SINGAPORE BUDGET 2013

How progressive is the new tax structure?

Budget 2013 sees the introduction of wealth taxes on luxury homes and cars. The tax system is getting more progressive, but the Government also has to increase social spending and transfers to reduce the income gap.

By CHIA VEE CHONG FOR THE STRAITSTIMES

AS an open economy, Singapore has to strike a balance between maintaining international tax competitiveness and achieving domestic equity in its fiscal policy. Budget 2013 thus aims for “quality growth and an inclusive society”.

As the income gap has thinned up, fiscal policy is one tool to narrow that gap. Thus, any move to increase the income gap is done at both ends—targeting the low- to middle-income worker by redistributing income, and lowering disposable incomes at the higher end by taxing higher incomes and wealth.

Budget 2013 does both.

At the lower end, the Government will boost wages by co-paying 40 per cent of pay increases for Singaporean workers earning up to $4,000 for three years. As the median gross monthly income from full-time work is $3,480, the Wage Credit Scheme will help lift wages for at least half the local workers. The enhanced Workfare scheme for low-wage earners will boost the income of those earning up to $1,000.

Those who read Professor Lim Chong Yan’s controversial “wage shock therapy” proposal will recall that he had suggested a rapid rise in incomes at the bottom and a wage freeze for top income earners. Budget 2013 does not introduce anything as controversial, of course. But it does make good use of a wealth tax to increase the tax burden on luxury homes and cars.

Overall, Budget 2013 sets Singapore on the path of greater tax progressivity. This has been a declared intention of fiscal policy, as Finance Minister and Deputy Prime Minister Tharman Shanmugaratnam has said.

But will making a tax system more progressive also reduce income inequality?

How progressive is this?

But first, some basic definitions. A progressive tax system is one where a richer person pays a higher percentage of his income in tax than someone less well-off. Those below an income threshold may pay no tax.

How progressive is Singapore’s personal income tax structure?

Data from the Inland Revenue Authority of Singapore’s annual report for year of assessment 2011 shows that resident taxpayers with annual incomes below $100,000 contributed 36 per cent of all personal income tax. The top 1.5 per cent earners contributed 38 per cent of the tax share.

A study on the progressivity of taxes by Mercatus Centre senior research fellow Veronica de Rugy at Georgia Mason University shows that the richest 10 per cent of American households (those making US$121,124, or S$140,373) contributed 45.1 per cent of all income taxes. The Organisation for Economic Co-operation and Development (OECD) average is 31.6 per cent of total tax share from top earners.

This puts the US among the most progressive income tax systems among OECD countries, along with Canada, Australia, the Netherlands and New Zealand.

In other words, in Singapore, the top 1 per cent of earners contribute almost 86 per cent of the total tax taken, compared to 45.1 per cent for the US and 31.6 per cent for OECD countries. Singapore is more tax-progressive than the US and the average of OECD countries since the top 10 per cent pay a bigger share of taxes.

The 30 per cent income tax rebate, subject to a cap of $8,500, announced in Budget 2013 will make the tax system even more progressive as the median income worker needs pay no taxes.

What more can be done? Currently the highest marginal tax rate is 20 per cent for taxable income exceeding $320,000. Adding more tiers will increase tax progressivity; for example, taxing those who earn above $500,000 or $1 million at higher rates.

Tax the rich more?

Apart from taxing personal income, a tax system can also be made more progressive through a surtax—a tax on an existing tax on the ultra-rich.

Budget 2013 marks a decisive shift towards taxing wealth to make a tax system more progressive, going beyond the usual way of shifting higher rates of tax on income. The rich will now have to pay higher taxes on premium cars and luxury housing.

The Additional Registration Fee (ARF) is a tax on car ownership. It is calculated based on the open-market value (OMV) of a car. Before the certificate of entitlement (COE) vehicle quota system was introduced in 1990, the ARF was the key fiscal tool to curb car ownership.

It started out at 15 per cent of OMV in 1994, rose to 35 per cent in 1997 and then to 100 per cent in 1997 and 1998. When the COE scheme was introduced in 1990, the ARF was reduced to 140 per cent in 1998. It has remained at 100 per cent since 2008.

Budget 2013 introduces a new tiered formula for ARF that makes the car tax more progressive. More expensive cars with open-market values exceeding $20,000 will pay higher ARF, at 140 per cent or 160 per cent. The higher ARF can amount to tens of thousands of dollars, or in excess of $100,000 for luxury cars, significantly increasing the cost of owning a luxury or a sports car in Singapore.

The revised tiered car ownership tax rate means Singapore has one of the highest tax on luxury cars and luxury yachts. This will shift some of the demand for luxury goods to the Indian and Chinese market. Singapore can use the tax on luxury goods to fund its welfare and education spending.

The shift to luxury goods also highlights the need for a demand management plan. Singapore is planning to reduce the number of private sector employees in the public sector to 30 per cent by 2015. The government will also have to aggressively press the China market and target other countries, and make sure that there is a demand management plan for luxury goods.

Making up for lost income.

The short answer is that it helps, but not enough. A more progressive tax burden can only shift burden from the lower half of the household income for the rich so the rich bear a bigger load. At the same time, the state needs to redistribute income not just to the rich, but to the less well-off. Such redistribution is needed to fight poverty and social inequality. The state needs to redistribute income not just to the rich, but to the less well-off. Such redistribution is needed to fight poverty and social inequality.

First, the state can collect more taxes. Singapore’s tax to gross domestic product (GDP) ratio, at 12.7 per cent of GDP, is lower than the 17 per cent average in the US. Lower taxes, such as sales tax, can go to bridges and income divide. Singapore runs a small surplus government with overall social spending of just above a third of the GDP average. There is room to raise this judiciously.

Second, this year’s Budget is conservative one with an estimated overall surplus of 0.7 per cent of GDP. Compared to last year, the estimated expenditures (total expenditure minus transfers and top-ups) are lower. The budget for special transfers and top-ups are higher than this year. Special transfers and top-ups have been a major financing structure for social protection programs in Singapore. While this year’s Budget has made the tax system more progressive, there is still scope to increase targeted government spending to reduce income inequality.