THE OECD/G20 INCLUSIVE FRAMEWORK ON BEPS

# An Early Snapshot of BEPS 2.0 Potential Impact and Opportunities for Singapore from the Perspective of Private Clients and Family Enterprises

August 2021

## Highlights

### Pillar One

**Objective:** To ensure fairer distribution of profits to be taxed among countries by re-allocating taxing rights over multinational companies to countries where they operate and derive profits, regardless of whether they have physical presence there.

**Potential impact:**

With the current ongoing global pandemic, we may see family enterprises increasingly expanding into other jurisdictions, to spread their risk; as well as applying digitalisation to reach out to their clients and customers, given the current travel and movement restrictions.

An impact assessment should be undertaken to understand whether operations currently cross, or could potentially cross, revenue and profitability thresholds under Pillar One and if so, start to consider and quantify the potential impact to operations in order to adequately plan for the long term.

### Pillar Two

**Objective:** To limit competition among countries over corporate income tax rates, by introducing a global minimum corporate tax rate.

**Potential impact:**

The attractiveness of Singapore as a location for establishing the family enterprise's Headquarters (HQ) may need to be balanced from a business perspective given that, tax incentives may not be as fruitful as before. However, the abundant attractive features of Singapore from a business and personal perspective should remain clear for family enterprises to see Singapore as the choice of location for HQ.

For family enterprise and business groups affected, the substance carve-out provided may prove beneficial, in particular as we see Singapore becoming more of a key player in the advance manufacturing industry and other high-tech industries, with the potential for clients to start expanding into such segments. This is especially given family enterprises' drive for success and adaptability to modern industry trends.

## Taking stock: Summarising the recent changes announced on 1 July 2021

With the digitalisation of the economy, we have seen substantial changes to the international tax landscape over the last decade which reflect the move towards greater tax transparency and increased scrutiny on economic substance.

Consistent with this, the G20 discussions reached a groundbreaking milestone when the G20/Organisation for Economic Co-operation and Development (OECD) Inclusive Framework on Base Erosion and Profit Shifting (BEPS) published a Statement on the key components of the global tax reform for the 21st century. The Statement has currently been endorsed by 132 members, including Singapore.[1]

The finer detail remains unknown, in particular how each jurisdiction will interpret and implement the proposed new changes locally. We expect further details to be announced following the next G20 meeting in October, with the changes intended to take effect from 2023.

Whilst we await further clarification, we take stock of the current position, considering the key salient points of the proposed changes. We then drill down into the potential impact for Singapore with a particular focus on private clients and family enterprises, given that these form one of the current engines of growth for Singapore.

[1] As at 9 July 2021 (See: https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf)

FOR MORE INFORMATION

**KYLIE LUO**
Executive Director
kylieluo@bdo.com.sg
T: +65 9711 3760

**WU SOO MEE**
Executive Director
soomee@bdo.com.sg
T: +65 8333 0807

**HSU CHONG HOE**
Executive Director
chonghoe@bdo.com.sg
T: +65 9363 3719

**ABNER KOH**
Executive Director
abnerkoh@bdo.com.sg
T: +65 9685 3221

**BDO TAX ADVISORY PTE LTD**
600 North Bridge Road
#23-01 Parkview Square
Singapore 188778
Tel: +65 6828 9118
Fax: +65 6828 9111

www.bdo.com.sg

There are two pillars which underpin the Statement agreed by the member jurisdictions.

We summarise each briefly below:

### i. Pillar One: Reallocation of profits of multinational enterprises

- Pillar One aims to ensure a fairer distribution of profits and taxing rights among countries. Specifically, the underlying principle is that the largest and most profitable multinational enterprises (MNEs) will be required to reallocate a share of global residual profit to jurisdictions when their operations meet prescribed turnover (global turnover above EUR 20 billion) and profitability (profitability above 10%) thresholds. The thresholds will continue to be reviewed (and may be lowered), with the first review point currently set at seven years after implementation.
- In essence, where the turnover and profitability thresholds are met, a MNE will be required to reallocate a share of its residual profit to each of the market jurisdictions where it derives at least EUR 1 million in revenue. The amount of that residual profit that will be reallocated is yet to be finalized, however the expectation of the OECD is that this will be between 20% - 30%.
- Pillar One represents a significant change and signals a move from the requirement of a physical presence in a country before that country has a right to tax, to granting the taxing right based on where the larger MNEs earn their revenues. In summary, no physical presence will be required in a country in order to create a taxable nexus.

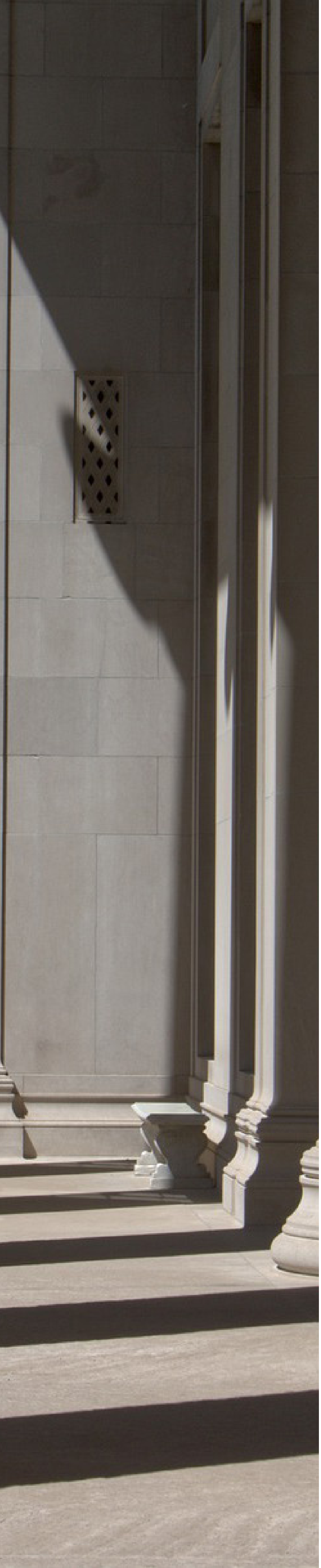
### ii. Pillar Two: An effective global minimum tax

- To summarise, and to put it very simply, the key mechanics of Pillar Two:
  a. two interlocking domestic rules (together the Global anti-Base Erosion Rules (GloBE)) rules including: (1) an Income Inclusion Rule (IIR) whereby the effective tax rate of each jurisdiction will be calculated and a top-up tax applied and charged to the HQ jurisdiction where it is less than 15%; and (2) an Undertaxed Payments Rule (UTPR) which is to be applied to the HQ jurisdiction and provides a backstop where the IIR does not apply to the HQ.
  b. a treaty-based rule (Subject to Tax Rule (STTR) which will apply to certain payments that are not subject to a minimum rate of tax in the jurisdiction of the payee.
- The STTR will apply in priority to the GloBE rules. The IIR will then apply in priority to the UTPR.
- A threshold has been proposed under the GloBE rules (see (a) above) whereby it will apply to MNEs with an annual consolidated group revenue of more than EUR 750 million – a considerably lower threshold in comparison the threshold prescribed under Pillar One.

We wait to understand further how the changes will be implemented in Singapore, in particular Pillar Two which provides greater flexibility to jurisdictions to implement the rules based on their requirements and is likely to affect more groups given the lower threshold prescribed. Initial projections however indicate that circa 1800 MNEs in Singapore will meet the revenue threshold prescribed under the GloBE rules and that the majority of these MNEs will have group effective tax rates below 15 per cent[2]. This could therefore trigger the IIR and/or UTPR in their HQ jurisdictions.

With the above new proposed changes in mind, we explore below the unique features of private clients and family enterprises in Singapore and then drill down into the potential impact of the two Pillars to our clients. Given the coverage of the developments of BEPS 2.0 in the media, it was no surprise that our regular conversations with many of our clients who own/manage family offices and family businesses, have frequently steered towards this subject matter.

[2]See: https://www.straitstimes.com/singapore/politics/global-tax-deal-will-make-it-harder-for-spore-to-attract-investments-lawrence



## Private clients and family enterprises in Singapore

Many high net worth individuals and families generate their wealth through the creation, maintenance and expansion of privately or family-owned businesses. Family enterprises have unique features and are premised on the objective of ensuring growth and preservation of the family wealth for future generations.

We are also seeing a growing number of families choosing to set up family offices as these high-net worth families transition into the next generation and are faced with a growing need to put in place proper family office structures to manage their wealth and assets, generated through their family businesses.

Singapore has seen significant growth in this industry and especially an influx of family enterprises choosing to use Singapore as their HQ. Besides holding typical investment instruments such as bonds, equities etc, some families choose to also use their family office structure to hold their operating family business entities; or to make strategic investments in other businesses.

### *What are the key features of a family enterprise?*

Family enterprises have a reputation for their adaptability and resilience and their focus on the long term to ensure that the family wealth can be preserved for future family generations. Privacy and trust are also important to family enterprises which is why typically they are managed by family members who are appointed as senior management as they can be trusted and have a vested interest to manage the family wealth appropriately.

Another key feature of family enterprises is their advantage of patience. They are able to wait and invest with a long-term perspective and only when they see an attractive investment which meets the family's values and objectives, a concept commonly referred to as "patient capital".

Thus, with a constantly changing business and taxation landscape, it is key that family enterprises keep abreast of the potential impact to their operations in order that they can continue to thrive and grow in the interests of the current and future family generations underpinning the enterprises. There is a need to monitor developments which can create permanent and fundamental changes – changes which family enterprises can take stock of, plan and adapt for before continuing with their investments.

We are already observing an increased number of our family enterprise clients reaching out to discuss the potential changes of the recent agreement. This is welcomed by us, and we encourage our clients to use this juncture to take stock and perform at least a preliminary impact assessment in order to adequately prepare. This is as we await further details from the OECD and also from Singapore in terms of local implementation which we expect to be announced as the year progresses. The below provides an early snapshot of potential implications and opportunities based on the current details that have been released.

## Drilling down into the impact to private clients and family enterprises

i. **Taxing right based on presence vs taxing right based on revenues – Pillar One**

- Given the higher revenue threshold of EUR 20 billion prescribed under Pillar One, our expectation is that only certain family enterprises, in particular those with a significant international presence may fall within scope.

- With the current ongoing global pandemic, we may see an increase in enterprises expanding into other jurisdictions in order to enter into untapped markets and to spread their risk. Another possible development in light of the ongoing pandemic is that family enterprises may start to rely and apply digitalization more commonly in order to reach out to their clients and customers in other jurisdiction markets, with the current travel and movement restrictions. We have seen family businesses in traditional brick and mortar sectors evolving to embrace digital means to survive and grow. We have also seen family businesses in traditional sectors either venturing into setting up their own tech startups; or acquiring other tech startups. This may then bring the application of Pillar One into the forefront.

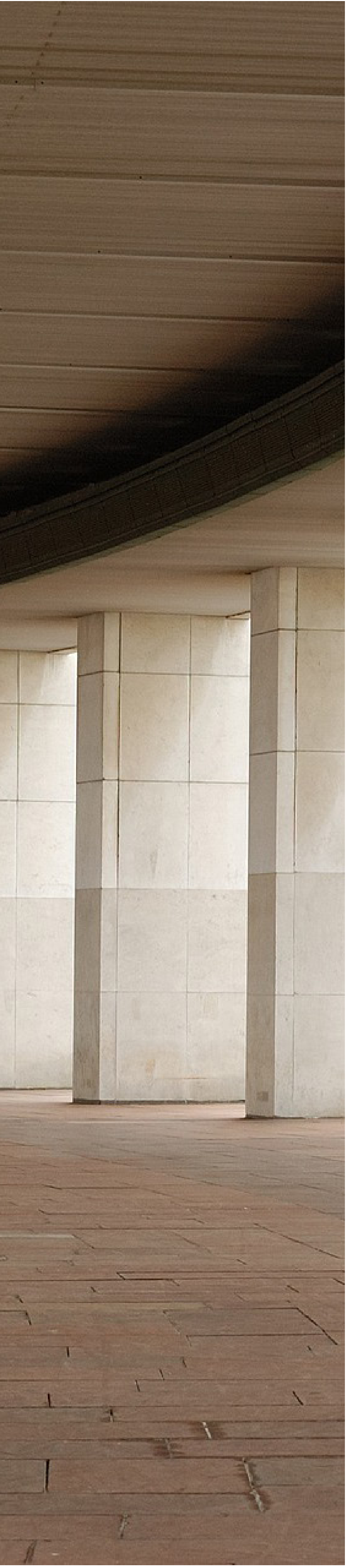
- As a starting point, we would recommend that family enterprises perform a preliminary assessment of whether they currently meet, or could potentially meet, the revenue and profitability thresholds prescribed and if so, start to consider and quantify the potential impact of Pillar One to their operations in view of the above, in order to adequately plan for the long term.

ii. **Location of headquarters – Pillar Two**

- The location of the HQ for any group is key as it is where the operations of the group will be centralised and driven from.
- Singapore has become a key location of HQs in the last decade. In particular, we have seen a rising trend of family enterprises with an international business presence setting up their global or regional HQ in Singapore and Singapore then acting as the hub from which the family manage and direct their global business activities. For family enterprises, the HQ is typically where the family will centralise and drive its business operations and also not surprisingly, where the family will choose to settle and root their entire family.
- Singapore is commonly used as a location for their HQ as it has various attractive factors.
- From a business perspective, it is known for its stable political environment, and it is well positioned as a well-established financial hub with a strong regulatory framework. It continually strives to remain a financial hub and location for groups to set up their HQ. Unique to Singapore is its attractive tax incentive framework. For example, Singapore provides qualifying HQ companies with a concessionary tax rate of 10% for up to 5 years for qualifying income arising from qualifying HQ activities and operations carried out from Singapore.
- From a more personal perspective (which is important for family enterprises), Singapore is viewed to be a safe and conducive place to live in and its robust education system, which is particularly important for young families looking to set up their family offices as well as HQ for their family enterprise in Singapore. Generally, families moving to or residing in Singapore for the personal benefits, will logically choose to structure their Family Office or HQ of their business in Singapore as well. At the forefront of the world's mind currently, with the recent COVID-19 pandemic, Singapore has been recognized globally for handling the pandemic with its careful and controlled approach in order to protect and look after its residents. This has again contributed to the increase in private clients and family enterprises setting up their HQ in Singapore.
- However, with the introduction of the global minimum tax rate of at least 15% (as introduced earlier), we consider the following fundamental questions:

  *Will Singapore continue to be an attractive location for family enterprises to set up their HQ? Will its attractive features such as its many tax incentives and relatively competitive corporate tax rate continue to be as fruitful and beneficial?*

- It is important to upfront distinguish that the rules should only apply to large taxpayers which derive revenue beyond the prescribed thresholds. However, based on the Statement, we caveat that countries are provided with the option to apply the IIR to MNEs that are headquartered in their respective country, even if the thresholds prescribed are not met.
- It currently remains unclear how Singapore will implement Pillar Two locally and whether it will be applied more widely than the current threshold permits. This will need to be closely monitored. Prima facie, we would expect that countries with higher tax rates will be more incentivized to apply the rules more broadly and countries with relatively competitive tax rates such as Singapore may not be as incentivized, given that a MNE headquartered in Singapore is likely to be holding entities and operations in jurisdictions with higher tax rates. Thus on





this basis, we may see Singapore continuing to preserve its attractiveness as a location for the HQ of a group and we may even see an increased number of family enterprises choosing to use Singapore as the location of their HQ and this will not be due to solely tax reasons. However, based on the mechanics of the rules, it is important to highlight that even if the IIR is not applied at the HQ jurisdiction (i.e. Singapore), the UTPR may still be triggered (since the UTPR is meant to be a "backstop") and additional taxes being collected in the countries where other group companies are located. As one can see, all these can result in much complexity and requires the cooperation of multiple jurisdictions. Nevertheless, this will still need to be carefully considered and is likely to require a complex assessment, as further implementation details are provided.

- Whilst we await further details, the workings behind the IIR and UTPR (and STTR) may take away some of the reasons as to why Singapore is currently a prime location for groups to set up their HQ e.g. the effectiveness of Singapore's tax incentives in attracting investments. However, we expect Singapore to continue to retain its hub status for locating HQs. In particular for private clients and family enterprises, Singapore continues to offer its many attractive features from a business and personal perspective which will continue to remain key to family enterprises, as highlighted above.

### iii. Substance "carve out" – Pillar Two

- The GloBE rules provide a formulaic substance carve-out that will exclude an amount of income that is at least 5% of the carrying value of tangible assets and payroll.

*Can family enterprises that meet the prescribed threshold benefit from the substance "carve out"?*

- In terms of payroll, family enterprises will typically employ family members and well qualified third party employees (who are usually based and tax residents in the location of the HQ) as senior management to drive their business activities. Such employees will be paid a market salary. The substance carve-out could therefore be of relevance for family enterprises (setting up HQs in Singapore) that meet the thresholds and should be considered.

- In terms of tangible assets, while it is hard to imagine large production or manufacturing facilities in land-scarce Singapore, Singapore is increasingly becoming known for the advance manufacturing industry; an industry which typically holds valuable sophisticated tangible assets and employ highly skilled staff. In the past decade, we have seen the industrial sector transformed by technology and in light of this, Singapore continues to embrace this and strive to become an industrial hub for advance manufacturing activities. We have already seen success here as leading firms across industrial sectors such as Shell and Micron have selected Singapore as a strategic manufacturing hub. Today, Singapore is the world's 4th largest global exporter of high-tech goods, with the production facilities being based in Singapore[3]. It is not only production facilities that are located in Singapore but also the HQ of such types of manufacturing companies which leads to senior management being based in Singapore who will receive market leading salaries. With the increased drive and investment of Singapore towards the advance manufacturing industry coupled with Singapore's family enterprises drive for success and adaptability to modern industry trends, we may well see clients start to expand into the segment and if so, the substance carve out may then become very relevant for these clients.

- For now, family enterprises in Singapore should bear in mind this substance carve out as the details of continue to be refined and we start to understand further how Singapore implements the new rules locally.

[3]See: https://www.edb.gov.sg/en/our-industries/advanced-manufacturing.html


## Key takeaways

The two-Pillar approach prescribed in the recent OECD/G20 Statement signals a major overhaul of the global tax system in the continued move towards a more ***stable and fairer international architecture***[4] for tax. Whilst relatively smaller in size compared to its key economic competitors, Singapore remains a global financial hub for the financial services industry and a growing hub for non-financial services such as advance manufacturing. Specifically, family enterprises continue to be attracted to Singapore and its attractiveness goes beyond its taxation rates to, for example its strategic location, its envied international connectivity, excellent infrastructure, and highly skilled workforce.

It is important that clients remain informed and resilient to changes and can easily adapt to the ever-changing tax landscape. With their focus on the long-term, family enterprises should start considering the potential impact, if any to their business operations and plan for the next step.

The insight from Singapore has been fairly limited to date, whilst we await further details from the OECD/G20. What is clear however is that Singapore will adapt and make adjustments to ensure that it keeps its competitiveness, and it will adjust its corporate tax system as needed in consultation with the relevant industries. It is imperative therefore that family enterprises consider and assess the potential impact to their business operations and engage in consultations with the local authorities.

With its strong reputation and envied features (both from a business and personal perspective), we are confident that Singapore will remain a global hub for investment, and we look forward to receiving further details of how Singapore will implement the two-Pillar approach later this year and when the OECD releases further details as well.

[4]See: https://www.g20.org/wp-content/uploads/2021/07/Communique-Third-G20-FMCBG-meeting-9-10-July-2021.pdf

**www.bdo.com.sg**

**CONNECT WITH US.**

Like us, follow us, engage us through our social media channels: