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Economic Affairs

Three priorities for Budget 2022

GST, wealth taxes and tax policies for large MNEs are among the challenges to address

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The Government is also under pressure to meet the constitutional requirement to balance the Budget by 2025. PHOTO: ST FILE

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During the run-up to Budget 2022, which will be presented on Feb 18, various wish lists have appeared from professional service firms, business federations and Members of Parliament. The broad message that emerges is that the economic recovery is fragile and uneven, many companies still need help and fresh incentives are needed to encourage investments in key areas. New taxes also need to be carefully designed.

While the proposals cover many subjects, including measures to speed up decarbonisation, incentives for specific sectors and social policies, let us evaluate those relating to three hot-button issues: the goods and services tax (GST), wealth taxes and tax policies for large multinational enterprises (MNEs).

The GST hike: Avoid delays

The GST is scheduled to be raised from 7 per cent to 9 per cent some time before the next general election in 2025. There is a unanimous call for clarity on when the increase will take effect, which, judging from recent ministerial statements, will almost certainly be provided in the Budget.

Some MPs, economists and members of the public have called for the Government to consider delaying the GST hike to avoid adding to inflation, which, as measured by the consumer price index, is running at nine-year highs.

The Singapore International Chamber of Commerce (SICC) has proposed at least deferring the hike till the start of 2025 for low-value goods and non-digital imported services, which would include some transport, travel and financial services. "Businesses are struggling to survive and introducing GST hike at this juncture will further aggravate the situation," the SICC points out.

While such concerns have merit, the case for delaying the GST increase because of them is weak.

As is well known, a $6 billion Assurance Package is already in place to cushion the impact of the GST increase on most households for five years, and for 10 years in the case of low-income groups, so the GST will hardly add to inflationary pressures as experienced by most people.

Such pressures should be countered by diversifying imports and building buffer stocks of essential goods as well as with exchange rate policy, not by postponing the GST hike.

And although there are indeed troubled parts of the economy, especially in the service sector, it would be more effective to support them through targeted and time-bound subsidies than by delaying the GST increase on a selective basis, which would also distort the tax system.

Many wish lists call for continued support for small and medium-sized enterprises by extending till March 2023 schemes such as the Productivity Solutions Grant (which subsidises costs of pre-scoped information technology solutions), the Enterprise Development Grant (which supports projects through which companies can upgrade and innovate) and the Enterprise Financing Scheme (which subsidises the costs of companies' overseas projects). The Singapore Business Federation has also proposed extending wage subsidies for three months under the Jobs Support Scheme for currently eligible businesses that are still reeling from pandemic-induced restrictions. These are reasonable proposals. Delaying the GST hike should not be added to them.

Revenue concerns are another reason for a GST hike to come sooner rather than later. Having run up cumulative Budget deficits of more than $75 billion over the last two years and drawn down reserves to the tune of $53.7 billion, there is some urgency to rebuild public finances. GST is one of the largest and most stable sources of revenue and cannot be easily substituted by any other tax.

The Government is also under pressure to meet the constitutional requirement to balance the Budget by 2025, which would be hard enough to do even if the GST increase is not delayed.

The Government could decide on a two-step hike, 1 percentage point at a time over the next two years, as in 2003 and 2004, but that would be a second-best solution. It would be preferable to go ahead with the 2 percentage point increase in one shot, latest by January 2023.

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To strengthen fiscal resilience over the longer term, which is an avowed goal of the Government and would be essential to fund social programmes and infrastructure in future, we also need to think beyond the impending GST hike.

One option worth exploring is broadening the tax base. Currently, GST is applied only to companies with a turnover of $1 million or more. By international standards, this is an extremely high threshold. For example, in Britain, value-added tax - the British equivalent of the GST - applies to companies with an annual turnover of £85,000 (about S$156,000), while in Australia it is A$75,000 (about S$73,000). Singapore should consider reducing its threshold for GST registration in stages to bring more companies into the tax net. GST offsets to compensate consumers could again be disbursed whenever that happens. Over time, the growth of the tax base will add to revenue resilience.

A $6 billion Assurance Package is already in place to cushion the impact of the GST increase on most households for five years. PHOTO: ST FILE

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Wealth taxes: Mind the loopholes

There is broad support for new wealth taxes both to reduce wealth inequalities and raise revenue. Possible wealth taxes could include capital gains taxes, property tax surcharges as well as taxes on high-value items such as private jets, yachts, sports cars and collectibles.

But many wish lists call for wealth taxes to be designed carefully to avoid downside risks. For example, the SICC cautions that poorly designed wealth taxes can lead to "wealth flight", creating incentives for rich individuals to relocate or move their wealth to other countries. They can also lead to tax avoidance or evasion by the rich, leading to higher tax burdens on the middle class.

While fears of wealth flight may be exaggerated - there would be many incentives for the wealthy to keep their wealth in Singapore even in the face of wealth taxes - it would only be prudent to design such taxes to avoid loopholes.

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For example, the SICC proposes collecting wealth taxes at the point of transaction rather than on declared wealth, which would be complicated to assess and lead to tax avoidance. To discourage wealth flight, it proposes imposing a high "exit tax" of at least 30 per cent on wealth that would be moved out of Singapore - although that would, like capital controls, be a drastic step that might discourage wealth from coming in.

To avoid burdening the middle class, the SICC proposes a high exemption limit of $5 million on inheritance taxes, if any, as well as exemptions on the sale of a first property and/or owner-occupied properties. The latter would spare the majority of property owners but also lead to substantially lower revenues. Exempting capital gains on sales of shares and other securities would also avoid burdening the middle class as well as prevent a negative impact on Singapore's securities markets.

The SICC proposes collecting wealth taxes at the point of transaction rather than on declared wealth. ST PHOTO: KUA CHEE SIONG

There are also calls for greater progressivity in existing property taxes as well as stamp duties - for example, by imposing higher taxes on high-value properties. The professional service firm Deloitte also proposes tiered rates on buyer stamp duties, with higher rates applied for more expensive properties. The consulting firm PricewaterhouseCoopers points out that making the existing tax regime more progressive would be easier to execute than imposing new taxes.

No doubt, wealth taxes would entail some risk. The challenge will be to design them so they can simultaneously address concerns around reducing inequalities, preventing property price spirals and raising revenue.

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Taxing MNEs: Clear the air

Several wish lists for Budget 2022 draw attention to the rules under last year's agreement at the Organisation for Economic Cooperation and Development to overhaul the tax system for MNEs to minimise tax avoidance through the shifting of profits to low-tax jurisdictions and prevent race-to-the-bottom tax competition between countries.

One of the pillars of this agreement calls for a global minimum tax of 15 per cent on MNEs with revenues of €750 million (S$1.15 billion) or more. This means, for example, that if any jurisdiction levies less than 15 per cent tax on American MNEs which fall into that category, those companies would need to top up the balance to the United States government.

Several large MNEs operating in Singapore pay effective tax rates of well below 15 per cent because of various tax incentives. Once the global minimum tax takes effect, which is expected to happen next year, many of those tax incentives will be redundant. The Ministry of Finance estimates that about 1,800 MNEs operating in Singapore meet the €750 million revenue threshold.

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The Government would need to raise the effective tax rate for these companies to close to 15 per cent, which would add to revenues, but at some cost to the companies. To encourage them to remain and continue investing in Singapore - as well as attract new investments from other large MNEs - many wish lists call on the Government to focus on non-tax considerations.

Singapore already has attractive non-tax incentives, including macroeconomic stability, an open economy, rule of law, and a large network of free trade agreements. But new incentives could be added.

For example, the SICC proposes the granting of investment credits - the deduction of a percentage of qualifying investments from tax liability. Other suggestions include direct cash subsidies for certain types of investments, which some other countries are offering. Deloitte points out that non-tax incentives would need to be customised, depending on the industry, which makes sense, but which will call for consultation with affected companies.

Of course, for MNEs that are not affected by the new rules - that is, the majority of those operating in Singapore - existing tax incentives can continue. But with MNEs under increasing pressure to finalise their tax planning strategies, and given their importance to the Singapore economy, the Government would need to clear the air on the tax policies they will face in the future. This, too, should be one of the priorities in Budget 2022.

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