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Headline: How progressive is the new tax structure?
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SINGAPORE BUDGET 2013

How progressive is the new tax structure?

Budget 2013 sees the introduction of wealth taxes on luxury cars and homes. 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 NGEE CHOON
FOR THE STRAITS TIMES

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 inched up, fiscal policy is one tool to narrow that gap. Narrowing 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 $1,900.

Those who read Professor Lim Chong Yah'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 well 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 progressive?

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 11 per cent of all personal income tax assessed. The remaining 89 per cent comes from those with assessed income above $100,000 a year. The ultra-rich – those earning above $1 million – contribute a greater share: 20 per cent of all personal income tax. The top 1.5 per cent earners contribute 38 per cent of the tax share.

A study on the progressivity of taxes by Mercatus Centre senior research fellow Veronique de Rugy at George Mason University shows that the richest 10 per cent of American households (those making US$112,124, or S$140,273) contributed 45.1 per cent of all income taxes. The Organisation for Economic Cooperation 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 11 per cent of earners contribute almost 80 per cent of the total tax takings, 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 $1,500, announced in Budget 2013 will make the tax system even more progressive as the median income worker need 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.

Data from the Inland Revenue Authority of Singapore's annual report for 2011 shows that resident taxpayers with annual incomes below $100,000 contributed 11 per cent of all personal income tax assessed. ST FILE PHOTO

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 slapping higher rates of tax on income. The rich will now 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 1968, rose to 55 per cent in 1974 and then to 100 per cent in 1975 and 150 per cent by 1980. When the COE scheme was introduced in 1990, ARF was gradually 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 180 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 hints at likely wealth taxes to come. Taxes on luxury yachts or other luxury consumer goods may be in the making.

But as a global city that wants to attract talent, Singapore cannot raise personal income tax too high. Tax authorities here and worldwide are thus turning to other means to generate tax revenue. Wealth taxes, "sin" taxes on alcohol and tobacco, and green taxes are likely avenues.

The other obvious tax to use is tax on property. Budget 2013 uses property tax to add tax progressivity. Before 2011, home owners who lived in their properties paid a flat tax rate of 4 per cent of the property's annual value. Since Jan 1, 2011, owners have been paying 0, 4 or 6 per cent for owner-occupied properties, with higher rates for homes of higher value. This year's Budget raised the rates to 8 to 16 per cent. For investment homes or non-owner-occupied residential properties, the tax rate of 10 per cent will go up to a tiered rate of 12 to 20 per cent.

Property tax is considered a fair tax on wealth as it is based on a person's ability to pay. It is also efficient as it is hard to evade or dodge: A property purchase needs to be registered by law and the price declared. In Singapore, public housing home owners form over 80 per cent of households, but pay only 15 per cent of residential property tax (in fiscal year 2011). In the last 10 years, property tax formed about 7 per cent of the total tax revenue.

The new property tax tier reduces tax rates for owners who live in their properties and load tax increases on higher-end housing that is rented out. This can help narrow the income gap. It also sends a message that a home is meant for living in – for consumption – and that property investors must brace themselves for higher property taxes.

Making people who buy luxury cars and own high-end investment homes pay more in taxes is one way to redistribute income from the wealthier households to the less well-off ones. Such redistribution is needed to forge a new social compact for Singapore.

But does introducing progressivity in tax reduce income inequality?

The short answer is that it helps, but is not enough. A more progressive tax burden can only shift some of the burden of taxation so the rich bear a bigger load.

To reduce income inequality, the state needs to redistribute income or give tax-related benefits to target groups. There is scope to do more in this area.

First, the state can collect more taxes. Singapore's tax to gross domestic product (GDP) ratio, at 12 to 17 per cent of GDP, is low compared to the OECD average at 34 per cent.

Next, spend more to bridge income divides. Singapore runs a small and lean government with overall social spending of just above a third of the OECD average. There is room to raise this judiciously.

Budget 2013 is a conservative one with an estimated overall surplus of 0.7 per cent of GDP. Compared to last year, the estimated expenditure (total expenditure plus transfers and top-ups) are lower. The budget for special transfers and top-ups is lower this year.

Special transfers and top-ups have been a major financing structure for social protection programmes in Singapore. While this year's Budget has made the tax system more progressive, there is still scope for more targeted government spending to reduce income inequality.

stopinion@sph.com.sg

The writer is associate professor at the department of economics and a steering committee member of the Singapore Centre for Applied and Policy Economics at the National University of Singapore.

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