Publication: The Business Times, p 9
Date: 19 February 2014
Headline: Fine-tuning the tax system for all

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Fine-tuning the tax system for all

Making changes to the PIC, corporate and individual taxes could help bring in more revenue, says Sum Yee Loong

SINGAPORE is gearing up for its 2014 Budget debate next month, and the government has to balance between investing to keep Singapore competitive in a globalised world, and ensuring that Singapore evolves to be a more equitable society that looks after the ageing and less well-off segment of the population.

Public spending is expected to go up as the government introduces universal medical insurance and ramps up infrastructure investments such as public housing and MRT lines. Tax policy plays an integral role in ensuring that there are enough funding for Singapore's various spending needs.

On the whole, there should not be any drastic changes to Singapore's tax system, says Singapore Management University (SMU) professor of accounting Sum Yee Loong, a former tax partner with Deloitte & Touche from 1986 to 2011.

Prof Sum, a practice professor, suggests several areas that can be tweaked. "I don't see a lot of changes, just fine-tuning. All the big initiatives have been introduced over the last 10 years. We're actually very competitive in the tax arena," he notes.

Adjustments can be made in four broad areas, he says.

The Productivity and Innovation Credit (PIC), a popular tax deduction scheme that encourages businesses to invest in technology and automation to enhance their productivity and innovation, should be fine-tuned to prevent abuses.

Another area that should be reviewed is the tax exemption scheme for new start-up companies. There has been some abuse in this area. On the personal income tax front, Singapore can also collapse some of the higher individual tax brackets together to simplify the system, and also bring back (individual) personal relief to help retirees who do not benefit from the earned income relief but still derive income from property investments.

Finally, to reduce the widening income gap, the government can consider bringing back two types of taxes: estate duty, as well as income taxes on higher-value homes and secondary residences. The government can also consider increasing taxes that casinos pay, Prof Sum said.

Tightening the PIC

The PIC scheme, introduced in 2010, enables businesses to claim a tax deduction of up to four times the expenses incurred for buying automation equipment or sending staff for training, among other things. The tax deduction can be claimed for up to $400,000 of such expenditures a year for each of the six activity types. Instead of the tax deduction, cash-strapped businesses can instead opt for a cash payout of 60 per cent of expenses up to $100,000 of expenditure (the cash payout was 30 per cent prior to Year of Assessment 2013).

"The PIC is a good scheme that has helped the commercial sector. We just need to improve it even more and tighten it," says Prof Sum.

One area of abuse is how businesses might be purchasing equipment at artificially high prices, to inflate PIC claims – a phenomenon against which the taxman has warned.

"Freebies are factored into the cost of such equipment to inflate the amount qualifying for PIC. In addition, automation equipment is only required to be owned for at least a year before disposal to avoid a clawback of the PIC claimed previously. This could give rise to abuse," Prof Sum says.

To stem such potential abuse, the government can consider increasing the length of time that businesses need to hold on to automation equipment before disposing them to avoid a clawback of the PIC previously claimed.

The holding period could be increased from one year to three years, he says. "Companies don't buy equipment for their own use and then sell them just after a year, these companies would certainly want to use the equipment for a longer period of time."

Corporate tax issues

Singapore collected $55 billion in various taxes and duties in the government's 2012 fiscal year, which ended March 31, 2013. Corporate income tax, personal income tax, and the goods and services tax (GST) are among the more sizeable sources of revenues.

On corporate tax, one area that can be tightened is the tax exemption scheme for new start-up companies, Prof Sum says.

Under the scheme, a newly incorporated company that meets qualifying conditions can claim full tax exemption on the first $100,000 of normal chargeable income for each of its first three consecutive years of assessment. A 50 per cent tax exemption is also given on the next $200,000 of normal chargeable income for the first three years; thereafter, the first $10,000 will qualify for a 75 per cent exemption and the next $290,000 will qualify for a 50 per cent exemption.

The full exemption scheme has also been abused by some companies in the services sector, Prof Sum notes. "After three years, you just start another company and deregister the first. This saves you $8,075 per year for the first three years (corporate tax rate is at 17 per cent). In fact, people do not become more enterprising because they can claim a full tax exemption of $100,000 for three years. People who are enterprising will go into business regardless of whether or not there is this full exemption. I would rather the government do away with this and use the money to help small and medium enterprises (SMEs) in a more targeted way," he says.

'People who are enterprising will go into business regardless of whether or not there is (this) full exemption (of taxes). Do away with this and use the money to help SMEs.'

– Singapore Management University (SMU) professor of accounting Sum Yee Loong (above)

Last year, the government had also announced a 30 per cent income tax rebate subject to a cap of $30,000 given to all companies. But again, this might be unnecessary for many companies, Prof Sum says.

"If companies are making money, there is no need to reduce their taxes. If I had a lot of money and I know my SMEs are suffering, let me set aside certain amounts to help them with training programmes, marketing, special initiatives, rental subsidies."

Individual tax issues

Finally, while Singapore has a relatively low top marginal tax rate of 20 per cent, Prof Sum thinks that this does not need to be raised. This is partly to ensure that Singapore remains attractive to talented individuals, and partly because the top corporate tax rate is only 17 per cent.

We should avoid a larger gap between the top individual tax rate and the corporate rate as it is not difficult for individuals to set up companies to enjoy the lower corporate tax rate and the after-tax profits can then be distributed as exempt dividends.

While there is talk that the GST may go up eventually beyond its current 7 per cent rate, it is a regressive tax that disproportionately affects the lower income, Prof Sum says.

To raise taxes, the government can collapse the top marginal tax bands for personal income – say by increasing the 11.5 per cent band to 12 per cent and moving the 15 per cent band to the 17 per cent band.

Retirees who do not have earned income should have a form of personal tax relief that they can claim against their investment income, he adds.

Meanwhile, Prof Sum proposes to bring back estate duty, a tax on a person's assets on death, as well as income taxes on properties.

"We had a very reasonable estate duty, with the first $12 million taxed at 5 per cent and the excess at 10 per cent. Honestly, 10 per cent is not high, and achieves a purpose. My personal opinion is that it should not have been abolished in 2008." Another tax that can be brought back is that of income taxes on properties, which was scrapped in 2009, Prof Sum says. While the government has introduced progressive property taxes that will impose marginal tax rates of as high as 20 per cent on property effective next year, he thinks that they are not enough to deter property speculators.

Previously, owners of luxury houses with annual values exceeding $150,000 (a very small proportion of homes here), attracted income taxes on the annual values of their properties. Investment properties were also subject to this income tax, based on personal income tax rates. If properties were left vacant, their annual values were also treated as "deemed income" and thus taxable. But this income tax was scrapped with effect from year of assessment 2010 following the global financial crisis.

High net worth individuals can well afford to pay the increase in taxes if the property income tax were to be reinstated, Prof Sum argues. Meanwhile, there are a lot of completed units left vacant on the market. The tax will be able to serve three purposes, Prof Sum says.

"We can thus address the rising income gap, indirectly nudge property owners not to leave their properties vacant, and also tax the very rich who have almost all their income outside Singapore and thus pay very little or no income taxes here."

To conclude, the various suggestions to tweak the PIC, corporate and individual taxes will bring in more revenues, Prof Sum says.

"We can address issues associated with the ageing population, subsidise healthcare, target money to help SMEs, and get more tax from the very rich people who take up residency or citizenship in Singapore and buy luxurious properties here but derive all their income from outside – they don't pay income tax here but are enjoying our facilities. Surely they can be taxed more," he added.

This is the eighth in a monthly series by the Singapore Management University. Next month's feature will look into preparing graduates to be workplace ready and relevant in a dynamic labour market