Taxing the Digital Economy: Impending changes to GST in Singapore

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Background

Should digital downloads, streaming services and online purchases from foreign entities be subject to goods and services tax (GST) in Singapore? How about off-premise cloud computing?

On 20 February 2017, many in Singapore tuned in to listen to Finance Minister, Heng Swee Keat, delivering the Government's Budget Statement (the Budget Speech). Not many, however, may have noticed a brief, but significant comment made by the Minister regarding the Base Erosion Profit Shifting (BEPS) Project, as well as adjustments being made by some countries to their GST systems in the context of increasing digital transactions and cross-border trade. These international developments have far-reaching effects, whether on multinational or local enterprises, or even consumers, given the pervasiveness of the internet in business and daily living.

The BEPS Project was initiated by the Organisation for Economic Co-operation and Development (OECD) and the G20 countries, to combat tax planning strategies which allow multinational enterprises to artificially shift profits to low or no-tax locations where there is little or no economic activity. The BEPS final package of reports was issued in October 2015, and in June 2016, Singapore joined as an associate member to work together with the OECD and G20 countries on the implementation of the final package measures (To find out more, please visit here).

The problem

Although the BEPS package is heavily focused on direct or income taxes, Action 1 of the final package (Addressing the Tax Challenges of the Digital Economy) notes that because the digital economy is increasingly becoming the economy itself, it would not be feasible to ring-fence the digital economy from the rest of the economy for tax purposes – and that includes indirect tax, or for Singapore's purposes, GST.

The evolution of technology has dramatically increased the capability of private consumers to shop online and the ability of businesses to sell to consumers globally without the need to be present physically or in the consumer's country. Without any update in countries' tax rules to address the ever-changing business models in the digital economy, nor standardisation among countries on how cross-border supplies are taxed, tax leakages are fueled, and also, as indicated by our Finance Minister, uneven playing fields are created between local businesses which are GST-registered, and foreign-based businesses which are not.

Generally, indirect taxes such as Singapore's GST, are taxes on consumption based on the destination principle, meaning tax applying in the location in which the product or service is "consumed". For this reason, domestic supplies as well as imports of products into Singapore from suppliers that are GST-registered, are in principle GST chargeable at standard rates, whereas exports of products consumed outside of Singapore are GST zero-rated (i.e.

GST charged at 0%).

For services, GST in Singapore is chargeable depending on the belonging status of the supplier. Where a supplier of service belongs in Singapore, the supply is considered to be made in Singapore and GST chargeable. However, generally speaking where the supplier belongs in Singapore but the customer of the service belongs outside of Singapore, the service may be considered an “international service” which is GST zero-rated.

With the advent of the digital economy, however, a country with laws still based on traditional business models would struggle to effectively tax imports of digital products and services or intangibles. Examples of tax leakages in Singapore arising from GST not being charged and collected would include:

a. online or e-commerce sales of low value non-dutiable goods by overseas suppliers, imported to Singapore customers by air or post, import value of which falls below the S$400 import relief threshold; or
b. supplies of digital or remote services to customers in Singapore, for example, supplies to digital content including e-books, movies, TV shows and music, or online supplies of games, apps, software or educational distance learning courses.

In both instances above, the relevant good or service is being consumed in Singapore. However, in instance a), the S$400 import relief threshold was intentionally legislated about the same time GST was first introduced in Singapore on 1 April 1994, ostensibly to facilitate the high volumes of small value consignments. It is likely that the key consideration at that point was that compliance costs in accounting for small amounts of GST could very well outweigh the potential GST collected, if all imports regardless of value were subject to import GST. The unprecedented rise in e-commerce transactions since then, has however put tremendous pressure on tax authorities to track and police situations in which online retailers exploit tax breaks by under-declaring the value of their shipments, or by splitting a single transaction into multiple packages.

In relation to instance b), such services would not be taxable in Singapore under the current rules, as such supplies made by suppliers belonging outside of Singapore are not considered chargeable for supplies made in Singapore. This is currently the case, even if such services are not consumed overseas, but in fact in Singapore. These rules now appear inadequate to address the myriad situations in which the consumption of services, with the use of technology, no longer have to take place at the same location in which the supplier belongs or the service is provided. In fact, with some services of today with borderless natures, it comes close to impossible to make such a determination, for example in cloud computing, where the supplier company may be in one location, but the servers, on which numerous applications are run and simultaneously accessed by millions of users from multiple locations, are located at data centres in a variety of other locations.

Apart from the issue of tax leakage, there is the issue of unfair competition for local retailers as well, where as a result of GST not being charged and collected in instances a) and b) above, consumers in Singapore then favour overseas suppliers over domestic GST-registered suppliers of the same good or service. This issue has garnered enough attention, for it to have been raised as a point in the Budget Speech currently under study by the Government. In the old economy, the content that is now delivered digitally would have been delivered in the form of physical media such as books, tapes, records, etc. These are classified as goods rather than services, and would have attracted import GST.

Across the globe, and certainly the OECD (International VAT/GST Guidelines published on 6 November 2015), countries have adopted destination principles (meaning, taxation as the place of consumption rather than the place of production) as a core concept to be encapsulated in their indirect or GST laws. However, this leads to further questions such as, who is then liable to account for GST in supplies of digital goods and services? What mechanisms should be used for compliance and payment of GST? What solutions would be appropriate for Singapore’s economy?

Possible solutions

1. Remove or lower current import relief

One possible option, in relation to instance a) above in a cross-border supply of tangible goods, is clearly the reduction or removal of import relief. Examples of countries which have already moved or are moving towards the lowering or removal of import relief include Australia, Switzerland, and the European Union (EU).

This appears to be a relatively straightforward option for the Government as it does not require the introduction of new GST legislation, and in terms of mechanisms, may rely on the pre-existing system for collecting import GST. While this serves to plug the tax leakage on this front, and also to even out the playing field for supplies of such goods, on the other hand, companies and in particular import intermediaries face much heavier compliance costs in accounting for GST on high volumes of small value consignments. Should the Government choose to reduce or remove import relief, our view is that this should be accompanied by measures to improve the existing system of tax collection, in order to mitigate the increased costs of compliance for businesses.

2. Requiring overseas suppliers to register for GST

The removal or reduction in import relief provides a possible solution for cross-border supplies of goods, but how about digital or remote services such as those in instance b), which do not pass through any customs collection points and are contracted directly by the end consumer without the intervention of domestic intermediaries?

One measure that Singapore could consider, that has also been implemented in other jurisdictions such as Australia, the EU, South Africa, and South Korea, is requiring offshore suppliers of digital services to register and remit GST on sales of services where the consumer is located in Singapore. Such a measure, if successfully implemented, would effectively contribute towards levelling the playing field between overseas and domestic suppliers, and at the same time also generate more tax revenue for the Government.

The actual implementation of such a measure would obviously be challenging for such offshore suppliers, as their clientele is likely to spread across multiple jurisdictions, each with their own separate indirect tax systems to be monitored and complied with. It has been suggested that the additional burden for these suppliers can be mitigated through a “simplified GST registration and compliance regime” (BEPS Action 1), as has been, or will be implemented in countries such as Australia and New Zealand.

Under the Australian model, an overseas supplier who sells low value goods to Australian consumers and has an annual turnover of AU$75,000 or more will be required to register and account for GST on goods imported to Australia. It has been said that this is not an especially high threshold and many foreign sellers are expected to exceed it. While foreign sellers caught by these new provisions will need to register for GST and file periodic GST returns, they can elect a limited form of GST registration to reduce their compliance burden. This allows them to only file GST returns on a quarterly basis (rather than monthly as might otherwise be the case), but the trade-off is that they cannot recover input tax credit for the GST included in their Australian costs (in practice, such costs may not be material for many foreign sellers).

However even if a similar simplified regime may be introduced in Singapore, there is the issue of convincing the suppliers to comply, meaning, an additional enforcement issue from the Government’s perspective. This approach is dependent on the overseas supplier complying with the requirement to register, collect and remit the GST. Without implementing a suitable mechanism to collect the tax in the particular jurisdiction, it is unlikely that the tax would be paid and it would be difficult for tax authorities to audit and sanction them. In Australia, entities that are required to be GST registered but do not do so will be subject to compulsory registration upon identification and may have a range of administrative penalties imposed under the existing law. It has also been suggested that as a “last resort” measure, the Australian Government may possibly also use its powers to block access to overseas retailers’ websites if they fail to comply with the new rules. While this measure is unlikely to have an impact on small companies, it is possible that big companies which contribute significantly to the digital economy may nevertheless comply for reputational reasons.

It has also been suggested that such a model is likely to require not only extensive changes to existing tax collection processes but also enhanced international and inter-agency (tax and customs administrations) co-operation to help ensure compliance by overseas suppliers. Such co-operation is more effective in member state countries such as in the EU, however it remains to be seen how independent states such as Singapore may co-operate with other countries. One possible avenue would be to piggyback on existing international conventions for bilateral or multilateral co-operation on direct taxes.

3. Activate the reverse charge mechanism

One other measure that Singapore could consider in addressing cross-border supplies of digital services in instance b) above, is activating the reverse charge mechanism under section 14 of the Goods and Services Act. The reverse charge mechanism works by allowing (or sometimes requiring) the customer to account for the tax on supplies received from foreign suppliers (i.e. customers self-account for GST). For obvious reasons, this is not practicable for Business-to-Customer (B2C) situations since private consumers are not required to register and account for GST.

The reverse charge mechanism may however apply in Business-to-Business (B2B) transactions, for example in the EU, where the customer must account for the tax, regardless of whether the supplier is based in the EU or otherwise. In the B2B context in Singapore, there is the issue of whether the reverse charge would also apply to customers who are not GST-registered. Even if the recipients are GST-registered, it is expected that in most situations, domestic businesses would be able to claim an input tax credit on the GST accounted for, resulting in an effective zero collection of GST revenue on such transactions, i.e. self-accounting of GST would essentially be offset by the same amount of input tax credits claimed. From the business perspective, the implementation of a reverse charge system will also inevitably require additional compliance efforts involved in the changing of internal processes to address such additional requirements.

The main business sectors from which GST revenue could potentially be collected from, would be the financial services sector and the residential property sector which make exempt supplies. Such companies can only claim input tax credits to a limited extent. Generally, input tax incurred in the making of exempt supplies is not claimable unless the De Minimis Rule is satisfied.

The reverse charge mechanism is thus not likely to be an effective solution on its own, given the above limitations.

Conclusion

It is unclear at this point, which direction the Government will choose in relation to this issue, but it is clear that the eventual solution(s) would have to strike a balance among multiple objectives, including the efficient collection of tax, minimisation of compliance burdens, promotion of local fair competition (but also free movement of goods and services), and the upholding of the destination principle.

It also bears noting that indirect tax rules and systems cannot be considered in a vacuum in the context of the digital economy, which also raises important questions on how direct tax rules and systems should be modified to adapt to constantly changing economic and business models. As mentioned above, the BEPS package is in fact focused mainly on direct taxes, and the measures contemplated will have a substantial impact on indirect taxes and GST, for example with respect to the definition of “permanent establishment”, transfer pricing, and tax information exchange among jurisdictions.

Just as we have seen a paradigm shift in the way that businesses are being conducted in the digital economy, we have likewise also seen how countries have started rethinking and reinventing tax systems, rules and concepts in a coordinated manner—the tax revolution too, has begun.

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