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Re: Budget 2022 and GST as an Indispensable Prong in the Taxation Trident

The Budget Debate which commenced on 28 February 2022 followed the Budget Statement delivered by the Minister for Finance on 18 February 2022. We highlight some of the key taxation principles of the taxation policy administered by the Ministry with focus on Goods and Service Tax ("GST") which was a significant topic of the Budget 2022 debate.

The Taxation Trident

The taxation trident comprises tax on income, assets and consumption. Broadly, income tax refers to corporate and personal taxes. Asset tax includes property tax, stamp duties and additional registration fees for motor vehicles. Consumption tax refers to goods and services tax. This trident of taxation ensures that Singapore's revenue base is both diversified and sustainable while adhering to the principles of fairness and progressivity.

Income Tax - Corporate Taxes

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting ("BEPS") has agreed a two-pillar solution to address the tax challenges arising from the digitalization of the economy.

KEY ELEMENTS OF THE TWO-PILLAR SOLUTION

Pillar One	Pillar Two
Taxing rights over 25% of the residual profit of the largest and most profitable MNEs would be re-allocated to the jurisdictions where the customers and users of those MNEs are located	GloBE rules provide a global minimum tax of 15% on all MNEs with annual revenue over 750 million euros
Tax certainty through mandatory and binding dispute resolution, with an elective regime to accommodate certain low-capacity countries	Requirement for all jurisdictions that apply a nominal corporate income tax rate below 9% to interest, royalties and a defined set of other payments to implement the "Subject to Tax Rule" into their bilateral treaties with developing Inclusive Framework members when requested to, so that their tax treaties cannot be abused.
Removal and standstill of Digital Services Taxes and other relevant, similar measures	Carve-out to accommodate tax incentives for substantial business activities
The establishment of a simplified and streamlined approach to the application of the arm's length principle in specific circumstances, with a particular focus on the needs of low capacity countries.	

Source: OECD 2021 Two-Pillar solution to address the tax challenges arising from the digitalization of the economy

International discussions are in progress on the reallocation formula for Pillar 1. In-scope companies are the multinational enterprises ("MNEs") with global turnover above 20 billion euros and profitability above 10% (i.e., profit before tax). Accordingly, the number of in-scope MNEs affected is expected to be small but these will be the largest and most profitable MNEs. From the Singapore tax collection standpoint any reallocation of profits away from Singapore from such an MNE may not be inconsequential.

The Pillar Two Model Rules (also referred to as the “Global Anti-Base Erosion” or “GloBE” Rules), was released on 20 December 2021. The GloBE rules are not mandatory and jurisdictions are not required to adopt the GloBE rules. Jurisdictions that choose to do so, agree to implement and administer them in a way that is consistent with the agreed outcomes set out under those rules. Even if a jurisdiction does not implement the rules, that jurisdiction accepts the application of the GloBE rules by another in respect of MNEs operating in its jurisdiction. The GloBE rules will apply to MNEs that have consolidated revenues of EUR 750 million in at least two out of the last four years.

Pillar Two places a limit to tax competition on corporate income tax through the introduction of a global minimum corporate tax at a rate of 15%. Tax incentives provided to promote substantial economic activity may be excepted (a carve-out). A carve-out allows countries to continue to offer tax incentives to promote business activity with real substance, like building a hotel or investing in a factory. The GloBE rules will provide for a formulaic substance carve-out that will exclude an amount of income that is 5% of the carrying value of tangible assets and payroll. The GloBE rules will also provide for a de minimis exclusion for those jurisdictions where the MNE has revenues of less than EUR 10 million and profits of less than EUR 1 million. The GloBE rules also provide for an exclusion for international shipping income. Pillar Two additionally, protects the right of developing countries to tax certain base-eroding payments (like interest and royalties) when they are taxed below the rate of 9%, through a “Subject to tax rule” (“STTR”). The STTR prevents companies from avoiding tax on their profit earned in developing countries by making deductible payments such as interest or royalties that benefit from reduced withholding tax rates under tax treaties and which are not taxed (or taxed at a low rate) under the tax laws in the treaty partner jurisdiction.

BEPS Pillars 1 and 2 represent a fundamental change in the competitive environment for countries like Singapore with limitations in land and labour. Companies will recalibrate their existing and new investments. Governments will seek to compete via non-tax investment incentives in place of neutralized tax incentives e.g., from greater investments in human capital to building new infrastructure and incentivising R&D, as in the case of Singapore. While the tax revenue outcome arising from the implementation of Pillars 1 and 2 remains uncertain at this time, additional tax revenue arising therefrom (if any), will need to be reinvested in ensuring Singapore remains competitive and continues to attract its fair share of investments to generate employment.

Income Tax – Personal Taxes

There is a limit to how much personal income tax (“PIT”) rates for the top income brackets, may be raised without impacting the PIT rates for income brackets below it. Retaining GST at 7%, while raising equivalent tax revenue, would require that the top marginal rate increase from 22% to 42% (applicable to chargeable income of $320,000 or more) and assumes that the tax base remains unchanged.

Currently, the top 10% of taxpayers who pay PIT, account for about 80% of Singapore's total PIT revenue. With the top marginal PIT rate at 24% (up from 22%), Singapore will be higher than the 17% top rate of Hong Kong, and closer to the Asian average top marginal PIT rate of 28%. A steep increase beyond 24% will substantially erode Singapore's competitiveness resulting in loss of Investments and jobs. Consequently, to raise the same amount as a GST increase through higher PIT, would require PIT rate increases for a broader group of income earners, including the middle and upper-middle income earners.

Wealth Tax

The proposed changes in Budget 2022 as regards wealth tax will result in a significant increase in property taxes as the regime has been structured to achieve a highly progressive outcome. Expectations are that the change will raise $380 million more per year from a base of only 7% of all owner-occupied residential properties, and all non-owner-occupied residential properties.

For owner-occupied residential properties, the property tax rates for the portion of Annual Value in excess of $30,000, would increase from the progressive rates of 4% to 16%, to 6% to 32%. This increase will impact the top 7% of owner-occupied residential properties and therefore, does not affect all owner-occupied HDB flats. Two-thirds of private residential properties, like condominiums in the suburban areas and lower-value landed properties, are also not affected. The remaining one-third of private residential properties which will bear the increased property tax burden are higher-end condominiums, as well as most landed properties.

The property tax rates for non-owner-occupied residential properties will increase from the progressive rates of 10% - 20%, to 12% - 36%. Non-owner-occupied residential properties will be subject to higher property taxes as these properties include second homes and those held for investment. The increases are also more significant for the higher-end non-owner-occupied residential properties.

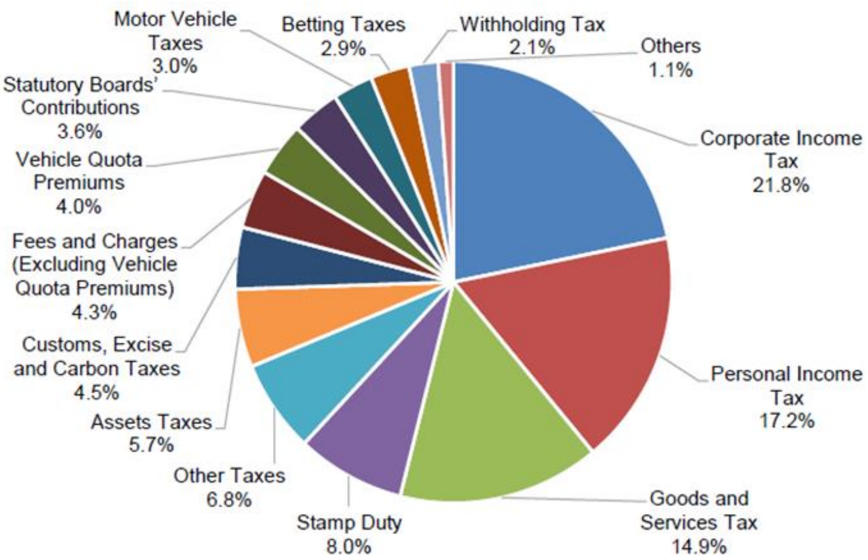
To eliminate the need for a GST-rate increase, all non-owner-occupied residential properties will have to be taxed at a significantly higher rate. Taxing all non-owner-occupied residential properties at a flat 36% may not be adequate. As the number of non-owner-occupied residential properties is considerably less than that of owner-occupied residential properties. there will be a need to raise property tax rates significantly for owner-occupied residential properties including for HDB flats.

Goods and Services Tax ("GST")

As it currently stands, GST is the 3rd largest tax revenue behind corporate and personal taxes (please see chart below). There are clearly limitations in terms of increasing corporate, personal and wealth taxes. Apart from infrastructure spending, continued investment in human capital, healthcare spending will be the main driver of the increase in social spending, owing to Singapore's rapidly ageing population. Budget 2022 introduced the Jobs and Business Support Package to help businesses and workers, as well as the Household Support Package to help households with their daily needs to shelter the continued economic fallout of the Covid 19 pandemic. GST will therefore, be an indispensable prong in the taxation trident.

The tensions in Eastern Europe culminating with Russia's invasion of Ukraine will impact the global economy and global energy markets, which in turn engenders risks in terms of economic growth and inflation in Singapore. Consequently, the GST increase has been delayed to 2023 and staggered over two stages. The first increase will take place on 1 January 2023, from 7% to 8%, and the second increase on 1 January 2024 from 8% to 9%.

Chart 1.1: Breakdown of Government Operating Revenue in FY2021[1]



[1]The Government's Overall Revenue comprises the Government's Operating Revenue and Net Investment Returns Contribution (NIRC). The Government's Operating Revenue, which includes tax and non-tax revenues (shown above) contributes to 79.8% of the Government's Overall Revenue in FY2021. NIRC, which is itemised in Section 1.5, contributes to the remaining 20.2% of Overall Revenue in FY2021.

Source: Analysis of Revenue and Expenditure - Financial Year 2022 Ministry of Finance 18 February 2022

GST Overview (2020 – 2023)

<u>GST Rate Change and the Transitional Rules</u>

When the GST rate is increased from 7% to 8% with effect from 1 January 2023, transitional rules will be applicable to transactions straddling the rate change. The transitional rules will impact the time of supply rules, the GST rates chargeable and the issuing of invoices, credit notes and other requirements. The same transitional rules will apply to transactions spanning the second change in GST rate when it is increased from 8% to 9% with effect from 1 January 2024.

In general, the time of supply rules determine when a supply is treated as taking place for GST purposes and therefore, when the liability to account for output tax arises. For most transactions, including imported services under the Overseas Vendor Registration ('OVR') regime, the time of supply will be the earlier of when an invoice is issued or when a payment is received. The GST rate chargeable on the supply will be the prevailing rate at the time of supply. For instance, if a supplier issues an invoice or receives payment for a supply before 1 January 2023, the supplier should charge GST at 7%. Conversely, if a supplier issues an invoice and receives the payment for a supply on or after 1 January 2023, the supplier should charge GST at 8%, unless the said supplier has elected to charge GST at 7% under the transitional rules for rate change where permissible. Please refer to the Annex for a more detailed elaboration.

GST Changes and Updates

Determining the supply of media sales for GST purposes

From January 1, 2022, the basis for determining whether zero-rating applies to a supply of media sales will be based on the place where the contractual customer and direct beneficiary of the service belong. A zero rate will apply if the service directly benefits either an overseas person or a GST-registered person in Singapore. The standard rate of GST will apply where there is a supply of media sales under a contract agreed with a local customer.

The anti-tax avoidance regime in 2020 – 2021

Section 47 of the GST Act confers powers to the Inland Revenue Authority of Singapore ("IRAS") to counteract GST avoidance arrangements. With effect from 1 January 2021, Section 47A empowers the IRAS to levy a surcharge equal to 50% of the amount of additional tax imposed on the taxpayer pursuant to Section 47 of the GST Act.

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ANNEX

<u>Change in GST Rates and the Transitional Rules</u>

Transitional rules apply to supplies during a change of GST rate, as supplies need to be accounted for at the new GST rate. A supply straddles the change of GST rate when the following events occur wholly or partially on or after 1 January 2023:

- the issuance of invoice;
- the receipt of payment (or the making of payment in respect of a reverse charge supply);
- the delivery of goods or performance of services.

The following are examples which are not exhaustive:

1. Tax invoice is issued for a supply on or after 1 January 2023 and full payment is received before 1 January 2023. The supply is subject to 7% GST.

2. Tax invoice is issued for a supply on or after 1 January 2023, full payment is not received before 1 January 2023 and a part or all of the goods or services have been delivered or performed before 1 January 2023. The supplier can elect to charge 7% GST on the higher of:

- the payment received before 1 January 2023; or
- the value of goods delivered or services performed before 1 January 2023.

The remaining value of the supply is subject to GST at 8%.

3. Tax invoice is issued before 1 January 2023, full payment is received before 1 January 2023, or if all the goods have been delivered or all the services performed before 1 January 2023, the entire value of the supply is subject to 7% GST.

In all other scenarios (see 4 & 5 below), 8% GST will apply on the lower of:

- the payment received on or after 1 January 2023; or
- the value of goods delivered or services performed on or after 1 January 2023.

4. Tax invoice is issued before 1 January 2023 for a supply of services (value of $1,000) and full payment is received on 4 January 2023. Part of the services (value of $400) has been performed before 1 January 2023 and the remaining part of the services (value of $600) after 1 January 2023. Under the transitional rules, 8% GST is to be charged on $600 of the supply (being the lower of the value of the payment received ($1,000) or services performed ($600) on or after the rate change date).

5. Tax invoice is issued before 1 January 2023 for a supply of services (value of $1,000). Before 1 January 2023, payment of $400 is received and part of the services has been performed (value of $200). After 1 January 2023, the remaining payment of $600 is received and the remaining part of the services performed (value of $800). Under the transitional rules, 8% GST is to be charged on $600 of the supply (being the lower of the value of the payment received ($600) or services performed ($800) on or after the rate change date).

The Overseas Vendor Registration (‘OVR’) Regime and the Transitional Rules

From 1 Jan 2020, a supplier belonging outside Singapore is required to register for GST in Singapore if it:

- has an annual global turnover exceeding $1 million; and
- makes B2C supplies of digital services to customers in Singapore exceeding $100,000.

Once registered for GST, it is required to charge and account for GST on B2C supplies of digital services made to customers in Singapore. B2C stands for business-to-consumer, and refers to transactions made by a GST-registered person, to a non-GST registered customer.

From 1 Jan 2020, under certain conditions, a local or an overseas operator of an electronic marketplace, may be regarded as the supplier of the digital services made by the overseas suppliers through its marketplace. It is required to include the value of these services to determine its GST registration liability. If it is liable for GST registration or is GST-registered, it is required to charge and account for GST on B2C supplies of digital services made through its marketplace to customers in Singapore on behalf of the overseas suppliers, in addition to digital services made by it directly to customers in Singapore.

Under the OVR regime, as supplies of digital services to consumers (i.e., individuals and non-GST registered businesses) are subject to GST, a GST-registered overseas service provider will have to determine if a customer is GST-registered to charge GST correctly. A GST-registered business purchasing digital services from a GST-registered overseas service provider under the OVR regime, will need to provide its GST registration number to the provider so that GST will not be charged on business purchases of digital services.

To minimize the compliance burden, the overseas suppliers and overseas electronic marketplace operators would be registered under a pay only regime, with simplified registration and reporting requirements. The current penalty regime that applies to local taxable persons will similarly apply to the overseas suppliers and electronic marketplace operators.

From 1 January 2023, GST will be extended to B2C imported non-digital services, through the OVR regime. Consequently, all B2C supplies of imported remote services, whether digital or non-digital, will be taxed by way of the extended overseas vendor registration regime. Remote services refer to any services where, at the time of the performance of the service, there is no necessary connection between the physical location of the recipient and the place of physical performance. A supplier of remote services who belongs outside Singapore, will be required to register for GST in Singapore if it:

- has an annual global turnover exceeding $1 million; and
- makes B2C supplies of remote services to customers in Singapore exceeding $100,000.

Once registered for GST, it is required to charge and account for GST on B2C supplies of remote services made to customers in Singapore.

A supplier of the remote services made by the overseas suppliers through its marketplace, is required to include the value of these remote services to determine its GST registration liability. If it is liable for GST registration or is GST-registered, it is required to charge and account for GST on B2C supplies of remote services made through its marketplace to customers in Singapore on behalf of the overseas suppliers, in addition to remote services made by it directly to customers in Singapore. If it also supplies low-value goods whether directly or on behalf of suppliers via its electronic marketplace, it will be required to aggregate the value of the B2C supplies of remote services and low-value goods to determine its GST registration liability. Once it is liable for GST registration or is GST registered, it is required to charge and account for GST on both B2C supplies of remote services and low-value goods, to customers in Singapore.

Low-value goods are goods which at the point of sale ('point of sale' being a reference to the time at which an order confirmation is issued by the OVR vendor or such other time as agreed with the Comptroller):

- are not dutiable goods, or are dutiable goods, but payment of the customs duty or excise duty chargeable on the goods is waived under section 11 of the Customs Act;
- are not exempt from GST;
- are located outside Singapore and are to be delivered to Singapore via air or post ('Singapore' refers to customs territory); and
- have a value not exceeding the GST import relief threshold of S$400.

The GST rate change transitional rules examples in (1) to (5) above will be applicable to the OVR regime.

<u>The Reverse Charge ('RC') Business and the Transitional Rules</u>

From 1 Jan 2020 a GST-registered business which is a partially exempt business that is not entitled to full input tax credit, or a GST-registered charity or voluntary welfare organization that receives non-business receipts, is required to account for GST on all services that it procures from overseas suppliers ("imported services") as if it is the supplier, except for certain services which are specifically excluded from the scope of reverse charge. It is correspondingly, entitled to claim the GST as its input tax, subject to the normal input tax recovery rules. From 1 Jan 2023, a GST-registered business who is subject to reverse charge ("RC business") is required to implement a reverse charge on low-value goods. In the circumstances where RC is applicable, the requirement will extend to all low-value goods including low-value goods purchased from local and overseas suppliers, electronic

marketplace operators and re-deliverers, regardless of whether they are GST-registered. Correspondingly, the GST-registered business applying the reverse charge, is entitled to claim the corresponding GST as its input tax, subject to the normal input tax recovery rules.

From 1 Jan 2020 in relation to a non-GST registered business, if the total value of its imported services for a 12-month period exceeds S$1 million and it would not be entitled to full input tax credit even if it were GST-registered, it would be liable for GST-registration. Once registered for GST, it would be required to account for GST on both its taxable supplies and imported services which are subject to reverse charge.

From 1 Jan 2023, if the total value of a non-GST registered business' imported services and low-value goods for a 12-month period exceed S$1 million, and it would not be entitled to full input tax credit even if it were GST-registered, it would be liable for GST-registration.

The GST rate change transitional rules would be applicable to the RC regime.

The following are examples which are not exhaustive:

1. The supplier's invoice is issued for a supply on or after 1 January 2023 and full payment is made before 1 January 2023. The supply is subject to RC at 7% GST.

2. The supplier's invoice is issued for a supply on or after 1 January 2023, full payment is not made before 1 January 2023 and a part or all of the services have been performed before 1 January 2023. The recipient can elect to charge 7% GST on the higher of:

- the payment made before 1 January 2023; or
- the value of the services performed before 1 January 2023.

The remaining value of the supply is subject to GST at 8%.

3. The supplier's invoice is issued before 1 January 2023, full payment is made before 1 January 2023, or if all the services have been performed before 1 January 2023, the entire value of the supply is subject to RC at 7% GST.

In all other scenarios (see 4 and 5 below), 8% GST will apply on the lower of:

- the payment made on or after 1 January 2023; or
- the value of the services performed on or after 1 January 2023.

4. The supplier's invoice is issued before 1 January 2023 for a supply of services (value of $1,000) and full payment is made on 4 January 2023. Part of the services (value of $200) has been performed before 1 January 2023 and the remaining part of the services (value of $800) after 1 January 2023. Under the transitional rules, RC at 8% GST is to be charged on $800 of the supply (being the lower of the value of the payment made ($1,000) or services performed ($800) on or after the rate change date). RC at 7% GST is applicable to the remaining value of the supply.

5. The supplier's invoice is issued before 1 January 2023 for a supply of services (value of $1,000). Before 1 January 2023, payment of $600 is made and part of the services has been performed (value of $200). After 1 January 2023, the remaining payment of $400 is made and the remaining part of the services performed (value of $800). Under the transitional rules, RC at 8% GST is to be charged on $400 of the supply (being the lower of the value of the payment made ($400) or services performed ($800) on or after the rate change date). RC at 7% GST is applicable to the remaining value of the supply.

6. If the recipient has been accounting for GST on its RC transactions based on the earlier of posting date or date of payment made, the transitional rules for rate change will take into account the posting date instead of the invoice date.

Other GST Changes and Updates

Determining the supply of media sales for GST purposes

Prior to 1 January 2022, the basis for determining whether zero-rating tax treatment applies to a supply of media sales depended upon the place of circulation of the advertisement. Media sales include advertising in newspapers, websites, TV and radio, and the sale of advertising spaces. Developments in digital technologies and the growth in online advertising, have made it increasingly difficult for suppliers of digital media sales to determine the place of circulation for GST purposes.

From January 1, 2022, the basis for determining whether zero-rating applies to a supply of media sales will be based on the place where the contractual customer and direct beneficiary of the service belong. A zero rate will apply if the service directly benefits either an overseas person or a GST-registered person in Singapore. The standard rate of GST will apply where there is a supply of media sales under a contract agreed with a local customer.

The anti-tax avoidance regime in 2020 – 2021

Section 33 of the Singapore Income Tax Act ('SITA') empowers IRAS to disregard or vary tax avoidance arrangements and make an appropriate adjustment to counteract any tax advantage obtained by the taxpayer. With effect from Year of Assessment 2023, Section 33A empowers the IRAS to levy a surcharge equal to 50% of the amount of tax or additional amount of tax imposed on a taxpayer or of the tax assessed pursuant to Section 33 of the SITA.

Similarly, Section 47 of the GST Act confers similar powers to the IRAS to counteract GST avoidance arrangements. With effect from 1 January 2021, Section 47A empowers the IRAS to levy a surcharge equal to 50% of the amount of additional tax imposed on the taxpayer pursuant to Section 47 of the GST Act.

Similar provisions have been applicable in the transfer pricing context. Section 34D of the SITA empowers IRAS to make tax adjustments to transactions not conducted at arm's length. The arm's length determination would be based on the actual commercial or financial relations between the 2 related persons and take into account both the form and substance of those relations, but disregarding the form of those relations to the extent it is inconsistent with their substance. In the event the transactions are not assessed to be arm's length, the IRAS may increase the amount of income of a person, reduce any deduction allowed to a person or reduce the amount of any tax loss to a person. Under Section 34E of the SITA, the IRAS is empowered to levy a surcharge equal to 5% of the amount of the increase or reduction as the case may be under Section 34D.

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