Publication: The Business Times, p 20
Date: 5 February 2015
Headline: Enhancing the budget to truly support SMEs

As an open economy with limited resources and vulnerable to global economic swings, it is timely to enhance the Budget's fiscal attractiveness to SMEs to ensure that we do not slip up on our economic restructuring measures. PHOTO: BLOOMBERG

Enhancing the Budget to truly support SMEs

Across the board measures leave an inequitable playing field for small businesses, who would benefit greatly from small cost advantages and tax breaks. **BY EUGENE KB TAN and GOH BUN HIONG**

IN RECENT years, the Singapore Budget has increasingly shifted its primary focus from fiscal attractiveness to social equity in view of the widening income divide. Governments around the world have been struggling to find the right solutions to the income and wealth divide. They face pressures from the growing number of people displaced by the new financial world order, whose needs and demands are often incongruent with the measures needed to strengthen the macroeconomic pillars of the country.

While Singapore has benefited in no small way from this new financial world order, our policy makers have also not been spared from the need to mitigate the pain of those socio-economically displaced while steadfastly pursuing strategic economic policies. They are two sides of the same coin.

To buffer against disruptive volatility from movements of multinational companies in Singapore, it is imperative that we continue to strengthen, support and grow our small and medium enterprises (SMEs), which employ the majority of the Singaporean workforce.

As an open economy with limited resources and vulnerable to global economic swings, it is timely to enhance the Budget's fiscal attractiveness to SMEs to ensure that we do not slip up on our economic restructuring measures. The following calibrated measures can enhance the Budget's relevance to SMEs.

The tightened foreign worker quotas have impacted significantly on companies in Singapore, with many SMEs being the hardest hit and consumers being inconvenienced. While there is merit in tightening the foreign dependency ratios (DRCs), it is necessary to consider a less stringent quota requirement, especially for sectors like retail and food and beverage.

With many SMEs having fewer than 20 (or even 10) employees, it is extremely difficult for them to compete with the big boys as they are unable to achieve a critical mass to "average down" their payroll costs. We should relook the possibility of allowing the micro-SMEs such a cost advantage to enable them to grow.

While easy to apply, a one-size-fits-all approach to DRCs is an extremely blunt regulatory tool. A nuanced approach with different DRCs for different sectors can work as employers have come to terms with making do with lesser foreign manpower.

Many SMEs operate as unincorporated businesses for ease of operations and establishment. Where financial management is concerned, however, unincorporated entities are no different from incorporated entities. They may not avail themselves to profits in the year they are earned as reserves are prudently set aside for a rainy day and growing operational needs.

Why not tax sole proprietorships and partnerships based on drawings, instead of profits earned? While such a change might open the door to negative tax planning possibilities, the economic rationale is not unsound. Business owners should not be taxed on profits that they do not enjoy. This tax break will further incentivise looking long-term.

Current tax legislation creates an economic anomaly between rental and ownership of business premises. Rental payments are tax deductible, while ownership of business premises is generally non-tax depreciable.

While one can argue that any eventual capital gain on the sale of the premises is not taxable, this argument is somewhat flawed as current legislation already allows for depreciation of capital assets like plant and machinery. In addition, such an argument is not particularly attractive to business owners who often value stability and have little intention of "flipping" their real estate holdings for a capital gain.

With rising rentals being a genuine concern and burden for business owners, many have hedged against this uncertainty by buying business premises, instead of renting them. However, this results in an undesirable effect of an increase in tax liabilities while also exerting upward pressure on commercial rents. With our economy being increasingly dominated by services, most companies in this sector have been hard hit consequently.

The benefits gained from depreciation on buildings can be recovered through a partial tax on any capital gain should the premises be sold, similar to a balancing charge on sale of plant and machinery.

Current policy does little to help SMEs in the area of commercial goods vehicle ownership. Perhaps the government could consider a token sum COE renewal of goods vehicles for small businesses? This can help small businesses manage overheads for a business necessity while not undermining our firm policy on vehicle control.

In encouraging our companies to expand overseas, we can consider the possibility of allowing our companies to take a deduction for losses in overseas branches. Not all ventures, in particular the early years, are immediately profitable. Revenue loss to Singapore can be mitigated by the taxation of such overseas branches when they are profitable (instead of allowing for foreign income exemption under current legislation).

Current legislation does not automatically exempt dividends from subsidiaries, which do not suffer a minimum headline tax rate of 15 per cent. However, this legislation also penalises genuine structures where no tax advantage was gained: for example, where a Singapore company owns another company (say a Chinese company) via a Hong Kong company, which is not subjected to a tax on capital and investment gains. Had the investment been made directly by the Singapore company, any dividends and capital gains from the shares of the Chinese company would not be subject to tax anyway.

Current legislation could be fine-tuned to automatically exempt dividends from intermediate companies where no financial advantage was gained. While an exemption application process is in place, it is still subjected to review. This creates uncertainty in investment planning, often resulting in lost opportunities or sub-optimal planning.

While there is a need to balance the benefits that the PIC is intended to achieve with the efficiency and effectiveness of implementing the scheme, we should strive to get more bang for our buck. Refinements could include additional bonus grants where substantive productivity improvements and/or innovation are demonstrated. Similarly, the scheme should be tightened so that taxpayers' monies are not used to fund basic tools of trade, or vanity projects under the guise of innovation, or where productivity improvements are dubious.

An analogy suffices: If I am using an abacus and upgrade to a laptop, there is productivity improvement. But if I am already using a laptop and use PIC funds to buy a new laptop, then what exactly are the productivity and innovation improvements? Simplistic messages about productivity and innovation will result in SMEs missing this closing window of opportunity to revamp how business is done.

In conclusion, while Singapore has always prided herself for a transparent and level playing field for all economic players, absolute parity creates an inequitable playing field for home-grown enterprises.

Targeted measures sensitive to ground realities can provide a much-needed boost to indigenous SMEs, an integral player of our national competitiveness, without compromising the national imperatives of productivity improvements and the management of foreign manpower numbers in this critical phase of our economic restructuring.

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