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Donna Liew

Ernst & Young Solutions LLP

+65 6309 6129 / +65 9873 7078

donna.liew@sg.ey.com

Budget 2010 wish list: learning from the past to build the future

Latha Mathew and Russell Aubrey discuss how the upcoming fiscal budget should build on the lessons learnt from the recent economic recession to lay the foundation for future growth

Singapore has passed the test of the recent global economic downturn, according to its recession report card. Whether it aced that test is subjective. The next assessment is for Singapore to ensure its long-term economic survival.

The government's response to the global financial meltdown which started in September 2008 was bold, swift, and unprecedented. For the first time, the Singapore government dipped into its reserves to line the pockets of employers with cash in order to help save as many jobs as possible. It also shared the risks of extending credit to keep banks' funding lines open to companies. The 2009 budget's Jobs Credit and Special Risk-Sharing Initiative were innovative measures designed to address the twin problems of jobs and cash against the backdrop of a bleak global economy.

More than a year has passed. The "doom and gloom" scenario for Singapore's trade-reliant economy, and most of the rest of the world, seems to have been avoided. By the third quarter of 2009, Singapore's economy was out of recession. If the twinkling Christmas lights on Singapore's main shopping belt Orchard Road are any indication, the future does seem brighter. Still, although Singapore sprang out of recession faster than expected, it cannot be complacent.

As the 2010 budget approaches, the government has indicated that it will continue to leave the spending taps open. Though economic stimulus is still needed, the new agenda will shift away from broad-based measures to those that are “targeted specifically at restructuring, enhancing productivity, and preparing for growth over the medium to longer term”, as Finance Minister Tharman Shanmugaratnam has indicated.

The 2010 budget should focus on cementing Singapore’s growth story and ensuring that businesses are in the best possible shape to take advantage of an economic upturn. The challenge is to ensure that we do not stray from the path of sustainable growth.

Our wishes for the 2010 budget focus on what we can learn from the recent crisis in order to adopt the right response to not only cushion Singapore from future shocks but also lay the foundation for future growth.

Keep taxes competitive

Businesses make investment decisions based on what they expect the tax rate to be in the future. They prefer to conduct business where their earnings will not be overtaxed and where their after-tax profits can be maximised, and this becomes even more important in difficult economic times.

At present, we believe the headline corporate tax at 17%, is very competitive, given that it is already one of the lowest in the region. A competitive corporate tax rate will encourage overall business growth and in the long run, this will increase overall tax revenues from not only corporate tax, but also personal income and consumption taxes.

It is equally important for investors to have confidence in the medium to long term path of tax rates. Low tax rates need to be sustainable both economically and politically, and Singapore scores highly in this respect.

At the same time, there is still room to narrow the gap between the top personal tax rate of 20% and the corporate tax rate of 17%. An eventual harmonisation of the top personal and corporate tax rates will give Singapore a competitive advantage in attracting and retaining foreign talent. And in streamlining the tax rates of personal and corporate taxpayers, it provides greater flexibility for individuals in business in determining their business structure.

Helping businesses with cash flow

If anything, the global credit crunch has taught us that cash is king. Companies which have a cash hoard will have a clear competitive advantage during tough economic conditions. They will also have the ammunition to chart faster growth during an economic recovery.

The world, with the exception of the US, is moving towards taxation at source. A permanent tax amnesty on foreign-sourced income, rather than the temporary one-year reprieve granted in the previous budget, should be something Singapore should work towards. This will put us on par with Hong Kong and Malaysia, which have already fully liberalised their foreign-sourced income exemption regimes.

If a permanent exemption on foreign-sourced income cannot be granted in this budget, then we should at least take baby steps towards that goal. This could include extending the tax amnesty for another year or liberalising some of the conditions imposed. This will foster the free flow of funds and encourage companies to expand and be able to respond quickly to cash needs wherever they may be.

A tax system which is more responsive to changes

The reasons for implementing a current-year assessment scheme have become more compelling in light of the recent global economic recession. A worker who has suffered a wage cut or is retrenched still has to pay taxes for higher income earned in the previous year. The time lag between payment of taxes and when income is earned exacerbates economic fluctuations. On the one hand, it reduces the ability to spend in a recession, hindering an economic recovery. On the other, it stokes spending during the boom years, which could cause the economy to overheat. The pay-as-you-earn scheme would not only better match income with taxes, but would also act as an automatic stabiliser to the economy by smoothing out cyclical swings. This will give the economy a stronger foundation to better withstand global economic shocks.

It is an opportune time to introduce the current-year assessment scheme now, but the switch should be accompanied by a one-year tax holiday during this transition year. The government's loss of revenue from a one-year tax waiver on income earned last year would be lower given the slowdown in the economy in 2009. Besides, it will still continue to collect taxes on a current year basis in 2010 under the pay-as-you-earn scheme.

Lowering business costs

Enterprise is the backbone of our economy. From a tax perspective, we should do what we can to help businesses to lower their costs. This will help them to stay competitive.

Expenses incurred prior to the commencement of business such as wages, utilities, office rentals, marketing expenses and interest expenses are normally regarded as not tax deductible because they are incurred before the production of income and are not part of expenditure incurred in the production of income. However, companies can claim a tax deduction for revenue expenses incurred from the first year that income is earned. This puts companies which start generating income early in the year at a tax disadvantage from those which start generating income at the end of the financial year. To encourage start-ups and foster entrepreneurship, we hope that the government will provide a tax deduction on pre-commencement costs incurred in the six months prior to date when income is first derived. Extending a tax deduction for costs incurred six months prior to first generating income will give start-ups a headstart in their business and will be fairer on businesses which start to generate income at the beginning of the financial year.

Tourists who buy goods in Singapore can claim a refund of the Goods and Services Tax (GST) paid. Why not business travelers too? We hope the government will extend a GST refund to businesses which are neither established nor registered for GST in Singapore when they incur corporate expenses such as accommodation and entertainment expenses in Singapore. This would be timely considering the opening of the integrated resorts in 2010 and would be in line with Singapore's aim to establish itself as a meetings, incentive travel, conventions and exhibitions (or MICE) hub. Countries such as Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Japan, Luxembourg, the Netherlands, Sweden, Switzerland and the United Kingdom currently offer such Value-added Tax (VAT) or GST refunds to businesses that are not established in their countries on the condition of reciprocity. A non-established business is generally allowed to claim VAT/GST to the same extent as a VAT/GST registered business.

Businesses can currently get a deduction for borrowing costs other than interest expense, which are used as a substitute for interest expense or to reduce interest costs. However, only borrowing costs identified in a prescribed list are deductible. This list should be expanded to include upfront fees, management fees, guarantee fees paid in lieu of providing deposits and other similar fees payable to banks in lieu of interest or to reduce interest costs.

To encourage mergers and acquisitions, we hope the government will allow the acquirer to transfer the funding costs to the acquired company and allow a deduction of the funding costs against the income of the acquired company. In addition, where there is an amalgamation after a shares acquisition in which funding costs are incurred to acquire the shares, it will be helpful if the interest costs are allowed as a deduction against the income generated from the acquired business.

Embracing the green movement

The recent Copenhagen summit has focused the spotlight on green issues and the need for countries around the world to work together to lower their carbon footprint and reduce gas emissions. It is timely for the government to introduce “carrots” in the form of green tax incentives to drive corporate behavior and encourage businesses to “go green”.

This would demonstrate Singapore’s commitment to gradually shift Singapore to a low carbon economy and lay the foundation for future sustainability. Businesses which are more “carbon efficient” may be better able to weather any future downturn, or large increase in energy prices, given that they have the hardware or software in place to reduce waste or save on energy. Being more energy efficient will contribute directly to the bottom line by reducing business costs.

In this context, the government could consider tax allowances or incentives to encourage businesses to consume energy from renewable sources, reduce waste, recycle, use recycled and environment-friendly materials, and adopt technologies which will promote energy and water usage efficiency.

We hope the government would consider providing an investment allowance of say 130% for businesses which replace non-energy efficient equipment with energy-saving ones. The government could also offer enhanced tax deductions for companies which engage advisory or consultancy services to evaluate or implement more efficient processes or energy-saving hardware. Going a step further, it would also be helpful if companies which employ people to do clean-related analytical work could get additional tax deductions for the salary costs and training costs incurred.

Another green initiative could be to link tax incentives to the Green Mark Scheme by the Building and Construction Authority for energy-efficient buildings. Such tax incentives might include reductions in corporate tax rates for a portion of income, or property tax rebates.



New beginnings

If 2009 was all about surviving and emerging from the recession, then 2010 is all about new beginnings. It is about consolidation to strengthen Singapore's economy and laying the groundwork to safeguard future growth.

Singapore's 2010 budget will likely be expansionary. But in time to come, fiscal prudence will have to prevail again.

In November 2009, acting chief economist of the Organisation for Economic Co-Operation and Development (OECD) Jorgen Elmeskov said: "Unprecedented policy efforts appear to have succeeded in limiting the severity of the downturn and fostering a recovery to a degree that was largely unexpected six months ago".

He added: "It is now time to plan the exit strategy from the crisis policies, even if its implementation will be progressive."

Indeed, balancing short term stimulus with long-term prudence will be the cornerstone of public policy for many governments in 2010.

Latha Mathew is a Tax Partner and Russell Aubrey is Head of Tax at Ernst & Young Solutions LLP

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