business expenditure on R&D increased from \$4.4 billion in 2012 to \$4.5 billion in 2013. Growth in R&D expenditure among local enterprises was the most rapid, with an increase of \$60 million from \$1,300 million in 2012 to \$1,360 million in 2013 which reflects a growing capacity for innovation among local enterprises.

Besides the R&D activities as defined according to A*STAR guidelines, and instead of R&D centres, we see Singapore businesses having innovation centres undertaking projects to produce new or improved products or processes, given the compelling need to innovate and stay competitive. In the R&D space, such activities would be more in the nature of development (i.e. the “D” in “R&D”). While it is encouraging to see these innovation efforts, one wonders why there appears to be a divergence in the take-up rate on R&D (and PIC) tax claims and this indicative growth of the R&D ecosystem in Singapore. One naturally also wonders if improving the attractiveness of these incentives could give an added impetus to investments in R&D and innovation.

Our recommendations

How can the R&D and PIC incentives be reformed to better place Singapore to face



the future? How can they incentivise local businesses to innovate and become experts in their field? How can they be made easier to access and administer?

Singapore is at a crucial point in its economic development as it aims to restructure its economy into a more knowledge-based one. What we hope is for Singapore to be the premier centre of excellence for high-value, high-impact products and services. We therefore provide the following suggestions to encourage businesses to have their innovation centres here.

- We suggest a broader interpretation of “R&D” for tax purposes for example to be more in line with the findings of the OECD report *Supporting Investments in Knowledge Capital, Growth, and Innovation*. According to the OECD, R&D tax systems play a crucial role in boosting innovation and policymakers should adopt an enlarged concept of innovation, beyond the conventional view and that other forms of knowledge-based capital, such as data, should also be policy targets. The report goes on to say that creating economic value from large data sets is at the leading edge of business innovation.
- Documentation for R&D (and PIC) claims requires time and effort. Singapore businesses prefer upfront certainty on the eligibility of their R&D projects for the incentives before they incur time and effort on the documentation and compliance work. We would suggest that a pre-claim framework for Singapore businesses to be able to obtain upfront of certainty on the eligibility of their projects for R&D tax claims before more extensive documentation is created. In this regard, we would suggest having R&D claims evaluated by economic agencies for pre-approval, instead of having claims considered upon review of tax returns. This is to have upfront certainty of claims. In addition, the relevant agencies, being bodies that work closely with the industry, are also in the better position to evaluate the types of technological breakthroughs that Singapore is looking to encourage and achieve.

(ii) Moving to Singapore

IP has moved to the top of boardroom agendas today because it has become a core business asset and strategic driver of competitive advantage for companies throughout the world. This elevated status has been fuelled by rapid evolution of technology, increased market competition and the swift pace of globalisation.

Singapore recognises the importance of IP and endeavours to develop an attractive and conducive environment for IP management throughout the IP lifecycle. There has been significant commitment to encourage IP-driven industries to expand their business footprint to and from Singapore. One of the primary benefits of using Singapore as an IP management hub is the robust IP protection and enforcement regime provided by the governing laws and legal infrastructure. Multinationals can locate their IP in Singapore knowing that their strategic business assets will be well protected.

Our recommendations

The following tax reform proposals may need to be considered for making Singapore even more appealing for the centralisation of IP management activities:

- It may be beneficial to introduce a tax credit scheme, similar to what countries like Australia have introduced. Under this scheme, a company with less than a specified annual turnover in a tax loss position could forgo deductions for R&D expenditure in return for a cash credit or refund (that is equal to the prevailing corporate tax rate multiplied by the amount of R&D expenditure without a cap). Effectively, the credit would act as a subsidy for further R&D activities of these companies. The scheme would be particularly useful where group relief is not available and would encourage research-intensive, start-up companies which may be in a tax loss position for some time whilst they seek to grow their business.

- There is presently no capital gains tax in Singapore. As IP is inherently not an asset that is traded, in most cases, it should be possible to demonstrate (based on the 'badges of trade' test) that a gain made upon divestment of IP is capital in nature and hence non-taxable. However, multinationals may see the inability to obtain complete certainty of tax treatment as an impediment towards transferring legal ownership of their IP rights to Singapore, particularly if they have large IP portfolios. If Singapore wishes to attract the dominant IP players, the tax rules should be modified to specifically exempt gains from the divestment of IP. Alternatively, like in case of share transfer, safe harbour rules can be introduced to provide certainty of tax treatment of gains made upon divestment of IP.
 - Multinationals may not wish to transfer legal ownership of their valuable IP to a Singapore entity, but they may be keen to provide long-term territorial rights to exploit such IP either by way of a licensing arrangement or transfer of economic ownership of IP rights. A few years ago, the rules were modified to allow writing down allowances (WDA) over five years for capital expenditure incurred to acquire only economic ownership of IP, provided the EDB gave its approval. As a next step in encouraging multinationals to shift economic ownership of IP to Singapore, this requirement to obtain prior EDB approval for WDA could be done away with so long as such transfer of economic ownership is at arm's length, and the transfer value is supported by an independent valuation report.
 - Royalties received from overseas parties by a Singapore company will generally be subject to foreign withholding tax. In most cases, a tax treaty would help to reduce the withholding tax exposure, given Singapore's extensive treaty network. However, Singapore does not have a treaty with the US, which levies a hefty 30% withholding tax on royalties. This lack of a tax treaty with the US can make it commercially unviable for Singapore resident companies to license their IP rights to US licensees. It is therefore imperative for Singapore to continue exploring opportunities to engage with US policy makers and negotiate a favourable tax treaty. This will enable the Singapore resident licensors (which will include a number of SMEs) to access the US market, which is one of the largest sophisticated markets in the world.
 - Measures to encourage exploitation of IP from Singapore, and not just the acquisition and protection of IP should be considered. For example, an IP or patent box type of regime which allows taxpayers to claim a notional tax deduction against income and gains arising from the exploitation of qualifying IP (such as patents, trademarks, copyrights and designs). This is less likely to have CFC and other overseas tax implications as it is not a reduction in the tax rate.
 - To bolster the IP financing ecosystem it may be worthwhile to consider introducing certain tax incentives for lenders who take the risk of lending money against IP as collateral. This could be in the form of tax credits, which can be used to offset the lender's annual tax liabilities.
- Singapore has created a robust foundation on which to build a knowledge-based economy. It is a favoured springboard for unleashing the value of the vital business assets we know as IP. Tax reform is an essential tool to catalyse and propel Singapore's progress towards its objective of becoming a global IP management hub. Some of the above proposals could be reviewed further to boost Singapore's already beneficial fiscal regime for IP management activities.
- (iii) Transfer pricing and tax positions related to intangibles***
- As discussed earlier, Singapore seeks to attract IP and to retain high value-add activities and offers tax incentives to multinationals which are to locate key IP here. These incentives should not, in substance constitute BEPS as these taxpayers are typically required to also undertake high value creating activities here. However, in order

for Singapore to be perceived accurately as a value-creating jurisdiction, it would be helpful if clarity could be provided on certain matters such as:

- Provide guidance on its position on the OECD BEPS papers on intangibles;
- Provide guidance on the substance requirements (i.e. functions, assets and risks) that would be expected in Singapore of a fully operational IP principal or “control tower”. As an example, it would probably be easier to demonstrate this in the technology/media sector;
- Inserting a definition of royalties in the Income Tax Act;
- Outline acceptable IP valuation methodologies, and in particular, whether a valuation (of inbound IP) that has been agreed to by the tax authorities in the transferor country (if not, this will be a MAP issue) would be acceptable. This might require guidance on the acceptability of cost-based methods for early stage technologies;
- Specify Singapore’s position on cost-sharing agreements, particularly those involving intangibles;
- Provide guidance on IRAS’s position on variable royalties.

III. Transfer pricing and cross-border arbitration

Over the last 20 years, Singapore has built up its reputation as a successful substantive business hub. Besides providing competitive tax rates which support entrepreneurship and encourage individuals’ hard work, Singapore also strives to ensure that its tax regime affords essential certainty and stability to taxpayers. Taxpayers require certainty and stability in a business and tax environment to thrive. Among other things, a robust domestic and cross-border dispute resolution framework is a critical factor to complement a competitive tax environment.

In the case of cross-border transactions, the MAP facility provided in Singapore’s tax treaties affords a helpful platform where taxpayers can access practical options to seek redress against double taxation that may arise from different interpretation and application of the provisions of the tax treaties. For instance, APAs typically address issues such as transfer pricing and profits attribution to permanent establishments. MAP may also address other double taxation issues that fall within the scope of the tax treaties.

As governments around the world continue to intensify their efforts to raise more revenue, tax authorities have displayed greater willingness to challenge international business transactions carried out within multinational corporations with aggressive tax positions, including the application of laws and rules in determining the transfer prices of related party transactions. In this regard, international tax disputes arising from economic double taxation has significantly increased over the last couple of years. For example, the US’s inventory of MAPs has increased 33% between 2006 and 2013 from 430 to 573 cases. Similar developments can be observed for many of the large economies that report their closing inventory of MAP cases on a regular basis (e.g. an increase in the UK of 25% and Germany of 65%).¹⁰ In Asia, China has reported a total of 43 MAP cases at the end of 2013. On average, it takes more than two years for MAP cases to complete, and the protracted nature of these procedures probably contributes, at least in part, to the fact that many MAP cases are withdrawn before completion, without eliminating double taxation. This makes the need for the effective resolution of international tax disputes an even more pressing one.

As one of Asia’s key business hubs, it is critical that Singapore continues to expand its capacity in dispute resolution. Besides building on its APA programmes, Singapore can consider incorporating an arbitration clause in its tax treaties with a view to offering another avenue for resolving disputes. Additionally, Singapore can unilaterally help to provide greater certainty to taxpayers by establishing certain transfer

¹⁰ See Mutual Agreement Procedure Statistics 2006 – 2013, <http://www.oecd.org/ctp/dispute/map-statistics-2006-2013.htm>



pricing safe harbour rules, e.g. for routine services, bundled royalties/services, cost sharing, management fee allocations.¹¹

This section considers the seemingly growing trend of acceptance by sovereign states to resolve international tax disputes through arbitration, and why Singapore can and should leverage on its existing status as an international commercial arbitration hub to become a centre for tax arbitration in Asia. Please refer to Appendix 4 for further commentary on other measures to enhance the dispute resolution environment.

(i) International developments in tax arbitration

States have traditionally resisted the use of arbitration as a means to resolve tax disputes

as it was considered to be a surrender of one's fiscal sovereignty. Until recently, bilateral tax treaties that contain an arbitration clause were relatively uncommon. The European nations were some of the earliest to adopt arbitration in resolving international tax disputes through the adoption of a multilateral agreement, Convention 90/436/EEC on the Elimination of Double Taxation in connection with the Adjustment of Profits of Associate Enterprises (the "Convention"). The Convention was signed on 23 July 1990 and, upon ratification by all signatory states, entered into force with effect from 1 January 1995 for an initial period of five years.¹² Under the Convention, where double taxation arises between enterprises of different signatory states due to a transfer pricing or permanent establishment allocation issue, the competent authorities of the relevant signatory

¹¹ However, it must be acknowledged that safe harbour rules are appropriate only in limited circumstances, where transactions may be readily defined and characterised. They are not be suitable in all instances, and the following constraints must be considered:

- It must be recognised that safe harbours cannot completely eliminate ambiguity. For example, the routine services which qualify for cost-plus 5% and pass-through cost arrangements is defined. However, it will not be as easy to determine the appropriate margins for more complex transactions.
- Whilst it would be helpful to have more safe harbours to limit the burden of proof and administrative costs for the taxpayer, this may be interpreted by other tax authorities to mean that the IRAS is overly liberal. As noted above, this perception may work against Singapore when it seeks to engage other tax authorities in bilateral APA negotiations. It is worth noting that while the US and Australia have them, not many tax authorities in the region have a list of safe harbours.
- Safe harbours may result in conflicts with other jurisdictions, to the extent that the counterparty applies a different safe harbour for the same activity. To this end, Singapore should encourage the tax authorities of other members of ASEAN (for a start) to agree to a range of transfer pricing safe harbour rates to provide certainty for transfer pricing of common activities in Asia. This will save considerable time and cost for multinationals operating in the ASEAN region. This is discussed further in section IV(ii) below.
- Transactions evolve over time, and will become more complex. For example, as financial instruments evolve, it may become difficult to decide when a safe harbour for loan interest, for example, can be applied. This will again create uncertainty for taxpayers unless Singapore is prepared to proactively review safe harbour rules periodically.

¹² The Convention is extended automatically by periods of five years through the subsequent adoption of a Protocol to the Convention, unless opposed by a signatory state.

states have two years to resolve the matter by MAP, failing which the competent authorities must establish an advisory commission within six months to decide the case. However, there is a grace period of six months before the opinion of the advisory commission becomes binding.

There was a strong case for the use of tax arbitration by European states given that double taxation would have been an impediment to the economic integration of the region. Where the pursuit of such regional economic integration is less fervent, there would be less incentive for states to enter into a multilateral arrangement that requires them to concede their tax sovereignty to a third party. This possibly explains why bilateral treaties with an arbitration clause were relatively uncommon until in recent times. The key milestone was the 2008 Update to the OECD Model Tax Convention, in which a new paragraph 5 was introduced to Article 25 on MAP providing for mandatory arbitration as a dispute resolution mechanism supplementary to the MAP. Since then, mandatory binding MAP arbitration has been included in a number of bilateral tax treaties, even though the adoption of MAP arbitration has not been as broad as the OECD had expected.¹³ At around the same time, the US moved from a voluntary arbitration approach in its individual bilateral tax treaties to provide for mandatory binding arbitration in a number of its latest bilateral tax treaties, namely, those with Germany, France, Belgium and Canada. Whereas the US treaties adopt a “baseball” or “final offer” approach in relation to arbitration, i.e. the arbitrator will choose between the proposed solutions put forth by each competent authority and is not free to create its own conclusion, the Commentary to Article 25 of the OECD Model Tax Convention leaves it to the respective tax authorities to determine whether the arbitrator will be free to reach its own independent opinion based on the evidence presented and resulting in a written opinion from the arbitrator, or be bound by the “baseball” or “final offer” approach.

In its report entitled *BEPS Action 14: Making Dispute Resolution Mechanisms More Effective* published on 5 October 2015, the OECD noted that whilst there is no consensus among all OECD and G20 countries on the adoption

of arbitration as a mechanism to ensure the resolution of MAP cases, a group of countries¹⁴ has committed to adopt and implement mandatory binding arbitration as a way to resolve disputes. This represents a major step forward as together these countries are involved in more than 90 percent of outstanding MAP cases at the end of 2013, as reported to the OECD.

(ii) Factors supporting the creation of a tax arbitration hub in Singapore

There is definitely a trend towards the use of arbitration for resolving international tax disputes, and BEPS Action 14 could potentially accelerate the acceptance of arbitration by sovereign states as a means to resolve their tax disputes. As the number of business transactions involving at least one Asian country increases, so will the likelihood of a tax dispute involving the competent authority of at least one Asian country. Singapore would be a prime choice as the seat of arbitration for such tax disputes for a number of reasons, including:

- *Geographical convenience* – Singapore is located in the heart of Southeast Asia with major economies including China, India and Australia further afield, making it an ideal choice for arbitration cases involving one or more of these countries.
- *Neutrality and enforceability of arbitration awards* – Singapore is generally seen to be a politically neutral country and therefore serves as an ideal neutral forum for the resolution of disputes, especially where sovereign states are parties to the arbitration. More importantly, the courts in Singapore have consistently upheld arbitration agreements, enforced foreign awards and confirmed that a decision by parties to arbitrate should be upheld and given effect as a matter of public policy except in the most extreme situations. Singapore has also given effect to the appropriate conventions relating to the enforcement of arbitration awards, including the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (“New York Convention”) and the International Convention on the Settlement of Investment Disputes between States and Nationals of other States through the enactment of the

¹³ See paragraph 41 of the OECD Public Discussion Draft entitled BEPS Action 14: Make Dispute Resolution Mechanisms More Effective published on 18 December 2014.

¹⁴ The countries that have expressed interest in doing so include Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the UK and US.

International Arbitration Act (Cap. 143A) and the Arbitration (International Investment Disputes) Act (Cap. 11) respectively.

- *Arbitration-friendly procedural laws* – Singapore has adopted the Model Law on International Commercial Arbitration adopted by the United Nations Commission on International Trade Law and conciliation proceedings through the enactment of the International Arbitration Act (Cap 143A), which regulates the international commercial arbitrations in Singapore. With relatively few mandatory provisions, parties to an international arbitration in Singapore are given much freedom to decide on issues relating to representation (foreign lawyers can participate in international arbitration proceedings in Singapore), procedure, language and tribunal. The national courts' roles are effectively limited to that of supporting the arbitration process and assisting with the enforcement of the award.
- *Existing arbitration support infrastructure* – The Singapore International Arbitration Centre (SIAC), established in July 1991, is a well-regarded arbitral institution. It supports arbitrations in Singapore by assisting parties with the appointment of arbitrators where there is no consensus on such appointment, management of the practical aspects of arbitration (including support and administrative services), and facilitation to ensure the smooth progress of arbitration. The SIAC also assists parties in arranging the recognition and enforcement of awards in other signatory countries of the New York Convention. The SIAC's panel of arbitrators consists of over 380 independent arbitrators with a wide range of expertise from across 32 different jurisdictions, with a majority of them based in the Asian region. The exemption of tax on income derived by non-resident arbitrators from arbitration conducted in Singapore will encourage tax experts from around the world to serve as arbitrators on tax arbitrations with a Singapore seat.

(iii) Challenges

It seems then that Singapore would, in principle, be an excellent venue to hold international tax arbitration. However, the positioning of Singapore as a tax arbitration hub will not be without its challenges. One of the key issues is whether there will be a sufficient number of tax arbitrations in Asia. Arbitration is only a measure of last resort in bilateral tax treaties, and will be resorted to only if MAP fails. Countries may prefer to avoid arbitration for sovereignty reasons. There is some empirical evidence that the introduction of mandatory arbitration clauses in US tax treaties have prompted parties to resolve controversies before the matter proceeds to arbitration. This casts doubts on whether the arbitration procedure will actually be frequently used. Moreover, two major Asian economies, China and India, have displayed resistance to the idea of mandatory and binding arbitration in BEPS Action 14; and it is questionable if the use of arbitration to resolve international tax disputes will be widespread in Asia without the buy-in of these two economic giants. The problem could be further exacerbated by restrictions that may be imposed on the subject matter qualifying for arbitration. For example, the procedures for mandatory arbitration under the Germany-US tax treaty specify a variety of cases that are not eligible for mandatory arbitration, including cases where the relevant tax authorities agree that the case is not suitable for arbitration.

Another problem arises from Singapore's popularity with multinationals for carrying out regional headquarter, trading and other business functions. Where the tax dispute relates to the amount of income that ought to be attributed to a multinational's Singapore operations, Singapore would be a party to the dispute, which in turn raises questions on whether Singapore will be seen by the other tax authority to be a neutral forum. This is largely an issue of perception since the Singapore Courts generally will not interfere with the decision of the arbitral tribunal except on certain limited grounds set

out in the International Arbitration Act (Cap. 143A): see for example *PT Prima International Development v Kempinski Hotels SA* [2012] SGCA 35. Nevertheless, it is not hard to imagine that a competent authority may reject Singapore as the seat of a tax arbitral proceeding on grounds of neutrality or lack thereof if it is a party to the dispute.

(iv) Our recommendations

Tax arbitration clauses will likely become more commonplace in bilateral tax treaties in the future. While some doubts remain as to whether tax arbitration will take off in a big way, Singapore does have the necessary attributes to take on the role of a tax arbitration hub in Asia, especially where it is not a party to the tax dispute. However, if Singapore is to position itself as a tax arbitration hub in Asia, it will need to walk the talk. With only one of its 76 comprehensive tax treaties containing an arbitration clause, namely the treaty signed with Mexico in 2012 which provides only for voluntary arbitration, questions will be raised on Singapore's own commitment to the use of arbitration for international tax disputes.

IV. Tax treaties

(i) Evolving Singapore's tax treaty network

Singapore has an extensive tax treaty network that has served it well for many years. However, there are two key opportunities that would substantially enhance Singapore's attractiveness to multinationals. We acknowledge that the Government is indeed actively looking to update existing tax treaties and to expand Singapore's tax treaty network, and these options require the involvement of other governments (e.g. renegotiation of tax treaties). Hence, it is not a simple task to deliver those options. In addition, there is no doubt that politics has a part to play in the BEPS project and this will inevitably influence the receptiveness of some other governments at the negotiation table.

Singapore's large tax treaty network is often listed as a compelling reason why multinationals should locate their hub for Asia here. Singapore currently has 76 comprehensive double tax treaties with both developed and developing countries. We note though that many of these treaties are really dated such as Australia (concluded 11 February 1969 and updated by two Protocols signed on 16 October 1989 and on 8 September 2009) and India (concluded 24 January 1994 and updated by two Protocols signed on 29 June 2005 and on 24 June 2011). Other countries are concluding double tax treaties with some of our treaty partners, some with more favourable terms than ours; hence Singapore may start to lose its edge if multinationals see treaties elsewhere as more favourable. Some options the Government could consider to help maintain the attractiveness of Singapore's treaty network:

1. Expand treaty network and clarify terms of existing treaties

To help businesses, Singapore can already begin to expand its treaty network – starting with other ASEAN countries such as Cambodia and Laos.

Singapore does not have a treaty with the US, although bilateral trade amounted to \$76.7 billion in 2014, and Singapore was the US's largest trading partner from Southeast Asia while the US was Singapore's third largest trading partner worldwide.¹⁵ In light of BEPS, Singapore would be well served by a treaty with the US (at least a MAP treaty if not a comprehensive one) and if it wants to position itself as a gateway to the ASEAN economic community for US investors.

We are cognisant that the challenges and obstacles in concluding a treaty with the US. Nonetheless, it would be remiss not to mention the continuing need to work towards a US tax treaty, for it is a key part of our toolkit for developing an economic policy to promote greater trade flows for Singapore.

¹⁵ IE Singapore website, <http://www.iesingapore.gov.sg/Venture-Overseas/Browse-By-Market/Americas/United-States-of-America/Country-Information>

In addition, the competent authority, IRAS, could also help to provide taxpayers with greater certainty on when they are eligible to apply treaty benefits: for example, where treaties contain specific terms not used in the OECD Model Convention or where the provisions depart from the OECD Model Convention (for which Singapore's position has not been clarified in the 2014 Commentary to the Convention) and which may be open to differences in interpretation, it would be helpful if the competent authorities could publish technical interpretation notes to clarify how they are meant to be applied. Where treaties provide for relief on payments paid or received by specified organisations or entities, the list of such organisations as agreed between the two competent authorities should be published so that taxpayers can ascertain if they qualify for relief without having to write to the relevant competent authorities.

2. Continue to renegotiate older treaties

Hong Kong is the major competitor to Singapore in terms of a base for businesses expanding in the region and while Hong Kong has fewer than half the number of treaties compared to Singapore, most of those are much more recent having been negotiated over the last 10 years. Notably, Indonesia recently executed a treaty with Hong Kong that is more competitive than Singapore's treaty with Indonesia. This has led

to some multinationals questioning whether Singapore is still the best location for their investments into Indonesia.

Despite Singapore's expansive network, some treaties are really quite old. A few examples include:

| Treaty partner | Date of conclusion |
|----------------|--------------------|
| Australia | 11 February 1969 |
| Canada | 6 March 1976 |
| India | 24 January 1994 |
| Indonesia | 8 May 1990 |
| Philippines | 1 August 1977 |
| Thailand | 15 September 1975 |
| UK | 12 February 1997 |

While a number of these older treaties have seen protocols agreed in the intervening years, these are often tidy-up type aspects and not fundamental changes.

More important than the age of the treaties is that they are obviously less modern or less in keeping with the OECD Model Convention. A number are also less favourable in certain aspects than our competitors. Again, some brief examples using Hong Kong as the comparative are as follows:

| | Withholding Tax Rates | | |
|----------------------------|--------------------------|--------------------|-----------|
| | Dividends ⁽¹⁾ | Interest | Royalties |
| Indonesia | | | |
| Treaty with Singapore | 10% | 10% | 15% |
| Treaty with Hong Kong | 5% | 10% | 5% |
| China⁽²⁾ | | | |
| Treaty with Singapore | 5% | 10% | 10% |
| Treaty with Hong Kong | 5% | 7% | 7% |
| Canada | | | |
| Treaty with Singapore | 15% | 15% | 15% |
| Treaty with Hong Kong | 5% | 10% | 10% |
| UK | | | |
| Treaty with Singapore | NA | 5% | 8% |
| Treaty with Hong Kong | NA | Special conditions | 3% |

(1) 25% holding

(2) Admittedly, Singapore's treaty with China was concluded in 2007

We appreciate that it is neither an easy task nor a short term commitment to embark on treaty renegotiations but a program over a reasonable timeframe would be welcomed and is important to maintain Singapore's positioning in the Asia Pacific region. Renegotiation may also be desirable to reflect the preferences of Singapore and the other treaty countries in the region with respect to a number of the OECD BEPS proposals including:

- Prevent treaty abuse
- Exchange of information including country-by-country reporting
- Prevent the artificial avoidance of permanent establishment status

For example, BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances proposes that additional tests be introduced for taxpayers to access tax treaty benefits, including a general anti-avoidance rule. Under this rule, if one of the principal purposes of a transaction or arrangement is to obtain treaty benefits, those benefits would be denied unless it is established that granting those benefits would be in accordance with the object and purpose of the treaty.

As a hub for international trade in goods and services, Singapore should ensure that the derivative benefits clause, proposed in the BEPS Action 6 Final Report, is included in its treaties. This provision will allow certain foreign-owned Singapore resident entities to enjoy benefits under a treaty between Singapore and another country, if those entities are in turn owned by residents of a third state whose treaties with that country provides for similar benefits as Singapore's. The derivative benefits clause would be important to preserving Singapore's attractiveness as a headquarters location from which multinationals can invest into the rest of Asia Pacific.

(ii) Improving consistency on tax issues across ASEAN

One of the major frustrations for companies operating in this part of the world is the inconsistent approaches taken by various countries' tax authorities on what many consider to be uncontroversial tax issues. This leads to considerable inefficiency and a general wariness of investing substantially in the region. Given that Singapore is the logical home for most

multinationals' regional headquarters in this part of the world, it is in Singapore's interest for a more standardised, logical approach to be taken across the region. We appreciate that political considerations and the different stages of economic development across ASEAN will pose significant challenges to any attempt for harmonisation of tax rules within the ASEAN Economic Community. Nonetheless, some interim steps which may be considered include:

- Bringing governments together to agree a streamlined tax dispute resolution process.
- Bringing tax authorities together to agree a series of unilateral safe harbours for transfer pricing over routine services. This issue of transfer pricing safe harbours is also discussed in the section below.

1. Transfer pricing

Our focus here is primarily on transfer pricing. Singapore, through IRAS and the Tax Academy linked with universities, is well positioned to take the lead in engaging other ASEAN tax authorities in seeking to align practices and approaches across a number of the above aspects, under the auspices of ASEAN 2015. In the transfer pricing space, we suggest that areas of focus might be as follows:

- Obtaining some level of agreement that transfer pricing documentation filed in one ASEAN country that relates to transactions with another ASEAN country is generally adequate for both countries, and that such documentation will be reviewed before the tax authorities take a transfer pricing position.
- Obtaining in-principle agreement on respecting and accommodating requests for bilateral APAs, and clarifying when bilateral APA requests will, or will not, be considered.
- Seek to establish some agreed safe harbours for transfer pricing over more routine aspects. For example, the following could be defined:
 - What constitutes a routine service and agreeing that such services would carry a mark-up of between 2-5%. The recent BEPS report (under BEPS Action 10) relating to low value-adding intra-group services, covers this very well.

- What a reasonable range of returns on sales might be for a simple distribution function (i.e. with minimal spend on advertising, branding, etc.). For example, this might be 2–5%.
- A range of returns for typically acceptable brand royalties or industrial royalties for which there might be a set of agreed criteria for enquiry. This would typically be at the low end of the scale.
- The minimum level of evidence required to justify regional head office management fees and defining acceptable allocation methods. This may include agreement by ASEAN countries to accept the head office allocations if adequately reviewed by the home country tax authority.

2. Permanent establishment

On this issue, a major barrier, in an ASEAN 2015 context, relates to whether services provided in one state by personnel coming from another state constitute a permanent establishment. This is particularly prevalent in the construction industry, with advisory and quality control-type services, with installation services or, simply, visiting employees. Many of the ASEAN countries have different rules regarding when a taxable presence has been created and even under the various tax treaties between contracting states, the thresholds (of days spent in country) before one triggers a permanent establishment can differ from treaty to treaty. This will also have a flow-on effect on the tax exposure of the individuals themselves. Ideally, the criteria for determining when a permanent establishment has been created should be aligned across ASEAN states.

3. GST/VAT

Finally, another area would be to try to align GST/VAT principles on inter-company charges and royalties paid between taxpayers in different ASEAN countries. This would give greater certainty and reduce circumstances of differing interpretations and discretion of regional tax authorities, which can only be good for cross-border transactions.

(iii) Our recommendations

While we are optimistic that progress will eventually be made in the areas we have discussed, we recognise that in multilateral negotiations, it will take considerably more time for concrete outcomes to materialise. In the meantime, we have focussed, in the rest of this paper, on how the Government can unilaterally or bilaterally help to provide greater certainty for taxpayers on cross-border tax issues.

V. Attracting talent

Human capital is Singapore's only natural resource, and it is a very mobile one. Jurisdictions are competing aggressively to attract capital and talent, and this will only continue. Thanks to a well-developed education system, Singaporeans have options available—whether that is working in New York, London, Shanghai or Sydney; or working here at home with world leading technology houses. If Singapore is to continue to flourish, it must retain its people by providing the same opportunities for success that they would have overseas.

Personal income tax is a vital part of Singapore's taxation system as well as its talent strategy. It is an important means of collecting taxes. But in Singapore it also sends important messages, both to the people of Singapore and internationally. Firstly, many who are employed in Singapore do not pay personal taxes due to the tiered system and the availability of reliefs that exempts many. For the Year of Assessment 2013, 668,986 out of over 2 million individuals assessed did not have to pay income tax.¹⁶ It shows that the personal taxation burden on income is minimised for many and taxation for this group of taxpayers is primarily on consumption.

Low individual tax rates are also a means to encourage individuals who can contribute to Singapore's economy to be located in and to remain in Singapore. This can result in a win-win situation for both Singapore and such individuals. A lower tax rate is often seen as one way to attract talent – those who can contribute to the economy: decision makers, innovators, strategists, experts in a particular field, etc. A competitive tax regime, coupled

¹⁶ Individual Income Tax, Assessable Income of Individuals by Income Type as at 31 March 2014 for the Year of Assessment 2013, IRAS website, https://www.iras.gov.sg/IRASHome/uploadedfiles/IRASHOME/Publications/IIT_AI%20of%20Individuals%20by%20Income%20Typ_YA04-YA13.xls

with the vast opportunities for personal and professional development and an attractive living environment, also help tip the balance in relocating to Singapore's favour. The greater the numbers, the greater the personal income tax takings for the nation.

The spending of such individuals will also benefit the economy and further increase collection of taxes from consumption. However, there is also an often-overlooked benefit where such individuals also contribute to the value added and substance of activities that can be undertaken in Singapore. From a global perspective this generally translates to greater income to be attributed to the employer or the enterprise in Singapore that employs such individuals. Accordingly it should also translate to greater taxable corporate profits earned in Singapore.

Socially, personal taxation also demonstrates how those who derive more are seen to contribute to the rest of society. As illustrated above it does not mean that there is a need to increase personal income tax rates to increase takings from the taxation of individuals. What is needed is to attract a greater number of individuals who can derive higher employment income.

But often the intent of the latter two reasons appear to run contrary to each other. Lower taxes are often seen as something that benefit the rich. However it needs to be recognised that lower personal tax rates do not necessarily benefit the well-off and business owners who derive income through other means such as returns on investments that are not normally taxed in Singapore, e.g. capital gain or return from equity such as dividends. This is what is key and it is worth noting.

While it is necessary to have a personal tax system that encourages the inflow to Singapore

of a greater number of highly paid employees it must also continue to encourage investment in capital. There is a need to encourage individuals and employees to invest into capital in Singapore enterprises and further the entrepreneurial thinking – to have 'skin in the game' in Singapore Inc.

Singapore does not tax return of capital. There are no taxes on gains on capital. We do not tax individuals on returns on equity or generally on loans/deposits. Such a system needs to continue and be further enhanced so that entrepreneurs or key employees can be a part of this. We need to encourage enterprises in Singapore to have employees take part in the growth of such Singapore enterprises and have a stake in the capital return and growth.

Share award schemes are often seen as akin to employment income. Generally, they are taxed upon vesting/exercise. Timing of taxation often creates cash flow concerns since it is likely that a recipient may be taxed on receipt of shares but may not wish to liquidate the investment to meet the tax costs. Such an approach does not encourage the awarding and even the holding of such investments.

It also needs to recognise the inherent risk that the recipient undertakes and while the rewards are available the benefits of building capital can help enhance the economy. We may want to consider schemes where share awards are taxed at an incentive rate or even tax free where the holding period is for an extended period. Or even to have a deferral of such taxation to a future period subject to such investments paying off. This will mean the holders will get to have 'skin in the game' and be incentivised to build value in such capital for greater dividends and incremental value.

Such incentives to participate in capital building should be extended to not only shares in listed





enterprises but also closely held ones that provide phantom shares or non-voting shares that track the value of say ordinary shares. Adequate protection should be given to such share awards without compromising the flexibility given to owners of such closely held enterprises.

Currently, there are no employer provided pension schemes available to employees working in Singapore. Whereas Singaporean citizens and Permanent Residents are able to contribute to the Central Provident Fund, the “end of work” retirement balances for a majority of such employees is often seen to be inadequate. Furthermore, there is no viable supplementary pension scheme available to foreigners. For high end talent wishing to save for retirement in Singapore, the options are thus limited and inadequate. The lack of retirement savings schemes may deter key talent from relocating to Singapore and staying for the longer term.

We see governments in other countries (such as France, the UK and the US) encourage the set-up of alternative pension schemes by providing tax relief for employer and employee contributions to such schemes provided the funds are locked into such schemes in the long term and subject to vesting restrictions. Singapore could consider introducing a regime that offers a supplementary employer provided

pension scheme with vesting restrictions and providing tax relief for both the employer and employee contributions. This could encourage more talent to relocate to Singapore, and having done so, to stay in the long term, thereby reaping the same benefits to the Singapore economy as enumerated above.

The development of various personal taxation measures to balance the growth of personal taxation income especially as the population ages is paramount. Where we can concurrently attract corporate revenue and the relevant taxation income such a double benefit would add to our economy. How we can further provide incentives to participate in the capital and grow our Singapore enterprises is also vital. Years ago our founding fathers deemed it necessary to have our people own part of Singapore and the strategy was through greater home ownership. This strategy needs to be enhanced through our enterprises to further fuel the economy.

VI. Future of Singapore’s tax system

Because it has been so successful, Singapore has, at times, received misplaced criticism from others about its tax system. This cannot be ignored, but at the same time it is important that the facts about Singapore’s tax system are fully

understood. It is not a tax haven because taxes are paid and substance is required. Despite the Government's best efforts, the tax system may still be criticised by those who are not familiar with its workings, therefore the primary focus should be the needs of the Singapore economy.

Singapore has long welcomed foreigners to its shores to live and work and build Singapore with Singaporeans. However, the Government is mindful that a careful balance has to be struck between attracting multinationals and foreign individuals to move to Singapore, and the need to provide strong career prospects for Singaporeans. It is fair to assume that the Government will ensure that any reforms to Singapore's tax system in response to the moving global tax system will take into account the needs of the Singapore people *vis-a-vis* the role that multinationals and foreign workers should play in Singapore's economy.

In addition, we are mindful that one cannot take away from the tax base (e.g. reduce tax rates or remove taxes) without considering its impact on the ability of the Government to fund the same level of public services. If anything, the level of services the Government will need to provide can only be expected to increase as the population grows and ages (lower worker-to-retiree ratio), and there is an expectation that the standard of living will continue to increase. Therefore, any measure which seeks to reduce the incidence of tax will need to be considered with an offsetting increase in revenue (be it through rate increases or a larger tax base through growing the economic pie) or decrease in expenditure somewhere else. Inevitably, this will lead to winners and losers in the community.

The changes that are happening – and those that are likely to happen – to the way the tax systems of all the major economies of the world interact present a tremendous opportunity for Singapore to reflect on its past success and adapt its tax system for the future. We set out below some ideas for discussion.

(i) Tax rates

1. GST

The current GST rate of 7% has been in place for more than eight years now and the topic of GST hikes comes up for discussion and debate every now and then. Ahead of the 2011 General Elections, the Government went on record and gave assurance that the GST rate would not be increased for at least the following five years. However, it continued to hint at the inevitable need to raise tax revenue in the future in order to fund increased spending (against the backdrop of an ageing population which was one of the reasons for introducing the GST in the first place, and slower economic growth). In his 2013 National Day Rally speech, Prime Minister Lee Hsien Loong reminded us that “All good things have to be paid for”.

Now that the five-year “promise” is close to an end, all eyes are on the Government's next move as far as the GST rate is concerned especially with the 2015 General Elections just concluded. In early August 2015, the MOF dispelled talks of an impending GST hike in a post on the Government's website,¹⁷ explaining that the increased spending for the rest of the decade is sufficiently provided for by measures that the Government had already taken. This included (amongst other tax changes) the amendment of the Constitution in July 2015 to include returns from Temasek Holdings in the Net Investment Returns (NIR) framework starting from the next fiscal year. The move enables the Government to draw on up to 50% of Temasek's long term expected returns. This was reiterated by both Mr Tharman Shanmugaratnam, Deputy Prime Minister (DPM) and former Minister for Finance,¹⁸ and Mr K. Shanmugam, Minister for Law and former Minister for Foreign Affairs,¹⁹ in the lead up to the 2015 Elections.

¹⁷ <http://www.gov.sg>

¹⁸ Speaking at a Peoples' Action Party rally held at Petir Road in Bukit Panjang on 5 September 2015, <http://www.channelnewsasia.com/news/specialreports/sgvotes2015/latest/no-way-to-give-something/2105026.html>

¹⁹ Speaking during a walkabout at Northpoint Shopping Centre on 5 September 2015, <http://www.channelnewsasia.com/news/specialreports/sgvotes2015/latest/politics-is-about-success/2103630.html>



Does this mean that the GST rate would not be increased until the end of the decade – effectively for another five years? The answer may lie in the additional contribution to the revenue coffers after the inclusion of Temasek into the NIR framework.

In the second reading of the said Constitution Amendment Bill in July 2015, the DPM indicated that Temasek's inclusion in the NIR framework is estimated to increase the total NIR contribution to the Budget from about 2% of Gross Domestic Product to about 3% on average over the next five years.²⁰

A back-of-the-envelope calculation (using the 2014 GDP figures of US\$307 billion as a starting point) shows that the move would add about \$2 to \$3 billion to the Government coffers annually. Currently, the contributions from the NIR framework amount to \$8.55 billion (or 13% of the Budget) for the 2014 fiscal year. In comparison, the revenue from

GST collections amounted to \$10.11 billion for the same fiscal year.

If the Government is able to rely on the expanded NIR framework to fund the inevitable increase in social and infrastructure spending, it might have a less pressing need to increase the GST rate in the near future.

What is clear though, is that a need for increased tax revenue is inevitable in the long run in view of likely increases in social spending. This may eventually need to be funded by further broadening the tax base or increasing tax rates (whether corporate or individual income tax, or GST). Implicit in this is the assumption that an increase in GDP will result in increased tax collections even if the tax rates and base remain the same.

It is now par for the course on Budget Day to expect the Minister for Finance to announce

²⁰ Ministry of Finance, "Second Reading Speech by Mr Tharman Shanmugaratnam, Deputy Prime Minister and former Minister for Finance, for the Constitution of the Republic of Singapore (Amendment) Bill", accessed 17 August 2015, <http://www.mof.gov.sg/news-reader/articleid/1513/parentid/59/year/2015?category=Speech>

additional taxes on the wealthy and give pay-outs or subsidies to the middle class and lower income groups. However, continuously taking from the proverbial barrel will eventually result in us reaching its bottom one day, no matter how much fiscal prudence and discipline we put into it. Sustainability should be the key refrain.

Historically, hiking the GST rate to offset falling income tax receipts has been the favoured approach, in line with the policy objective of expanding the tax base. The increased tax burden on the lower income groups are offset by GST vouchers and other subsidies. Nevertheless, there are other levers that the Government can pull to meet the increased demands on its coffers. More recently, the taxation policy has taken on a socialistic flavour with a shift towards a more progressive personal income tax structure where those in the higher income bracket pay a higher percentage of tax. If the GST rate is to be increased, we would suggest that there be a minimum period of 12 months from the date of announcement of any such increase to allow for adjustment to be made by both businesses and consumers.

2. Limited scope to increase income tax rates further

The top marginal personal tax rate will also be increased to 22% next year, contrary to the general trend of decreasing corporate income tax rate. When the rate increase was announced at this year's Budget, tax practitioners quite naturally made comparisons with Hong Kong, which has a top personal income rate of 17% but with a much less progressive structure. While the personal tax burdens in the two jurisdictions are currently comparable, it would seem that Singapore is near the end of the road on future personal tax rate increases, if it wants to remain competitive with Hong Kong for global talent. As the DPM stated in a rally speech on 5 September 2015, "...You can't [provide something for everyone] just by taxing the top 1%...First, because the top 1% know how to move money around the world...But secondly, you can't jack up the tax rate for the top 1% without affecting the next 5% or 10%".²¹

On the other hand, increasing the corporate income tax rate is increasingly becoming difficult for Singapore for competitiveness reasons. Globalisation amid slow global economic growth has given rise to greater competition for investment dollars among countries. Developed countries are leading the race to the bottom in cutting their headline income tax rates, a notable example of which is the UK which will cut its corporation tax rate to 18% by the year 2020. It was 28% just a few years back. To maintain its economic edge, Singapore can ill afford to raise its headline corporate tax rate in the face of such intense tax competition.

Quite the contrary, a reduction to the corporate tax rate may be necessary. In Singapore the effective tax burden may be reduced below the statutory 17% tax rate by the system of incentives and super-deductions which have been a key lynchpin of Singapore's tax policy through much of its developmental years. As the economy matures with slower growth, these should continue to serve as the bedrock of a deliberate tax policy to continue to attract new investments and cutting edge technologies which will benefit other related sectors of the economy. If well executed, this should grow the economic pie for everyone to bring in more tax revenue despite the lower corporate income tax rates.

(ii) Capital gains tax

A number of developed economies levy capital gains tax (CGT). CGT regimes vary from jurisdiction to jurisdiction with two different basic approaches. Some impose CGT as a tax separate from income tax at perhaps a different rate. Others may incorporate CGT into the prevailing income taxation system for ease of administration. Capital appreciation and CGT are familiar concepts in international business. CGT is generally understood, and importantly, seen as a fair measure – capital gains are mainly made by the wealthy from investment growth which would be broadly attributable to economic progress and stability of the system. So it is justifiable that a part of it goes back to society.

²¹ Speaking at a Peoples' Action Party rally held at Petir Road in Bukit Panjang on 5 September 2015, <http://www.channelnewsasia.com/news/specialreports/sgvotes2015/latest/no-way-to-give-something/2105026.html>

However, in Singapore's case, a CGT is hardly the panacea to its dilemma. With a small, open economy that is hugely dependent on foreign direct investments, a CGT regime is likely to take away one of the key features of Singapore's tax system to which foreign investors are attracted.

(iii) Transaction taxes

Turning to other transactional taxes like stamp duty and asset taxes (primarily property tax in Singapore's context), these are not insubstantial sources of revenue, contributing in the region of 10% to the Government operating revenue. But the inflows from these sources are very much dependent on the general economic conditions. Nonetheless, it would make Singapore more competitive to abolish stamp duty on share transfers altogether instead. There are currently exemptions and remissions available for certain share transactions, but administratively, these require time and effort to get. It would be simpler to just abolish the duty on share transfers (with exceptions for shares in land rich companies to preserve the integrity of the system where transactions in properties are taxed).

(iv) Purpose-specific charges or levies

The other way to increase Government revenue is to introduce new forms of taxes or charges to be channelled towards specific spending needs. It has done this for charges such as the foreign worker levy which mainly funds subsidies for worker training. A wider scope of charges may be considered, say, an education levy to subsidise child care or a national defence tax on residents who are not required under current laws to serve national service. These may be more amenable as they could appeal to the altruistic aspirations of individuals. Vehicle taxes on owners of more than one private car may be also increased to encourage greater discretion to be exercised by individuals. This may be seen as a populist move but may be justified given the efficiency of the public transportation system and the limited area that we can set aside for roads. It will be important to convey the right message to those who end up shouldering more of this burden, given the mobility of talent and capital. Obviously this would not be an easy task.

While prudence and discipline in spending remain hallmarks of the Government's fiscal policy, Singapore has reached an inflexion point of slowing economic growth but yet increasing spending demands on the Government from an aging population and greater social safety nets for the disadvantaged. The Government will have to be creative in expanding its revenue base and take a hard look beyond its traditional sources of tax revenue to strengthen the sustainability of its fiscal position.

(v) Expansion of income tax base

Any discussion of tax system design will not be complete without mentioning the implications of a territorial basis of taxation verses one that taxes worldwide income. An overview of these regimes is set out in Appendix 5. It is beyond the scope of this paper to consider the economic considerations that underpin the design of this aspect of the tax system. A fundamental review is needed before any conclusions can be drawn (including the implications on Singapore's competitiveness), although it is observed that many developed countries have moved to some form of source-based taxation in recent years (e.g. the UK, Germany and Japan offers various exemptions of foreign income).

While Singapore has been unfairly criticised by some as a tax haven, it would be remiss to mimic some of the tax treaties of other countries (e.g. CFC, dividend withholding tax) just to refute such accusations. This is because these measures are not consistent with the policy choices taken in Singapore and hence cannot be coherently imported into Singapore tax reform without creating arbitrage opportunities. A brief consideration of these features in the local context is set out in Appendix 6.

What's next?

Singapore is at a cross-roads in economic development amidst global tax change with BEPS. In times of change, there are always winners and losers, so now would be an opportune time to re-look at our tax system to ensure that we emerge as a winner through these uncertain times.

Let's have a conversation about this as a community. This report is our initial contribution to that conversation.



APPENDIX 1: A changing landscape – BEPS, reforms and reactions around the world

a. BEPS

A major revolution is currently underway to the global tax system, as a result of the OECD and G20 BEPS project. International goal posts that have stood for approximately 80 years are about to be moved and all multinationals will be affected. This may change their behaviour and investment decisions – which in turn could affect sovereign jurisdictions, including Singapore. The BEPS reforms focus attention on a number of issues that are relevant to every major economy in the world.

The climate of budget deficits and austerity in many developed countries since the global financial crisis focused mainstream media on the social obligation of corporations to pay their “fair share” of tax in the countries in which they operate. There is also a general perception that international tax rules, originally designed to prevent corporate profits from being taxed twice, are outdated and do not reflect the globalised nature of today’s international business. Backed by unprecedented political will, the OECD launched its BEPS project in February 2013. A key focus of the project is on preventing cases where profits may inappropriately escape tax or where profits recognised is separate from the location of the activities that generate the profits.

BEPS refers to tax planning strategies that take advantage of mismatches in tax rules to move profits to low or no-tax locations. This results in less overall corporate tax being paid anywhere in the world.

In an increasingly globalised world, national tax laws have not always been able to keep up with the way global corporations do business, the fluid movement of capital, and the growth of the digital economy. The BEPS project seeks to put tax on an equal footing with business realities. Fifteen actions in total are being developed to provide governments worldwide with domestic and international guidelines which will help to address these gaps and mismatches in tax rules. The final package of measures were released on 5 October 2015.

Even as work is ongoing on the BEPS project, countries have unilaterally taken action to safeguard their domestic tax base. The EC has published a Tax Transparency Package, the UK has introduced a Diverted Profits Tax, and certain industries (technology, mining, pharmaceuticals, etc.) have come under scrutiny in Australia which has also announced tax integrity measures to target profits earned in Australia that are seen to be diverted to low-tax jurisdictions. Countries and corporations (rightly or wrongly) accused of BEPS also have to deal with the negative publicity that comes from those accusations, therefore it is increasingly important not only to do, but also to be seen to be doing, the right thing.

The table on the following page provides a summary of the 15 BEPS action points.

| Action point | Target |
|---|--|
| 1 Address the tax challenges of the digital economy | Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop options to address these difficulties, considering both direct and indirect taxation. |
| 2 Neutralise the effects of hybrid mismatch arrangements | Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect of hybrid instruments and entities. |
| 3 Strengthen CFC rules | Develop recommendations regarding the design of controlled foreign company rules. |
| 4 Limit base erosion via interest deductions and other financial payments | Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense. The work will evaluate the effectiveness of different types of limitations and transfer pricing guidance will be developed regarding the pricing of related party financial transactions. |
| 5 Counter harmful tax practices more effectively, taking into account transparency and substance counter harmful tax practices more effectively, taking into account transparency and substance | Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange of rulings related to preferential regimes and on requiring substantial activity for any preferential regime. |
| 6 Prevent treaty abuse | Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. |
| 7 Prevent the artificial avoidance of permanent establishment status | Develop changes to the definition of a permanent establishment to prevent artificial avoidance of a permanent establishment status in relation to BEPS. Work on this issue will also address profit attribution issues. |
| 8 Assure that transfer pricing outcomes are in line with value creation: intangibles | Develop rules to prevent BEPS by moving intangibles among group members. |
| 9 Assure that transfer pricing outcomes are in line with value creation: risks and capital | Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to group members. |
| 10 Assure that transfer pricing outcomes are in line with value creation: other high-risk transactions | Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely occur between third parties. |
| 11 Establish methodologies to collect and analyse data on BEPS and the actions to address it | Develop recommendations regarding indicators of scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. |
| 12 Require taxpayers to disclose their aggressive tax planning arrangements | Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of increasing number of countries that have such rules. |
| 13 Re-examine transfer pricing documentation | Develop rules regarding transfer pricing to enhance transparency for tax administration, taking into consideration the compliance costs for business. |
| 14 Make dispute resolution mechanisms more effective | Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases. |
| 15 Develop a multilateral Instrument | Analyse the public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. |

b. A Singapore-specific lens on the proposals

As we have seen, the global economy is changing and in order for Singapore to remain attractive to multinational enterprises, it needs to communicate its engagement with what other countries' governments are doing with respect to the 15 BEPS actions submitted by the OECD as well as its own position on these actions.

Singapore's tax system has evolved since its colonial beginnings and has over the years developed in tandem with the country's economic needs. It has been effective in supporting the growth of the economy, and one reason for this is that tax policy is adapted in response to the changing needs of the country as well as the global economic environment. Now, as a fast-developing and expanding First World economy, there is continuing pressure on our nation to maintain Singapore's progress and to make sure its development is sustainable for future generations. It is important that this process of adaptation continues – more so now than ever, given that BEPS may lead to some of the most significant changes in the international tax system in the last 100 years. Underscoring these changes is the fact that Singapore has always maintained its sovereignty and decided what tax policies are relevant for its purposes.

In the next few paragraphs, we will apply a Singapore-specific lens to some of the BEPS reforms, which will demonstrate that Singapore has an excellent story to tell in a post-BEPS world. However, we will also see that by sitting back and doing nothing, Singapore could risk damage to not only its economy but also its reputation.

(i) Address the tax challenges of the digital economy

As the global tax system is effectively based on principles that were introduced some 80 years ago, it is no surprise that it is really struggling to cope with the global, digitised economy that exists today. The taxation of internet transactions, location of servers, IP and royalty flows are all being considered, and it is inevitable that a clearer consistent approach will be recommended in the future.

This is of particular relevance to Singapore given its ambitions to be a smart nation and an IP hub. Singapore companies now exist and operate in an environment that is truly a global, digitised economy with mobile capital and employees. It is commonplace for transactions to be effected over the internet, creating complex tax questions over which country has the right to tax which business. For example, who has the right to tax proceeds from a transaction where goods are made in China, the customer support is provided from a call centre in the Philippines, the web page is hosted in Ireland, market intelligence is derived in and the customer is from the US, and the headquarters for the multinational enterprise is in Singapore where key decisions are made and Singapore serves as key logistics centre for shipment?

Singapore can play a key role in such a value chain and many other variations that exist in the digital economy as it is a place of substance for the critical parts of the value chain and hence can rightly lay claim to a fair share of the taxes on the overall profits generated.

(ii) Counter harmful tax practices more effectively, taking into account transparency and substance

Singapore has been labelled by some as a tax haven.¹ To most, a "tax haven" is a jurisdiction which refuses to share information with foreign tax authorities and its tax laws may not accord with global practices.

As discussed in section I, neither of those features applies to Singapore. Singapore is a rule-based jurisdiction with a revenue authority – the IRAS – that is sophisticated, well-connected globally with other revenue authorities and actively engaged in global tax initiatives. Singapore has offered a range of tax incentives to multinational corporations, but done so on a consistent and principled basis. Singapore has long required that substantial economic substance be located in Singapore in order for a company to enjoy a tax incentive and/or to access Singapore's competitive tax treaty network. In addition, IRAS requires companies located in Singapore to comply with global transfer pricing rules, meaning that intra-group transactions involving a Singapore company must comply with arm's length pricing standards as applied by most major economies.

¹ Sydney Morning Herald, <http://www.smh.com.au/business/singapores-government-says-its-not-a-tax-haven-its-a-valueadding-hub-20150430-1mwvdu.html>

Furthermore, a competitive tax regime is not the sole reason why multinationals have chosen to establish themselves on Singapore's shores. Other key elements include a robust and transparent legal system, political stability, an educated workforce, close geographical proximity to a range of growing markets and a highly liveable environment for expatriates as Singapore has world-class schools, world-class medical facilities, strong social infrastructure, and a friendly community that is welcoming to foreigners.

In the context of the global BEPS reforms, Singapore has a very strong and positive story to tell. In fact, the introduction of BEPS reforms and the wider evolution of the international tax system in response to a globalised, digitalised economy is a powerful opportunity for Singapore to further expand the reach of its home grown multinationals. Foreign multinationals needing an Asian or even a new global base should also continue to be attracted to Singapore given the wide range of non-tax related reasons for establishing a regional headquarters or substantial economic function here.

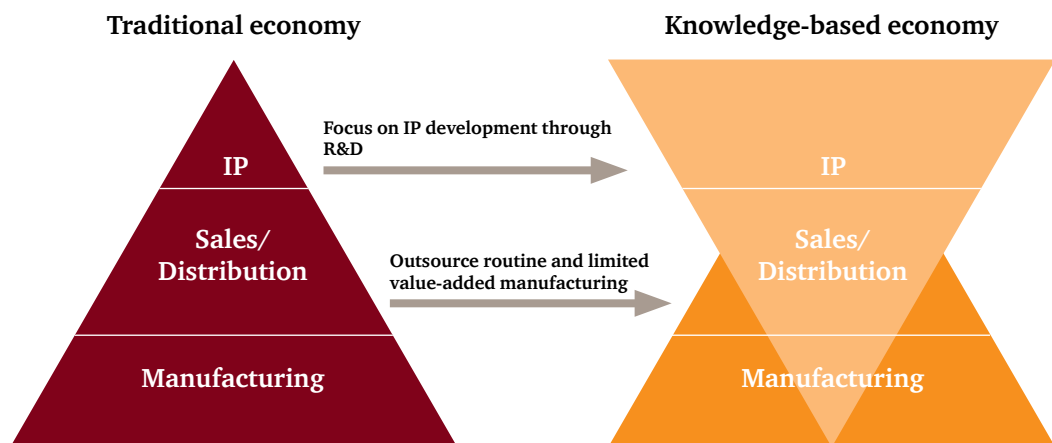
There is thus an opportunity for Singapore to be bolder in promoting itself as a jurisdiction that is competitive, but nonetheless BEPS-compliant. To borrow a phrase from the Irish, Singapore will always be a jurisdiction that plays fair, but plays to win. The role of Singapore's tax incentives in the post-BEPS world and our recommendations in this regard are discussed in section I.

(iii) Assure that transfer pricing outcomes are in line with value creation: intangibles

The BEPS project and the focus on the tax policies of multinational corporations paying their fair share of tax have undoubtedly changed the global tax landscape, and attracted attention to some of the more aggressive tax avoidance strategies that some say are abusive. The taxation of IP and the many countries around the world that have introduced specific regimes to attract multinationals to move IP to their jurisdiction have come under scrutiny. In Europe, countries such as the Netherlands, Luxembourg and Ireland are being investigated by the European Commission as to whether tax deals made with multinationals constitute illegal state aid. Non-government interest groups are also drawing scrutiny to multinationals which are perceived to be engaging in harmful tax practices – typically those which have located their IP (and the resulting profits) in “tax havens”. This focus will eventually turn to the many and varied approaches taken to granting tax incentives by other governments around the world.

This may be particularly relevant to Singapore as the shortage of land and labour means that its incentives must be directed at attracting activities at the top of the value pyramid if it is to continue growing its economy. In today's knowledge-based economy, as illustrated in the diagram below, the activities at the top of the value pyramid are non-land and labour intensive, and revolve around the creation and exploitation of knowledge.

Figure 1: Traditional vs knowledge-based economy



Governments have introduced, and will no doubt continue to introduce, further integrity provisions into their laws and treaties which are designed to cancel the tax benefits flowing from more aggressive BEPS structures (e.g. the UK recently introduced a diverted profits tax and Australia recently proposed a multinational tax anti-avoidance rule). However, most governments have not gone so far as to say that they will stop using tax policy as a means of attracting business to their shores, or that they support a consistent global tax system where the tax rules and rates are aligned, thereby eliminating differences that might be used to attract multinationals to one country over another.

The focus of the OECD and G20 on BEPS is unlikely to affect tax competition between governments. Each country has the sovereign right to determine its own tax laws, and it is unlikely that countries will cede significant revenue raising power over their tax residents or the transactions that occur in their jurisdiction to any other jurisdiction or body. We continue to see governments actively developing tax policies designed to attract and retain multinational activities to their shores. Some do this via low flat tax rates (e.g. Ireland offers a flat 12.5% tax rate for many types of income), others use attractive IP regimes (e.g. the patent box provisions in the UK) while others use R&D tax incentives (e.g. Australia), some use targeted tax incentives (e.g. Singapore) and others offer government funding or other concessions, such as payroll tax holidays and even cash awards. Accordingly, it would appear that targeted and principle based tax policy decisions to attract and retain business in a particular jurisdiction is likely to remain a key feature of the international tax system.

Yet, the outlook for some tax incentives could remain hazy in the days to come. In the 2015 report, the OECD included its review results on 30 preferential regimes. These 30 regimes were in turn bifurcated into two broad divisions, namely “Regimes other than intangible regimes” and “Intangible regimes”, and noticeably the OECD refrained from concluding on whether any one of the 15 regimes within the “Intangible regimes” were “harmful” or otherwise.

This evokes the point that intangibles remain a highly complex topic to deal with in the field of taxation, and suggests that the debate surrounding some of Singapore’s tax incentives intrinsically linked to IP, could well remain for the foreseeable future. But Singapore should and will no doubt continue to adopt internationally accepted principles that promote fair taxation based on real substance around intangibles.

(iv) Country-by-country reporting requirements

This will draw attention to taxpayers with high revenue and relatively lower headcount, paying lower taxes (e.g. a procurement hubs operating under an incentive). Multinationals need to justify their transfer pricing arrangements through qualitative analysis, and be prepared for foreign tax authorities challenging their assertions, particularly where facts taken out of context could be misconstrued to suggest that revenue is being shifted to a tax incentivised structure in Singapore without appropriate substance to support it.

As noted earlier, Singapore is resource-constrained and needs to focus on high-value activities around intangibles in order to continue to grow its economy. These are however, precisely the type of activities to which country-by-country reporting is likely to draw scrutiny.

Incentivised multinationals which have intangibles and high value activities in Singapore must be prepared to justify their transfer pricing arrangements and the IRAS should be prepared to defend its resident taxpayers in cases of cross-border dispute resolution. Once again on the back of its having real and tangible substance, Singapore will not only be confident to be a transparent global citizen but also be able to leverage its strong reputation in many relevant areas.

(v) Prevent treaty abuse

It is proposed that additional tests be introduced for taxpayers to access tax treaty benefits (e.g. reduced withholding tax rates, clarity on the allocation of taxing rights on cross border transactions), requiring specific objective

facts around substance to be satisfied before those benefits can be enjoyed. Further, it has been proposed that a general anti-avoidance rule be introduced whereby the benefits of the treaty will only be enjoyed if it can also be established that one of the principal purposes of structure was not for tax avoidance. Some of the more recent Singapore treaties have already incorporated some variation of such anti-abuse provisions, for example, in treaties with the UK, Finland, New Zealand, Poland and India. The proposed inclusion of a “derivative benefits” provision, which will allow certain entities owned by residents of other states to obtain treaty benefits that these residents would have obtained if they had invested directly, should also bode well for Singapore which serves as a hub for international trade.

Singapore will be well-positioned where the benefits are proportionate to the real activities in Singapore. It is hoped that the international arena will not apply too excessive an approach to take into account jurisdictions like Singapore that provide for many commercial benefits as a key hub in the overall value chain.

c. Increased tax transparency

One of the outcomes of the BEPS project and the wider debate about multinationals paying their fair share of tax is that the corporate tax affairs of multinationals will be more transparent to stakeholders than ever before, through various initiatives being adopted globally. Some initiatives will see information made public – such as the recently introduced Australian rules which will require the Australian Tax Office (ATO) to publish details of the profits and Australian tax paid by Australia’s largest companies. Others will see very detailed tax information being provided to revenue authorities – such as the country-by-country reporting requirements proposed by the OECD and already agreed to by many major jurisdictions.

In this regard, it is relevant to note that Singapore is a transparent jurisdiction and an active participant in global information sharing between revenue authorities. Singapore has signed the Convention on Mutual Administrative Assistance in Tax Matters, meaning it will be (upon ratification of the instrument) an active

participant in global tax cooperation between countries. Singapore is on the OECD “white list” of financial centres that have substantially implemented the internationally agreed tax standard for the effective exchange of information and there is no longer a requirement for court approval for IRAS to share taxpayer information with another revenue authority under a double tax agreement or exchange of information agreement. In addition, Singapore entered into a Model 1 Intergovernmental Agreement with the US in respect of the Foreign Account Tax Compliance Act (FATCA) provisions and has agreed to implement the Standard for Automatic Exchange of Financial Account Information proposed by the OECD (the Common Reporting Standard), subject to certain requirements concerning the participation of other financial centres.

Increased transparency over the tax affairs of multinationals is likely to be a prominent feature of the international tax system in the future. Such disclosures will give stakeholders more confidence in the system and a better understanding of the tax profiles of those affected groups. However, there is a real risk that these requirements will impose an enormous administrative burden on multinationals, which should be taken into account as the rules are designed.

Subject to if, when and how this is implemented, increased transparency through the country-by-country reporting that will be provided to revenue authorities may show that some multinationals derive income in Singapore and pay a lower rate of tax than the tax rates in their headquarter jurisdictions (which in some cases can be almost 40%). In the context of the activities in Singapore, it is important that this information is read in its full context - e.g. taking into account the number of individuals located in Singapore, the seniority of their roles in the organisation and value that they add.



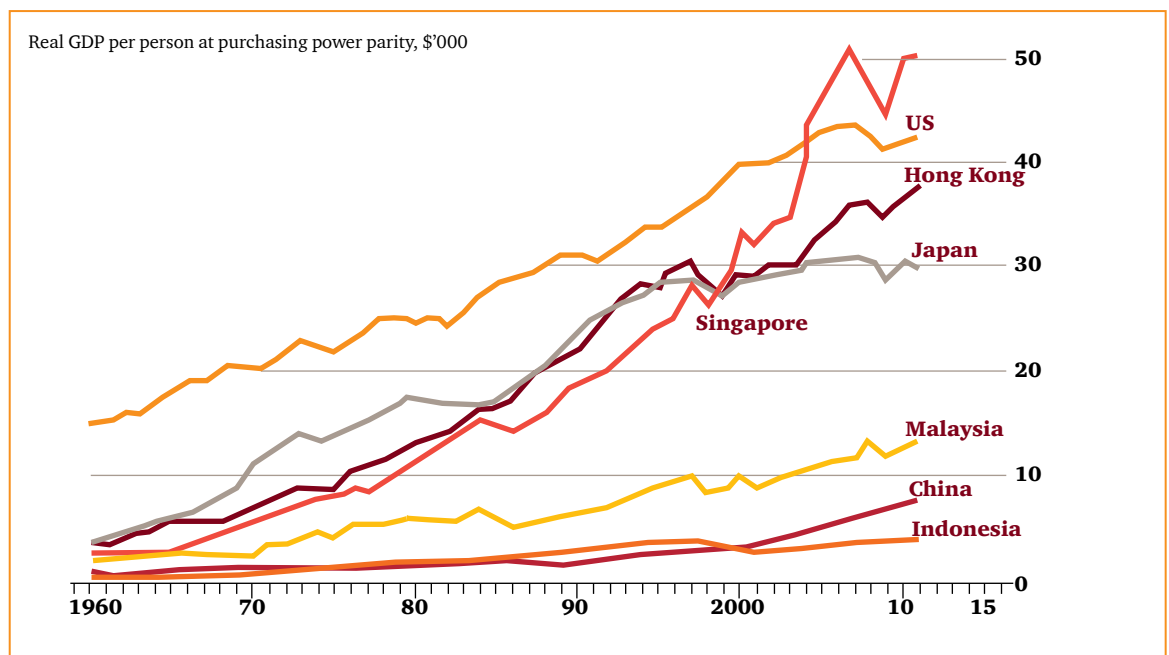
APPENDIX 2: An overview of the Singapore economy - past, present, and future

Over the last 50 years, the Singapore Government's trade policy, pro-business strategy and fiscal prudence have served the economy well. As an independent city-state, Singapore has no natural resources, extremely limited land space, and a small population by global standards. As such, it has always understood the need to look beyond its own shores to overcome the limitations of its domestic market. It managed to grow from a third world country with a GDP per capita of less than US\$320¹ fifty years ago into a metropolis with a GDP per capita of almost US\$54,000 in 2015. Today, Singapore is a major trading and aviation hub and a respected member of the global community.



Source: SingStat

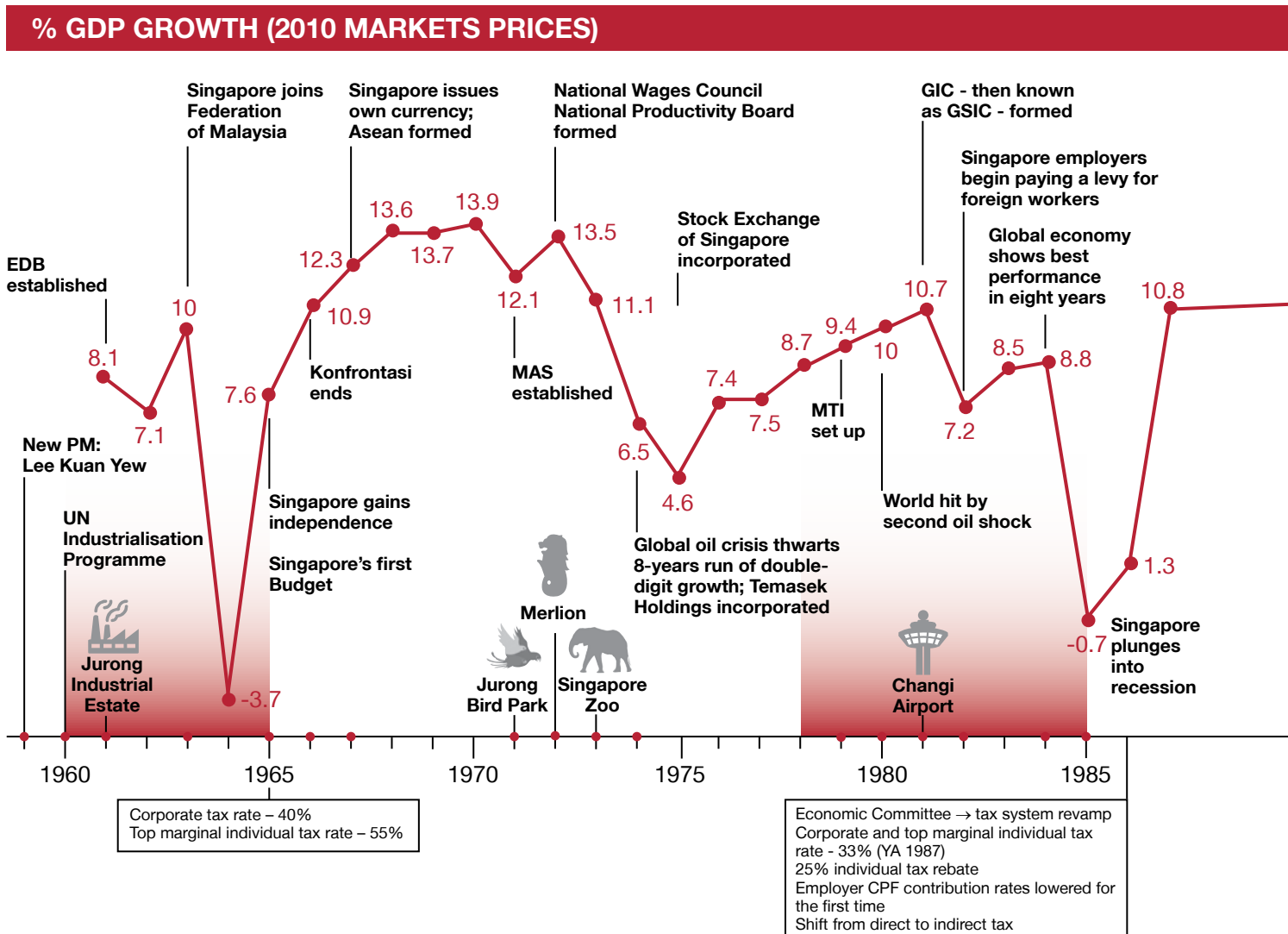
Figure 2: Comparison of various countries' GDP



Source: Penn World Table, University of Groningen: The Economist

¹ Singapore was a British colony (1819-1959). In 1959, it obtained internal self-rule, joined the Malaysia federation from 1962-1965 and became an independent country on 9 August 1965.

Figure 3: Singapore – Five decades of transformation



FIVE DECADES OF TRANSFORMATION

1960 – 1964

- Small country, no natural resources
- Dependent on entrepot trade, British military bases
- Little industrial know-how & domestic capital

GROWTH STRATEGIES

- 1960: First state development plan by UN team
- EDB set up to spearhead industrialisation effort, attract foreign investments
- Import-substitution approach, tariffs on imports

OUTCOMES

- Growth averaged 5.2% pa
- Manufacturing's share of GDP grew from 11% in 1960 to 13% in 1964

1965 – 1978

- After separation from Malaysia, import substitution no longer relevant
- High unemployment of 10%, exacerbated by closure of British bases which provided 40,000 jobs
- Konfrontasi threatened trading post role

GROWTH STRATEGIES

- Export-oriented approach
- Attract foreign investors to grow manufacturing and financial sectors
- Investments in infrastructure, nationalised companies in areas where private sector lacked expertise

OUTCOMES

- Growth averaged 10% pa
- Unemployment rate fell to 3.6% in 1978
- Manufacturing's share of GDP grew from 14% in 1965 to 24% by 1978

1979 – 1985

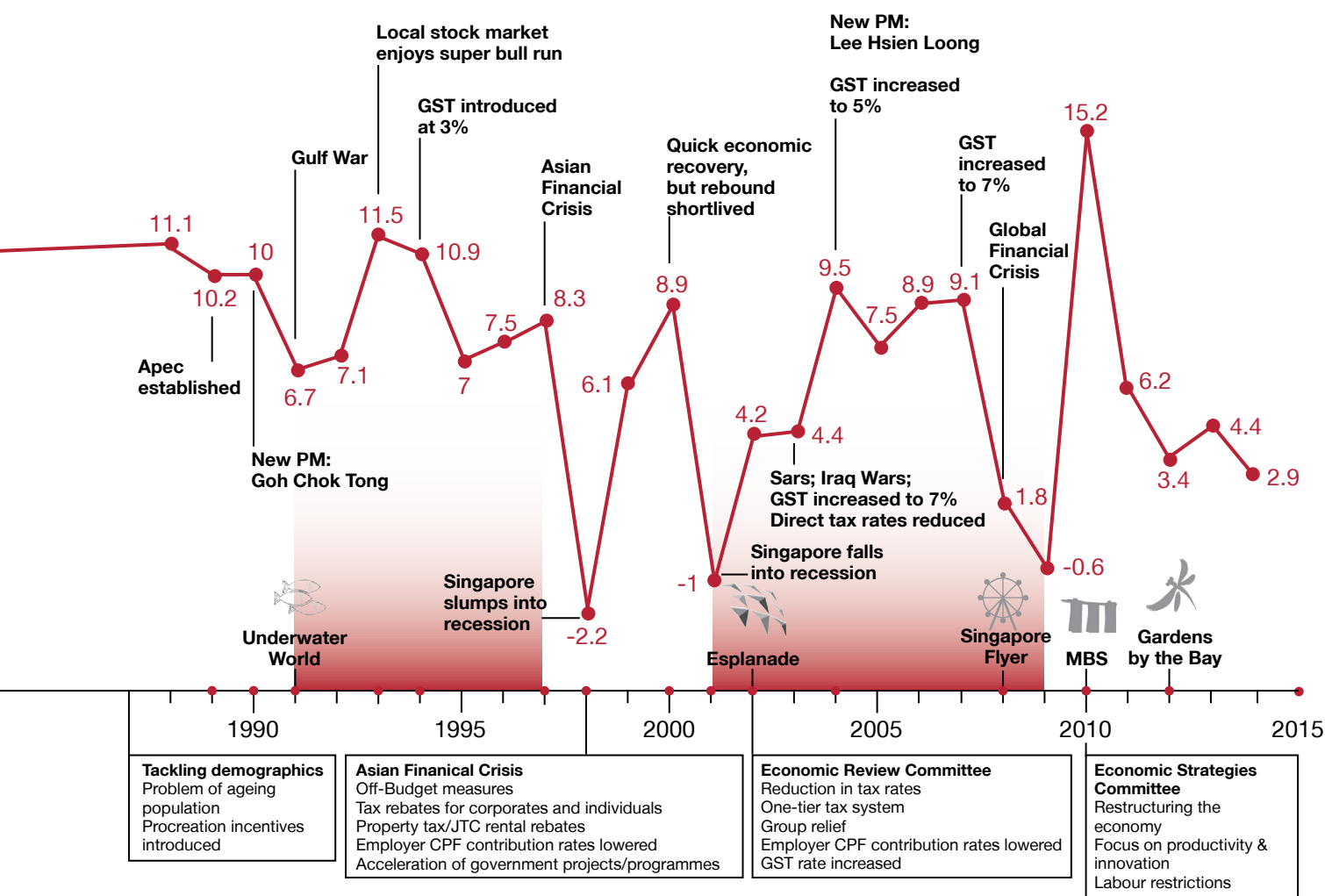
- Rising wage costs, tight labour market
- Competition from lower-cost developing countries

GROWTH STRATEGIES

- Shift to higher value-add and skills-intensive investments
- 1979: three-year wage correction policy to push up wages, induce efficient use of labour
- 1981: First productivity campaign, emphasising manpower development, automation

OUTCOMES

- Growth averaged 7.7% pa
- Nominal value-added per manufacturing worker rose by S\$8,600 over period
- Skilled employment doubled to 22%



1985 – 1991

- 1985-1986: First recession since independence
- Due to weak external demand and fundamental internal problems (loss of competitiveness, construction slump, oversaving)

GROWTH STRATEGIES

1986 Economic Committee Report

- Cost-cutting measures: reduce employers' CPF rate, wage restraint
- Promote services – eg tourism & banking – as actively as manufacturing

OUTCOMES

- Quick rebound, double-digit growth by 1987

1991 – 1997

- More mature economy, slower growth
- Faster rising costs, more binding resource constraints
- Greater overseas competition
- Relatively low-tech base

GROWTH STRATEGIES

1991 Strategic Economic Plan

- Growth Triangle network of Singapore, Riau Islands, Johor
- Move to developed economy: enhance human resources & soft infrastructure; help local firms expand abroad

OUTCOMES

- Growth averaged 8.5% pa
- Direct investments abroad shot up from S\$16.9b in 1990 to S\$75.8b in 1997

1997 – 2001

- 1997: Asian Financial Crisis
- Rise of China & India brings opportunities, challenges

GROWTH STRATEGIES

1998 Committee Report

- Vision to become globally competitive knowledge economy
- Manufacturing and services as twin engines of growth
- Develop globally competitive local firms
- Government to be business facilitator

2001 – 2010

- 2001: Singapore economy contracts 1.2%; Dotcom bubble; Sept 11 terrorist attacks
- 2003: Sars crisis, tourism & entire economy suffer
- 2008/2009: Global Financial Crisis

GROWTH STRATEGIES

2003 Economic Review Committee

- Ensure competitiveness, cut corporate & income tax to 20% from 25%
- Flexible foreign worker policies
- National continuing education & training body recommended

OUTCOMES

- Economy grew strongly, on the back of strong inflows of foreign workers
- But reliance on cheap foreign labour led to lower productivity growth
- Infrastructural pressures

2010 – Present

- New & volatile global economic environment
- PM Lee Hsien Loong forms Economic Strategies Committee to build capabilities, maximise opportunities, foster sustained and inclusive growth

GROWTH STRATEGIES

2010 Economic Strategies Committee Report

- Raise productivity of workers in all sectors, with raising wages as end-goal
- Reduce reliance on foreign workers by raising levies progressively
- Budget 2010: National Productivity Fund set up, Productivity and Innovation Credit (PIC) introduced

Unsurprisingly, Singapore's economy has been ranked as the most open in the world.² It also topped PwC's Cities of Opportunity 2014 survey in ease of doing business, has the third highest GDP per capita in the world, in terms of purchasing power parity. This strong economic performance reflects the success of its open, transparent, and outward-oriented development strategy, aimed at promoting long-term economic growth.

Part of this success comes from economic strategy aimed at attracting and retaining long-term investment to develop and grow high value industries in Singapore. Today, most of Singapore's GDP comes from the Manufacturing industry, which amounted to 18.4% of Nominal GDP in 2014. This was followed closely by Wholesale & Retail Trade at 17.5%, then Business Services at 15.8% and Finance and Insurance (or what many refer to simply as financial services) at 12.5%.

Figure 4: PwC's Cities of Opportunity 2014

How the cities rank

| | Intellectual capital and innovation | Technology readiness | City gateway | Transportation and infrastructure | Health, safety, and security | Sustainability and the natural environment | Demographics and livability | Economic clout | Ease of doing business | Cost | Score |
|------------------|-------------------------------------|----------------------|--------------|-----------------------------------|------------------------------|--|-----------------------------|----------------|------------------------|------|-------|
| 30 London | 200 | 107 | 172 | 112 | 112 | 79 | 141 | 118 | 173 | 76 | 1,290 |
| 29 New York | 186 | 98 | 137 | 95 | 110 | 89 | 119 | 114 | 194 | 93 | 1,235 |
| 28 Singapore | 148 | 91 | 153 | 139 | 112 | 71 | 133 | 95 | 219 | 69 | 1,230 |
| 27 Toronto | 190 | 73 | 98 | 118 | 130 | 106 | 123 | 90 | 182 | 105 | 1,215 |
| 26 San Francisco | 195 | 96 | 109 | 89 | 113 | 112 | 136 | 92 | 167 | 102 | 1,211 |
| 25 Paris | 204 | 75 | 143 | 114 | 108 | 116 | 128 | 107 | 142 | 59 | 1,196 |
| 24 Stockholm | 192 | 105 | 96 | 111 | 132 | 121 | 126 | 77 | 158 | 73 | 1,191 |
| 23 Hong Kong | 158 | 100 | 151 | 99 | 86 | 63 | 133 | 91 | 197 | 78 | 1,156 |
| 22 Sydney | 181 | 71 | 119 | 80 | 130 | 121 | 142 | 82 | 146 | 81 | 1,153 |
| 21 Chicago | 174 | 86 | 93 | 91 | 112 | 96 | 119 | 78 | 167 | 117 | 1,133 |
| 20 Berlin | 162 | 74 | 113 | 107 | 128 | 116 | 135 | 64 | 134 | 95 | 1,128 |
| 19 Los Angeles | 182 | 93 | 105 | 74 | 100 | 96 | 98 | 78 | 172 | 120 | 1,118 |
| 18 Tokyo | 172 | 84 | 151 | 104 | 105 | 69 | 96 | 88 | 151 | 66 | 1,086 |
| 17 Seoul | 161 | 107 | 125 | 115 | 79 | 61 | 67 | 84 | 160 | 84 | 1,043 |
| 16 Madrid | 121 | 60 | 148 | 112 | 98 | 91 | 101 | 77 | 124 | 83 | 1,015 |
| 15 Dubai | 98 | 57 | 141 | 105 | 91 | 37 | 108 | 73 | 100 | 103 | 913 |
| 14 Kuala Lumpur | 75 | 62 | 131 | 103 | 53 | 55 | 80 | 76 | 156 | 94 | 885 |
| 13 Milan | 117 | 58 | 93 | 91 | 103 | 84 | 91 | 81 | 98 | 64 | 880 |
| 12 Beijing | 96 | 44 | 156 | 90 | 42 | 63 | 70 | 115 | 97 | 40 | 813 |
| 11 Shanghai | 117 | 40 | 137 | 94 | 59 | 46 | 85 | 105 | 72 | 53 | 808 |
| 10 Moscow | 106 | 52 | 97 | 101 | 32 | 96 | 77 | 86 | 77 | 57 | 781 |
| 9 Mexico City | 94 | 28 | 88 | 98 | 52 | 71 | 63 | 60 | 126 | 67 | 747 |
| 8 Johannesburg | 72 | 33 | 94 | 43 | 51 | 57 | 79 | 53 | 108 | 108 | 698 |
| 7 Buenos Aires | 73 | 44 | 68 | 115 | 58 | 82 | 65 | 47 | 51 | 61 | 664 |
| 6 Istanbul | 68 | 28 | 111 | 70 | 35 | 61 | 59 | 59 | 79 | 75 | 645 |
| 5 São Paulo | 61 | 23 | 76 | 87 | 37 | 64 | 59 | 61 | 79 | 51 | 598 |
| 4 Rio de Janeiro | 55 | 19 | 51 | 83 | 33 | 70 | 65 | 58 | 71 | 42 | 547 |
| 3 Mumbai | 35 | 35 | 57 | 87 | 30 | 57 | 25 | 73 | 66 | 58 | 523 |
| 2 Jakarta | 30 | 32 | 58 | 79 | 25 | 42 | 35 | 50 | 70 | 75 | 496 |
| 1 Nairobi | 30 | 14 | 34 | 31 | 15 | 74 | 64 | 36 | 62 | 79 | 439 |

Each city's score (here 1,290 to 439) is the sum of its rankings across variables. The city order from 30 to 1 is based on these scores. See maps on pages 14–15 for an overall indicator comparison.

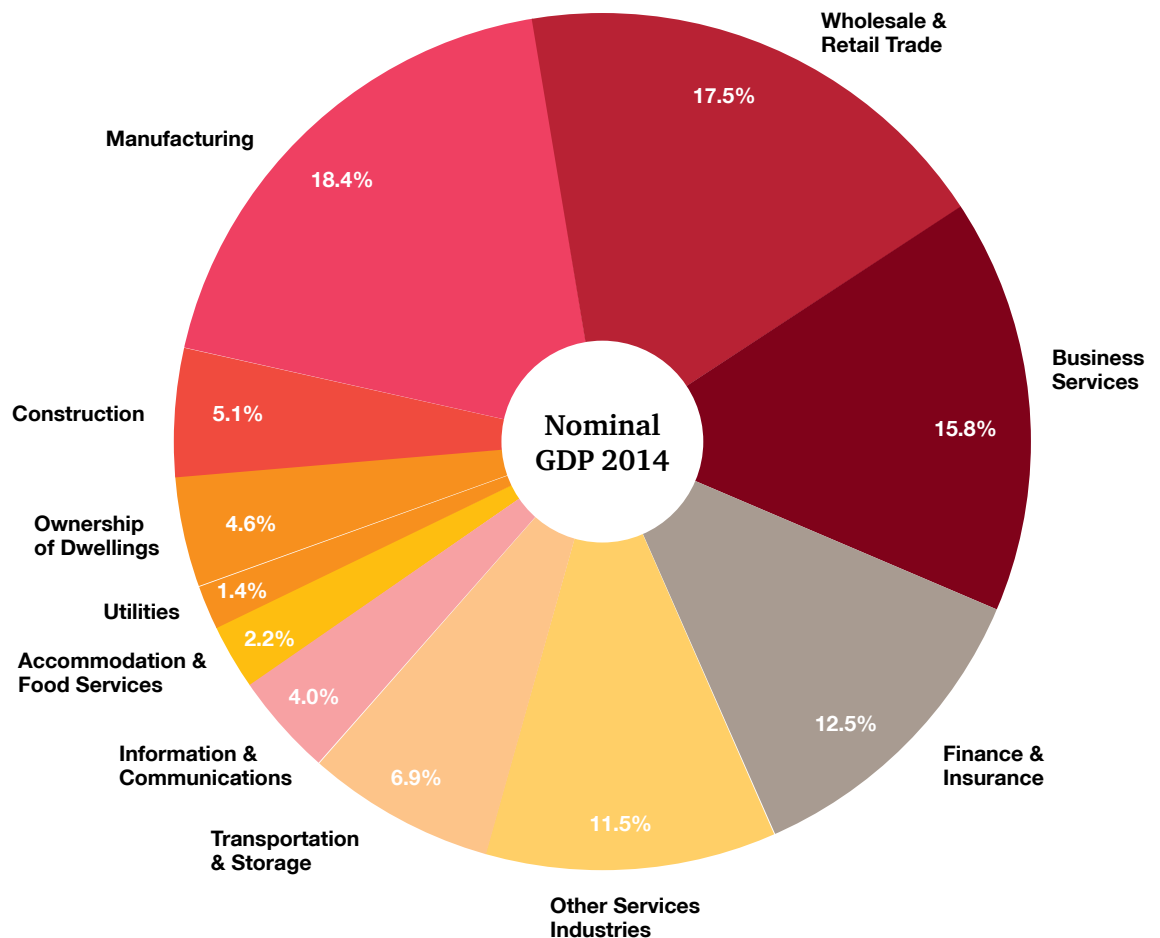


² World Economic Forum's Global Enabling Trade report

According to Mercer's 2015 Quality of Living survey,³ Singapore ranked 26th globally, but came out top in Asia for quality of life for expatriates. Mercer evaluates local living conditions according to 39 factors, grouped in 10 categories:

- Political and social environment (political stability, crime, law enforcement, etc.)
- Economic environment (currency exchange regulations, banking services)
- Socio-cultural environment (media availability and censorship, limitations on personal freedom)
- Medical and health considerations (medical supplies and services, infectious diseases, sewage, waste disposal, air pollution, etc.)
- Schools and education (standards and availability of international schools)
- Public services and transportation (electricity, water, public transportation, traffic congestion, etc.)
- Recreation (restaurants, theatres, cinemas, sports and leisure, etc.)
- Consumer goods (availability of food/daily consumption items, cars, etc.)
- Housing (rental housing, household appliances, furniture, maintenance services)
- Natural environment (climate, record of natural disasters)

Figure 5: Overview of industries as part of GDP



Source: SingStat

³ <http://www.uk.mercer.com/newsroom/2015-quality-of-living-survey.html>

While this outward-looking economic strategy has been accompanied by fiscal policy directed primarily at promoting long-term economic growth, success of this economic strategy lies in the value that Singapore — as both a living and business location — now has in the form of a stable political and social environment, reliable infrastructure, internationally recognised education system, well-regarded local talent pool, world class maritime and air ports, global economic standing, etc.

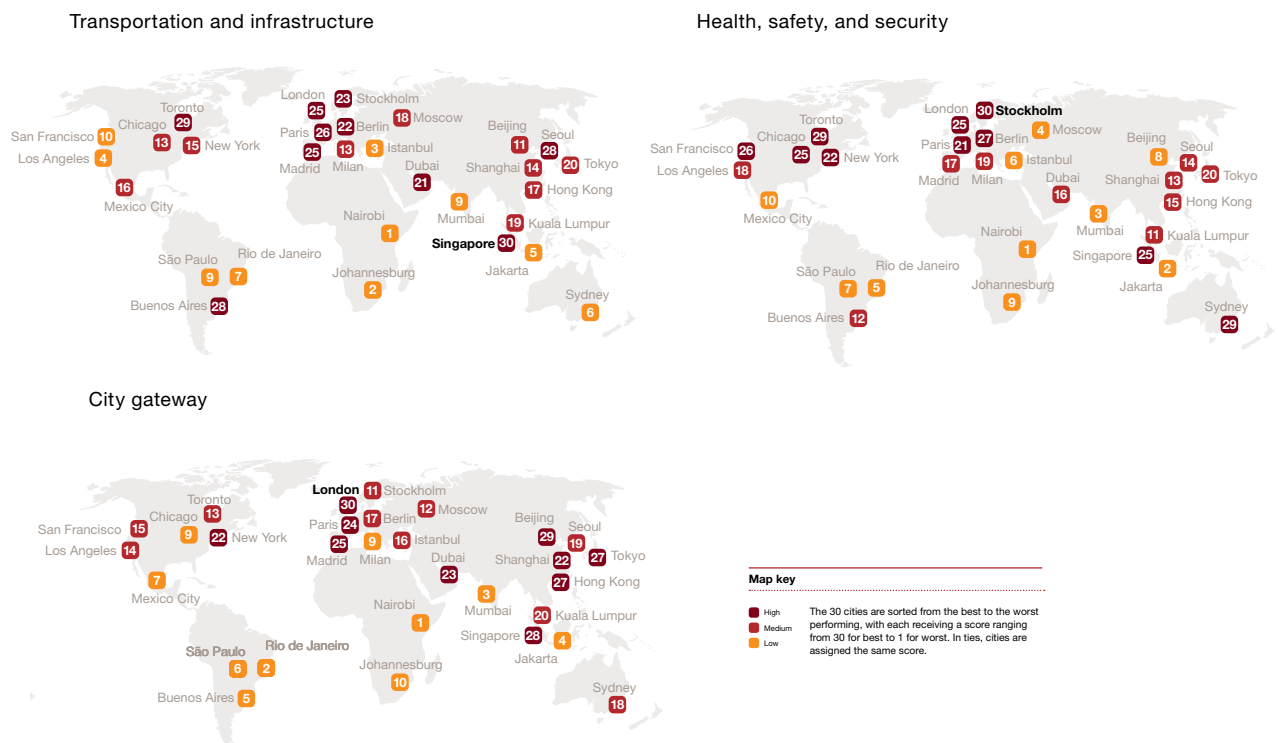
PwC's Cities of Opportunity⁴ ranked Singapore third overall, behind London and New York. The city-state repeated its top ranking from the previous Cities of Opportunity study for the quality of its transport and infrastructure, leading the ranking for housing, which is arguably the most important variable within the indicator, as well as tying for third with Paris, Stockholm and Berlin in terms of public transport systems. Notably, Singapore also improved six places to be ranked third out of the 30 cities measured in the city gateway⁵ indicator, demonstrating its importance as a global gateway, just after London and Beijing. Singapore was also listed as the only Asian city in the top 10 in health, safety and security.

These are essential ingredients for the successful development of business and human capital, which in turn have attracted numerous multinational corporations and global talent to anchor themselves in Singapore. However there are challenges and uncertainties ahead. Singapore economy is slowing, while competition from regional and international cities is intensifying. The Government has always been very far-sighted. During Budget 2015, it identified five growth clusters – areas where there is growing demand and where Singapore has the capacity to excel – to position Singapore's economy for the future. They are:

- Advanced manufacturing,
- Applied health sciences,
- Smart and sustainable urban solutions,
- Logistics and aerospace, and
- Asian and global financial services.

Beyond this, Singapore needs to look at the macro factors (tax or otherwise) that will play a part in shaping the global business world of the future to stay ahead of the competition in today's rapidly transforming global business environment.

Figure 6: PwC's Cities of Opportunity 2014 - Indicator rankings at a glance



⁴ Cities of Opportunity analyses the development of 30 global cities, and through their performance seeks to add insight on the policies and actions that make cities function best (<http://www.pwc.com/us/en/cities-of-opportunity/>)

⁵ Cities of Opportunity 6 measured 30 global cities across seven variables that indicate a city's accessibility and attractiveness as a travel destination (for business or otherwise). The seven variables were number of hotel rooms, number of international tourists, number of international meetings, ingoing/outgoing passenger flows, airport to CBD access, top 100 airports, on-time flight departures.

WHAT'S NEXT? 2015 AND BEYOND

As Singapore's economy matures and enters a new phase, the government is expecting slower but better-quality growth. Expansion will be driven by deep skills and innovation, with Singaporeans at the core.

Three main dimensions to future growth:

- 1 FROM VALUE ADDITION TO VALUE CREATION**
 - Pervasive innovation in every firm, industry
 - Develop own products & services
 - Become leading centre for value creation in business strategies of foreign companies
- 2 MASTERY OF SKILLS**
 - Hone deep skills in every vocation
 - Learning at every stage of life
 - Multiple pathways to success
- 3 SINGAPOREAN CORE**
 - High-skilled, innovative teams in every sector
 - Good careers for Singaporeans
 - Globally competitive local companies

In Budget 2015, five growth clusters of the future were identified. The aim is to build on existing strengths, and to focus on areas with growing demand, and where Singaporeans can excel.

| 1 ADVANCED MANUFACTURING | 2 APPLIED HEALTH SCIENCES | 3 SMART & SUSTAINABLE URBAN SOLUTIONS | 4 LOGISTICS & AEROSPACE | 5 ASIAN & GLOBAL FINANCIAL SERVICES |
|--|--|---|---|---|
| <ul style="list-style-type: none"> New opportunities from technological trends Deep capabilities in wide spectrum of disciplines – electrical, mechanical, and process engineering Diverse portfolio of industries concentrated in a city-state | <ul style="list-style-type: none"> New demand for non-traditional models of care, due to growing affluence and rapidly ageing population in Asia and elsewhere Strong science foundation, respected healthcare services, deep Asian consumer and market insights | <ul style="list-style-type: none"> Growing urbanisation worldwide Countries in region already look to Singapore as a model and pioneer of sustainable city management | <ul style="list-style-type: none"> Rising volumes of trade in Asia Allow companies to compete on factors other than costs Already Asia's leading logistics hub, airport, and seaport | <ul style="list-style-type: none"> Rapid growth of Asian finance Rise in areas like infrastructure funding, structured trade finance, wealth Already among the top five international finance centres in the world |

Source: Business Times

Singapore of the Future

PwC has identified⁶ five megatrends that will not only shape the future; they will have an indelible effect on Singapore's growth both as a nation as a world economy. The five megatrends are:

- Shift in economic power
- Demographic and social change
- Rapid urbanisation
- Climate change and resource scarcity
- Technological breakthroughs

a. Shift in economic power

The aggregate purchasing power of the 'E7' economies – Brazil, China, India, Indonesia, Mexico, Russia, and Turkey – is projected to overtake that of the G7 by 2030.

China has also already overtaken the US as the world's largest economy in 2014.⁷ India is projected to be the world's 3rd largest economy by 2030, from its current 8th position. ASEAN is emerging as an economic powerhouse. Collectively, the region's GDP is the eighth largest in the world,⁸ and its share of exports exceeds that of Brazil, India and Russia. By 2030, Southeast Asia's GDP is projected to be top five in the world, reaching US\$10 trillion.⁹

Economic power is shifting from west to east, from developed economies to developing ones. Such global shifts are remarkable not only for their scale, but also for their sheer speed. As a result, there is little doubt that in a decade's time, the global economic landscape will be vastly different from that of today.

Figure 7: Ten largest economies by decade

| | 1990 | USD trn | 2000 | USD trn | 2010 | USD trn | 2020 | USD trn | 2030 | USD trn |
|----|---------|---------|---------|---------|---------|---------|-----------|---------|-----------|---------|
| 1 | US | 5.8 | US | 10.0 | US | 14.6 | China | 24.6 | China | 73.5 |
| 2 | Japan | 3.0 | Japan | 4.7 | China | 5.9 | US | 23.3 | US | 38.2 |
| 3 | Germany | 1.5 | Germany | 1.9 | Japan | 5.6 | India | 9.6 | India | 30.3 |
| 4 | France | 1.2 | UK | 1.5 | Germany | 3.3 | Japan | 6.0 | Brazil | 12.2 |
| 5 | Italy | 1.1 | France | 1.3 | France | 2.6 | Brazil | 5.1 | Indonesia | 9.3 |
| 6 | UK | 1.0 | China | 1.2 | UK | 2.3 | Germany | 5.0 | Japan | 8.4 |
| 7 | Canada | 0.6 | Italy | 1.1 | Italy | 2.0 | France | 3.9 | Germany | 8.2 |
| 8 | Spain | 0.5 | Canada | 0.7 | Brazil | 2.0 | Russia | 3.5 | Mexico | 6.6 |
| 9 | Brazil | 0.5 | Brazil | 0.6 | Canada | 1.6 | UK | 3.4 | France | 6.4 |
| 10 | China | 0.4 | Mexico | 0.6 | Russia | 1.5 | Indonesia | 3.2 | UK | 5.6 |

Sources: IMF, Standard Chartered Research

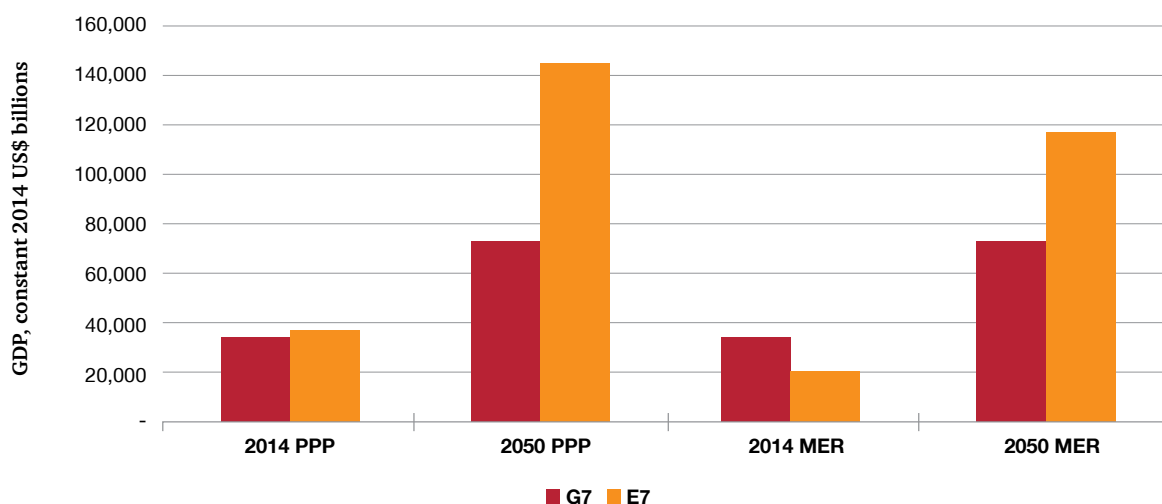
⁶ Global Annual Review 2014, <http://www.pwc.com/gx/en/issues/megatrends/index.html>

⁷ The World in 2050, <http://www.pwc.com/gx/en/issues/the-economy/assets/world-in-2050-february-2015.pdf>

⁸ After EU, US, China, Japan, Germany, France and UK. Based on the International Monetary Fund's 2012 estimates.

⁹ Projections by IHS Global Insights.

Figure 8: Relative size of G7 and E7 economies, 2014 and 2050 - E7 will replace G7 by 2050¹⁰



Source: IMF for 2014 estimates, PwC projections for 2050

PPP: Purchasing Power Parity
MER: Market Exchange Rate

With Singapore's strategic geographical position, it is an ideal hub for businesses and their key decision makers to reach the rest of the region. In order to remain attractive as a stable and reliable base from which businesses can leverage to develop knowledge and IP assets, as well as maximise opportunities to drive growth in the region well into the future, Singapore must continue to leverage on its strengths. But in today's volatile business and regulatory environment, that in itself might not be enough. Singapore needs to take the next step and start to address potential problem areas that could, and will likely, arise due to our rapidly globalising marketplace. An important ingredient that has long been a crucial part (but never a driver) of Singapore's success has been a focus on a dynamic and competitive tax system.

Singapore needs to find a balance between continuing to remain attractive and yet improving tax collections. It is clear that Singapore will need to continuously improve its infrastructure – be it transportation, ports, potential new sources of energy that are cleaner and more sustainable, etc. And also to address an ageing population that would potentially need more health care. But it must still maintain levels of taxation that would continue to attract investors, even as tax rates around the world move to match Singapore's.

In Appendix 1, we discussed the BEPS project being driven by the OECD and G20, which is already influencing the tax policies of major global economies. Closer to home, the formation of the ASEAN Economic Community (AEC) will bring new growth opportunities to Singapore-based businesses to take advantage of in the form of the five core principles of the ASEAN single market and production base:

- Free flow of goods
- Free flow of services
- Free flow of investment
- Free flow of capital
- Free flow of skilled labour

However, it may not be a straightforward affair for businesses to leverage this new single market and production base for growth. To illustrate, Singapore-based SMEs have been encouraged to leverage the formation of the AEC to expand their operations within the region. We are seeing, however, that these SMEs are not making significant inroads into Southeast Asia, especially when compared with the rest of Asia. One stumbling block may be in the area of legislation and practices, which currently differ significantly among the ASEAN countries. For example, tax rules are not always clear, and there are differences in the way they are interpreted and implemented in the various ASEAN member states.

¹⁰ The World in 2050, <http://www.pwc.com/gx/en/issues/the-economy/assets/world-in-2050-february-2015.pdf>

b. Demographic and social change

Within the next minute the global population will increase by 145. By 2025, the world will have added another billion people to reach about 8 billion, with the over-65s the fastest-growing group. But there will be sharp regional variations: Africa's population is projected to double by 2050, while Europe's is expected to shrink.

While these demographic changes bring risks for those that fail to respond adequately, they also bring major opportunities for the forward-looking. PwC has identified three core sources of growth: the consumption power of growing population segments, the innovative potential of a diverse workforce and global mobility. The number of people being assigned by their employers to roles outside their home country has increased by 25% over the past decade – and we project a further 50% rise by 2020.

Across all these opportunities, the common thread is the move to a more diverse world with increased global flow of and competition for talent. And there's growing evidence that

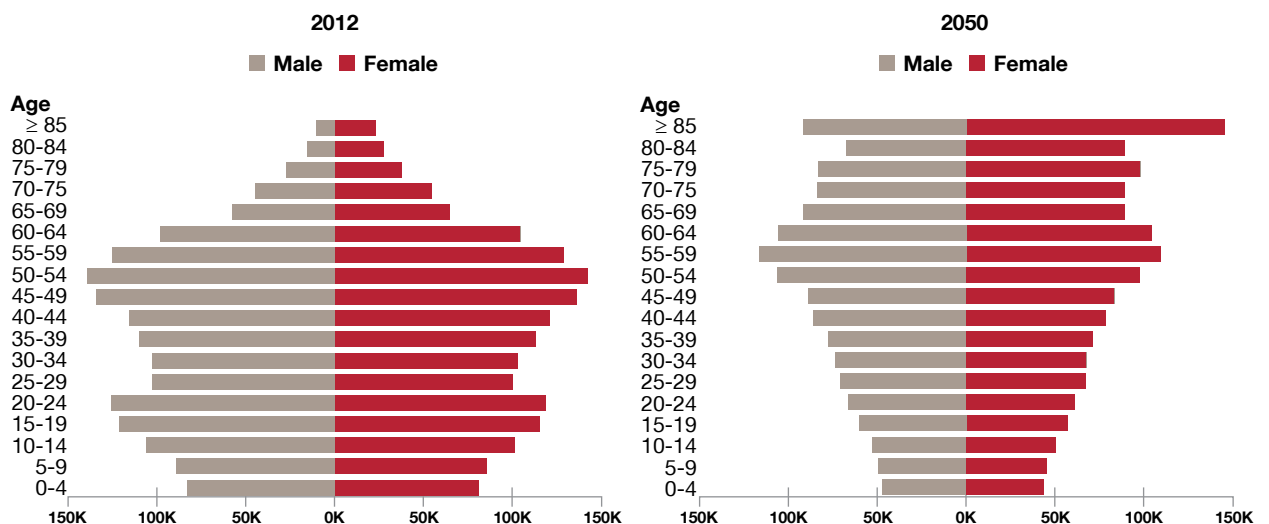
workforce diversity is linked to improved performance by businesses and economies. According to a recent survey, 95% of ASEAN CEOs who had implemented a diversity and inclusiveness strategy say that it has improved their bottom line.¹¹

However, alongside the opportunities, demographic change also brings challenges. The combination of rising life expectancy and – in some parts of the world – declining birth rates, will drive dependency ratios upwards. In 2050, the average age in Japan is set to be 53, against 21 in Nigeria.

Whichever side of this divide they sit, countries have to respond quickly to take advantage of the demographic dividend or to take care of the ticking demographic time bomb.

Singapore is facing an ageing population (see Figures 9 and 10), where a further challenge is rising healthcare costs – all pointing to increased social spending which will translate to an increased need for revenue/funding.

Figure 9: Our changing citizen age profile¹²

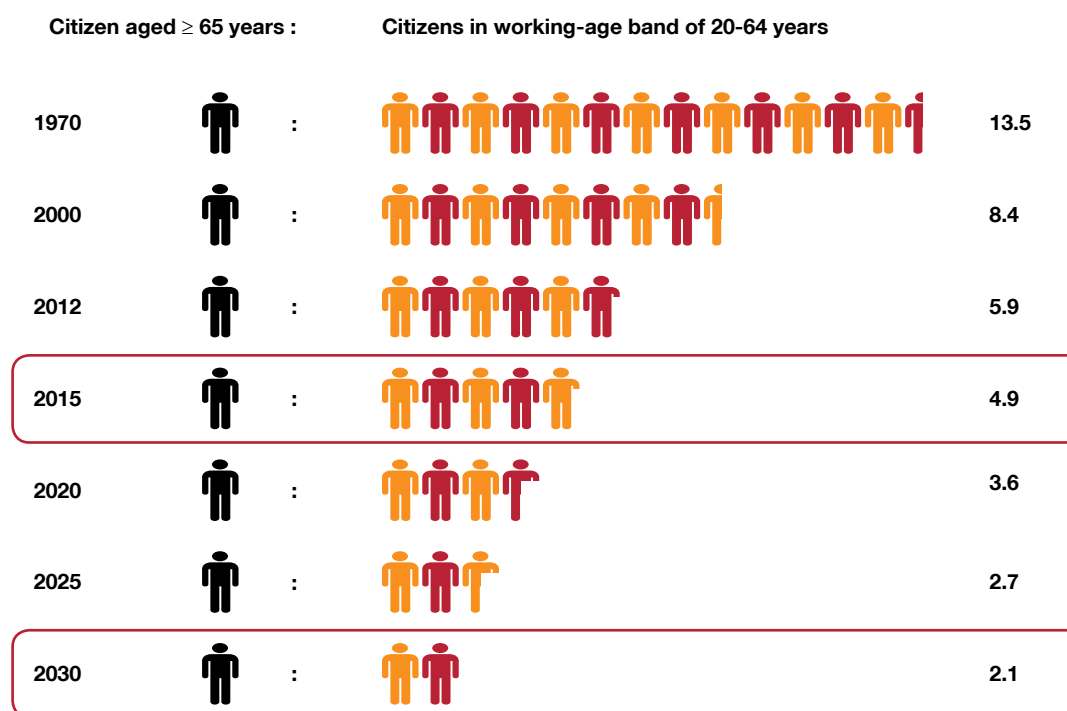


Assuming current birth rates and no immigration from 2013 onwards
Source: SingStat

¹¹ PwC's 18th Annual Global CEO Survey.

¹² A sustainable population for a dynamic Singapore, Population White Paper, January 2013, <http://population.sg/whitepaper/downloads/population-white-paper.pdf>

Figure 10: Declining old-age support ratio¹³



Assuming current birth rates and no immigration from 2013 onwards
Source: SingStat

c. Rapid urbanisation

The global rise of cities has been unprecedented. In 1800, 2% of the world's population lived in cities. Now it is 50%. Every week, some 1.5 million people join the urban population around the world, through a combination of migration and childbirth.

Rapid urbanisation brings major implications for businesses as they refocus their offerings, marketing and distribution towards an increasingly urban customer base with distinct needs and consumption habits. And they must be alert to new opportunities arising from lifestyles shaped by rising population density and readier access to resources.

For city leaders, the implications are also significant as they work to ensure that cities grow in a sustainable way. Leaders face tough choices trying to keep their cities liveable. Options being examined globally include floating cities — especially relevant for low-lying regions threatened by rising sea levels — and revitalising 'ghost' cities or failing economies through crowdfunding.

A further approach is to build a new city around the latest technologies: the 'smart city'. Singapore is a leader in this race and poised to be the world's first Smart Nation. Other countries are jumping on the smart cities bandwagon, for example, India's Prime Minister Narendra Modi announced that he will build 100 smart cities across India. Indonesia has also planned to develop smart cities.

As all these initiatives and opportunities demonstrate, technology is having a major impact on our cities. Their main attraction used to be jobs. Now people come seeking a better quality of life – at any age.

Singapore has identified smart and sustainable urban solutions as one of the five key growth areas¹⁴ and is exporting its expertise in city planning and management – a laudable step. Singapore's Surbana Jurong recently designed the masterplan for India's Andhra Pradesh government to build a new capital city Amaravati, projected to house 10 million by 2050.

¹³ A sustainable population for a dynamic Singapore, Population White Paper, January 2013, <http://population.sg/whitepaper/downloads/population-white-paper.pdf>

¹⁴ 2015 Budget Speech

d. Climate change and resource scarcity

As the world becomes more populous, urbanised and prosperous, demand for energy, food and water will rise. But our planet's natural resources to satisfy this demand are finite.

As a small island nation, Singapore is more aware than most about the challenges that resource scarcity can bring. The availability of water has been an issue for Singapore since independence. In the 1960s to 1970s, Singapore was relying on Malaysia as its main source of water and was also facing urbanisation challenges such as polluted rivers, water shortages and widespread flooding. However, over the last 50 years, Singapore has invested heavily in water technology and has successfully adopted an integrated approach to water management. As a result, Singapore now boasts a diversified and sustainable water-supply strategy that utilises local catchment, imported water, reclaimed water and desalinated water.

Singapore has identified water and environment technologies as a key growth sector since 2006, and is now well-placed to take the lead as an R&D base and innovative leader of water solutions.¹⁵ The Environment and Water Programme Office (EWI), an inter-agency outfit led by PUB, is spearheading efforts to transform Singapore into a global hydrohub through funding promising research projects to foster leading-edge technologies and create a thriving and vibrant research community in Singapore. Today, Singapore has a thriving cluster of over 130 water companies and 26 research centres. PUB is actively working with the industry to come up with new, innovative ideas that may make a difference to the water world.

e. Technological breakthroughs

In PwC's latest Global CEO Survey,¹⁶ business leaders told us technology is one of the biggest disrupting forces in their organisations. One aspect is that the lead time from breakthrough technology to mass-market adoption has dramatically shortened. In the US, it took the telephone 76 years to reach half the population. The smartphone did it in under 10 years. The price of new technologies is falling equally

rapidly. For instance, the cost of DNA sequencing per genome has plunged from US\$96m (S\$135.6m) in 2001 to less than US\$6,000 (S\$8,500).

Technology disruption is so pervasive that no country or business is immune from its impact. Technologies like robotics, 3D printing, Internet of Things are starting to redefine global value chains. Algorithms and artificial intelligence are disrupting professional services. Digital platforms are disrupting traditional business models. Airbnb offers more rooms than any other hotel in the world and is worth more than traditional industry heavyweight, the Hyatt Group. Alibaba started out as an e-commerce platform, and now offers loans to reach the unbanked masses more effectively than banks.

From a business perspective, companies need to adapt and innovate rapidly or risk becoming obsolete. From a government perspective, the pace of change is too fast for policy and regulation to keep up e.g. rapidly changing industries make it harder for government to regulate. Jobs are also at stake. Technology breakthroughs could hollow out the jobs in the middle. An Oxford University study estimated that 47% of US employment is under threat of being computerised within two decades. The pay asymmetry could increase between the "cogs" – those who are not educated to work with technology or have commoditised skills – and the "cognitive elites" – those can leverage tech to their benefit, and the market places a premium on such skills. These are serious issues that policy makers have to grapple with. As technology dis-intermediates traditional hierarchies and disrupts industries, the changes that lie ahead may be complex, but they also present opportunities.

To ride the wave of technology breakthroughs, Singapore has put in place many industry development programmes to develop the right ecosystem, capabilities, talent, and platforms required for excellence in the next big areas of technology – data and analytics, cloud, enterprise mobility solutions, etc. Singapore is also pushing ahead with a nation-wide manpower development initiative – SkillsFuture – to upgrade the skills of the workforce and enable its people to develop skills mastery.

¹⁵ Public Utilities Board website, <http://www.pub.gov.sg/water/Pages/singaporewaterstory.aspx>

¹⁶ PwC's 18th Annual Global CEO Survey, <http://www.pwc.com/gx/en/ceo-survey/2015/index.jhtml>

Such efforts are paying off. Singapore's tech ecosystem is becoming more vibrant. The Economist highlighted the Singapore Government's efforts to support start-ups and singled out Block 71 in Ayer Rajah as "the world's most tightly packed entrepreneurial ecosystem".

At a broader level, Singapore's ambition to develop into the world's first Smart Nation further demonstrates that as a nation, it is at the forefront of the digital disruption game and is ready to leverage existing and new technological infrastructure to transform the nation. Singapore is already test-bedding Smart Nation solutions, starting with its pilot programme at Jurong Lake District, involving 14 government agencies, with the aim of developing this programme into a nation-wide initiative in a sustainable way.

Singapore is also aiming to be a Smart Financial Centre, led by the Monetary Authority of Singapore (MAS) and working in close collaboration with the industry. MAS will commit \$225 million over the next five years under the Financial Sector Technology and Innovation scheme to provide support for the creation of a vibrant ecosystem for innovation. This will help entrench Singapore as the leading financial services hub in the region, and globally.

Singapore has always been able to overcome the odds and seize the opportunities despite its constraints and challenges. In this white paper, we offer a perspective on how tax can play a complementary role in enabling Singapore to continue to thrive as a leading city-state in a changing domestic and global landscape.



APPENDIX 3: Comparison of tax regimes

a. Comparison of Singapore's tax regime with that of other financial centres

| | Singapore | UK | Australia | Hong Kong | US | Ireland |
|---|-----------|------------------|------------------|------------------|------------------|--------------------|
| Headline corporate tax rate | 17% | 20% ¹ | 30% | 16.5% | 35% ² | 12.5% ³ |
| Are tax incentives available? | Yes | Yes ⁴ | Yes ⁵ | Yes ⁶ | Yes ⁷ | Yes ⁸ |
| Are foreign non-portfolio dividends exempt? | Yes | Yes | Yes | Yes | No | Yes |
| Is there a dividend withholding tax? | No | No | Yes ⁹ | No | Yes | Yes ¹⁰ |
| Does the jurisdiction have an extensive treaty network? | Yes | Yes | Yes | Yes | Yes | Yes |
| Is there generally capital gains tax on the disposal of shares in an active foreign subsidiary? | No | No | No | No | Yes | Yes |
| Is there a general anti-avoidance rule? | Yes | Yes | Yes | Yes | No | Yes |
| Are there CFC rules? | No | Yes | Yes | No | Yes | No |
| Are there thin capitalisation rules? | No | Yes | Yes | No | Yes | No |
| Is there an IP patent box regime? | No | Yes | No | No | No | No |
| Are the EU tax concessions available to residents? | No | Yes | No | No | No | Yes |
| Is the jurisdiction a member of the G20? | No | Yes | Yes | No (China is) | Yes | No |
| Is the jurisdiction a member of the OECD? | No | Yes | Yes | No | Yes | Yes |

¹ It is proposed that the corporate tax rate be reduced to 19% with effect from 1 April 2017, and 18% from 1 April 2020 onwards.

² State income taxes typically increase this rate to in excess of 40%.

³ On most types of income.

⁴ Enhanced capital allowances, R&D tax credits and annual investment allowance are generally available to UK companies. There are no tax holidays/incentives that provide for a reduced tax rate.

⁵ Tax incentives in the form of R&D tax concessions, payroll tax and other state tax concessions and accelerated depreciation of plant and equipment are available, but a lower tax rate is generally not available.

⁶ Tax concessions relating to financial services (e.g. gains from qualified debt instruments and offshore funds), enhanced capital allowances and deductions on R&D and IP-related expenditure are available.

⁷ US offers a wide range of tax credits at the federal, state and local level (e.g. R&D credits, energy efficiency credits, etc.). There are no tax holidays in the US but certain state and local governments do provide for lower state and local tax rates to reduce the overall tax burden on US corporations.

⁸ R&D tax credits and deductions for capital expenditure related to acquisition of qualifying IP assets. Corporate tax holidays are given to certain start-ups commencing trade between 2009 and 2015. A favourable tax regime known as "Section 110" companies provides an investment platform with access to Ireland's treaty network and with appropriate structuring, companies can attain an effective tax rate of close to 0%.

⁹ Unless the dividend is franked, in which case the dividend withholding tax is nil.

¹⁰ Malaysia tax-resident companies are exempted from dividend withholding tax.

b. Comparison of Singapore's tax regime with that of neighbouring countries

| | Singapore | Malaysia | Indonesia | Thailand |
|---|-----------|-------------------|-------------------|-------------------|
| Headline corporate tax rate | 17% | 25% ¹¹ | 25% | 20% |
| Are tax incentives available? | Yes | Yes ¹² | Yes ¹³ | Yes ¹⁴ |
| Are foreign non-portfolio dividends exempt? | Yes | Yes | Yes | Yes |
| Is there a dividend withholding tax? | No | No | Yes | Yes |
| Does the jurisdiction have an extensive treaty network? | Yes | Yes | Yes | Yes |
| Is there generally capital gains tax on the disposal of shares in an active foreign subsidiary? | No | No ¹⁵ | Yes | Yes |
| Is there a general anti-avoidance rule? | Yes | Yes | Yes | Yes |
| Are there CFC rules? | No | No | Yes | No |
| Are there thin capitalisation rules? | No | Yes | Yes | No |
| Is there an IP patent box regime? | No | No | No | No |
| Are the EU tax concessions available to residents? | No | No | No | No |
| Is the jurisdiction a member of the G20? | No | No | Yes | No |
| Is the jurisdiction a member of the OECD? | No | No | No | No |

¹¹ To be reduced to 24% with effect from YA2016.

¹² On top of R&D tax credits and enhanced capital allowances, there is a wide range of tax incentives that closely mirror Singapore's incentive offerings (e.g. Pioneer incentive, Regional Headquarters and International Headquarters incentives). Tax holidays are available in certain special economic regions such as Iskandar Malaysia, which provides income tax exemption on certain streams of income earned by companies operating within the Iskandar Malaysia economic zone.

¹³ Tax holidays are granted to companies in pioneer industries (e.g. oil refining and renewable energy), subject to specific qualifying conditions. Foreign investors investing in high priority economic sectors are afforded specific tax reliefs such as accelerated depreciation/amortisation of capital assets and reduced withholding tax on dividends paid to non-residents.

¹⁴ Tax credits are given for expenditure incurred on R&D and staff training. There are several tax incentives which provides for tax exemption/reduction in corporate tax rates for a stipulated period of time. Examples of such incentives include the Board of Investment incentive; Investment Promotion Zone incentive, Regional Headquarters, International Headquarters and International Trade Centre incentives.

¹⁵ To the extent foreign subsidiary is not considered a Real Property Company under Malaysia Tax Law.

APPENDIX 4: Measures to enhance cross-border dispute resolution

The hallmarks of a successful APA/MAP program lies in the tax treaty network. Singapore has historically had one of the most extensive treaty networks in the Asia Pacific region with 76 comprehensive tax treaties in force. It has tax treaties with most of its major trading partners.

The IRAS has also been active in negotiating new treaties with new trading partners in Africa and Latin America. Most recently in Financial Year 2014/2015, the IRAS signed three new tax treaties and updated the terms of another three treaties.¹

From an international perspective, IRAS should continue building on this strong foundation to further expand Singapore's tax treaty network where feasible. This was discussed in section IV of the report.

a. Enhancing the APA processes

Multinationals may restructure for various operational reasons, such as to target growth in new markets, take advantage of newly opened labour markets, achieve operational efficiency from streamlining activities to optimise headcount, achieve labour arbitrage, centralise key entrepreneurial functions for efficiency (e.g. management "control towers", IP hubs).

As tax authorities and corporations around the world become increasingly sophisticated, such restructuring may attract scrutiny and tax uncertainty, particularly in the present global fiscal environment.

As discussed in earlier sections, Singapore has positioned itself with some success as a headquarters and business hub location for Asia Pacific and beyond. Such high-value functions tend to attract a higher return, and a multinational that restructures its operations to allow that higher rate of return to the Singapore entity may be viewed with suspicion and scepticism by the tax authorities in other jurisdictions in which the group carries out its operations.

Most multinationals in Singapore value tax certainty. They are fully aware of the potential implications that the OECD's BEPS initiative may have on their structures and indeed are keen to ensure that the transfer pricing policies they implement are or will be considered acceptable by the local tax authorities. Further, we note that the transfer pricing-specific initiatives under BEPS emphasise consideration of all parties to a related party arrangement. For example, Working Party 6 (WP6) has considered methodologies such as the profit split and valuation based methods (over methods such as the transactional net margin method), which cannot be implemented in isolation without considering returns to the counterparty(s).

Hence, the importance of APAs.

(i) Expected increase in volume of tax disputes

The number of cross-border tax disputes globally is expected to intensify. More than ever, taxpayers will be increasingly pressured to obtain timely resolution of their tax disputes or potential tax disputes. While the IRAS has a strong and dedicated team working on APA and MAP cases, in anticipation of the expected increase in demand for competent authority assistance in resolving tax disputes, it may need to consider further strengthening its APA/MAP team to cope with the increased volume of tax disputes in the future. In addition, it is important that the IRAS continue to actively support taxpayers in resolving cross-border double taxation issues that have arisen. The IRAS should continue to focus on the spirit embedded in the MAP article of a tax treaty, which is to endeavour to eliminate double taxation that has arisen, and show greater flexibility in doing so to assist taxpayers in this regard. This should apply to any situation where a taxpayer has been inappropriately subject to double taxation of income by the tax authority of the other jurisdiction.

¹ IRAS Annual Report FY 2014/2015

(ii) Processes and timelines

The IRAS's guidelines on the APA process and the timelines it expects taxpayers to comply with have been formally documented since 2008 and clarified in the second edition to the Transfer Pricing Guidelines issued on 6 January 2015. While the process is well documented, there is a general view that the APA application timelines around the timings for pre-filing meetings and the submission of the APA application is rather lengthy.

Based on the APA guidelines, taxpayers will need to submit the APA application package at least six months before the start date of the APA. Prior to this, a pre-filing meeting should be anticipated at least three months earlier (where pre-filing materials should be submitted approximately a month prior to the pre-filing meeting). In other words, the preparations for the APA filing in Singapore (excluding any Group internal analysis and preparations to plan for the transaction/arrangement) should take place more than nine months before the start date of the APA.

In general, such timeline is increasingly impractical in the current fast-paced business environment. It is often challenging if not unfeasible for companies wanting to have upfront certainty on their transactions/arrangements to practically align their decision making processes with the timeline indicated by the IRAS. At times, the transactions or arrangements are only determined nearer to the commencement of the APA period desired by the taxpayer and if so, it is not feasible for the taxpayer to comply with the timelines. In addition, taxpayers also value the input of IRAS (and other tax authorities) as part of their tax planning and risk management processes prior to entering into material transactions/arrangements. Accordingly, a shortened timeline would facilitate internal tax planning and risk management processes as well as compliance with the filing timelines.

Where timelines for APAs are misaligned with other jurisdictions, this has often posed significant difficulties to taxpayers seeking to meet varying timeline requirements. For example, a corporate group which wishes to apply for a bilateral APA between Singapore and Korea for a five-year period commencing 1 January 2017 is only required to file the APA application with the Korean Competent Authority by 31 December 2017 and often it is unable to engage the Korean Competent Authority earlier than 2017. However, local rules require the taxpayer to have a pre-filing meeting by March 2016 and to file the APA application by June 2016, almost one and a half years ahead of the timeline for the corresponding filing of application in Korea. In this case, both competent authorities can at the earliest only commence discussion shortly after 31 December 2017. Instead information provided closest to the APA period will represent the most up to date information.

Harmonizing the APA filing timelines with more countries in such a case will not only allow the taxpayer to engage both competent authorities around the same time and to meet their respective timelines, but also help minimise the burden on the taxpayer in managing the information flows between both competent authorities.

b. Flexibility – unilateral vs bilateral APAs

Both unilateral as well as bilateral APAs are accepted in Singapore's APA program. Both APA applications follow a similar process. While the speed of obtaining bilateral APAs is, to a large extent dictated by the interactions of two competent authorities and may therefore not be within the control of the IRAS, the same cannot be said in the case of unilateral APA cases. It would be useful to have a more transparent and streamlined approach in working with taxpayers to speed up the progress of unilateral APA cases.

For example, agreeing on an indicative APA step plan with the taxpayer for unilateral APA cases.

This should set out the expectations of taxpayers and the commitments required of them; it should give taxpayers greater visibility over the post-filing process and timelines. Taxpayers would then have a clear roadmap on how to ensure timely resolution of APAs, which would afford taxpayers the opportunity to better manage the process and the associated tax risks of the proposed transaction/arrangement.

This will help to reinforce Singapore's commitment to the APA process as it will help to eradicate potential uncertainties by setting out a timeline for the progress and conclusion of the APA if both parties were to meet their respective commitments.

The APA step plan may be agreed on a case-by-case basis with taxpayers depending on specific facts and circumstances, and provide indicative timelines and communication protocols between the taxpayers and the IRAS following the APA application submission. However, for this to be effective, the step plan must incorporate reasonable timelines which should be equally applicable to both parties. The IRAS should consider setting clear, reasonable milestones of when it will get back to the taxpayer with requests for additional information, and when it will reach resolution of the APA upon receipt of the information requested.



APPENDIX 5: An overview of territorial vs worldwide basis of taxation

Generally, countries around the world adopt either “Territorial basis of taxation” or “Worldwide basis of taxation”. Under worldwide basis of tax system, all income earned by a resident is taxed in its home country regardless of where it is earned. In contrast, under a territorial basis of tax system, foreign sourced income earned by a resident is not taxable in its home country.

Singapore follows a quasi-territorial basis of taxation whereby only income earned in or derived from Singapore is taxed in Singapore. Income earned from sources outside Singapore is not subject to Singapore tax till such time that the income is received in Singapore. Subject to satisfaction of prescribed conditions, certain foreign sourced income is not subject to Singapore tax even if they are remitted to Singapore.

It is pertinent to note that many of the OECD member countries have adopted the territorial basis of taxation that, subject to certain conditions, exempts 95% to 100% of qualifying dividends received from foreign affiliates. Some of these countries limit territorial exemption to affiliates resident in countries with which they have a treaty relationship or that have robust income tax systems.

Interestingly, two OECD member countries (Finland and New Zealand) which switched from a territorial to worldwide system of taxation subsequently reinstated their territorial basis of taxation. Six OECD member countries that currently have a worldwide tax system (US being one of them) have been using such a system since the Second World War. Today many

of the world’s largest non-US multinationals are headquartered in countries that adopt a territorial basis of taxation. This is because countries with worldwide tax system suffer from certain drawbacks, such as:

- It encourages companies to park income overseas in foreign subsidiaries rather than remitting it back to the home country where it would be subject to tax;
- It increases overall compliance costs. This is because worldwide tax systems have complex rules which result in companies investing heavily in tax preparation services instead of directing these resources elsewhere; and
- Worldwide tax system acts as a deterrent for global businesses to be headquartered in such jurisdictions.

A territorial tax system, on the other hand, increases international competitiveness, allows countries to plough back overseas income, lowers compliance costs and makes it more likely that global businesses are headquartered in such countries.

Singapore’s quasi-territorial system of taxation has helped Singapore in terms of being considered a preferred business jurisdiction for new companies, increase in foreign direct investment inflows and surge in the number of companies using Singapore as global headquarters or headquarters for Asia Pacific operations.

APPENDIX 6: A brief consideration of certain tax features of developed countries

Keeping in view the global BEPS initiatives, Singapore should carefully consider whether there is a need to tweak its tax system to avoid being blamed for abetting double non taxation of income. Some of the typical tax features which some developed countries typically adopt, and their practical implications in the Singaporean context are discussed below:

- *Dividend withholding tax* – Singapore adopts the one-tier corporate taxation system under which profits are taxed at the corporate level and this is a final tax. Singapore dividends are tax exempt. This system was introduced to simplify the tax code, reduce the cost of compliance and administration for companies and to remove restrictions on the distribution of dividends from capital gains. It also allows unlimited flow-through of exempt dividends to all tiers of shareholders, regardless of shareholding level.¹ A dividend withholding tax is therefore inconsistent with the principles of the one-tier tax system.
- *CFC rules* – CFC rules are typically imposed by countries which tax the worldwide income of their residents, but which allow for tax deferral of foreign income where it is legitimately reinvested overseas. The rules in these instances operate to disallow the tax deferral when the income is “parked” in a related entity which typically does not have substantive business operations. CFC rules therefore are inconsistent with Singapore’s territorial basis of taxation as foreign-sourced income does not come within Singapore’s tax net unless it is received in Singapore. Further, it should be noted that many of Singapore’s tax treaties contain a “limitation of benefits” clause which allows treaty benefits on passive income in the payer’s jurisdiction only to the extent that the income that is remitted to and taxed in Singapore. Hence to claim treaty benefit for such income, there is a need to remit the income to Singapore anyway. The risk of taking treaty benefits for passive income without corresponding taxation in the resident state is thus already addressed.
- *Thin capitalisation rules* – Thin capitalisation rules generally operate to deny excessive tax deductions to subsidiaries which are under-capitalised. In Singapore, interest is deductible only to the extent it is incurred in the production of taxable income. While there is a standard interest allocation formula which may be applied to most businesses to determine the amount of deductible and non-deductible interest, it should be recognised that the basis of determining the amount of deductible interest expense (and hence conversely the non-deductible interest) is fact-dependent and hence sometimes subject to dispute. Replacing this with thin capitalisation rules may provide greater certainty for taxpayers. It would also remove the in-built disincentive to borrow for capital investment. That being said, it is questionable whether such a move is necessary since there is already an inherent integrity measure built into the current regime – interest is deductible to the extent it is incurred in generating taxable income. The same interest is taxable to a domestic lender or subject to withholding tax if paid to a non-resident lender.

¹ MOF website, <http://www.mof.gov.sg/MOF-For/Businesses/One-Tier-System>

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