

## Singapore Budget FY2007: A Response to Globalization

**Alvin Liew**  
(65) 6539 3923  
[Alvin.LiewTS@UOBgroup.com](mailto:Alvin.LiewTS@UOBgroup.com)

**Suan Teck Kin**  
(65) 6539 3922  
[Suan.TeckKin@UOBgroup.com](mailto:Suan.TeckKin@UOBgroup.com)

**Jimmy Koh**  
(65) 6539 3545  
[Jimmy.KohCT@UOBgroup.com](mailto:Jimmy.KohCT@UOBgroup.com)

While the previous budget was very much a "people's budget", the current FY2007 Budget focuses more on meeting the challenges brought about by globalization. While Singapore has benefited immensely from the globalization phenomenon, the government recognizes the process has inevitably left segments of its people behind, and at the same time, the winds of globalization has swept new competitors into the global arena armed with enticing tax incentives and other advantages. The changes in the tax structure will provide the further comprehensive adjustments to sharpen Singapore's competitive edge as an investment and business destination while the addition of the Workfare Income Scheme (WIS) as the 4th pillar of social security system and the introduction of Post-Secondary Education Accounts (PSEA), will provide a stronger yet responsible safety net and the ability for improving the quality and the earning-power of the future workforce respectively. In addition, employer's CPF contribution rate would also be raised by 1.5 percentage points to 14.5% which will benefit the lower income group most. These broad and comprehensive measures strike a balance between economic competitiveness as well as maintaining social security. Taking all the measures into account, the government expects FY2007 overall Budget Balance to be in a modest deficit of \$0.7bn. However, we feel that the government's prudent fiscal stance and the increase in investment income may actually result in a small surplus of S\$0.6bn in FY2007.

### Key Fiscal Measures

#### Tax-Restructuring for the Future

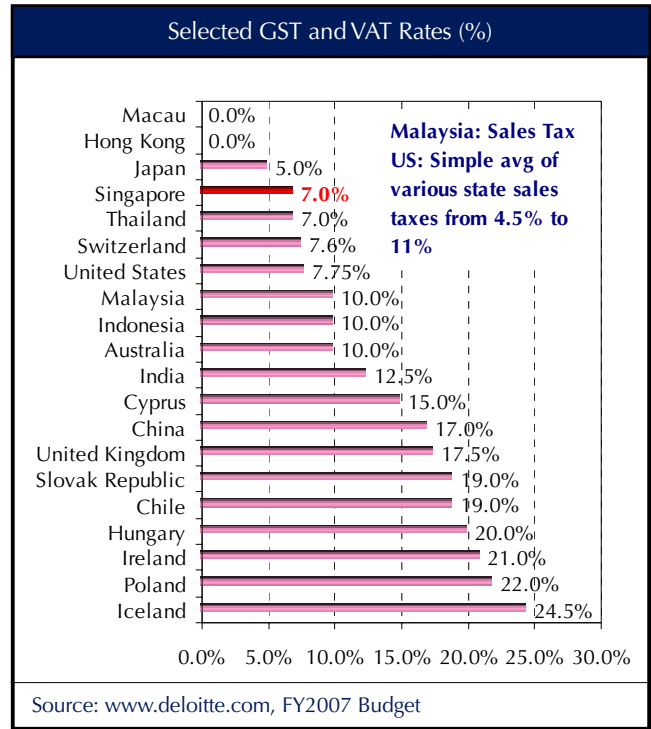
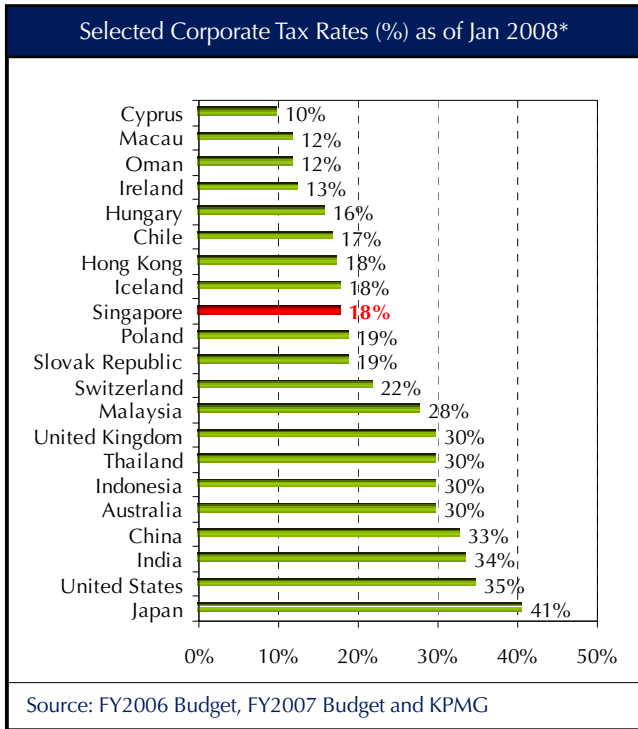
One of the highlights of the Budget FY2007 was the shift of the tax revenue base away from direct taxes and more towards indirect taxes. The increase indirect taxation has allowed the government to reduce the overall tax burden on income and capital while maintaining tax revenue largely unchanged. Key changes among the measures were the significant 2% point cut in corporate tax rate cut to 18% (estimated revenue loss is S\$800mn), as well as the raising of GST rate to 7% from 5% (estimated revenue gain is S\$1.5bn per annum) as part of the tax restructuring process. If we include the revenue losses due to changes in other tax items including the reduction in road tax and the increase in the tax exemption threshold to S\$300,000, the net effect is actually still a gain of S\$310mn per annum according to the MOF Budget report.

The current GST rate in Singapore is comparatively lower compared to other countries when matched against the corporate income tax structures. (Please refer to the charts) And based on the MOF report, tax revenue from GST only makes up a low 14.9% of total tax revenue in FY 2005 while the rest comes from income and other taxes, as compared to OECD countries, which derives an average of 32% of tax revenue on GST/VAT and 35% on income taxes. And while no indication has been given so far about possible cuts in personal income tax rates, we can apply the same comparison against other countries and we note that Singapore's rates are already very competitive. Nonetheless, as the sourcing and retaining of foreign talent intensify, we do not discount the possibility of further cuts to personal income tax rates to entice top entrepreneurs/specialists to our shores, especially when there is still room for GST increases to make up for the tax revenue shortfall. Thus, looking at the competitive environment, it is conceivable that there is still room for Singapore's GST to be adjusted upwards beyond 7% while corporate and/or personal income tax rates are furthered lowered towards the league of sub-20%.

The implementation of the GST hike in July 2007 would imply a one-time increase in inflation in 2H07 and 1H08. Assuming that the GST hike affects around 70-75% of the CPI basket (a rough estimate using the methodology by MAS in an earlier report), we expect a one-off GST hike to

increase inflation by 0.6%age point in 2007 and as a result, inflation is expected to come in at 2% for the full year (previously it was 1.4% in 2007 without the GST). As the impact is one off, we do not expect the MAS to change in the current 'modest and gradual appreciation of the SGD stance' in the April's monetary policy meeting.

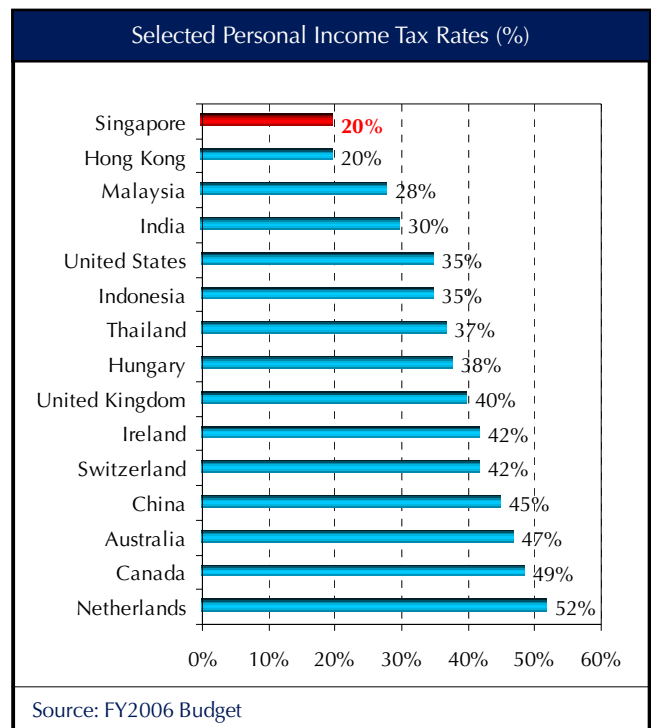
Other than the tax-structure shift, the Budget also addressed subjects ranging from increasing R&D investment to 3% of GDP annually by 2010, from 2.4% in 2005, to granting SMEs rebates and increasing the corporate tax exemption threshold from \$100k to \$300k. The government is also promoting legal and financial services where Singapore has potential to thrive in by giving qualified companies in these industries attractive tax breaks.



### Managing the Income Gap

To address the problem of increasing income inequality as well as compression of wages at the lower income levels, the Government has made a major policy shift, with the permanent implementation of Workfare Income Supplement (WIS) scheme. While every Singaporean will get something from the Budget in the form of cash, rebates, top-ups etc, the bulk of the benefits accrue to the older low income earners who have been most disadvantaged and "left behind" during the economic restructuring over the past years. The WIS is specifically targeted at this segment of the population and is a well-conceived social-security program that helps supplement the income of the older low-income citizen without creating disincentives to work as the scheme requires the recipient to be involved in regular productive work.

In addition, employer's CPF contribution rate would also be partially restored by 1.5 percentage points to 14.5%. Back in 1999, the government slashed the contribution by employers from 20% to 10% on grounds of deteriorating competitiveness before restoring 3%age points to the rate in subsequent years. The CPF hike is expected to have positive impact on property (as affordability is enhanced) and to insurance and CPF-approved



unit trust funds. Interestingly, the government may also be mulling over a variable employer CPF rate component, which we think will be able to restore the employer's contribution rate to 20% in good years, and to cut the rates below the [expected] 15% in recession years. The government's decision to amend the Constitution and seek the President's approval to re-define Net Investment Income (NII) to include capital gains, would make available substantially more funds for special transfers to the less privileged. Previously, the Constitution defines NII as the dividends and interest earned from investing past reserves. The inclusion of capital gains could substantially increase the NII component within the Budget. The NII for 2006 was S\$2.8bn and we have conservatively estimated NII this year to be higher at S\$3.5bn. The increase in NII would also help offset the revenue reduction from lowered corporate tax rates and allow the government to embark on deeper corporate tax cuts and even personal income tax reductions.

On the whole, all these measures including, the permanent implementation of the WIS, the partial 1.5% restoration of the employers' CPF contribution, the redefining of NII and the GST Offset Package (please refer to Table) should positively impact on the low-income group.

### Building a Better Future

The Budget also addresses an important aspect of breaking the low income cycle that is by investing in the future through education. Via the introduction of Post-Secondary Education Accounts (PSEA), this provides the opportunity of life-long learning to every child, enhancing both the productivity of the people to the economy as well as the earning power of the individual.

Singapore Budget Statistics							
S\$bn	FY2002	FY2003	FY2004	FY2005	FY2006 (Revised)	FY2007 (Budget)	FY2007 (Forecast)
Operating Revenue	25.47	25.31	27.47	28.17	30.00	32.36	31.6
Total Expenditure	27.15	28.50	28.96	28.63	30.55	33.00	32.0
Primary Budget Balance	-1.68	-3.19	-1.49	-0.46	-0.55	-0.64	-0.4
% of GDP	-1.1	-2.0	-0.9	-0.23	-0.3	-0.3	-0.2
Less: Special Transfers	1.80	0.60	1.66	0.83	3.58	2.07	2.5
Add: NII Contribution	3.68	1.90	3.04	2.77	2.84	2.02	3.5
Overall Budget Balance	0.20	-1.89	-0.11	1.49	-1.28	-0.69	0.6
% of GDP	0.1	-1.2	-0.1	0.8	-0.6	-0.3	0.3

Source: MoF, UOB Estimates

## Singapore Key Budget Initiatives

**(a) For Businesses****Estimated Cost to Government****For all companies**

- |  |                  |
|--|------------------|
| 1) Reduce the corporate tax rate by two percentage points to 18% from Year of Assessment (YA) 2008.  | \$800mn per year |
| 2) Increase the corporate tax exemption threshold from \$100,000 to \$300,000 from YA2008.   | \$150mn per year |
| 3) Allow tax deduction for other specified borrowing costs that are paid as a substitute for interest expense, from YA2008. IRAS to release details by May 2007. | \$110mn per year |
| 4) Extend the concession permitting writing down allowances for acquired intellectual property from 31 October 2008 to 31 October 2013.                          |                  |
| 5) Increase the qualifying period for the investment allowance incentive for assets acquired on hire-purchase basis (starting 15 Feb 2007), from 5 to 8 years.   |                  |

**For start-ups and SMEs**

- |   |         |
|---|---------|
| 6) Remove the YA2009 expiry date for the corporate tax exemption scheme for start-ups, which exempts the first \$100,000 of chargeable income.  |         |
| 7) Grant SMEs cash rebates on the first \$80,000 of total employer and employee CPF contributions over 2 years. Further details of the application process for rebates and the eligibility criteria will be released by 1 May 2007.             | \$110mn |
| 8) Provide a grant for SMEs voluntarily registering for GST (capped at \$5,000 per SME) to support up to 50% of GST registration-related costs, such as hardware, software, Internet connection and IT implementation consultancy and training. |         |

**Promoting Legal Services**

- 9) Allow 50% tax exemption for law firms' incremental income from international arbitration activities. The incentive will be available from 1 July 2007 to 30 June 2012. More details to be released by May 2007.

**Promoting Financial Services**

- 10) Remove the 80/20 rule under the tax exemption scheme for non-resident funds under Section 13C of the Income Tax Act, subject to conditions.
- 11) Enhance tax exemption schemes for income of funds managed by local fund managers with effect from 15 February 2007
- 12) Enhance the Financial Sector Incentive (FSI) scheme, w.e.f. 15 Feb 2007, to include income earned from providing investment advisory services under fund management delegation arrangements with foreign fund managers.
- 13) Expand scope of activities qualifying for the Finance and Treasury Centre (FTC) incentive scheme by allowing investments in qualifying unit trusts, with effect from 15 Feb 2007.
- 14) Extend the existing tax exemption on over-the-counter (OTC) financial derivative payments by five years to 19 May 2012.
- 15) Enhance the Qualifying Debt Securities (QDS) scheme. Details to be released by May 2007.

**Promoting Philanthropy Services and NPOs**

- 16) Grant income tax exemption to all registered charities without requiring them to spend at least 80% of their annual receipts in Singapore within 2 years.
- 17) Relax the 80/20 spending rule under the fund raising permit for foreign charitable causes for donations raised from private donors and not from the general public.
- 18) Allow double tax deductions for donations to foundations and grantmakers as long as the donations are channelled to charities with Institution of a Public Character (IPC) status within a specified time frame. Details will be released by Sep 2007.
- 19) Grant income tax exemption to attract not-for-profit organisations (NPOs) with regional or international charters from 15 Feb 2007.

## Singapore Key Budget Initiatives

**Estimated Cost to Government****Promoting Logistics, Maritime, Aviation Services**

- 20) Extend the incentive period for Approved Shipping Logistics Enterprise (ASL) scheme from 5 to 10 years w.e.f 15 Feb 2007. Details to be released by May 2007.
- 21) Enhance the Aircraft Leasing Scheme (ALS) for the period of 1 March 2007 to 29 February 2012. Details to be released by May 2007.
- 22) Zero-rate GST for expenses incurred to service, buy, or lease containers in the international transport of goods w.e.f. from 1 April 2007. Details to be released in March 2007.

**Others**

- 23) Extend stamp duty relief for intra-group transfer of assets to unlimited companies, Limited Liability Partnerships where partners are companies, and Statutory Boards, w.e.f. 15 Feb 2007.

**b) For Individuals****GST Offset Package**

- |  |                         |
|--|-------------------------|
| 24) GST Credits of up to \$1,000 for all Singaporeans aged 21 and above, depending on his annual Assessable Income and Annual Value of his home.                                 | \$1.8bn over four years |
| 25) Senior Citizens' Bonus of up to \$1,000 for all Singaporeans aged 55 and above, and who have an annual Assessable Income of \$100,000 or less, in cash and Medisave Account. | \$400mn over four years |
| 26) Top-ups to Post-Secondary Education Accounts (PSEA).   | \$400mn over two years  |
| 27) Utilities-Save, Service and Conservancy Charges (S&CC) and Rental Rebates.   | \$800mn over five years |
| 28) One-off property tax rebate of up to \$100 per year in 2008 and 2009, for all owner-occupied residential properties.   | \$200mn over two years  |
| 29) Assistance for Low-Income Families with Young Children   | \$6mn per year          |
| 30) Increase Singapore Allowance by \$20 per month and raise gross pension ceiling from current \$1,100 to \$1,150 per month, for government pensioners residing in Singapore.   | \$4mn per year          |
| 31) To provide lower-income households with additional help for their public transport costs.  | \$10mn over three years |
| 32) Assistance through Citizens' Consultative Committees (CCCs), Self-Help Groups and Volunteer Welfare Organisations (VWOs).  | \$10mn over five years  |
| 33) Additional Subsidies for Healthcare, Education and S&CC.   | \$62mn per year         |
| 34) Abolition of Cess.   | \$30mn per year         |
| 35) Reduce road tax for passenger cars and motorcycles by 8% per annum.  |                         |
| 36) Reduce Foreign Domestic Worker Levy (FDWL) by \$30 from \$295 to \$265 from 1 July 2007 and extension of FDWL concession from 1 Nov 2007.                                    |                         |
| 37) Extension of \$7,000 tax relief for cash top-ups to CPF.   |                         |

**(c) CPF Restructuring & Workfare**

- 38) Employer component of CPF contribution rates will be increased by 1.5% from 1 July 2007 with 1% to worker's Ordinary Account (OA) and 0.5% to the Medisave Account (MA). This will not apply to older low-wage workers - those who earn \$1,500 or less and are also above 35 years old.
- 39) Reduce the employee component of CPF contribution rates for all employees earning \$1,500 or less a month and for workers above 35 years old and earning \$1,500 or less a month.
- 40) Reduce Medisave Contribution Rates for Self-Employed and Informal Workers

**Workfare Income Supplement (WIS) Scheme**

- 41) The WIS will more than compensate for the reduction in CPF contributions for full-time workers aged above 45 years who earn \$1,000 or less. But WIS benefits will extend to a wider group - those above 35 years who earn \$1,500 or less - at a lower rate. Payouts of up to \$1,200 a year. For employees, the WIS will be paid with a cash-to-CPF ratio of 1:2.5. The WIS scheme will be reviewed after three years.