EU tax changes vs Singapore's sovereignty

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For The Straits Times

Last month the European Commission launched its Anti Tax Avoidance Package, propelled by unprecedented political support for the fight against perceived tax avoidance by multinationals.

In it the European Union stresses its full support for recent recommendations of the Organisation for Economic Cooperation and Development's (OECD) BEPS project and it seems eager to show the world it can lead the pack in effectively curbing tax avoidance.

BEPS or Base Erosion and Profit Shifting refers to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low- or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. In the light of such practices by multinational enterprises, the OECD BEPS project provides governments with solutions for modernising international tax rules.

The EU package contains a wide range of concrete measures to prevent aggressive tax planning, boost tax transparency and create a level playing field for all businesses in the EU. The package addresses topical issues, such as non-taxation of foreign income, the abuse of tax treaties and country-by-country reporting. We focus below on two measures that are of most likely interest to Singapore.

Previous EU measures were typically confined to tax practices of the EU member states or the arrangements of multinationals within the EU, but the package contains two elements that will affect EU multinationals doing business in countries outside the EU, like Singapore. Will the package also influence how countries like Singapore design their tax systems? If so, this represents a serious challenge to Singapore's sovereignty.

IMPACT ON S'PORE

One relevant element of the package is a proposal for a Tax Avoidance Directive. A rule of special interest to EU multinationals with operations outside the EU is a so-called "minimum tax rule", which would oblige EU member states to fully tax the profits that EU multinationals receive from operations in low-tax countries. The test for what is a "low tax" has been set at 40 per cent of the statutory rate of the relevant EU member state. With a statutory corporate tax rate of 17 per cent (higher than 40 per cent of the highest statutory corporate tax rate in the EU), Singapore should be outside its scope, even in respect of companies enjoying tax incentives.

Another relevant element of the package is a Communication, expressing the European Commission's aim for a common approach to third countries on tax good governance matters. According to the commission, there should be a new EU strategy to ensure the profits of EU multinationals in third countries are taxed effectively.

On fair tax competition, the Communication states that it is no longer sufficient to take into account only the EU's own Code of Conduct rules, but that the OECD BEPS recommendations must also be taken into account. This could significantly affect companies in Singapore.

The commission envisages two ways for enforcing the tax good governance rules on countries outside the EU. One is by including good governance clauses in agreements between the EU and third countries, or even regions, such as Asean. State aid provisions would become part of them, preventing countries from subsidising local companies through tax measures and making it difficult for EU companies to compete at a level playing field. If so, this would seriously challenge how Singapore uses tax incentives (as one of many reasons) to attract investments.

The second way ties in with the perceived need for stronger instruments if countries like Singapore are regarded as not respecting the EU's tax good governance standards. Presently, many EU member states have listed non-compliant countries, but they rely on different criteria and apply different counter-measures. In the commission's view, the end goal would be a common EU system for assessing, screening and listing third countries and taking counter-measures.

S'PORE NEEDS TO RESPOND

Although Singapore complies with the latest international standards on exchange of information, the Communication also refers to far-reaching EU rules on automatic exchange of tax rulings and pricing arrangements.

Furthermore, the Communication mentions the criteria for harmful tax measures under the EU's own Code of Conduct rules, and a lack of transparency is listed as one of them. As the precise conditions for Singapore's important incentive regimes are not officially published, it is vital to see how Singapore would be assessed by the commission against the EU's transparency standards.

The same uncertainties surround the notion of fair tax competition. Singapore's tax system seems EU Code of Conduct-proof, but the Communication also refers to specific EU state aid rules. These are stringent rules, which have a drastic effect on the discretion of member states in designing their tax systems. If the EU were to attempt to apply the state aid rules to Singapore's incentive regimes, there could be several practical issues. This is even though Singapore's incentives are subject to very stringent requirements around substance, commercial activity, real employment, quantitative criteria, etc. Although it is not fully clear which specific rules would apply to countries like Singapore, the commission recognises the different position of third countries (for instance, politically and economically), and it remains to be seen how this element will weigh in any external assessment of Singapore's tax system.

In our view, Singapore should not stand still but stand tall.

Singapore should defend its sovereign right to design a tax system that complies with OECD norms, that is based on substance, embraces the arm's length principle, and prevents tax avoidance. It should make the point that the EU's rules, which govern a group of member states that are uniquely integrated economically and politically, cannot easily be transposed across EU borders. EU multinationals, which have invested in Singapore and commercially benefit from real economic activities, should not be penalised for being here.

Finally, it is fair to say that the issues identified above confirm that deliberations over the design of Singapore's tax system must be very conscious of dynamic and fundamental changes happening outside Singapore.

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Both Republican candidate Donald Trump (left) and Democratic hopeful Bernie Sanders are capitalising on growing American disillusionment with globalisation in their presidential campaigns. PHOTOS: BLOOMBERG, REUTERS

The revival of American isolationism

Gideon Rachman

Why is the Middle East in flames and Russia on the rampage? In both Europe and the Middle East, it is common to hear the blame placed on Mr Barack Obama. The United States President, it is charged, is a weak and disengaged leader who has allowed international events to get out of control. Many Americans – both liberals and conservatives – make the same accusation. Mrs Sarah Palin, darling of the American right, has called Mr Obama "capitulator-in-chief". Mr Roger Cohen, a New York Times columnist, has blamed Syria's agony on the "fecklessness and purposelessness" of the Obama administration.

Those who yearn for a more muscular US foreign policy often assume that Mr Obama will prove to be an aberration and that the next president will "put America back in the game". But that could well be a misreading of the underlying direction of US politics and foreign policy. The current front runners in the presidential election campaign – Mr Donald Trump on the Republican side and Mr Bernie Sanders for the Democrats – have embraced ideas that are isolationist, in all but name. If those ideas prevail, they would make Mr Obama look like a super-engaged internationalist.

Even if Mr Trump and Mr Sanders never get close to the White House, the popularity of their campaigns – and their influence on the more mainstream candidates – suggests that there is now a strong constituency in the US for a retreat from globalism: Repudiating international military and economic commitments.

The inherent isolationism in Mr Trump's thinking can be disguised by his chest-thumping rhetoric about rebuilding the military and getting tough with foreigners. But it is no accident that his signature initiative is to build a gigantic wall along America's southern border. Mr Trump's economic rhetoric is all about shutting out the world. He is the most explicitly protectionist candidate in the field, promising, for example, to make sure that Americans buy US-made cars and machinery, not Japanese imports. He denounces the trade deals that the US has signed as bad for the country and has pledged to rip them up.

He takes a similarly mercantilist attitude to security, promising to force South Korea and Japan to pay for America's military protection. The implication is that there is no inherent US national interest in underwriting the security of the Asia-Pacific region. That logic, taken to its obvious conclusion, would be a formula for America pulling back from its security commitments all over the world.

Mr Trump is also a frank admirer of Russian President Vladimir Putin, calling him a "strong leader" and basking in Mr Putin's praise. In a recent Republican debate, all the presidential candidates queued up to denounce Mr Obama for not crushing the extremists of the Islamic State in Iraq and Syria, but none mentioned Russia's intervention in Syria. As a foreign policy "realist" and self-proclaimed deal-maker, Mr Trump would undoubtedly be attracted to granting Mr Putin his longed-for Russian "sphere of influence" in Eastern Europe. And once that is done, why not cut a similar deal in East Asia with Chinese President Xi Jinping, another tough-guy foreign leader who Mr Trump openly admires?

Mr Sanders has not embraced the militarism of Mr Trump's view of the world. Instead, he has opted for the left-wing version of isolationism: Denouncing the idea that America should be "policeman of the world". Mr Sanders also has a Trump-like distaste for free trade, proclaiming: "Unfettered free trade has been a disaster for working Americans."

Together, Mr Trump and Mr Sanders are capitalising on growing American disillusionment with globalisation. The living standards of middle-income Americans have been under pressure for decades, and foreigners and an internationally connected elite are easy scapegoats. Both the far right and the hard left in America are now promising a retreat from globalisation. But any such retreat would have profound consequences, not just for the international economy, but for America's role as the world's most powerful nation.

Of course, both Mr Sanders and Mr Trump are still a long way from the White House. The bookmakers' favourite to be the next president remains Mrs Hillary Clinton. And yet, even she has had to respond to the new public mood. Last week, she adopted Mr Sanders' claim that the economy is "rigged" in favour of a privileged elite.

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Mrs Clinton has also come out against the Trans-Pacific Partnership (TPP), a new trade deal that she once championed as secretary of state. As president, Mrs Clinton would probably find a way of supporting the TPP, which she used to argue is a crucial part of America's "pivot" to Asia. She certainly takes a conventional "establishment" view of the importance of American leadership in the world.

But the current course of the presidential election suggests that it would be foolhardy to dismiss the chances of either Mr Trump or Mr Sanders actually winning their parties' nominations and, ultimately, the presidency.

If that were to happen, the commentators bemoaning the "weakness" and "fecklessness" of Mr Obama would come to realise that, in fact, he might be the last in a line of serious and committed internationalists to occupy the Oval Office. THE FINANCIAL TIMES