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Tax Alert

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Go slow but go far in rebooting taxes for next-gen needs

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Over the last decade, the two areas where government spending has been heavy are social and infrastructure investments.

Social expenditure has gone up significantly from S$12.7 billion in 2006 to S$32 billion in 2017. A large chunk of this was pumped into healthcare subsidies for the ageing population.

Meanwhile, spending on transport infrastructure is also set to rise with the building of Changi Airport Terminal 5, the Tuas mega-port and the cross-island MRT line.

Besides healthcare and transport infrastructure, government expenditures in defence and security as well as education are expected as well to rise in the coming years.

Against increased expenditures, the need for our tax system to catch up has certainly set the stage for a significant reboot of the tax engine in the upcoming Budget.

Traditionally, the revenue base for the Singapore government stems from four sources: corporate income tax, personal income tax, Goods and Services Tax (GST) as well as the Net Investment Return Contribution (NIRC), which is income from the investments of Temasek and GIC.

As it stands, Singapore's corporate income tax rate is one of the most competitive in the world.

However, it needs to remain nimble to be able to adjust or lower the rate if required in order to remain competitive globally, especially now that major economies like the United States have also reduced their tax rates.

In the area of individual income tax, Singapore's rapidly ageing population means that this source of income is likely to decline as more baby-boomers retire.

More recent calls to revisit wealth and estate taxes have also surfaced, though these typically do not contribute significantly to overall revenue.

The NIRC, on the other hand, is largely dependent on global macroeconomic developments and, therefore, prone to fluctuation.

In any financial year, up to 50 per cent of the NIRC can be taken into the government's operating budget that year. Annually, the exact amount fluctuates due to changes in the fiscal position.

Against the confluence of global economic changes, increased competition for global investments and an ageing population, the government is now considering various options to raise revenue.

'Heartware' must be a focus when GST rises

Much speculation has already started surrounding the probability of a GST hike to be announced at Budget 2018. From our perspective, a GST hike could be possible.

The government has said that it has sufficient revenue for the current term, or until the end of this decade, and there should be enough time for businesses and consumers to absorb the news of a potential hike. Hence, Budget 2018 would probably shed light on how and when the government would introduce the hike.

Also, the need for the GST hike policy to be more socially inclusive cannot be over-emphasised.

As a whole, the GST is a broad based tax, affecting all consumers of the population. While our GST rate has remained at a single digit over the last two decades, its effects can be regressive when a hike occurs.

For instance, as Singapore has no GST exemptions on necessities such as food and healthcare, this tax is therefore regressive for lower-income groups. The situation worsens when the cost of inflation sets in.

To soften the effects of a GST rate hike on vulnerable groups, the government will need to provide more targeted reliefs. Existing GST vouchers and rebates will no doubt continue to help the needy, but the best way forward would be to actively listen to the grassroots and recalibrate measures to help affected groups.

Reverse charge mechanism to hit businesses?

The introduction of a reverse charge mechanism is also likely to be announced in Budget 2018.

A reverse charge taxes companies who import services, and places the onus on accounting for this GST in the hands of the buyer. In essence, it levels the playing field for overseas and local service providers by imposing GST on all parties.

Most countries with a GST or Value-Added-Tax (VAT) regime already have a reverse charge mechanism in place. Singapore is currently a notable exception.

Based on a consultation paper the Inland Revenue Authority of Singapore (IRAS) has released, it is worth noting that the reverse charge will not impact all businesses with imported services.

Rather, it is intended to target partially taxable businesses. These include banks, financial institutions, commercial and residential mixed developers and restructured hospitals.

Broadly, the reverse charge spells out two things for affected businesses.

First, it will complicate compliance requirements, involving additional processes for companies to correctly account for imported services.

Second, it imposes an additional tax burden on businesses as a reverse charge is not claimable as a GST credit.

For affected businesses who outsource functions offshore, parts of their work process will now be taxed under the reverse charge.

Whether the reverse charge would be an efficient tax is also debatable. The cost of compliance to the affected businesses may not justify the incremental revenue to the authorities.

Furthermore, it is also unclear if a reverse charge would make a significant contribution to the tax collection.

Therefore, Singapore should not rush into the implementation of the reverse charge tax until proper feedback is gathered from businesses that will be affected.

E-commerce levies: Step back and survey

As Singapore transitions into a digital economy, a gap that the government hopes to plug in the tax space is the fast-growing e-commerce sector.

Given the value of e-commerce opportunities and the uncharted waters of taxing overseas businesses outside of one's country, e-commerce taxes are likely to be a focal point during the Budget.

Currently, consumers need not pay tax for online purchases of goods under S$400, only if it is imported by SingPost or via air couriers, and for services obtained from overseas non-GST-registered vendors.

With the government looking at an overseas vendor registration regime, consumers may find themselves having to pay additional GST on digital services such as downloads and streaming of music, books and movies should the tax be implemented.

The administration of the e-commerce tax, however, will not be an easy one.

The government needs to take a step back, consult online marketplaces and wider constituents, and observe how other countries have implemented their e-commerce levies to fully understand the challenges involved. It could draw important lessons from Indonesia, South-east Asia's largest e-commerce market, as the country pushes ahead to reform its e-commerce levies.

Zooming out of e-commerce to focus back on the overall scheme of things, we can expect this year's Budget to tilt more heavily towards taxes, especially when the government's intent is to increase its tax base to finance higher expenditure.

While we know that the government's choices are likely to be practical yet easy to implement, the size and timing of the taxes will still need to be carefully considered without eroding Singapore's underlying competitiveness and the welfare of its citizens.

The adage 'go slow to go far' would well apply here.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

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