Restructuring the Tax System for Growth and Job Creation

ECONOMIC REVIEW COMMITTEE:
SUB-COMMITTEE ON POLICIES RELATED TO TAXATION, THE CPF SYSTEM, WAGES & LAND

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PREFACE

The Economic Review Committee (ERC) was convened in December last year to review Singapore's development strategy and formulate a blueprint to restructure the economy. The Sub-Committee on Taxation, Wages, CPF and Land was set up as part of the ERC to review government policies with economic implications, including taxation, the CPF system, land allocation and the framework for wage competitiveness.

The Sub-Committee accelerated its consideration of the tax system so that recommendations related to tax policies could be forwarded to the government for consideration in time for Budget Day (3 May 2002). This report summarises our assessment and presents our main findings and recommendations in four parts. Part One provides a stock-take of the current situation. Part Two contains recommendations on direct taxes while Part Three focuses on indirect taxes. Part Four contains specific proposals relating to tax incentives and the budgetary system. Annex A contains a detailed listing of the Sub-Committee's proposals.

EXECUTIVE SUMMARY

KEY PRIORITY - CREATING JOBS

1. Creating jobs is our key challenge for the future. We are living in turbulent times. Many Singaporeans experienced the pain of retrenchment and unemployment for the first time in their lives during the recent recession. Not since the last recession in 1985/86 has unemployment been such a major problem.

2. Part of the reason for the recession has been the slowdown in the US economy and in the global electronics industry. But that is not all. The world has changed. Competition is sharper. Even as the Singapore economy recovers, life will not be the same. Many old jobs will not return, as some business activities will shift to lower-cost countries such as China. Our competitiveness is also being eroded as many countries, including the developed ones, are improving their infrastructure, business laws, regulations and tax systems. There is greater uncertainty in the region, making it more challenging for Singapore as a business hub.

3. Our strategy must be to create new economic activities, bring in new investments and increase economic growth, so as to create good, well-paying jobs for Singaporeans. We need a comprehensive plan to develop new capabilities for Singapore, stay competitive in areas of existing strength, and develop new industries with growth potential. One major component of this strategy is to restructure the tax system.

A TAX SYSTEM TO GROW THE ECONOMIC PIE

4. Our tax system should help to grow the economic pie for all to share. We need to reduce taxes on income (direct taxes) to encourage and reward hard work, enterprise and investment, while making up the shortfall in government revenue through taxes on consumption (indirect taxes). This is the best way to help all Singaporeans have good jobs and better living standards in the years to come.

5. Our tax structure is losing competitiveness because developed countries, including Australia, Germany, Ireland, the Netherlands and the UK are already lowering their income tax rates. Others will follow. The premium that Singapore offered investors in the past through lower income tax rates is being eroded.

6. Businesses will go where they earn the best after-tax returns on their investments. Further, in the knowledge-based economy, talent is the key to

business success. Companies are increasingly locating high value-added activities in places where top management and the highly-skilled are willing to live and work. For such individuals, personal income tax, though not the only factor, is a key influence on where they choose to go. Attracting and retaining such people and activities is critical to our economic prosperity and future job creation.

7. Singapore therefore needs to cut income taxes decisively. We recommend **significant immediate reductions in corporate and personal income taxes, for income earned in 2002**. Over the medium term, we recommend a **target of 20 percent to be achieved within 3 years for both the corporate tax rate (from 24.5 percent) and the top marginal personal income tax rate (from 26 percent), with corresponding cuts across income bands**. These cuts send a strong signal of Singapore's intention to be an international hub for business and talent.

8. Fundamental changes are also needed in the corporate tax system to keep our business environment attractive. We recommend **introducing group relief** provisions, so as to give companies the flexibility to start new activities through subsidiaries. We recommend retaining our current system of taxing foreign source income but **liberalising the conditions for granting of foreign tax credits** so as to make our foreign tax credit system more effective in eliminating double-taxation. We also recommend **shifting from a full-imputation system to a one-tier corporate tax system**. This would promote the effectiveness of the group relief system, encourage the use of Singapore as a hub for holding companies and remove impediments to regionalisation. It would also reduce compliance costs.

9. Growth in the knowledge-based economy is driven by investments in intellectual property and other intangible assets, which are as critical as physical assets. To build up our capabilities in this area, we recommend giving more **liberal deductions for research and development expenses** incurred in the creation of intellectual property. We also propose that the **writing down allowance for acquisition of intellectual property** be given automatically, similar to the current practice for physical assets. To reduce the cost effect of withholding tax provisions, especially on fees and royalties, we recommend forming a consultative body, with representation from the private sector, to **review and rationalise the system of withholding tax**.

10. The cut in corporate tax rates will result in a **significant tax savings for small and medium enterprises**. Many of these companies will pay effective tax rates of **between 5~10 percent**[1]. To encourage consolidation in heavily fragmented industries, we recommend giving a **tax deduction, targeted at small and medium enterprises, for the front-end costs incurred in merger and restructuring exercises.** We also recommend

[1] After taking into account the partial exemptions for chargeable incomes of up to $100,000.

giving **tax deductions for selected expenses incurred prior to starting new businesses** as well as **expenses incurred in the listing of companies** to help promote enterprise development.

11. Besides lowering personal income tax rates, other changes are required to lighten the burden on individuals. We recommend **exempting tax on interest income earned in Singapore and overseas income remitted back to Singapore.** We should also **make changes in the tax treatment of stock options** to strengthen the entrepreneurial culture and compete effectively for talent.

12. To further enhance Singapore's attractiveness as a talent hub and centre for management of Asian business activity, we recommend **not taxing earnings attributable to the time spent outside Singapore for employees who spend a significant amount of time working abroad**. This would apply to 'temporary tax residents', who have not been living in Singapore for a long period before their current jobs[2]. To improve our attractiveness vis-à-vis other countries, we also recommend that **employers' contribution on behalf of expatriates into overseas private pension funds be exempt from tax.**

13. We propose to **lower car ownership taxes gradually** and **shift the balance of car taxes towards usage charges**. This would reduce the tax burden on car-owning families, and allow more people to own cars while keeping congestion at an acceptable level.

AVOIDING BUDGET DEFICITS

14. Government expenditure in Singapore, currently at 18 percent of GDP, is one of the lowest in the world. Over time, expenditures on healthcare and other social requirements are likely to rise because of higher costs, rising expectations and an ageing population.

15. The package of lower income tax rates and other pro-growth tax measures will significantly reduce government revenue. Unless we make up at least part of this revenue loss, our ability to spend on security, social and infrastructure needs will be compromised, and we will be at a real risk of a structural budget deficit.

16. Given the uncertainties in the global economic and security climate over the medium term, **it is important to make up at least part of the revenue loss from the direct tax reductions as early as possible**. We should continue to shift towards indirect taxes, a direction which was already set out in the 1986 Economic Committee Report. The government

[2] Hong Kong, Belgium and the UK have similar schemes.

introduced the Goods and Services Tax (GST) in 1994 at 3 percent. The GST has proved a resilient and important source of revenue, which has enabled us to bring direct taxes down from around 30 percent when the GST was introduced to around 25 percent today.

17. **We recommend that GST be raised from 3 percent to 5 percent in 2003**. Even with the proposed increase to 5 percent, we will continue to have one of the lowest GST rates in the world. The GST should continue to be applied across-the-board on all goods and services, with as few exemptions as possible, as is presently implemented.

18. Overall, the proposed tax changes will appreciably reduce the government's projected annual budget surpluses. But they will allow **the government to continue to budget for modest surpluses over the business cycle**. They are critical to achieve the objective of higher growth, more jobs and better income for all Singaporeans.

PACKAGE TO OFFSET IMPACT OF GST INCREASE

19. It will take time for the tax changes to bring in more and better paying jobs. In the meantime, Singaporean households, especially lower income ones, would be affected by the proposed GST increase. To help cushion the impact on them, **we strongly recommend that the government provide an offset package to help Singaporeans adjust to the GST increase**. In 1994, a similar package of measures lasting 5 years was implemented to offset the GST payable by households, and helped greatly in getting the new tax accepted.

20. **The offset package should ensure that most households, especially lower-income households, are no worse off during the transition**. Besides assistance to households, the government should pay particular attention to the impact of the GST increase on education, health care and public transport, and offset or moderate them appropriately. In addition, the government should **set up a committee to combat profiteering and undue price increases**, similar to what was done in 1994.

21. The GST rate increase constitutes an important limb of the entire economic restructuring package. It ensures that our drive to be competitive will not compromise the capacity of government to provide key goods and services to citizens. Helping Singaporeans through this transition should be a major concern of the government.

CONCLUSION

22. The global economic environment has changed. The economic contest has become more intense. Singapore's continued growth and prosperity would not come about without significant adjustments to our economic strategies. To succeed, we must look ahead, anticipate and adapt to the changing environment. If nothing is done, growth rates could be permanently reduced.

23. We have identified specific recommendations to strengthen Singapore's economic competitiveness and capabilities through adjustments in the tax system. For companies and businesses, lower taxes and the other proposed changes will encourage new investments, promote local enterprise, reduce business costs and enhance competitiveness. For individuals, lower tax burdens will reward hard work and enterprise, and hence help retain and attract talent. Taken together, the proposed changes will grow the pie and benefit all Singaporeans.

SUMMARY OF KEY RECOMMENDATIONS[3]

S/No	Recommendations	Objectives
Corporate Income Tax		
1.	Reduce corporate income tax rate significantly for income earned in 2002. As a medium-term target, the tax rate should be cut from the current 24.5% to 20% within 3 years. *Page 29*	• Strengthen competitiveness. • Encourage enterprise development.
2.	Implement group relief to allow corporate groups to offset the losses of one company against the taxable profits of another company within the same group. The group relief regime can be implemented with the following features: a) 75% shareholding threshold (i.e. two companies are members of a group if one is at least 75% owned by the other or if both are at least 75% owned by a common parent). The government could consider lowering this threshold after the full impact of group relief has been assessed. b) Transfer of 100% of current year unutilised capital allowances and losses. c) Government to consider implementing consortium relief and extending group relief for overseas branches and subsidiaries after it has put in place the basic features of the group relief regime. *Page 30*	• Give companies the flexibility to start new activities through subsidiaries. • Encourage innovative activities.
3.	Shift from a full-imputation corporate tax system to a simpler and more efficient one-tier system. This would enhance the effectiveness of the group relief system, encourage the use of Singapore as an international hub for holding companies and help reduce compliance costs. *Page 32*	• Enhance effectiveness of group relief. • Promote Singapore as an international hub for holding companies. • Reduce compliance costs.
4.	Liberalise the system of taxation of foreign income: a) Extend the availability of foreign tax credits	• Encourage companies to venture overseas.

[3] More recommendations are set out in Annex A.

S/No	Recommendations	Objectives
	beyond the first-tier investee company to lower-level subsidiaries. b) Expand the prescribed list of services that qualify for unilateral tax credits (UTC), or remove it altogether. c) Lower the minimum threshold (currently at 25%) to qualify for UTC. d) Set more flexible qualifying criteria for tax exemption of foreign source income under Section 13(8) of the Income Tax Act. *Page 35*	
5.	Introduce a one-year loss carry-back feature in the corporate tax system to relieve the cash-flow burdens of businesses suffering losses in the course of the business cycle. *Page 36*	• Relieve cash-flow problems of businesses suffering temporary losses over the business cycle.
6.	Allow more generous tax treatment of intellectual property: a) Give deduction for expenses incurred on R&D outsourced to any organisation, local or foreign. b) Apply the writing down allowance (WDA) automatically for acquisition of intellectual property, as is the case for physical assets. *Page 37*	• Encourage knowledge-based activities.
7.	Design tax incentives with more flexible and varied criteria, besides fixed asset investment and total business spending, so as to capture the full contributions of the company in the knowledge-based economy. *Page 39*	• Ensure that incentives remain relevant in the knowledge-based economy.
8.	Review and rationalise the withholding tax provisions. This should be done by establishing a consultative body, including representatives from the private sector, to address the needs of individual sectors while ensuring consistency in tax treatment. *Page 39*	• Reduce business costs.

S/No	Recommendations	Objectives
9.	Give tax deductions for mergers & acquisitions, especially to encourage consolidation in heavily fragmented industries. *Page 40*	• Promote enterprise development.
10.	Give tax deductions for selected expenses incurred prior to starting new businesses and in the listing of companies, to help promote enterprise development. *Page 40*	• Promote enterprise development
11.	Broaden the Technopreneur Investment Incentive (TII) to an Entrepreneur Investment Incentive (EII) to be made available to a wider group of entrepreneurs and not just those in the high-tech sector. *Page 40*	• Promote broader base of entrepreneurial activities.
Personal Income Tax		
12.	Reduce the personal income tax rates significantly for income earned in 2002. As a medium-term target, the top marginal tax rate should be reduced from the current 26% to 20% within 3 years, with corresponding cuts across all income bands. *Page 42*	• Lighten the tax burden. • Encourage hard work and enterprise. • Attract and retain global talent.
13.	Exempt interest income earned on all bank deposits, debt securities and other interest-bearing instruments. *Page 42*	• Reduce distortions in the way savings are taxed. • Increase liquidity in domestic financial markets.
14.	Exempt foreign source personal income remitted back to Singapore from tax. *Page 42*	• Increase liquidity in domestic financial markets.
15.	Introduce tax exemption for employment income attributable to time spent outside Singapore. This will apply to tax residents (both citizens and non-citizens), who have not lived in Singapore for the preceding 3 years or more. To qualify, such individuals must have significant international responsibilities requiring them to spend time abroad,	• Promote Singapore as business and talent hub.

S/No	Recommendations	Objectives
	for example at least 90 days annually. Qualifying individuals will receive the tax exemption for 5 years. *Page 43*	
16.	Exempt employers' contributions on behalf of expatriates to overseas private pension funds from tax. *Page 44*	• Attract and retain global talent.
17.	Encourage the use of stock options to align the interests of management and employees with the performance of the company and promote an entrepreneurial environment: a) Defer the tax payment of stock option gains to the point of sale of shares or after 7 years from the exercise date, whichever is earlier, with no interest charge on the deferred tax liability. b) Where there is a moratorium on the sale of converted shares, compute the tax liability based on the difference between the market price at the end of the moratorium and the exercise price. c) Allow for more flexible criteria to qualify for stock option schemes. For example, the 50% participation requirement to qualify for the Company Stock Option (CSOP) scheme should be relaxed to allow more companies to qualify for the scheme. d) Not tax the gains derived from stock options granted overseas when the individual exercises them in Singapore. This is achieved by treating the gains from stock options as employment gains and taxing the gains only to the extent that they are attributable to Singapore employment. e) Adopt a 'deemed exercise' rule for expatriates who leave the country with unexercised stock options. If the employer is willing to keep track of employee's movements, the tax liability can be raised at the point of actual exercise, with payment deferred to point of sale. f) Adopt similar tax treatment for employee share award schemes as that recommended for share options, where relevant. *Page 45*	• Strengthen entrepreneurial culture. • Compete more effectively for talent.

S/No	Recommendations	Objectives
18.	Revise the structure of estate duties: a) Raise the exemption limit for non-residential assets from $600,000 to $2 million. b) Exempt the 'movable' assets of non-domiciles from estate duty. This would encourage more expatriates to hold S$-denominated assets and boost Singapore's position as a private banking centre. *Page 48*	• Reduce imbalance between tax treatment of residential and non-residential assets. • Boost Singapore's attractiveness as a financial centre.
Goods & Services Tax (GST)		
19.	Raise the GST from 3% to 5% in 2003. Retain across-the-board coverage of GST with as few exemptions as possible. *Page 54*	• Make up for revenue loss arising from direct tax cuts. • More resilient tax base for the long term.
20.	Provide an offset package to help Singaporeans adjust to the GST increase. The package should ensure that most households, especially lower-income households, are no worse off during the transition. *Page 55*	• Help Singaporeans cope with impact of GST increase.
21.	Set up a committee to combat profiteering and undue price increases. *Page 55*	• Ensure no undue price increases due to GST rate increase.
Car Tax & Charges		
22.	Reduce taxes on ownership of cars to achieve a better balance between ownership and usage costs. This should be done by gradually reducing the Additional Registration Fee, Excise Duty and Road Tax. More COEs will have to be released at the same time to prevent a consequent increase in car ownership costs. Measures to keep congestion at an acceptable level should focus on increased usage charges, including ERP and parking charges. *Page 59*	• Allow more people to own cars at lower upfront costs while keeping congestion at an acceptable level.

<table>
<tr><th>S/No</th><th>Recommendations</th><th>Objectives</th></tr>
<tr><td colspan="3">Manufacturing Sector Incentives</td></tr>
<tr><td>23.</td><td>Enhance the Development and Expansion Incentive (DEI):

a) Reduce the minimum rate from 10% to 5%.

b) Rationalise some of the existing incentives in the Economic Expansion Incentives Act (EEIA) and put them under the umbrella of the DEI.

Page 65</td><td>• Enhance attractiveness of manufacturing sector incentives.

• Reduce tax administration and compliance costs.</td></tr>
<tr><td colspan="3">Services Sector Incentives</td></tr>
<tr><td>24.</td><td><u>Financial Services</u>

a) Rationalise and consolidate existing financial sector incentives.

b) Enhance the Finance and Treasury Centre (FTC) incentive by expanding its scope to cover treasury activities conducted for Singapore operations.

Page 66</td><td rowspan="3">• Enhance attractiveness of services sector incentives.

• Reduce tax administration and compliance costs.</td></tr>
<tr><td>25.</td><td><u>Info-Communications & Technology</u>

a) Enhance the Approved Cyber Trader Scheme by liberalising the eligibility criteria and reducing the concessionary rate (currently at 10%).

Page 67</td></tr>
<tr><td>26.</td><td><u>International Trading</u>

a) Enhance the Global Trader Programme (GTP) by reducing the tax rate to less than 10% for firms with significant business spending in Singapore. This can be done through a tiered concessionary tax rate regime.

b) Offer tax incentives for mid-tier trading companies that do not qualify for GTP.

Page 67</td></tr>
</table>

S/No	Recommendations	Objectives
27.	<u>Transport & Logistics</u> a) Enhance the Approved International Shipping (AIS) Enterprise scheme by liberalising the qualifying criteria and extending the scope of activities covered under the scheme. b) Give tax-exemption for the income derived from Protection & Indemnity Clubs' activities. *Page 68*	• Enhance attractiveness of services sector incentives.
28.	<u>Other Services (E.g. healthcare, legal services and tourism)</u> Specific incentives to promote these sectors are set out in Chapter 7. *Page 69*	
Using Capital Markets to Finance Bankable Projects		
29.	Use the capital markets instead of tax revenues to finance bankable or financially viable development projects. This would encourage greater commercial dynamism, innovation and efficiencies in the public sector. *Page 71*	• Smoothen out government spending. • Bring about more innovative and cost-efficient ways of providing public services.

PAST TRENDS, CURRENT SITUATION, FUTURE CHALLENGES

PART I

CHAPTER 1: REVIEW OF TAX CHANGES SINCE 1985

INTRODUCTION

1. The last major strategic review of Singapore's tax system was by the 1986 Economic Committee[4]. It recommended both short and long-term measures to bring Singapore out of the 1985/86 recession, and to strengthen the foundations for sustained longer-term growth. This chapter reviews and evaluates the progress of tax policy developments in Singapore since 1985, taking into consideration the changes in the external environment over the last decade.

1986 ECONOMIC COMMITTEE

2. The 1986 Economic Committee recommended the following key changes in the tax system to create a more conducive business environment to support hard work and enterprise, and nurture both MNCs and local companies:

a) Tax reductions totalling about $1.2 billion. This included a cut in the corporate tax rate from 40 percent to 30 percent (with further reduction to 25 percent as soon as the revenue position permits), a cut in the top marginal tax rate to 30 percent, and a 30 percent across-the-board investment allowance for expenditures on capital equipment and machinery.

b) Shift from direct to indirect taxes as the main source of Government revenue. Specifically, the Report stated that:

> *"Government should shift from direct to indirect taxes as its main source of revenue. Consumption taxes such as retail sales taxes may be administratively more difficult to collect but are economically preferable to income taxes. They do not penalize companies which are making profits or persons who are putting away savings. Tax is paid only when money is spent on consumption items, not when the money is invested in productive capacity"*

c) Remove the existing bias that favours manufacturing activities in our tax incentive schemes. Tax incentives should be broadened, to be enjoyed by both services and manufacturing firms.

d) Move towards a uniform, low corporate and personal income tax regime with minimal selective tax incentives as a long-term goal.

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[4] Report of the Economic Committee – The Singapore Economy: New Directions, Feb 1986

GLOBAL TREND TOWARDS LOWER DIRECT TAX RATES

3. The external environment has changed dramatically since the 1986 Economic Committee review. Globalisation and rapid technological advances have paved the way for an increased international flow of good and services. Since 1985, world exports have been growing well in excess of world GDP, while global FDI inflows have increased over twice as fast as world exports. New players in the global economy are strengthening their capabilities to compete with countries ahead of them, including Singapore. The most important new player is China. With its low costs and huge domestic market. China has been pulling away investments that could otherwise have located in Singapore or the region.

4. In today's integrated world, capital and skilled labour are more and more mobile and therefore less and less likely to stay put and pay taxes that are higher than those levied elsewhere. Investors and entrepreneurs can easily shift jobs, goods and capital to lower-tax environments. Studies have found that the average effective tax rates of countries have a significant influence over a MNC's choice of investment location, and the amount of capital invested there. As a result, many countries have been trying to make their tax systems more competitive by removing tax barriers and reducing tax rates to attract mobile capital and talent.

5. In recent years, the OECD and EU countries have been leading the drive for lower tax rates, as they seek to narrow the tax rate 'gap' between themselves and the less developed countries. Between 1997~2002, for example, the average corporate tax rate for OECD and EU countries was reduced by about 5 percentage points.

6. At least 15 countries lowered their corporate tax rates in the last two years, including Australia, Canada, France, Germany, India, Ireland, Korea and Switzerland. Germany implemented a comprehensive tax reform programme in Jan 2001 to simplify the tax system and reduce the corporate tax from 40 percent to 25 percent, a massive 15 percentage point cut. Ireland will be moving to a standardised rate of 12.5 percent by Jan 2003. In the region, Hong Kong is maintaining its low corporate tax rate of 16 percent.

7. Many of these countries offer generous tax breaks for both corporates and individuals on top of these basic rates to attract investments. Further cuts in tax rates are also likely. French President Jacques Chirac has recently proposed a package of tax cuts, including reductions in income taxes by a third[5]. The Japanese government is considering tax rate cuts to stimulate the economy. The *Keidanren* has recommended a cut in the corporate tax rate from 40 percent to 20 percent[6].

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[5] Wall Street Journal Europe, 5 Mar 2002

[6] Asian Wall Street Journal, 1 April 2002

8. Competition for human capital is intensifying. Companies scour the world and are willing to pay a premium for top-quality people. Hence, countries around the world are also lowering their personal tax rates to attract and retain talent, and encourage hard work and enterprise. Germany, Ireland, Malaysia and the US are among the countries that have cut their personal tax rates in recent years. Hong Kong's personal tax rate of 15 percent is one of the lowest in the world. Because there is no tax on earnings outside Hong Kong, a large number of expatriates in Hong Kong end up paying income taxes at well below the 15 percent tax rate.

9. Increasingly, many companies are locating their high value-added activities in places where top management and the highly skilled are willing to live and work. Although our personal tax rates are low compared to many of the industrialised countries, they may not be competitive enough to retain and attract the top tier of global talent, especially since many of these countries are also offering generous tax concessions, thus mitigating our advantage in terms of lower tax rates.

10. We are, therefore, facing increasing competition, not only from developing countries such as China with their low labour and land costs, but also from developed ones such as the US and Europe.

DIRECT INCOME TAX RATES

Corporate Income Tax

11. Our corporate income tax rate has been reduced significantly over the past two decades to maintain Singapore's international competitiveness. The first major cut was in 1986, when the government responded to the Economic Committee's recommendations with a reduction in the corporate rate from 40 percent to 33 percent. Since then, there has been a series of smaller rate cuts. The corporate rate was reduced from 33 percent to 32 percent in Year of Assessment (YA) 1990, 31 percent in YA1991, and 30 percent in YA1993. It was cut by 3 percentage points to 27 percent in YA1994 in a major tax reform that included the introduction of GST. The rate was subsequently lowered to 26 percent in YA1997, 25.5 percent in YA2001 and 24.5 percent in YA2002.

12. A new tax exemption scheme was also introduced in YA2002 to help small and medium-sized enterprises grow and establish themselves by reducing their effective tax burden. Under this new scheme, 75 percent of up to the first $10,000 of the company's chargeable income and 50 percent of the next $90,000 are exempt from tax. The remaining chargeable income is

taxed at the full rate of 24.5 percent. In effect, many small and medium enterprises and start-ups are taxed at less than half of the corporate tax rate.

Personal Income Tax

13. Singapore's personal income tax rates have also been reduced over time. Personal tax rates were cut significantly in 1986, together with the reduction in corporate tax rate, as part of the counter-recessionary package. The top marginal tax rate was cut from 40 percent to 33 percent, with corresponding reductions across all other income bands.

14. There were three subsequent rounds of tax reductions in the following years. The first was in YA1994 when the GST was introduced. The top rate was reduced by 3 percentage points to 30 percent, with proportionate reductions in other tax brackets. The second reduction in YA1997 saw a cut in the top rate from 30 percent to 28 percent, with corresponding reductions in the other rates. At the same time, the number of tax brackets was reduced from 14 to 10 to help lighten the tax burden of the middle-income group, particularly those with chargeable incomes between $25,000 and $100,000, many of whom were likely to pay substantial amounts of car-related taxes or foreign worker levy. The latest round of personal tax cuts was in YA2002 with a reduction in the top marginal rate to 26 percent, and corresponding cuts of between 2~5 percentage points in the tax rates of all other income bands.

15. Since the restructuring of the tax system when the GST was introduced in 1994, more than two-thirds of working adults in Singapore do not pay any income taxes.

INDIRECT TAX: GOODS & SERVICES TAX

16. Following the Economic Committee's recommendation to reduce reliance on direct tax and shift towards indirect tax, the Goods and Services Tax (GST) was implemented on 1 April 1994, as a tax on the final value of goods sold and services consumed locally. It was introduced at a single, low rate of 3 percent, levied across-the-board on all goods and services, except for a small group of exempt supplies, namely the sale or lease of residential properties and certain financial services.

17. When the GST was implemented in 1994, a generous offset package, comprising corporate and personal income tax reductions, rebates and subsidies was also implemented. The government also committed to keep the GST rate at 3 percent for at least 5 years.

TAX INCENTIVES

18. In the 1960s and 70s, tax incentives were mainly targeted at industrial activities due to Singapore's drive to promote and develop higher-technology and skills-intensive industries in the economy.

19. In line with the direction set out by the 1986 Economic Committee, there is now a better spread of tax incentives for both the manufacturing and services sector. More incentives for the services sector were gradually implemented in the 1980s and 90s. This included the Pioneer Status for service companies and the Operational Headquarters (OHQ) Incentive to encourage multinational companies to set up their regional headquarters in Singapore. Sector-specific incentives were also introduced to promote the financial, shipping, transport and logistics sectors. In the financial sector, incentives were implemented to encourage the establishment of Finance and Treasury Centres (FTCs) in Singapore, to develop the domestic bond market, and to promote the fund management and venture capital industries. In the trading and logistics sector, the Approved Oil Trader (AOT) and Approved International Trader (AIT) schemes were introduced to develop Singapore as a global entrepot and to promote international trading of major commodities in Singapore. To develop Singapore as an e-commerce hub, the Approved Cyber Trader (ACT) scheme was introduced in 1998 to encourage offshore trading activities conducted over the Internet.

20. Tax incentives have played an effective and important part in Singapore's economic development. However, they complicate the tax system and increase the costs of tax administration and compliance. In addition, incentives may not be the most cost-effective way of attracting new investments, especially if they end up rewarding activities that would otherwise have located in Singapore, even at the normal corporate tax rate.

21. The alternative to maintaining an extensive menu of tax incentives is to adopt a low flat corporate tax rate that will apply across all industries. This is the approach that countries like Ireland have adopted. Ireland is moving towards a standardized corporate tax rate of 12.5% but its personal income tax rates (top marginal tax rate of 44%) and consumption taxes (standard valued-added tax, or VAT, rate of 21%) remain high. Further, many of our competitors are offering incentives through tax breaks or grants.

22. We should continue to use incentives to develop new and high-growth sectors. However, to avoid inefficiencies in allocation of resources, incentives should have sunset clauses and focus on new and innovative business activities. We should also rationalise and simplify our incentive schemes so as to reduce compliance costs.

CONCLUSION

23. There have been significant changes in our tax system since 1985. Many of these were the result of the recommendations put forward by the 1986 Economic Committee, and the decisive steps taken by the government to implement these recommendations.

24. Competition in the global marketplace has intensified. Tax rates all over the world are steadily falling. Many countries are turning to corporate and personal tax reforms as vehicles and levers for economic growth. Singapore's current tax regime is therefore no longer sufficient to sustain our competitive edge. We need to take pro-active steps to restructure our tax system to help secure sustained growth and prosperity for Singapore.

CHAPTER 2: A GROWTH-ORIENTED TAX SYSTEM

INTRODUCTION

1. Given the prevailing uncertainties in the economic environment over the medium-term, we need a tax system that helps to grow the economic pie for all to enjoy. This can be effected through across-the-board cuts in corporate and personal incomes taxes, and shifting towards greater reliance on indirect tax to make up for any shortfall in government revenue. A growth-oriented tax system is designed to promote economic growth. Faster growth, in turn, means better-paying jobs and higher standards of living for all Singaporeans. This is the best way to help the lower income groups on a sustained basis.

PROGRESSIVE TAX SYSTEM

2. Singapore has a progressive tax system. The entire personal income tax burden is borne by the top 33 percent of working adults. The remaining two-thirds do not pay any income tax.

3. Compared with other countries, Singapore has a far more progressive tax system. The total tax burden of a high-income household[7] is about 15 times that of a low-income household. In contrast, the tax burden of high-income households is only around two times that of the lower-income in many European and US cities. This is mainly because of high consumption taxes, for example, 22% VAT in Finland, 21% in Ireland and 17.5% in the UK. In addition, most working adults in these countries pay income tax, unlike Singapore where only the top 33% pay income tax. The corresponding ratio of tax burden between high and low-income households in Kuala Lumpur and Taipei is higher than the US and Europe, but still significantly lower compared to Singapore (see Table 2-1).

Table 2-1: Ratio of Tax Burden of High-Income to Low-Income Households

Helsinki	Dublin	London	Los Angeles	New York	Sydney	Hong Kong	Kuala Lumpur	Taipei	S'pore
1.6	1.8	2.8	2.4	2.2	2.2	NA	7.5	3.8	15

From a study commissioned by the Ministry of Finance

[7] The 'High-income' assumption is based on the scenario of a 1-earner (with CEO-type salary) married couple with 2 children, owns a car, and a private apartment. The 'Low-income' assumption is based on the scenario of 2-earner married couple (with factory-worker salary) with 2 children, owns a small-sized car in the Europe/US, but uses public transport in the Asian countries, and rents an apartment.

4. After taking into account government transfers, such as CPF top-ups and Singapore Shares, the lower and middle-income households effectively pay 'negative' tax. For example, households in the lowest 30 percent income bracket faced an average net tax burden of -33 percent of household income in the year 2000[8]. Those in the next 30 percent income bracket faced an average net tax burden of around -8 percent of household income.

PRO-GROWTH TAX SYSTEM

5. The concept of a progressive tax system was popular in the 1950s and 1960s when people believed that governments could increase overall societal well-being by redistributing wealth and levelling down the more successful in society through taxation. These policies have generally resulted in inferior economic performance over the last few decades.

6. A growth-oriented tax system, characterised by lower corporate and personal income tax rates, will have immediate and longer-term beneficial effects on hard work, enterprise and investment. It offers companies higher after-tax returns on their capital and spurs local companies and entrepreneurs to venture into new businesses and markets.

7. We need to make a decisive shift to a pro-growth tax system because of the increasingly competitive global environment. We are up against significant odds. We face the inherent disadvantages of a small domestic market, shortage of land which leads to high costs, and the lack of natural resources. Our high costs and living standards have brought us into a new competitive league. We are up against advanced economies with deep pools of talent and accumulated expertise. At the same time, we face increasing competition from new emerging players such as China.

8. We survived and succeeded in the past through our ability to look ahead and anticipate change, and our nimbleness in moving quickly to seize new opportunities. We must continue to do so to overcome both current and future challenges. If we do nothing about our tax system now, growth rates could be permanently reduced, and everyone would be worse off. Shifting to a growth-oriented tax system gives us a much better chance of securing better jobs and higher living standards in the years to come.

[8] The taxes and charges included in this computation include property tax, GST, water conservation tax and other expenditure-related taxes (e.g. alcohol and tobacco). The government transfers include CPF Top-ups, Singapore Shares and the various non-tax rebates, for example, rebates for HDB rentals and service and conservancy charges.

AVOIDING BUDGET DEFICITS

9. We are of the view that the government should continue with its policy of financial prudence and budget for modest surpluses over the business cycle. Sound fiscal policies also underpin the success of our monetary policies to maintain a strong Singapore dollar, which allows for low inflation and high living standards for Singaporeans. Fiscal discipline is a critical factor in securing investor confidence and lays the foundation for robust economic growth.

10. Government expenditure in Singapore, currently at 18 percent of GDP is one of the lowest in the world. Over time, government spending is likely to increase as demands for more and better public services grow with rising affluence and expectations. Expenditures on healthcare and other social needs are also likely to rise because of the ageing population. By 2030, 24 percent of the population will be aged 60 and above, compared to 11 percent today.

11. Reducing income tax rates will decrease government revenue. Unless we make up at least part of this revenue loss, our ability to spend on security, social and infrastructure needs will be compromised and we will be at risk of a structural budget deficit.

12. We recommend that government seek to maintain smaller budget surpluses in the future, so as to release resources to the private sector as the engine of growth. We should also continue to shift towards indirect taxes so as to provide for a more resilient tax base and make up for any shortfall in revenue. This is consistent with the direction set out in the 1986 Economic Committee.

13. Our projections indicate that the government budget surplus would see an appreciable reduction over the next 5 years, if the corporate and personal income tax rates were cut to 20 percent and the GST raised to 5 percent. The revenue gain from increasing GST will offset less than half the revenue loss due to the cut in income taxes. Unlike the past years of high budget surpluses exceeding 5 percent of GDP, the proposed tax changes would result in a tighter budget position. However, the government would be able to maintain modest surpluses in the medium term.

14. Over time, the budget position should remain resilient in the face of potentially higher expenditure requirements as lower income tax rates stimulate enterprise and attract new economic activities into Singapore. It is difficult to quantify these longer-term fiscal impacts, but there is no reason to believe that they are trivial.

CONCLUSION

15. We recommend shifting to a pro-growth tax system to prepare Singapore for the challenges of increased global competition. This can be done by lowering the corporate and personal income tax rates to 20 percent and raising the GST to 5 percent, as recommended in subsequent chapters. Our fiscal projections indicate that a package of tax changes based on these broad parameters would allow the government to maintain modest budget surpluses in the medium term. The remaining chapters of the report provide more details of the pro-growth tax package that we are proposing to support Singapore's next phase of economic development in an uncertain world.

DIRECT TAXES

PART II

CHAPTER 3: CORPORATE INCOME TAX

INTRODUCTION

1. To compete effectively in the next 5-10 years and beyond, we need to evolve a knowledge-based economy and a vibrant entrepreneurial culture. Our corporate and personal tax system should facilitate this economic transition by creating the best conditions to develop enterprises in Singapore and attract and retain global players. This chapter outlines the proposed changes in the corporate tax rate and structure that will keep our business environment competitive.

CORPORATE INCOME TAX RATE

2. Singapore's corporate tax rate structure is losing competitiveness, because other countries such as Australia, Germany, Ireland, the Netherlands and the UK are lowering their tax rates. We have to keep pace or risk being marginalised. Lower corporate tax rates will offer companies and entrepreneurs higher after-tax returns on investments. It will also help to partially offset our labour and land costs, which will always be higher than that of our regional competitors.

3. **We recommend a significant reduction in the corporate tax rate for income earned in 2002. As a medium-term target, the tax rate should be cut from the current 24.5 percent to 20 percent within the next three years**. The exact timing of the cuts can be fine-tuned in response to economic conditions and the strength of the overall budget balance. This will send a strong signal of our commitment to remain internationally competitive and to lighten the tax burden for local companies in the coming years when economic growth is likely to be less robust.

Anti-tax Haven Rules

4. We have assessed the implications of lowering the corporate tax rate in the context of the anti-tax haven rules (also known as Controlled Foreign Corporation, or CFC, rules) of our investor countries. Our assessment is that the reduction in the corporate tax rate to 20 percent will have limited impact on the application of CFC rules to companies in Singapore. These rules are primarily targeted at low-tax jurisdictions that companies book their (passive) incomes in, without generating any real economic activity, for purposes of deferring taxes. Companies that engage in real business activities should not be affected. There are exclusions (also known as safe harbour provisions)

that would exempt such companies from the CFC rules of their home countries.

GROUP RELIEF

5. One of Singapore's micro-economic weaknesses is the lack of entrepreneurial dynamism in our firms. For example, in the Global Entrepreneurship Monitor (GEM) 2000 report, Singapore was ranked poorly -- 19th out of the 21 countries surveyed -- in terms of the prevalence of entrepreneurial activities. The tax system can help to encourage enterprise by providing a more conducive environment for businesses and companies to take risky but potentially profitable ventures.

6. Under our current tax system, each company within a group is considered as a separate tax legal entity and is taxed independently. The losses from one company cannot be used to offset the taxable profits of another company within the same group. Many institutions, however, operate through many different forms of legal entities, either due to regulatory and legal constraints, or as a commercial preference. A group with an overall loss position could still end up with a positive tax liability under our current tax system if it has both profit-making and loss-making members. This increases the cost of doing business in Singapore.

7. As our economy develops and becomes more sophisticated, group companies will become more prevalent. Our tax system should recognise the economic reality of group companies. Ignoring this reality creates economic irrationalities (for example, taxing companies that register loss on a group basis) and business distortions (for example, the bias for setting up divisions instead of subsidiaries, resulting in a loss of 'limited liability' protection for new businesses[9]).

8. **We, therefore, recommend introducing group relief in our corporate tax system** to allow corporate groups to offset the losses of one company against the taxable profits of another company within the same group. This will also give companies flexibility to start new activities through subsidiaries and contribute to a more supportive environment for innovation and risk-taking.

[9] In general, the commercial preference is to set up subsidiaries to undertake new risky ventures in order to limit liability. However, without group relief provisions, companies may choose to set up new divisions to undertake risky ventures so that the losses can be used to offset the income generated by other profitable divisions.

Main Features of Group Relief

9. We recommend adopting the loss transfer model[10] of group relief, which is less complex to administer, will not require a fundamental overhaul of our corporate tax regime and can therefore be introduced quite quickly. Possible parameters of the group relief regime are:

a) Shareholding threshold of 75 percent (i.e. two companies are members of a group if one is at least 75 percent owned by the other, or if both are at least 75 percent owned by a common parent).

b) Allow transfer of 100 percent of current year unutilised capital allowances and losses.

10. It is administratively complicated to implement a group relief regime. It is also difficult to estimate the revenue loss[11]. Hence, many countries that introduced group relief (for example Australia and Japan) started with a conservative approach of imposing a 100 percent shareholding threshold. However, we think that this would be overly restrictive, and are therefore **recommending a 75 percent threshold** instead. This would make our system as competitive as most other group relief regimes in the world, for example, Ireland and the UK (shareholding threshold of 75 percent) and the US (shareholding threshold of 80 percent). We also **recommend that the government consider lowering the shareholding threshold further after it has fully assessed the impact of group relief**.

<u>Consortium Relief</u>

11. Even at 75 percent, we recognise that the shareholding requirement may be too high for some companies to qualify for group relief, particularly for those that enter into joint ventures with strategic partners. One way of allowing loss transfer for joint ventures and companies that do not meet the 75 percent requirement is through the provision of consortium relief. The UK, for example, has a consortium relief regime, which defines a company to be owned by a consortium if not less than 75 percent of its ordinary share capital is both directly and beneficially owned by companies which each owns at least 5 percent. **We recommend that the government consider the implementation of consortium relief as part of the group relief**

[10] The loss transfer model is applied in the UK, Ireland, New Zealand and Finland. Under this system, the losses of a company within a group can be utilised by another company within the same group for tax purposes. The alternative approach is the group consolidation system adopted by US and much of continental Europe. This system requires a single return to be submitted by the parent based on the computations prepared by individual members of the group.

[11] One way to mitigate the revenue loss is to pro-rate the amount of loss-transfer according to the parent's shareholding. This, however, brings about additional administrative complexities, including the issue of how much loss to be transferred to sibling companies (since sibling companies do not own each other).

regime, after the basic features of the group relief regime have been put in place.

Overseas Losses

12. In order for Singapore companies to grow into global champions, they have to start venturing into new markets and businesses overseas. Extending the group relief provisions to allow companies to offset the losses of overseas branches and subsidiaries against local profits is one way of encouraging companies to venture abroad.

13. However, Singapore operates a territorial system of taxation, where only income earned in Singapore is subject to income tax. Foreign incomes are not taxable unless they are remitted into Singapore. If foreign losses are allowed to set off local profits, and yet foreign profits are not taxed domestically, this would result in the government 'subsidising' losses without being able to effectively tax any corresponding profits after allowing for foreign tax credits. Therefore, the relaxation of group relief rules for purposes of allowing overseas losses needs to be studied carefully in relation to our current framework on the taxation of foreign source income. **We recommend that the government study this issue further after it has put in place the basic features of the group relief regime.**

ONE-TIER CORPORATE TAX SYSTEM

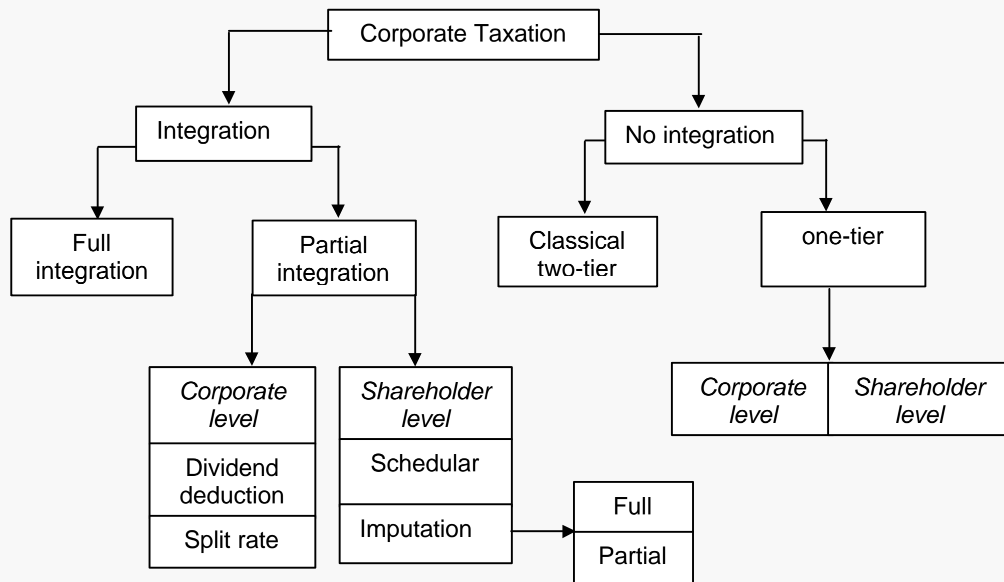
14. Singapore currently has a full-imputation system[12] where corporate profits, whether distributed or retained, are taxed at the corporate level (see Box 3-1 for the main corporate tax systems that exist today). When the corporate income is distributed as a dividend, the corporate tax paid is allowed as a credit (known as tax deducted at source) against the tax of the shareholder. In effect, the corporate income is only subject to tax once in the shareholders' hands and at the respective marginal income tax rates of the shareholder.

15. The main feature of our full-imputation system is that tax is paid in accordance to the shareholders' marginal tax rates. However, there are several major drawbacks with the existing imputation system:

- First, the full-imputation system hinders companies from distributing corporate income to shareholders, as they need sufficient tax credits (in what is known as the *Section 44* account) before they can pay dividends. This also discourages many holding companies from using Singapore as a hub for their regional activities.

[12] The details of the full-imputation system in Singapore are in Sections 44 and 46 of the Income Tax Act.

Box 3-1: Main Corporate Taxation Models



No integration

A 'no integration' corporate tax system is one that considers companies and shareholders as different entities. Hence, corporate income and dividends are treated as totally distinct from each other and taxed independently. There are two types of *no integration* tax systems:

Classical two-tier system
Tax is levied on both corporate income and distributed profits (i.e. dividend). This results in double taxation of the same income. Few countries adopt such a system, like Switzerland and the US.

One-tier system
Tax is levied only once, either at the company's level or at the shareholders' level. Hong Kong and Ireland adopt this system.

Integration

Tax systems that adopt the principle of integration are those which recognise that dividends are of the same source as corporate income. As such, tax relief (partial or full) is given to avoid double taxation of income. There are two types of integration tax systems:

Full integration
Tax all profits at the shareholders' level only, regardless of whether the profits are actually distributed. This system has yet to be adopted by any country.

Partial integration
Relief is accorded at either at the corporate or shareholder level. Many variations of partial integration exist, the main ones are the dividend deduction, split rate, and imputation (full or partial). Singapore has a full-imputation system.

- Second, the full-imputation system is not adaptable to sophisticated business transactions and increases compliance costs. As a result, tax provisions relating to these transactions are often complex to confront tax avoidance concerns. These problems are likely to exacerbate, as business transactions become more complex and sophisticated.

- Third, the full-imputation system complicates the implementation of new tax policies. For example, whenever there is income being exempt from tax, there must be provisions specifying that such amounts be separated from the tax on 'normal' corporate profits and credits allowed to enable the exempt income to be distributed. The computation and compliance of such provisions are always complex and laborious. In addition, the continued retention of the imputation system could undermine the value of group relief.

16. **We therefore recommend moving to a one-tier corporate taxation system, with tax imposed only at the corporate level.** Dividends would be exempt from tax. The one-tier corporate taxation system would complement and strengthen the effectiveness of the group relief regime[13]. It would **encourage the use of Singapore as an international hub for holding companies** and remove impediments to regionalisation. Overall, we would expect simpler tax codes with the introduction of such a system. This would greatly reduce tax compliance and administration costs for businesses. Both Hong Kong and Ireland also adopt the one-tier corporate tax system.

17. One implication of shifting to a one-tier system is that tax credits on dividend income would no longer be given. Hence, individuals with low marginal tax rates would cease to collect tax refunds on dividend income received under the one-tier system. However, this would not have significant impact for most shareholders. First, for individuals who are affected, our proposal to exempt interest income from tax (see Chapter 4) would offset the loss of tax credits on dividend income. Moreover, most individuals who either do not pay income tax or are in the lower-income tax brackets invest more heavily in deposits and savings accounts rather than equities. Second, higher income individuals and institutional investors, who account for the majority of equity investments, should not be significantly affected by the shift to a one-tier system. Third, the one-tier system could free companies from a number of restrictions relating to the distribution of corporate profit as dividends. This could result in higher dividend payouts for all shareholders.

[13] Under the present system, a company may not have a credit in its Section 44 account to distribute dividends freely out of profits due to utilising of the group losses without having to pay a Section 44 charge.

18. There is also a need to manage the transition from the current full-imputation system to a one-tier system. Some companies have accumulated substantial credits in their Section 44 accounts. As Section 44 accounts are not needed in a one-tier system, the **government should consider appropriate transitional arrangements** to deal with the outstanding credits in these accounts.

TAXATION OF FOREIGN SOURCE INCOME

19. In view of our small domestic base, the need to venture overseas to seek and establish new markets has always been and will continue to be a cornerstone of Singapore's development strategy. We have received feedback that the current system of taxing foreign source income is an impediment to overseas investments and the subsequent repatriation of foreign-earned income, especially when such income is subject to tax more than once, i.e. in the foreign country where the income originates and in Singapore upon remittance. This would occur if the income was sourced from jurisdictions with tax rates lower than Singapore.

20. **After deliberating over this issue, however, we are of the view that the present system of taxation of foreign source income ought to be retained**. Exempting foreign source income from tax, especially those from low or zero-tax countries, may have serious revenue implications. Round tripping of corporate revenues may result, where companies transfer profits out of Singapore and subsequently re-channel these profits back to Singapore tax-free. There are, therefore, merits to retaining the present system unless mechanisms can be found to prevent abuse in a cost-effective manner.

Improvements to the Existing System

21. The present treatment of foreign income remittances is to provide tax relief through the tax credit system (either under an avoidance of double tax agreement or unilaterally under domestic law), in which tax credits granted on foreign tax paid can be used to offset against the Singapore tax on remitted income. In effect, this is no different from an outright exemption of foreign source income remittances, if the foreign income has been subject to tax equal or higher than the Singapore tax rate. In instances where the foreign tax rate is lower than the Singapore tax rate, only the difference between the foreign tax suffered and Singapore tax assessed is to be paid. This ensures that both domestic and foreign incomes are taxed at the same level. Given our relatively low tax rates compared to other countries, most businesses are not likely to incur any additional tax on foreign source income

upon remittance to Singapore. **There are, however, specific areas where the current system can be improved**.

a) **Extending foreign tax credits beyond the first-tier investee company.** Currently, foreign tax credit is given only for foreign taxes paid by the overseas company remitting the dividends back to Singapore. It is not available for foreign taxes paid beyond the first-tier overseas company, even though income from these companies are eventually remitted to Singapore via the first-tier company. For companies with corporate groups formed within their foreign investee company, significant double taxation could still arise. **We therefore recommend extending the availability of foreign tax credits to lower-level subsidiaries.**

b) **Liberalising the prescribed list of services that qualify for unilateral tax credit (UTC).** Currently, UTC is granted only in respect of income arising from a specified list of services. This is overly restrictive. If the intention is to encourage outward business expansion, there is little reason why there should be a list of prescribed services. **We recommend expanding the list of services that qualify for UTC, or doing away with the need for such a prescribed list altogether.**

c) **Lower the minimum threshold to qualify for UTC.** Currently, UTC is given only if the Singapore company owns at least 25 percent shareholdings in the overseas company remitting the overseas income. **We propose to reduce the effective shareholding requirement** by setting it at the lower of the existing 25 percent shareholding threshold or a minimum dollar quantum for the equity investment. This would enable more companies to qualify for UTC.

22. Besides the tax credit system, foreign source income can also be remitted tax-free if exemption has been granted under Section 13(8) of the Income Tax Act. Currently such exemptions are granted only if the income is reinvested and contributes to productive economic activity in Singapore. To encourage more companies to bring their funds back to Singapore, **we recommend allowing for more flexible criteria to qualify for tax exemption of foreign source income under Section 13(8),**

CARRY-BACK OF LOSSES

23. Many of our companies that are generally profitable suffer cash flow problems in the course of the business cycle. Our current tax system allows a company to **carry forward** its unabsorbed trading losses to offset its future

tax liability, provided there is no substantial change of the company's shareholders and their shareholdings. However, this does not help immediate cash flow.

24. In addition to a loss **carry-forward** system, some countries also allow their companies to **carry-back** their losses to be set-off against past years' profits. Hence, companies with current year losses will be eligible to receive a refund on income taxes paid in previous tax years. This is a feature adopted in countries like Germany, Japan (both 1-year carry-back), the Netherlands (3-years carry-back), and the US (2-years carry-back).

25. We recognise that a loss carry-back feature would lead to greater uncertainty in government revenue. However, there is no long-term impact on government revenue as the current system already allows losses to be carried forward. The loss of revenue only arises if the company does not recover from its current losses and subsequently fails. It would also help relieve the cash-flow burdens of businesses suffering losses during hard times. **We therefore recommend introducing a one-year loss carry-back feature in the corporate tax system.**

TAX TREATMENT OF INTELLECTUAL PROPERTY (IP)

26. The Singapore economy is being re-positioned from an investment-driven, capital-intensive one where efficiency is the key competitive advantage, to an innovation-driven, knowledge-intensive one where intellectual capital is the key competitive factor.

More Generous Tax Treatment of IP

27. Growth in such a knowledge-based economy is increasingly driven by investments in intellectual property and intangible assets. Our ability to invest and leverage on such assets will play an integral role in Singapore's next phase of innovation-driven economic development. There are already various incentives for the promotion of intellectual property activities, for example, the Development and Expansion Incentive and the partial exemption of income of authors, composers and inventors. We propose two measures to further underscore the strategic importance of intellectual property to our future economic growth.

Deduction for Expenses Incurred in Creation of Intellectual Property

28. As a late-starter in the intellectual property field, we must now nurture and encourage investments that contribute to the creation of intellectual

property assets, such as new inventions and patents, which can potentially reap significant economic returns when they are commercialised and brought to market. The tax system should facilitate this process.

29. R&D activities form a significant component of the investments made in the creation of intellectual property. Currently, we allow tax deduction for R&D expenses incurred in-house or R&D expenses incurred by approved R&D organisations that conduct their research activities in Singapore. This may not be sufficient given that companies are increasingly carrying out their research activities in collaboration with offshore affiliates or the R&D outfits of other companies.

30. We therefore propose that the government allow more **liberal deduction for R&D expenses incurred in the creation of intellectual property.** Among other things, the government should **allow a single deduction for expenses incurred on R&D outsourced to any organisation, local or foreign**.

Automatic Writing Down Allowances (WDA) for Acquisition of Intellectual Property

31. Besides building up our own intellectual property creation capabilities, acquisitions of intellectual property from overseas companies would be another means of building up a critical mass of intellectual property in Singapore. Frequently, the value of an intellectual property is not just in the direct products that can be made from it, but also in its network spin-offs. For example, a particular intellectual property may be a critical component of a product involving an entire series of intellectual properties, from which research on other components are based on.

32. Before 2001, writing down allowance (WDA) was only applicable for physical assets and approved know-how and patent rights. Since 2001, the government has introduced a WDA incentive for 7 types of legally enforceable intellectual property. Companies have to apply to the Economic Development Board (EDB) or the Infocomms Development Authority (IDA) for the incentive and only approved acquisitions are granted the WDA. The objective of this approval process is to address concerns of the valuation of the intellectual property, which can be very subjective.

33. To send a strong signal that intellectual property is as important, if not more important than physical assets for the next stage of Singapore's economic growth, **we propose that the writing down allowance for acquisition of IP be made automatic and across the board**, i.e. there should not be a need to apply to any government agency. This is already the practice for physical assets.

More Varied Criteria for Tax Incentives

34. Tax incentives are based on a set of criteria requiring the recipient companies to make specific commitments, usually in terms of fixed asset investment and total business spending. As we move towards a knowledge-based economy, a growing proportion of business activities will leverage on intellectual property and proprietary know-how rather than fixed assets. Hence, some of the existing criteria for tax incentives need to be updated and made relevant.

35. **We recommend that tax incentives be designed with more flexible and varied criteria,** besides fixed asset investment and total business spending, so as to capture the full contributions of the company in the knowledge-based economy.

WITHHOLDING TAX

36. Withholding tax is a tax imposed on the incomes[14] of non-residents. Withholding tax legislation was introduced to make the tax collection procedure more effective and efficient. The effect is to prevent non-residents from evading the payment of Singapore tax simply because they are physically outside Singapore. The imposition of withholding tax involves deducting the tax from amounts to be paid to non-residents and forwarding that to the Inland Revenue Authority of Singapore (IRAS). In effect, the payer becomes a tax-collecting agent.

37. There are, however, several problems associated with the withholding tax regime today. First, many businesses have weaker bargaining powers and end up bearing the cost of the withholding tax, because the non-resident suppliers insist on net-of-tax payments. This increases the cost burden to businesses, affecting our competitiveness. Second, the administrative requirements can be quite onerous, particular for businesses (for example, banks) that have numerous transactions with non-resident persons.

38. We think that there are merits to retaining the withholding tax system. Withholding tax is a tax on non-residents, who ought to pay their fair share of tax. Removing withholding tax could also lead to an uneven playing field between Singapore and foreign businesses. Furthermore, removing withholding tax may result in a transfer of revenues to foreign treasuries[15], without any corresponding benefits to Singapore. As the number of cross-

[14] It is applicable to several classes of income, including interest, royalties, management fees, directors' remuneration and gains from short-term real property transactions.

[15] Countries usually grant a tax credit for foreign taxes suffered. As a result, these countries collect less tax after netting off the foreign tax credits. If Singapore does not impose any withholding taxes, the foreign country does not need to grant any foreign tax credit to the business (since there is no foreign tax suffered), thus collecting more taxes.

border transactions increase and the risks of tax evasion rise, the withholding tax mechanism will become even more important.

39. However, we need to update our withholding tax provisions to ensure that it does not inadvertently discourage cross-border transactions and disincentivise people and companies from locating their activities in Singapore as a regional hub. This would require a more in-depth and comprehensive study. **We therefore recommend that a consultative body be formed, with representatives from the private sector, to review the withholding tax system,** rationalise the scope of the withholding tax provisions and study possible changes to the administrative process. It should also ensure consistent treatment of industry specific withholding tax requirements.

TAX MEASURES FOR ENTERPRISE DEVELOPMENT

40. With the cut in corporate tax rates, **small and medium enterprises (SMEs) will enjoy a significant reduction in tax burden.** Many of these companies will pay **effective tax rates of between 5~10 percent**[16].

41. However, many of our local companies are small and lack sufficient funds. The industries they are in are fragmented. To compete effectively and capitalise on business opportunities in the global marketplace, companies have to pool their resources and capabilities.

42. Under our income tax system, capital gains are not taxable. As a corollary, capital-related costs are generally not tax deductible. Capital-related costs include costs incurred in merger & acquisition and restructuring activities. The inability to deduct these restructuring costs for tax purposes represent additional costs for small companies consolidating and streamlining their activities.

43. To encourage consolidation in heavily fragmented industries, we recommend **giving a tax deduction for the front-end costs incurred in merger and acquisition exercises.** This should be targeted at small and medium-sized companies across all industries, but with a sunset clause. We also **recommend giving a tax deduction for selected expenses incurred prior to starting new businesses (pre-commencement expenses) as well as expenses incurred in the listing of companies (listing expenses) to help promote enterprise development.**

44. Many entrepreneurs face difficulties securing adequate seed-stage funding to bring their ideas to market. In the US, private investors or 'business angels' form the backbone of a small company's start-up capital.

[16] After taking into account the partial exemptions for chargeable incomes of up to $100,000.

They are generally willing to risk their investments to reap potentially large gains when the venture succeeds.

45. To promote investment in seed-stage technopreneurial start-ups, the Technopreneurship Investment Incentive (TII)[17] was implemented in September 1999 under the Technopreneurship 21 Programme. However, the TII is only available to high-tech start-ups. Promotion of entrepreneurial activities in Singapore should be broadened across all industries, not just the high-tech or IT sectors. **We therefore recommend that the TII be broadened to an Entrepreneur Investment Incentive (EII).** The EII should be made available to a wider range of entrepreneurs and not just those deemed to be high-tech.

CONCLUSION

46. The changes to our corporate tax regime will create the conditions to attract global players and encourage the growth of private enterprise in Singapore. In addition to reducing corporate tax rates, fundamental changes such as introducing group relief and shifting to a one-tier corporate tax system will make our business environment more attractive and relevant for companies and businesses. In addition, the improvements in the tax treatment of intellectual property and the measures to promote enterprise development will help our local enterprises.

[17] The TII provides investors in qualified start-ups with loss insurance for their investments by allowing them to deduct losses against their taxable personal or corporate income.

CHAPTER 4: PERSONAL INCOME TAX

INTRODUCTION

1. Human capital is the key to success in any company or country. The talented and highly-skilled provide critical expertise needed for knowledge-based activities. If Singapore is to succeed in its drive towards a knowledge-based economy, we will have to provide maximum incentive for individuals, both Singaporeans and foreigners, to work in Singapore and help create value for our economy.

2. To build a conducive personal tax environment, we looked at various areas of tax that are relevant to individuals, including the taxation of employment income (in terms of salaries, options and benefits), investment income, foreign source income remitted back to Singapore and estate duty.

PERSONAL INCOME TAX RATES

3. Although Singapore's current personal income tax rates are generally competitive, our advantage is being eroded, as other countries are also lowering their personal income tax rates to attract and retain global talent. Countries like Germany, Ireland, Malaysia and the US have all lowered their personal tax rates in the last two years, while Hong Kong continues to offer one of the lowest personal tax rates in the world. Some of these countries, including the Netherlands and Sweden, also offer special schemes which lower the effective tax rates for international talent.

4. We recommend a significant reduction in the personal income rates for income earned in 2002. As a medium-term target, the top marginal tax rate should be reduced from the current **26 percent to 20 percent within the next 3 years,** with corresponding cuts in all income bands. This will encourage and reward hard work, innovation and enterprise. It is a strategic move, sending a strong signal of Singapore's intention to be a talent capital.

TAX-EXEMPTION FOR INTEREST INCOME AND FOREIGN SOURCE PERSONAL INCOME REMITTED BACK TO SINGAPORE

5. We note that the tax-exemption of interest income earned from POSB deposits is being removed gradually from this year onwards. We also note that non-residents, unlike Singapore residents, continue to be exempted from Singapore income tax on their interest income from deposits with Singapore resident banks. In addition, domestic funds are being transferred overseas every year, as investors seek better after-tax returns on their savings.

6. We **recommend tax exemption on interest income arising from all bank deposits, debt securities and other interest-bearing instruments.** This would reduce distortions in the way savings are taxed and increase liquidity in promoting the domestic capital markets. The revenue impact is likely to be small, as the revenue collected from tax on interest income is minimal.

7. Currently, personal income from abroad that is remitted into Singapore by Singapore tax residents is subject to tax. This includes income from overseas employment and overseas investments. Foreign source personal income is only exempt from Singapore tax if it is remitted by non-resident individuals and individuals who migrate to Singapore[18]. This is unlike the practice in many countries such as Australia, China, Hong Kong, Ireland, Malaysia, Netherlands, Sweden, and the UK where such foreign remittances are not subject to tax.

8. We therefore **recommend exempting all foreign source personal income remitted back to Singapore from tax**. This should be implemented together with the proposal to exempt interest income from tax. This way, individuals will be encouraged to bring back their overseas funds to earn tax-free interest on their savings and investments. This will have significant positive spin-offs for the financial sector and the Singapore economy.

'DAYS-IN DAYS-OUT' SCHEME

9. An important enhancement of our personal tax system is to exempt from tax the earnings attributable to work outside Singapore for employees who spend a significant amount of time working abroad. This would strengthen Singapore's attractiveness as a talent hub and a centre for management of Asian business activities.

10. We recommend implementing a system of time apportionment of employment income, based on the days-in days-out method of calculating the individual tax burden. This means that an individual's employment income which is liable for tax in Singapore is pro-rated based on the number of days he spent in Singapore during the year. In effect, the employment income attributable to time spent outside Singapore is exempt from tax.

11. Our current tax rules allow for time apportionment of employment income on a very limited basis, for employees of non-resident companies based in Singapore to perform their duties in Singapore and other regional countries. This will not be sufficient as businesses globalise their operations and more and more individuals take on jobs with overseas responsibilities.

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[18] If they can show that the foreign income received was earned prior to their relocation to Singapore.

12. We therefore **recommend extending time apportionment of employment income to a wider group of individuals with significant international responsibilities**. The aim is to reduce the tax burden on top executives, especially given the regional and global nature of their jobs. Following the tax treatment in the UK for persons who are 'resident, but not ordinarily resident', the scheme would apply to all tax residents who have not been living in Singapore for the preceding 3 years or more. Besides the UK, similar schemes are also offered in Hong Kong and Belgium (See Table 4-1).

Table 4-1: Time Apportionment Schemes in Other Countries

Country	Target Individuals
Hong Kong	Mainly expatriates
UK	"Resident, but Not Ordinarily Resident" individuals who intend to remain in UK for less than 3 years.
Belgium	This is part of a special regime for expatriates with special knowledge and responsibilities

13. To qualify for the scheme, such individuals must have international responsibilities requiring them to spend substantial time abroad, for example, at least 90 days annually. They should also spend a minimum amount of time working in Singapore, for example at least 90 days. Qualifying individuals would receive the tax exemption for 5 years.

EMPLOYERS' CONTRIBUTION TO OVERSEAS PRIVATE PENSION FUNDS

14. Currently, when an employer contributes to an overseas private pension fund on behalf of an expatriate worker in Singapore, the contributions are subject to tax. This puts us at a disadvantage compared to countries like Ireland, the Netherlands, and the UK where employers' contributions to approved funds[19] are not taxable. We are also viewed less favourably vis-à-vis countries such as Hong Kong where all employer contributions for employees into private pensions are not taxable at the point of contribution. With our current system, expatriates based here on overseas assignment may suffer double taxation as they may be taxed once in Singapore at point of contribution and again, at the point of withdrawal in their home countries. **To improve our attractiveness vis-à-vis these countries,**

[19] Overseas pension funds qualify for approved status only if the country of the overseas fund gives reciprocal treatment.

we recommend that employers' contribution on behalf of expatriates into overseas private pension funds be exempt from tax.

TAXATION OF STOCK OPTIONS

15. Employee stock options are becoming increasingly prevalent tools for nurturing a vibrant entrepreneurial environment and improving corporate performance. As options make up an increasingly larger proportion of an individual's remuneration, the way we tax stock options in Singapore will significantly affect our attractiveness as a talent capital.

16. There are already several schemes in place to encourage employers to make use of options as a performance-linked compensation tool. However, we received strong representations from the private sector that the current schemes are not attractive enough, particularly compared to the incentive schemes offered in countries like Ireland, the UK and the US (see Box 4-1 for the different approaches to taxing stock options).

17. We therefore recommend **changes in the tax treatment of stock options** to strengthen the entrepreneurial culture and compete effectively for talent. This will also encourage remuneration packages that better link the interests of management and employees with the performance of the company. The following proposals on the tax treatment of stock options should also apply generally to **share awards**, as both are equity-based methods of remuneration.

Deferral of Tax Payment

18. Currently, under the Qualified Employee Stock Option (QSOP) scheme, employees are allowed to defer payment of taxes on stock option gains for up to 5 years from the point of exercise, subject to an interest charge. While this tries to address the cash shortage problems that employees face in having to pay the tax obligations, feedback indicates that the terms remain unattractive for many employees. Many therefore sell the converted shares immediately upon exercise. This negates the original aim of stock options to promote employee loyalty and commitment, and remuneration that shares in the risk of the firm's profits.

19. We recommend **extending the deferment period to the point of sale of the converted shares or 7 years from the exercise date, whichever is earlier.** We also recommend **removing the current interest charge on the tax deferred**. This will allow us to remain competitive vis-à-vis other countries like Ireland, which also does not charge interest on tax deferred

under its stock option scheme, and the US, which taxes at the point of sale under its Incentive Stock Option scheme.

Box 4-1: Taxation of Stock Options

Gains from stock options are taxed because they constitute income from employment. There are various approaches to taxing stock options.

Approach to Tax	Countries
Taxation at the point of grant • Taxable gains = Fair value of options (Countries differ in their opinion of the fair market value of options)	Belgium, Netherlands and Switzerland.
Taxation at the point of exercise • Taxable gains = (Market price of shares – Exercise price)	UK, Hong Kong, **Singapore**, Ireland, and Non-qualified stock options in the US.
Taxation at the point of sale • Taxable gains = (Market price of shares at point of sale – Exercise price) *[The gains are taxed at the capital gains tax rate]*	Incentive Stock Options in the US, Approved Stock Option plan in Ireland, and Enterprise Management Incentive scheme in UK.

Singapore adopts the method of taxing stock options gains **at the point when the options are exercised.** There are three incentive schemes for stock options:

<u>a) Qualified Employee Stock Option Scheme (QSOP)</u> allows employees to defer payment of tax on taxable stock option gains for up to 5 years, subject to an interest charge. This incentive is given to alleviate the cash flow problems faced by some employees who do not sell their shares after exercising the stock option.

<u>b) Company Stock Option Scheme (CSOP)</u> is given to encourage more established companies to set up performance-linked compensation systems to motivate their employees towards greater innovation and enterprise. Under this scheme, income tax exemption will be granted for up to $1 million of gains from the exercise of stock options over a 10-year period.

<u>c) Entrepreneurial Employee Stock Option Scheme (EESOS)</u> gives a 50% income tax exemption to employees on assessable stock option gains of up to $10 million arising from the exercise of the stock options over a 10-year period.

Shift Tax Liability to End of Moratorium Period

20. Some stock options are issued with a moratorium or a holding period on the sale of the converted shares. After exercising the options and converting them into shares, the individual is not allowed to sell the shares and cash in his benefits for a certain period of time. We are of the view that individuals should be taxed on a 'benefit' only when it becomes realisable. Hence, in such cases, we **recommend that the tax liability be raised only at the end of the moratorium period, based on the difference between the market price at the end of the moratorium period and the exercise price.**

More Flexible Criteria to Qualify for Stock Option Schemes

21. We note that some of the qualifying criteria for the stock option schemes are overly stringent and ought to be refined so that more companies can qualify for these schemes. For example, the requirement for a 50 percent participation rate automatically rules out many manufacturing MNCs from qualifying for the Company Stock Option (CSOP) scheme. This is because the usual policy set by head office is to exclude bargainable staff from stock option plans, and the Singapore subsidiary usually has no authority to amend the terms of these plans. As a general principle, we recommend **setting more flexible qualifying criteria** so that more companies can benefit from the stock option schemes that are in place today.

Not Taxing Gains Derived from Stock Options Granted Overseas

22. Currently, all gains arising from the exercise of stock options in Singapore are fully taxable, regardless of whether the options are granted for work done overseas or in Singapore. This creates an immediate disincentive for individuals to relocate and work in Singapore, as they have to pay up a potentially large tax liability whenever they exercise their options.

23. **We recommend not taxing the gains from the exercise of options in Singapore, if the options were granted for work done overseas.** This means that the gains from stock options would be treated as employment gains and taxed only to the extent that they are attributable to Singapore employment. This is consistent with practices in other countries, like Ireland and Australia.

Adopt a 'Deemed Exercise' Rule for Departing Expatriates with Unexercised Stock Options

24. We also propose that **departing expatriates should settle their taxes on unexercised stock options on a "deemed exercise" basis at the point of departure**. This requirement may be waived if the employer is willing to be accountable for tracking its employee upon his departure from Singapore. Further, if the tax liability at actual exercise is lower than that at "deemed exercise", re-assessment of the tax liability of individuals should be allowed, as is the case in Hong Kong.

Other Proposals

25. Besides changes in the tax treatment of stock options, we have also received feedback on other measures to encourage the use of stock options. These are being studied by the ERC Sub-Committee on Entrepreneurship and Internationalisation. For example, the number of shares that can be made available under stock option plans currently must not exceed 15 percent of the issued share capital for mainboard-listed companies. This can be increased to, say, 25 percent to allow listed companies more flexibility in setting aside more issued share capital for stock options.

26. In addition, a qualifying employee of a stock option plan currently cannot hold more than 25 percent of the voting shares of the company. This is to ensure that an employee who is a controlling shareholder does not take advantage of the stock option scheme by issuing an inordinately large amount of stock options to himself. This 25 percent hurdle can be increased to 30 percent in line with the revised definition of 'Effective Control' based on the provisions of the Companies' Act for take-overs.

ESTATE DUTY

27. When a person passes away, the assets (both movable and immovable) left by him form his estate. For a person domiciled in Singapore, estate duty is payable on the aggregate market value of all assets (both movables and immovables) in Singapore and movable assets outside Singapore. For a person domiciled outside Singapore, estate duty is payable only on all assets in Singapore. Table 4-2 shows the current exemption limits beyond which estate duty is chargeable and the current rates of estate duty.

Table 4-2: Structure of Estate Duty

Exemptions

Assets	**Exemption Limit**
a) Dwelling houses	Up to the value of $9 million
b) All other assets (including CPF balance)	Up to the value of $600,000
c) If the CPF balance exceeds $600,000	The entire CPF balance, including the excess over $600,000

Rates of Duty

Estate subject to duty	**Rate**
For every dollar of the first $12 million	5%
For every dollar exceeding $12 million	10%

28. The current exemption limit, above which estate duty is chargeable, is significantly higher for residential property compared with all other assets. The intention of the higher exemption limit for residential property is to not penalise ownership of houses. However, the significant differential in exemption limits has resulted in distortions in the portfolio allocation of most Singaporeans today. Individuals tend to invest heavily in real estate compared with other assets in light of the much smaller estate duty that would be chargeable. To correct this distortion, we recommend that the **exemption limit for all other assets be raised from $600,000 to $2 million.**

29. **We also recommend exempting the movable assets of non-domiciles in Singapore from estate duty.** This would encourage more expatriates to hold S$-denominated assets and boost Singapore's attractiveness as a private banking centre.

CONCLUSION

30. The proposed changes to our personal income tax system will lighten the tax burden on individuals. It will encourage hard work and enterprise, and strengthen the incentive for individuals, both Singaporeans and foreigners, to work in Singapore and help create value for our economy. As human capital is the key driver of economic growth, a talent-friendly fiscal environment will be instrumental in sustaining Singapore’s economic prosperity.

INDIRECT TAXES

PART III

CHAPTER 5: GOODS AND SERVICES TAX

INTRODUCTION

1. The Goods and Services Tax (GST) was introduced in 1994 to broaden Singapore's tax base and reduce our reliance on direct taxes. It enabled us to reduce corporate and personal income tax rates in the 1990s to enhance the attractiveness of the business environment.

2. Singapore's strategy for economic growth must include a restructuring of the tax system so as to bring in new investments and create good, well-paying jobs for Singaporeans.

3. The competitive premium that Singapore offered to investors in the past through lower income tax rates is being eroded (see Chapter 1). Our current tax structure is losing competitiveness because other countries are lowering their income tax rates.

4. We have recommended decisive measures to restructure taxes to encourage individuals and businesses to spur the growth of economic activities in Singapore (see Chapters 3 and 4). These centre on cuts in income taxes, which should be accompanied by a shift towards greater reliance on indirect taxes, principally the GST, to make up for any shortfall in revenue.

THE NEED TO RELY MORE ON GST

5. Most countries have moved to GST as a more economically efficient form of tax. There are several reasons why this is so:

a. GST preserves the incentive to work and encourages enterprise. As people's income increases, income tax will push them into higher tax brackets, which take larger proportions of their income. GST will not.

b. GST minimises economic distortions, because it covers a comprehensive range of goods and services. It can also raise a given amount of revenue with a lower percentage tax rate, compared to other taxes.

c. GST is an efficient tax to administer. It is self-policing, which cuts down avoidance and evasion.

Avoiding Budget Deficits – A More Robust Tax Base

6. The package of lower income tax rates and other pro-growth tax measures will decrease government revenue and limit our ability to spend on our security, social and infrastructure needs. Expenditures on healthcare and other social requirements are likely to rise because of higher costs, rising expectations and an ageing population. The government should ensure it has adequate revenue to fund such expenditures.

7. Singapore's ageing population trends also indicate that our income tax base will decline. If we continue to rely heavily on personal income taxes, growth and enterprise will be inhibited. Increasing GST and decreasing income tax rates will lessen the problem by spreading the burden of taxation more broadly among the population. It will put our tax base on a more resilient footing. It is critical to make up for at least part of the revenue loss from income tax cuts as early as possible. This will allow the government to continue to budget for modest surpluses over the business cycle.

8. **We therefore recommend that the GST rate be raised from 3 percent to 5 percent in 2003. This will provide a wider and more resilient tax base to support government revenue through the challenge of economic restructuring.** Even at 5 percent, this will still be one of the lowest GST rates in the world (see Box 5-1).

9. The GST should continue to be applied at a single rate and across-the-board on all goods and services, with as few exemptions as possible. We have received several proposals to implement a two-tier GST system, with 'zero-rating' for basic essentials, to help the lower-income. This actually helps the high-income more than poorer Singaporeans. A well-off household usually spends much more on 'essentials' - whether this is food or healthcare or other basic 'necessities' - than a low-income household. If we were to exempt 'essentials' from GST, there would be a need to make up for the revenue shortfall through a higher GST rate on other goods and services, which the lower income households would also have to bear.

10. The experience of other countries have demonstrated that granting exemptions will distort production and consumption decisions, and lead us into a contentious and highly complex process of determining which goods and services merit exemption. This will increase compliance and administration costs for businesses.

11. Hence, it is far better for us to maintain a relatively low, single GST rate of 5 per cent on all goods and services. The lower-income groups will be better taken care of through more direct schemes to offset the impact of the increase in GST.

Box 5-1: GST Rates Around the World

Even at 5 percent, we will still have one of the lowest GST rates in the world. The examples below refer to GST or VAT rates. Many other countries impose sales taxes that are higher than 5 per cent, for example, Malaysia (5% or higher), US (example, 8.25% in New York, 8.5% in California, 8.75% in Chicago), Canada (7% GST +7.5% sales tax in Vancouver).

Country	GST / VAT Rate (percent)
Australia	10% comprehensive, with essential items zero-rated.
Denmark	25% comprehensive, with a list of items exempted, e.g., healthcare, education, cultural activities.
France	19.6% comprehensive, with some essential items at 5.5% and 2.1%.
Germany	16% comprehensive, with some essential items at 7%.
Japan	5% comprehensive.
Korea	10% comprehensive.
Luxembourg	15% comprehensive, with some items at reduced rates of 12%, 6% and 3%.
Netherlands	19% comprehensive, with some items at reduced rates of 6%.
New Zealand	12.5% comprehensive, zero-rated for exports and international services.
Sweden	25% comprehensive, with some items at reduced rate of 12% and 6%.
Switzerland	7.6% comprehensive, with some basic items at 2.4% and 3.6%.
UK	17.5% comprehensive, with some essential items zero-rated.

PACKAGE TO OFFSET IMPACT OF GST INCREASE

12. When GST was introduced in 1994, the government provided a comprehensive package of assistance that included:

a. Rebates for HDB service and conservancy charges;
b. Rental rebates for HDB flats;

c. Additional subsidy for state-provided health and education services;
d. Increase in Singapore Allowance;
e. Additional Public Assistance for the destitute; and
f. Grants for Citizen's Consultative Committees' assistance schemes.

13. It will take time for the pro-growth package to bring in more and better paying jobs. In the meantime, Singaporean households, especially lower income ones, will be affected by the proposed GST increase. To help cushion the impact, **we strongly recommend that the government provide an offset package to help Singaporeans adjust to the GST increase, as was done in 1994. The package should ensure that most households, especially lower-income households, are no worse off during the transition.**

14. Besides assistance to households, the government should pay particular attention to the impact of the GST increase on education, healthcare and public transport, and offset or moderate them appropriately.

15. In addition, the government should set up a **committee to combat profiteering and undue price increases,** as was done in 1994. This committee should monitor prices of selected basic goods and services, and develop effective consumer education programmes to ensure general price stability before and after the change in the GST rate.

CONCLUSION

16. Tiding Singaporeans through this transition should be a major priority of the government. The GST rate increase constitutes an important limb of the entire economic restructuring package. It ensures that our drive to be competitive will not compromise the capacity of government to provide key goods and services to citizens.

CHAPTER 6: CAR TAXES & CHARGES

INTRODUCTION

1. Taxes and charges on car ownership are presently a significant component of the fiscal burden faced by middle and upper-middle-income households. We propose to lower car ownership taxes gradually and shift the balance of car taxes towards usage charges. This would reduce the tax burden on car-owning families, and allow more people to own cars while keeping congestion at an acceptable level.

CURRENT SITUATION

2. In view of our limited space, Singapore has put in place various measures to manage the demand for cars and road usage so as to ensure that traffic conditions remain smooth. We rely on a range of ownership and usage restraint measures, with greater emphasis placed on ownership controls.

3. The main **ownership** restraint measures used in Singapore are the **Additional Registration Fee (ARF)** and **Excise Duty (ED)**, the **Vehicle Quota System (VQS)**, which serves to control vehicle population in Singapore through the release of **Certificate of Entitlement (COE) quotas**, and **Road Tax**[20]. The ARF and ED for cars are fixed at 140 percent and 31 percent of the open market value (OMV). For example, a 1.6 litre Toyota Corolla with OMV of $20,000 could end up with a final price tag of $95,000[21]. In terms of usage charges, the main policy lever is the Electronic Road Pricing (ERP).

4. Our current system has proven to be highly effective in containing congestion. Traffic density in Singapore is relatively low compared to other major cities. However, as a result of our tight ownership restraint measures (COE quota plus high upfront taxes), many cannot afford to own a car. The price of a 1600 cc car is around 2.5 times our per capita GDP, much higher than the corresponding ratio in other cities (see Chart 6-1).

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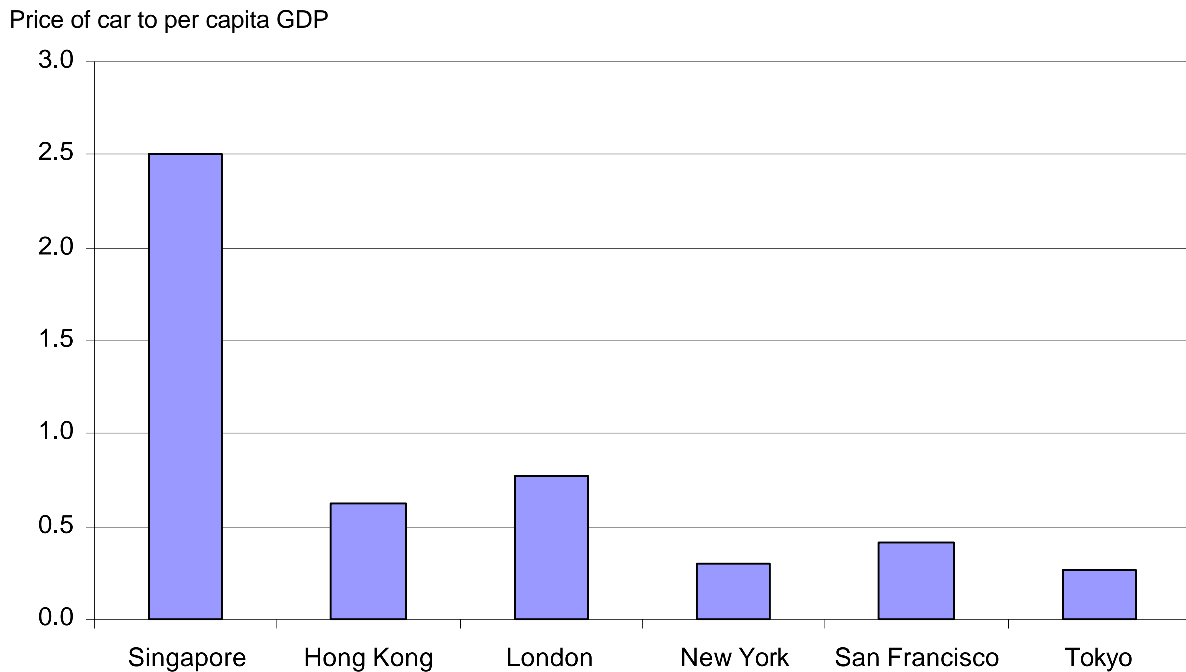
[20] Road tax is effectively a form of ownership tax, even though it is paid on a yearly basis, since all car-owners are required to pay road tax on their cars.

[21] This includes the combined ARF and ED of 171 percent of OMV, GST, Registration Fee, COE (around $30,000) and Dealer's Margin.

Chart 6-1: Car Price to Per Capita GDP Ratio



5. Among those who own cars, usage tends to be high. The mileage clocked by a car in Singapore averages 18,000 km per year -- very high by international standards. This is not entirely surprising, given that motorists see the usage charges as being relatively low compared to their sunk costs. Another reason for the high mileage is that most households in Singapore own one car (due to the ownership controls) compared to other countries, and hence, the single car is used more often.

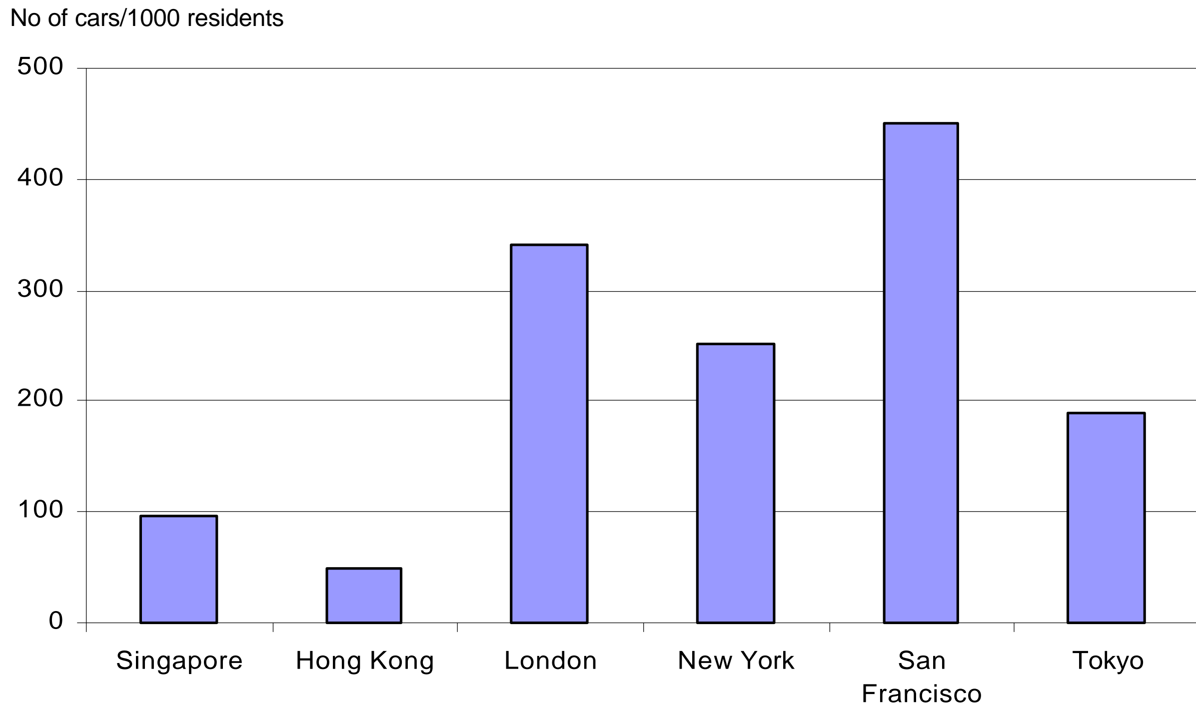
6. As a result of the high upfront restraint measures imposed to control car ownership and congestion, **ownership taxes and charges**[22] account for about **80 percent of total car taxes**. In addition, these taxes and charges on car ownership are significant components of the fiscal burden faced by middle and upper-middle income households. This disproportionate tax burden imposed on car ownership is a blunt tool for controlling traffic congestion and imposes unnecessary costs. It is not satisfactory in the long-run.

RISING ASPIRATIONS TO OWN CARS

7. The car-to-population ratio in Singapore is significantly lower compared to other global cities like London, New York and Tokyo, although higher than Hong Kong (see Chart 6-2).

[22] As highlighted in Para 3, ownership taxes and charges include the ARF, ED, COE and road tax.

Chart 6-2: Car Ownership in Singapore vs. Other Major Cities



8. Singaporeans will continue to want to own cars because of convenience, flexibility, and social status. Increasingly, car ownership is being viewed as a necessity of middle and upper-middle income lifestyle. The proportion of people with aspirations to own cars is likely to grow over time, as education level rises and people start to benchmark their lifestyle options against global standards.

LOWERING THE COSTS OF CAR OWNERSHIP

9. We recognise that Singapore is unique and different from other cities. Unlike London or New York, car ownership rates in Singapore will always be limited by the fundamental fact that we do not have a hinterland where people can use their cars outside of the city. Hence, there is a need for us to adopt different approaches in managing the demand for cars and road usage.

10. Policies such as the VQS have proven to be effective in capping car population growth and should be retained. Besides the VQS, we also imposed high ownership taxes in the past because we lacked effective usage-charging mechanisms. The introduction of the ERP in 1998 allows us to charge for road usage in a more efficient and equitable way. **We**

therefore recommend gradually reducing taxes on ownership of cars to achieve a better balance between ownership and usage costs.

11. This would reduce the deadweight loss[23] arising from high upfront taxes. Motorists would then have better control over their expenditure in that they can decide whether to drive and incur higher usage costs. Such a system would be a significant improvement over the current one in which all car owners are made to pay high upfront costs regardless of the level of car usage and the contribution to congestion.

Reducing Car Ownership Taxes and Charges

12. We therefore **recommend reducing car ownership taxes and charges, namely the ARF** (currently at 140 percent of OMV)**, ED** (at 31 percent of OMV) and **Road Tax** (currently at $500 or more every year, depending on engine capacity).

13. While this will reduce the upfront tax burden, it may not necessarily translate fully into lower purchase price, as there could be leakage into (Certificate of Entitlement) COE premiums and dealers' margins. Hence, **more COEs will have to be released** at the same time in order to increase the car ownership base and prevent a rise in COE premiums arising from reduced ARF/ED charges.

14. The government should determine the number of additional COEs that can be released, after studying the impact on traffic congestion and other infrastructure requirements such as roads and residential car parks. **We should continue to keep congestion low.**

15. Currently, car owners who scrap their cars before the age of 10 years are eligible for Preferential Additional Registration Fee (PARF) benefits, which can be used to offset against the cost of their next car. The PARF benefits are graduated from 130 percent of OMV if the car is scrapped before 5 years, to 80 percent of OMV if scrapped after 9 years, but before 10. With the proposed reductions in ARF and ED, the **PARF rates will have to be correspondingly lowered** so that ARF does not go below the current maximum PARF of 130 percent of OMV.

Increased Usage Charges

16. The effect of reducing ownership costs coupled with the increase in number of COEs is that there will be more cars. **Measures to keep**

[23] Deadweight loss refers to the loss of total surplus arising from distortions such as taxes. It is a measure of the size of the inefficiency created by market distortions.

congestion at an acceptable level should focus on increased usage charges, including ERP and parking charges.

Adopting a Gradual Approach

17. We recommend that the reduction in ownership taxes be implemented carefully and gradually. This will give time for motorists and the market to adjust. There is also a need to consider the road and car park infrastructure requirements for higher car ownership.

CONCLUSION

18. The current system of tight ownership controls on cars, with high upfront taxes, is not satisfactory in the long-run. As we already have the ERP system in place, we propose to reduce taxes on ownership of cars to achieve a better balance between ownership and usage costs. This will help to reduce the tax burden and lower the cost of owning a car, while keeping congestion at an acceptable level.

19. Notwithstanding these changes, the cost of owning and using a car in Singapore will remain high. Improvements in the public transport system, which the majority of the population uses, are essential. We should continue to improve our public transport system to give people a wider range of quality commuting alternatives to car ownership.

OTHER PROPOSALS

PART IV

CHAPTER 7: TAX INCENTIVES

INTRODUCTION

1. Tax incentives have been an integral part of Singapore's economic development strategy since the 1960s. For more than 30 years, tax incentives have been used to attract investments and create jobs.

2. We agree with the recommendation of the 1986 Economic Committee to move to a low corporate tax regime, with minimal selective tax incentives as a long-term goal. By doing so, we will avoid inefficiencies in resource allocation and reduce tax administration and compliance costs. Nevertheless, over the medium-term, we believe that tax incentives will continue to be an effective tool to attract new activities of strategic importance to Singapore, as well as to maintain competitive tax rates for sectors that traditionally operate in low tax environments.

3. Hence, we recommend two broad thrusts in enhancing our tax incentives regime. **First, to enhance the incentives so as to attract new, innovative activities, and to grow in areas where Singapore has underlying strength but has to compete with other locations offering low tax rates. Second, to streamline and rationalise the current incentives for greater ease of administration and compliance.** This chapter highlights several key initiatives proposed by the various ERC Sub-Committees and their Working Groups in line with these broad thrusts.

4. The ability of the government to grant the incentives proposed below would depend, not only on the merits of the individual proposals, but also on the overall impact on government revenue. We recommend that the government study these proposals carefully in this context.

MANUFACTURING SECTOR INCENTIVES

5. Many countries are competing aggressively for global investments in the manufacturing sector. Singapore can only remain viable in the manufacturing sector by ensuring that business costs are kept at a competitive level. We therefore need to enhance the attractiveness and flexibility of our incentives so that more innovative incentive packages can be designed and customised for key investor companies.

6. Currently, companies are granted different tax incentives for different projects committed at different times. This requires the segregation of income streams, which increase the costs of compliance. The Manufacturing Sub-Committee recommends simplifying the tax incentive process by offering

the option of a single effective tax rate, which takes into consideration the company's commitments in the various projects. This can be achieved with the following changes to the Development and Expansion Incentive (DEI):

a) **Reduce the minimum tax rate of the Development and Expansion Incentive (DEI) from the current 10 percent to 5 percent.** The DEI was introduced in 1996 with the objective of attracting investments and technology innovation. Companies granted the DEI currently enjoy a concessionary rate of not less than 10 percent for profits above a pre-determined base. However, an across-the-board 10 percent rate may not be attractive to companies, particularly those that are already enjoying a mixture of pioneer incentives and DEI on some of their activities. **To enhance the DEI, the minimum tax rate should be reduced to 5 percent.**

b) **Rationalise some of the existing incentives in the Economic Expansion Incentives Act (EEIA)** and put them under the umbrella of the DEI.

SERVICES SECTOR INCENTIVES

Financial Services

7. The current range of financial sector incentives are sufficiently broad to promote high-value added activities and other desirable activities for which tax incentives are also accorded by our competitors. We should, however, continue to review our existing incentives, and streamline and update them to ensure their continued relevance and effectiveness.

8. The Financial Services Working Group has recommended several changes to enhance the effectiveness of the financial sector incentives. Two key proposals are:

a) **Rationalise and consolidate existing financial sector incentives. Several of the eleven existing incentives[24] can be collapsed into a single umbrella financial sector incentive scheme**, which offers lower concessionary tax rates (for example, at 5 percent), simpler administrative procedures and more flexible qualifying criteria. The details of how such a scheme can be implemented should be studied and any impact on tax revenue should also be taken into

[24] Tax Incentive for Asian Currency Unit (ACU), Approved Boutique Fund Manager (ABFM), Approved Fund Manager (AFM), Enhanced Fund Manager (EFM), Approved Trustee Company (ATC), Approved Bond Intermediary (ABI), Approved Securities Companies, SGX-DT and DC members, insurance business, marine hull and liability business, and Tax Exemption Scheme for Syndicated Facilities.

consideration. The incentive should be awarded to all applicants carrying out qualifying high growth value-added activities and not be tied to licences. For activities that are regulated by licenses, the incentive should not be a means to bypass the regulatory requirement.

b) **Expand the scope of the Finance and Treasury Centre (FTC) incentive to cover treasury activities conducted for Singapore operations.** The Finance and Treasury Centre (FTC) incentive was introduced to encourage MNCs to use Singapore as a base to conduct treasury activities for their related entities in the region. With Singapore's success in attracting manufacturing and service operations, we have now become an integral part of many companies' Asian operations. Hence, the scope of the FTC incentive should be expanded to cover treasury activities conducted for their Singapore operations.

Info-Communications & Technology (ICT)

9. The ICT sector comprises services related to IT hardware and software, telecommunications, and media and entertainment. To promote Singapore as an electronic commerce and ICT hub, the Approved Cyber Trader (ACT) scheme was introduced in 1998 to encourage offshore trading activities conducted over the Internet.

10. However, the current 10 percent tax rate offered in the ACT scheme is not competitive enough to attract new companies, as e-commerce activities can be structured with close to zero tax cost. The ICT Working Group recommends **enhancing the ACT scheme by liberalising the eligibility criteria**, and **reducing the concessionary tax rate (currently at 10 percent) or giving a full tax exemption** for approved Cyber Traders. This will enhance Singapore's attractiveness as an e-commerce centre.

International Trading

11. International trading is a highly mobile and tax sensitive industry. Although Singapore has flourished as a trading hub, we are neither a key producer nor a consumer market. Instead we have leveraged on the presence of international trading companies to build up our global reach. As countries around us develop their own infrastructure and network, Singapore will be faced with greater competition. This is further accentuated by the availability of various incentives offered by countries such as Hong Kong and Dubai, which are attracting companies to locate their trading outfits there. Such countries offer "zero tax" on offshore trading compared to Singapore's 10 percent tax rate.

12. The Working Group on Trading recommends several changes in our tax incentives to strengthen our competitiveness vis-à-vis these trading hubs. Two key recommendations are:

a) **Enhance the Global Trader Programme (GTP) by reducing the tax rate to less than 10 percent for firms with significant business spending in Singapore.** The GTP has served us well, increasing the volume of offshore trade from about US$30 billion in 1991 to US$120 billion in 2001. However given the intensity of the competition and the nature of trading activities, the **current tax rate of 10 percent should be reduced** to make the scheme more attractive. This can be done through a **tiered concessionary tax rate regime, tied to a company's turnover and business spending.**

b) **Offer tax incentive for mid-tier and medium-sized trading companies**. With globalisation and market liberalisation, companies are likely to establish decentralised procurement and distribution operations. We should seize this opportunity to attract high-growth enterprises to use Singapore as a springboard to trade between Asia and the rest of the world when they internationalise. The current GTP is not applicable for such companies as they would not be able to meet the minimum qualifying turnover of US$100 million. **Therefore, the government could consider creating a separate incentive programme to attract these mid-tier trading companies to Singapore**.

Transport & Logistics

13. Singapore has achieved success as a transport and logistics hub because of our world-class infrastructure, extensive connectivity to worldwide cargo sources and value-added services provided by leading international players operating in Singapore.

14. However, competition is intensifying as other countries build up their capabilities and physical infrastructures. In addition, there is a structural shift in manufacturing and trade patterns with activities heading northwards to China and the surrounding region. These challenges, if not addressed, have the potential to draw cargoes away from Singapore. We need to strengthen our capabilities and capture high value-added activities that will secure our position as a leading international transport and logistics hub. In particular, the recommendations of the Transport & Logistics Working Group to create an internationally competitive environment for shipping and related services include:

a) **Enhance the Approved International Shipping (AIS) Enterprise initiative.** The shipping industry is accorded liberal tax-exempt status worldwide. While Singapore exempts shipping income from tax through the AIS, this comes with strict qualifying criteria such as incremental business spending. These criteria curtail the operating flexibility of shipping companies. **Changes should be made to liberalise the qualifying criteria for the AIS so that more shipping companies can qualify for the scheme**. In addition, the **scope of activities covered under the AIS should be expanded** to include shipping-related activities such as ship management and international activities.

b) **Exempt the income of Protection & Indemnity (P&I) Clubs from tax**. P&I Clubs are part and parcel of the maritime scene. London, the leading maritime services hub, is the biggest world centre for P&I Clubs managing over 20 of such clubs. These add to the wide range of maritime insurance services that the UK provides. P&I Clubs are exclusive only to participating shipping members. Typically, members contribute to a common pool, which they can subsequently draw from for third-party protection. These characteristics make P&I Clubs different from general insurance services where protection is available to anyone. Currently, P&I Clubs' profits are subject to tax in Singapore at the same rate as other general insurance companies. To attract more P&I services, the **government could consider exempting the income of P&I Clubs from tax**. This is also the practice in London.

Healthcare Services

15. The healthcare services industry is one of the key areas we can leverage on to build up Singapore's capabilities as a total service hub for the Asia Pacific region. Tax incentives would help to lower the business costs of healthcare service providers and enhance our cost competitiveness as a service hub.

16. Currently, several industries such as banking and trading enjoy concessionary tax rates on profits arising from international activities. This helps to promote overseas expansion of these activities. The Healthcare Services Working Group **recommends extending this concessionary rate of tax to income from healthcare services provided to non-resident patients by approved healthcare institutions**. This will fuel the growth of the healthcare sector

Legal Services

17. The use of tax incentives can foster the growth of specific areas in the legal services with high growth potential. In particular, the growing international arbitration industry is one area Singapore can do well in. With our central location, excellent transport links and sound legal infrastructure, Singapore is well-placed to become an important international dispute resolution centre. Currently, payments to international arbitrators and mediators are subject to withholding tax at 24.5 percent. **To enhance the competitiveness of the arbitration industry in Singapore, the Legal Services Working Group recommends reducing the withholding tax rate to 15 percent.**

Tourism

18. The Tourism Working Group recommends the use of incentives to promote the tourism industry, particularly in the hotel, and food and beverage industries. Currently, hotels are entitled to a special allowance under the **Hotel Refurbishment Scheme**, which covers 150 percent of qualifying expenditure incurred for approved refurbishment of hotels. However, this allowance expires in June 2003. The government could consider **extending this scheme** so that the hotels will continue to be maintained in conditions that meet the needs of tourists and visitors.

CONCLUSION

19. Tax incentives have served us well in the past. There will be less need for targeted incentives in the long-term, as we continue to build up a pro-business environment. However, in the medium term, tax incentives will remain effective tools to attract new and innovative activities to Singapore, as well as to enable us to stay competitive in industries that operate in low tax environments elsewhere.

CHAPTER 8: USING CAPITAL MARKETS TO FINANCE BANKABLE GOVERNMENT PROJECTS

INTRODUCTION

1. Bankable projects are those that have the potential to generate sufficient revenue to provide a reasonable financial return to investors and justify funding from financial institutions or equity investors, after taking into account operating subsidies from the government. Examples include public transport infrastructure (roads, rail lines etc), public housing, schools, and hospitals.

2. Thus far, such projects have been funded directly by the government. We believe that there is scope to consider the use of capital markets as an alternative source of funds for these projects. This will reduce the lumpiness of government expenditure. Such smoothening of the budget position will be more important as the government runs smaller budget surpluses in future.

USING THE CAPITAL MARKETS

3. Currently, government agencies are given direct capital grants, funded out of government revenue, to finance their projects. This offers little incentive for the government agency or contracted operator managing the project to make effective choices between capital and other financial resources. Using the capital markets to finance bankable government projects would help to address this concern by introducing market discipline and efficiency in the use of capital.

4. The use of capital markets would also bring about positive changes in the way government spending is reflected in the budget. Where the projects are funded through private capital, government expenditure (in the form of operating subsidies) would effectively show up as an accrual cost reflecting depreciation charges and the cost of capital spread out over the lifespan of the project, instead of a single upfront cash outlay. This helps to smoothen out the lumpiness in government spending. It is also a more accurate representation of the true economic costs of the project at the various stages of its useful lifespan.

5. We recognise that using the capital market for funds will only make economic sense if the cost of using private capital is equally or more economical than government funds. Using such a criterion will ensure cost-efficiencies when the government taps on the capital markets to finance its bankable projects. In addition, the use of capital markets will, over time, help to bring about a new dimension of market discipline among government

agencies and encourage them to look for more innovative and cost-efficient ways of providing public services that ensure quality, efficiency and value for money.

6. Other countries like Australia, New Zealand and the UK have made extensive use of private capital markets to finance large-scale infrastructure developments such as roads, bridges and dams. Such projects are commonly known as private-sector build-and-own (B&O), build-own-operate (BOO) or build-own-operate-transfer (BOOT) schemes. The UK Treasury, for example, launched the Private Finance Initiative (PFI) in 1992, where large-scale projects such as schools, hospitals or housing estates are designed, built, financed and operated by a private sector consortium[25] for a period of up to 60 years.

7. In the case of Singapore, many of the government operations and projects that are bankable and have a bottom-line, have already been corporatized as normal companies operating in the private sector, for example, Singtel and PSA. Nonetheless, there are still existing government projects like rail infrastructure (MRT) and public housing that can be funded through the capital markets. In fact, both LTA and HDB have been issuing bonds in the market, albeit in a limited scale.

8. **We recommend that the government consider more extensive use of the capital markets to finance these and other bankable projects.** Doing so would bring about greater efficiencies in the delivery of public services. It would also add to activity in the capital markets.

CONCLUSION

9. With the growing sophistication of our capital markets, we believe that there is greater scope to consider more extensive usage of private capital in the financing of bankable government projects. This will also help to inject commercial dynamism, innovation and efficiencies in the public sector.

[25] Usually consisting of a construction company, a bank or financier, a facilities management contractor and consultants.

ANNEXES

ANNEX A

LIST OF RECOMMENDATIONS OF THE SUB-COMMITTEE

Part A of this Annex provides a detailed listing of the recommendations of the Sub-Committee, including those that we think merit further study and assessment by the government. The more significant proposals have been included in our report.

Part B of the Annex contains a list of the proposals that we do not support for any of the following reasons:

- (i) the underlying objectives of the proposals are already achieved through other recommendations in our report;
- (ii) they will lead to significant losses in government revenue and cannot be supported at this point;
- (iii) they are not consistent with sound tax principles or raise issues of consistency and equality of treatment across industries;
- (iv) there is significant potential for abuse.

(A) RECOMMENDATIONS FOR IMPLEMENTATION OR FOR FURTHER STUDY AND ASSESSMENT BY THE GOVERNMENT

Corporate Income Tax

1. Reduce corporate income tax rate significantly for income earned in 2002. As a medium-term target, the tax rate should be cut from the current 24.5% to 20% within 3 years.

2. Implement group relief to allow corporate groups to offset the losses of one company against the taxable profits of another company within the same group. Government to consider implementing consortium relief and extending group relief for overseas branches and subsidiaries after it has put in place the basic features of the group relief regime.

3. Shift from a full-imputation corporate tax system to a one-tier system.

4. Liberalise the system of taxation of foreign income:

   a) Extend the availability of foreign tax credits beyond the first-tier investee company to lower-level subsidiaries.

   b) Expand the prescribed list of services that qualify for unilateral tax credits (UTC), or remove it altogether.

c) Lower the minimum threshold (currently at 25%) to qualify for UTC.

d) Allow for more flexible criteria to qualify for tax exemption of foreign source income under Section 13(8) of the Income Tax Act.

5. Introduce a one-year loss carry-back feature in the corporate tax system.

6. Allow more generous tax treatment of intellectual property:

   a) Give deduction for expenses incurred on R&D outsourced to any organisation, local or foreign.

   b) Apply the writing down allowance (WDA) automatically for acquisition of intellectual property, as is the case for physical assets.

7. Extend/Enhance existing DTAs and conclude DTA with US.

8. Design tax incentives with more flexible and varied criteria, besides fixed asset investment and total business spending, so as to capture the full contributions of the company in the knowledge-based economy.

9. Review and rationalise the withholding tax provisions.

10. Promote enterprise development by:

    a) Allowing tax deductions for mergers & acquisitions, especially to encourage consolidation in heavily fragmented industries.

    b) Allowing tax deductions for selected expenses incurred prior to starting new businesses and in the listing of companies.

    c) Allowing tax deductions for fees incurred in raising capital.

11. Broaden the Technopreneur Investment Incentive (TII) to an Entrepreneur Investment Incentive (EII) to be made available to a wider group of entrepreneurs and not just those in the high-tech sector.

12. Allow more liberal tax treatment (e.g. single deduction) for M&A expenses, expenses incurred in starting a new business and listing expenses.

13. Allow double deduction of foreign talent recruitment costs.

14. Allow capital allowance in respect of interest expenses incurred in acquiring capital assets.

15. Allow flow-through of exempt dividends. Review tax legislation on 2-tiered flow-through of exempt dividends and remove the tier restriction on the flow-through as long as the shareholding of 50% beneficial interest is satisfied.

16. Allow a wider range of earnings for funding Finance and Treasury Centre (FTC) activities.

17. Grant allowances for office buildings and land.

18. Simplify administrative procedures for various tax incentives.

19. Review Section 13E exemptions to allow exemptions to preferential shareholders.

20. Reduce/exempt tax on investment income to encourage investment into the domestic economy.

21. Extend headquarters incentives to cover Singapore network companies.

22. Remove the outdated definitions on qualifying trades under the industrial building allowance regime and the need for special approval under section 18(1)(l) of the Income Tax Act.

23. Allow concessionary taxation on offshore/onshore investment income to attract offshore funds currently residing overseas and to retain onshore funds from moving out.

24. Make tax incentives available to all sorts of business entities (e.g. partnerships), not just companies.

25. Allow depreciation relief for cost of premium paid for short term leases.

26. Remove restrictions on dealings conducted by Finance and Treasury Centres (FTCs) with clients resident in tax haven countries.

27. Allow for flow-through of Section 44 tax credits (under the Income Tax Act) and foreign tax credits.

28. Remove the imputed 5% mark-up on cost for service companies.

<u>Personal Income Tax</u>

29. Reduce the personal income tax rates significantly for income earned in 2002. As a medium-term target, the top marginal tax rate should be reduced from the current 26% to 20% within 3 years, with corresponding cuts across all income bands.

30. Exempt interest income earned on all bank deposits, debt securities and other interest-bearing instruments.

31. Exempt foreign source personal income remitted back to Singapore from tax.

32. Exempt foreign individuals from tax on the foreign income that they remit to Singapore for purposes of purchasing the property

33. Broaden the scope of area representative status to include those providing regional duties and employed by regional headquarters in Singapore

34. Introduce tax exemption for employment income attributable to time spent outside Singapore.

35. Exempt employers' contributions on behalf of expatriates to overseas private pension funds from tax.

36. Encourage the use of stock options to align the interests of management and employees with the performance of the company and promote an entrepreneurial environment:

    a) Defer the tax payment of stock option gains to the point of sale of shares or after 7 years from the exercise date, whichever is earlier, with no interest charge on the deferred tax liability.

    b) Where there is a moratorium on the sale of converted shares, compute the tax liability based on the difference between the market price at the end of the moratorium and the exercise price.

    c) Allow for more flexible criteria to qualify for stock option schemes. For example, the 50% participation requirement to qualify for the Company Stock Option (CSOP) scheme should be relaxed to allow more companies to qualify for the scheme.

    d) Not tax the gains derived from stock options granted overseas when the individual exercises them in Singapore. This is achieved by treating the gains from stock options as employment gains and taxing the gains only to the extent that they are attributable to Singapore employment

    e) Allow for more flexible criteria to qualify for stock option schemes. For example, the 50% participation requirement to qualify for the Company Stock Option (CSOP) scheme should be relaxed to allow more companies to qualify for the scheme.

    f) Not tax the gains derived from stock options granted overseas when the individual exercises them in Singapore. This is achieved by treating the gains from stock options as employment gains and taxing the gains only to the extent that they are attributable to Singapore employment.

    g) Adopt a 'deemed exercise' rule for expatriates who leave the country with unexercised stock options. If the employer is willing to keep track of employee's movements, the tax liability can be raised at the point of actual exercise, with payment deferred to point of sale.

h) Adopt similar tax treatment for employee share award schemes as that recommended for share options, where relevant.

37. Treat “overseas allowance” as reimbursements, rather than personal income tax.

38. Allow foreigners to contribute to the Central Provident Fund (CPF) and to re-look at the applicability of the Supplementary Retirement Scheme (SRS) for foreigners based in Singapore.

39. Review personal reliefs (for example tax relief for handicapped parents, parent relief, personal tax relief) and non-tax rebates (utilities and service and conservancy charges) to lighten the tax burden for individuals, particularly for the lower-income households.

40. Extend the 60-day exemption rule to independent professionals.

41. Exempt capital gains from tax under the Supplementary Retirement Scheme (SRS).

42. Revise the structure of estate duties by:

a) Raising the exemption limit for non-residential assets from $600,000 to $2 million

b) Exempting the ‘movable’ assets of non-domiciles from estate duty. This would encourage more expatriates to hold S$-denominated assets and boost Singapore's position as a private banking centre.

c) Extending the $9 million estate duty exemption to indirectly held residential properties.

Indirect Taxes

43. Raise the GST from 3% to 5% in 2003. Retain across-the-board coverage of GST with as few exemptions as possible.

44. Provide an offset package to help Singaporeans adjust to the GST increase. The package should ensure that most households, especially lower-income households, are no worse off during the transition.

45. Set up a committee to combat profiteering and undue price increases.

46. Provide clearer guidelines on zero-rating provisions.

47. Review input tax recovery rules to allow input tax recovery on expenses financed by grants especially charities, schools and non-profit organisations, and to allow overseas persons to have an avenue to claim input tax credit for GST paid on purchases in Singapore.

48. Allow gross margin scheme to be applicable to financiers offering financing via financial instruments other than hire-purchase agreements (e.g. finance leases, conditional sales agreements) to customers.

49. Review input tax recovery rules to allow traders to claim input tax incurred for economic activities to encourage entrepreneurship.

50. Reduce taxes on ownership of cars to achieve a better balance between ownership and usage costs.

Tax Incentives

We note that the ability of the government to grant the following sector-specific incentives would depend, not only on the merits of the individual proposals, but also on the **overall impact on government revenue**. We therefore recommend that the government study these proposals carefully in this context.

51. **Manufacturing Sector Incentives.**

a) Reduce the minimum rate of the Development and Expansion Incentive (DEI) from 10% to 5%.

b) Rationalise some of the existing incentives in the Economic Expansion Incentives Act (EEIA) and put them under the umbrella of the DEI.

c) Review and enhance the pioneer incentive to make it more attractive to companies.

d) Allow enhanced investment allowance scheme to help companies cope with project uncertainties.

52. **Services Sector Incentives.**

i. Financial services

a) Rationalise and consolidate existing financial sector incentives.

b) Enhance the Financial Treasury Centre (FTC) incentive by expanding its scope to cover treasury activities conducted for Singapore operations

c) Introduce incentives for personal pension plans.

d) Expand the range of financial sector incentives to allow other financial institutions and smaller niche players to qualify for these incentives.

e) Review tax treatment for different forms of share capital structures to allow greater flexibility in the tax treatment of the various capital structures so that banks can raise cheaper source of funds.

f) Grant incentives for outsourcing centres provided by third parties.

g) Grant incentives for developing the asset securitisation market by allowing a favourable tax treatment for special purpose vehicles (SPVs).

h) Grant incentives for developing the real estate investment trust (REIT) market.

i) Simplify the computation of the taxable income from life annuities.

j) Simplify the contribution limits for the Supplementary Retirement Scheme (SRS).

k) Allow a tax deduction for premium paid to purchase approved health insurance plans.

l) Review the basis of taxation of life insurers. The tax rate of 10% should also be reviewed to reflect more closely the reduction in the average rate of tax in recent years.

m) Allow for an accounting basis of taxation for financial instruments.

n) Set a lower effective tax rate of say 15% for the financial sector.

ii. Info-Communications & Technology

a) Reduce the concessionary rate (currently at 10%) for the Approved Trader Scheme.

b) Remove the minimum total business spending requirement for the Approved Cyber Trader scheme.

c) Allow deductions for investments in content creation projects; Offer incentives for intellectual and info-communications industries.

d) Grant tax incentive for the overseas sale of software with intellectual property developed locally in Singapore to encourage development of "Made in Singapore" software to compete internationally.

e) Allow double tax deduction (DTD) for information technology (IT) & manpower capability development.

iii. International Trading

a) Enhance the Global Trader Programme (GTP) by reducing the tax rate to less than 10% for firms with significant business spending in Singapore. This can be done through a tiered concessionary tax rate regime.

b) Offer tax incentives for mid-tier trading companies that do not qualify for GTP.

c) Allow interest attributed to approved investments of trading companies (with a nexus to the trading business) to be deductible against profits.

iv. Transport & Logistics

a) Enhance the Approved International Shipping (AIS) Enterprise scheme by liberalising the qualifying and extending the scope of activities covered under the scheme.

b) Institute the Approved International Shipping (AIS) Enterprise Incentive as a permanent fixture of Singapore's tax regime (with periodic reviews).

c) Give tax-exemption to the income derived from Profit & Indemnity Clubs' activities.

d) Reduce the tax liability on banks and insurance companies for the extension of loans and insurance to the Singapore shipping industry.

e) Establish a Singapore tax lease system to help develop the local ship financing industry.

v. Healthcare Services

a) Give concessionary tax rate for healthcare services provided to non-resident patients by approved healthcare institutions.

b) Apply existing incentives to the healthcare industry.

vi. Legal Services

a) Tax concessions for conversion of law firms into law corporations.

b) Allow more liberal tax deductions for legal firms and users of legal services, e.g. business development and training expenses.

c) Enhance section 13(8) exemption on the income for legal services.

d) Grant tax incentives for services performed in Singapore for a foreign client.

vii. Tourism

a) Offer tax incentives for the arts and events sector.

b) Extend the hotel refurbishment scheme (expiring in June 2003).

c) Exempt income on profits earned by non-profit sports groups from tax.

viii. Life Sciences.

a) Grant tax incentives for life sciences industries.

Other Proposals

53. Expedite the clearance of tax assessments.

54. Set clearer guidelines on the filing of tax returns.

55. Impose interest cost on the tax payable/refund.

56. Eliminate uncertainty with respect to certain tax rules and regulations.

57. Review property tax to reduce the rate and help lower business costs, and also to exempt HDB households from paying property tax to set off the effect of GST.

58. Use the capital markets instead of tax revenues to finance bankable or financially viable development projects.

(B) PROPOSALS NOT SUPPORTED

Corporate Income Tax

59. Expand the qualifying expenditure items for the existing double tax deduction (DTD) schemes.

60. Allow deductions for expenses incurred prior to overseas ventures (for example expenses for feasibility studies).

61. Grant tax exemption on foreign dividends for headquarter (HQ) companies.

62. Give cost relief, e.g. cash tax rebate equivalent, reduction in utilities or property tax offsets, to companies which cannot utilise the tax rebate due to either significant investment programmes or losses incurred.

63. Allow tax loss to be monetised.

Personal Income Tax

64. Allow deduction of investment costs against individual income.

65. Allow individuals investing in approved private equity funds, which dedicate a significant portion of their portfolio for equity purchase into Singapore-based companies wanting to internationalize, to deduct the value of their investment, up to S$1 million, against their taxable income.

66. Review tax treatment of home ownership to alleviate the cost of owning a home. For example, allow a deduction for home mortgage interest.

67. Exempt balances under Supplementary Retirement Scheme (SRS) from estate duty.

Indirect Taxes

68. Classify the purchase of goods and re-supply of goods by the financier associated with financial instruments (e.g. finance leases, conditional sales agreements) as an "excluded transaction".

Other Proposals

69. Impose stamp duty on property transactions for trading purposes only.

70. Grant tax incentives to promote globalisation, for example, extend the double tax deduction for expenses incurred in setting up of overseas marketing office to expenses in respect of full operational entities.

71. Establish a tax incentive package for companies with Regional Headquarters (RHQ) status that would provide a guaranteed minimum period of five years for reduced corporate tax.

72. Defer the taxation for qualifying start-ups to the 5th year from the time of incorporation.

ANNEX B

Terms of Reference of the Sub-Committee and Working Group

The Sub-Committee on Taxation, CPF, Wages and Land seeks to review government policies with economic implications, including taxation, the CPF system, land allocation, and the framework for wage competitiveness

Within the Sub-Committee, a Working Group on Taxation was set up to spearhead the study of taxation policies, with the following Terms of Reference:

- To review taxation policies in order to enhance our economic competitiveness, while remaining consistent with social objectives and ensuring sufficient revenue to fund government expenses on a sustainable basis:

- Review the structure of Government revenue and the existing budgetary framework, and recommend ways to better leverage on our fiscal strength as a competitive tool.

- Recommend the optimal tax structure and tax rates for Singapore that will encourage effort and enterprise among Singaporean companies and individuals, and attract global players.

- Review the corporate tax system, including the use of tax incentives, and recommend measures to ensure that our tax regime remains effective and relevant in a rapidly changing business environment.

ANNEX C

Composition of the Sub-Committee

Mr Tharman Shanmugaratnam ***(Chairman)***	Senior Minister of State Trade & Industry and Education
Mr Cheng Wai Keung	Chairman & Managing Director Wing Tai Holdings Ltd.
Mr Chia Wee Boon	Managing Director Hewlett Packard Singapore Pte. Ltd.
Mr Michael Dee	Managing Director Morgan Stanley Dean Witter Asia (Singapore) Pte. Ltd.
Mr Koh Boon Hwee	Chairman Singapore Airlines Ltd.
Mr Stephen Lee	President Singapore National Employers' Federation and Chairman Pro-tem Committee of Singapore Business Federation
Dr Lee Tsao Yuan	Executive Director Skills Development Centre Pte. Ltd.
Ms Lim Kwee Enn	Chief Executive Officer Knowledge Engineering Pte. Ltd.
Mr J R Ong	Executive Director First Engineering Ltd.
Mr Peter Ong	Second Permanent Secretary Ministry of Defence
Mr Peter Seah	President and Chief Executive Officer Singapore Technologies Pte. Ltd.
Ms Teo Swee Lian	Assistant Managing Director

	Financial Centre Development / Planning, Policy & Communications, Monetary Authority of Singapore
Ms Jeanette Wong	Senior Country Officer JP Morgan Chase Bank
Mdm Halimah Yacob	Assistant Secretary-General National Trades Union Congress
Mr Matthias Yao	Senior Minister of State Prime Minister's Office and Deputy Secretary-General National Trades Union Congress
Mr Robert Yap	Chief Executive Officer / Managing Director YCH Group

Composition of the Working Group on Taxation

Mr Tharman Shanmugaratnam ***(Chairman)***	Senior Minister of State Trade & Industry and Education
Mr Gerard Ee	President Automobile Association of Singapore
Mr K Karthikeyan	General Secretary United Workers of Petroleum Industry
Dr Lee Tsao Yuan	Executive Director Skills Development Centre Pte. Ltd.
Mrs Winnie Liew	Partner Arthur Andersen
Ms Lim Kwee Enn	Chief Executive Officer Knowledge Engineering Pte. Ltd.

Mr Ng Keat Seng	Deputy Commissioner Inland Revenue Authority of Singapore
Mr J R Ong	Executive Director First Engineering Ltd.
Mr Pok Soy Yoong	Director of Taxation Ernst & Young
Mr Peter Seah	President and Chief Executive Officer Singapore Technologies Pte. Ltd.
Mr Aloysius Tan	Tax Manager Shell Companies in Singapore
Mr Tan Kay Yong	Managing Director GlaxoSmithKline
Ms Teo Swee Lian	Assistant Managing Director Financial Centre Development / Planning, Policy & Communications, Monetary Authority of Singapore
Ms Jeanette Wong	Senior Country Officer JP Morgan Chase Bank
Mr Matthias Yao	Senior Minister of State Prime Minister's Office and Deputy Secretary-General National Trades Union Congress

ANNEX D

Resource Persons

Dr Paul Cheung	Chief Statistician Department of Statistics
Mr Heng Swee Keat	Permanent Secretary Ministry of Trade & Industry
Dr Khor Hoe Ee	Assistant Managing Director Economics, Monetary Authority of Singapore
Mr Moses Lee	Permanent Secretary Ministry of Health
Mr Liew Heng San	Permanent Secretary Ministry of Law
Mr Ong Khiaw Hong	Director Taxation, Ministry of Finance
Prof Tan Kong Yam	Chief Economist Ministry of Trade & Industry
BG(NS) Tan Yong Soon	Chief Executive Officer Urban Redevelopment Authority
Ms Yong Ying-I	Permanent Secretary Ministry of Manpower

ANNEX E

Secretariat (Taxation Working Group)

Economic Development Board

Mr Toh Wee Khiang

Inland Revenue of Singapore

Mr Andy Seah

Ministry of Finance

Ms Sharon Lim
Mr Ong Pang Chan
Mr Lawrence Wong

Ministry of Transport

Mr James Wong

Monetary Authority of Singapore

Mr Edward Robinson