

**SINGAPORE'S WRITTEN COMMENTS ON THE
UNITED NATIONS FRAMEWORK CONVENTION ON INTERNATIONAL TAX COOPERATION
WORKSTREAM II**

Abstract

It is important to have clear, predictable rules to provide tax certainty, enable administrative efficiency, and promote economic growth.

Value creation by the service provider has been the fundamental principle underpinning the allocation of taxing rights. The service providers undertake substantive economic activities, giving rise to the income, typically through functions performed, assets used, and risk assumed. Thus, the principle of value creation is aligned with physical presence. We support the continued relevance of physical presence as the primary nexus for taxation, which is rooted in tangible economic activity. We remain open to examining different taxation nexuses. These alternatives must be carefully assessed to ensure a principled, rules-based approach to the taxation of services. We suggest having optionality in the protocol, allowing jurisdictions to adopt mechanisms based on their needs, circumstances and policy preferences. This flexible and inclusive approach could allow each Member State to maximise the benefits of the protocol.

We agree that the Workstream's current focus should be on nexus, before addressing the manner of taxation. On scope, we support prioritising corporate income taxation of services, and suggest taking a calibrated approach, including potential carve-outs for smaller businesses.

Finally, the integrity of bilateral treaties should be respected, and jurisdictions must retain the sovereignty to negotiate the allocation of taxing rights based on internationally accepted principles and their needs.

Detailed inputs

1. We thank the Co-Lead and the Secretariat for preparing the Issues Note, and for the opportunity to provide our comments.
2. Singapore is committed to working with the other Member States and stakeholders to strengthen existing tax rules on taxation of cross-border services, while continuing to encourage investment, innovation and trade. We support nexus rules of taxation that are clear and predictable, to provide tax certainty while ensuring efficiency of tax administration.

Designing tax rules that are clear and sustainable

3. Value creation by the service provider has been the fundamental principle underpinning the allocation of taxing rights of service income, as these service providers undertake the substantive economic activities giving rise to the income, typically through functions performed, assets used, and risk assumed. Against this understanding, we note that the use of “value creation” in paragraph 18 of the Issues Note appears to adopt a different framing – one that attributes value to the contribution of market jurisdictions. As apparent in the Workstream II discussions, Member States hold differing views on what constitutes value creation. To provide clarity, we suggest that the reference to “value creation” should be rephrased as “location-based factors”, which more accurately reflects the market-oriented considerations being described.
4. Our view is that physical presence of the service provider is a key indicator of value creation, as it is key to where business activities with economic substance take place. At its core, physical presence reflects that business activities are taking place in the jurisdiction and associated with profit generation. We support the continued relevance of physical presence as a primary nexus for taxation and note how it is aligned with the principle of value creation.
 - a. This is rooted in tangible economic activity and the actual conduct of business within a jurisdiction, making it a robust and defensible basis for taxation. As pointed out at paragraph 9 of the Issues Note, a permanent establishment is generally a fixed place through which the taxpayer’s business activities are carried out.
 - b. The permanent establishment concept is not only widely adopted in tax treaties but is also well understood by businesses and tax administrations. This consistency provides much-needed legal certainty and predictivity, especially in the context of cross-border services. Physical presence (paragraph 16 of the Issues Note) has been, and should remain, a cornerstone in establishing taxation rights.
 - c. Moreover, as not all services can necessarily be provided digitally, physical presence should be considered alongside the other emerging nexus for taxation and continue to be the predominant basis for taxation. Prematurely displacing physical presence as a key nexus risks creates uncertainty and fragmentation in the international tax system.

Other nexuses of taxation

5. While we continue to see physical presence of the service provider as a relevant and meaningful basis for source taxation, we remain open to further examining the different potential nexus concepts identified in the Issues Note, such as the deductibility of payments and significant economic presence, with a view to better understand their implications. We have provided our high-level preliminary comments below.

6. We note the Workstream's suggestion to explore deductibility of payments as a nexus for taxation, as referenced in paragraph 15 of the Issues Note. At this point, further clarity is needed on how this concept can manifest as a practicable rule for taxation, especially on whether it can truly reduce compliance burden on taxpayers, and how linking taxing rights to the deductibility of payments results in a clear and sustainable outcome for both Resident and Source States, as well as businesses.
7. Next, we refer to the significant economic presence (SEP) test, as referenced in paragraph 19 of the Issues Note. We note that some Member States have opined that the SEP can provide a way to directly address digital companies, a key concern in today's age of digitalisation. However, we agree with the observation in the Issues Note that this approach was not discussed in detail and further discussion will be useful. Our view is that taxation should not stifle trade and investment flows or create disproportionate administration and compliance challenges for both tax administrations and businesses.
8. Generally, further discussion would be needed to better understand each proposed nexus. Member States should have a common, unambiguous understanding of the definition and criteria used in each nexus to assess their potential application in this Workstream. Fundamentally, it is essential to have a principled, rules-based approach to the taxation of services. We believe that there is room for discussion for a measured approach to source taxation that can support long-term revenue mobilisation, while also promoting inclusive growth, service availability, and a more predictable environment for cross-border economic activity.
9. Optionality: Furthermore, we recognise that because these concepts may be novel, it may be best to leave interested jurisdictions to adopt them in their tax treaties based on a mutual understanding between the bilateral parties. We suggest for the concept of optionality within the protocol, which allows Member States to opt in or opt out of mechanisms within the protocol depending on their needs, circumstances and policy preferences. This flexible and inclusive approach could allow each Member State to maximise the benefits of the protocol based on its unique circumstances.
10. Manner of taxation: We share the sentiment that the focus of the Issues Note, and current discussion should be on the nexus of taxation, following which the manner of taxation (i.e. gross vs net taxation) should be addressed accordingly.

Scope of Protocol

11. We note that the Issues Note (at paragraph 20) proposes to focus on the "nature of the tax, not what it is called", in light of the possible language barriers and differences in the classification of taxes. We agree with the need for substance over form, and that in deciding on the scope of the protocol, the focus of the Workstream should be on corporate income taxation of services.
12. In addition, we note that services differ significantly in how they are delivered and the economic functions they perform. In considering whether to introduce any new tax rules, we may need to consider whether the same tax rules should apply to all services or differentiated rules may be more appropriate, taking into account the nature of the services and both the administrative work for tax administrations and compliance efforts of businesses. We also encourage adopting a calibrated approach to ensure that the protocol focuses on services that present the greatest relevance or risk from a tax policy perspective. Carve-outs for smaller businesses may be

necessary, so that they need not face disproportionate compliance burdens under cross-border tax rules.

Importance of treaties in facilitating cross-border trade and investment

13. While the Issues Note highlights limitations in existing tax treaties as a significant barrier to taxing cross-border services, we believe it is important to recognise the broader economic objectives that tax treaties serve, such as eliminating barriers to cross-border trade and investment, providing legal certainty, and reducing risks of double taxation. These are legitimate policy goals that continue to underpin international economic cooperation.
14. In this regard, we emphasise that any work undertaken by this Committee or Workstream should respect the integrity of treaties that have been bilaterally negotiated and mutually agreed. Jurisdictions must remain free to bilaterally agree on taxing rights based on their needs, including those based on internationally accepted principles today.