Taxing CPF, SRS savings could raise $1b

Before raising GST, consider scrapping tax relief for retirement savings that benefit high earners more

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Prime Minister Lee Hsien Loong and Finance Minister Heng Swee Keat have warned that the Government needs to raise revenue to fund increasing social expenditure.

Actually, this begs the question of whether the Government should fund the expenditure from financial reserves accumulated by past governments by raising taxes from today.

Both options involve real costs. Society must pay today in the future, but leaving aside this issue for another day and assuming that the preference is to raise tax revenue today, let’s consider how additional revenue should be raised.

Various experts have suggested increasing the goods and services tax (GST). GST is levied on the purchase of goods and services. Poorer families spend a larger proportion of their income on consumption than do richer families. Hence, the burden of higher GST would fall disproportionately on poorer families. In that sense, an increase in GST would be regressive. Typically, the government offsets the regressivity of GST through GST vouchers.

Nevertheless, we suggest first exploring other tax options that are more progressive and directly raise revenue from better-off people.

SCRAP TAX RELIEF FOR SRS

Our first suggestion is to rescind the tax relief on contributions to the Supplementary Retirement Scheme (SRS). Introduced in 2001 and progressively expanded, SRS contributions of up to $3,600 for Singapore citizens and permanent residents and $83,700 for foreigners are exempt from tax.

If the member uses his SRS for investment, those returns on investment accretuate tax-free, and when the contributor retires, only 50 per cent of the withdrawal amount is subject to tax.

All sounds good, except that the loss of revenue means the Government is effectively subsidising retirement savings of these contributors to the SRS.

In the 2016 year of assessment, SRS contributions totalled $788 million. This could be worth more than $100 million annually in foregone tax revenue, assuming the typical SRS contributor pays a marginal tax rate above 15 per cent tax bracket. Relatively rich people probably contribute more than the less well-off.

People earning the median income of $4,106 a month, which amounts to less than $49,000 a year, are not likely to have $15,300 in post-tax SRS. So, the SRS is a regressive scheme in the sense of providing larger benefits to better-off people.

Conversely, this means that removing the tax relief for SRS would be progressive. Would the removal of tax relief on SRS reduce savings and hence preparedness for retirement?

Actually, we do not even know whether schemes such as SRS effectively promotes savings for retirement.

Research by economist Raj Chetty and co-authors shows that for most people, tax incentives do not increase savings. Some lack the disposable income, while others are too short-sighted.

Many respond to the tax incentives by simply shifting their savings from taxable to tax-exempt accounts. Instead of saving $15,300 in their SRS account, in this extent, the tax relief for SRS just reduces taxes on the rich.

TAX CPF CONTRIBUTIONS

Our second suggestion is to rescind the tax relief on contributions to the Central Provident Fund (CPF). CPF contributions up to specified limits are exempt from income tax, and the returns on CPF investments accumulate tax-free.

Again, like the SRS, this sounds helpful for retirement. But there is a cost – foregone revenue to the Government.

Although all employmed Singaporeans are subject to CPF contributions, the actual benefits to high-income earners relatively more. Those earning more than $120,000 a year pay the highest marginal rate of 22 per cent. For every thousand dollars of CPF contributions, their taxes are reduced by $220. By contrast, those earning pay less than $40,000 a year, a marginal rate of 7 per cent. For every thousand dollars of CPF contributions, their taxes are reduced by $70.

For the 2016 year of assessment, retirement-related relief totalled nearly $27.7 billion, or 57 per cent of post-tax CPF contributions. Based on the distribution of taxable incomes of resident taxpayers, we estimate that tax relief on mandatory CPF contributions costs about $1 billion in foregone tax revenue.

Our model estimates that the top decile of income-earning households receives about 30 per cent of all retirement tax relief benefits and the upper half, about 85 per cent of all benefits. Thus, the upper half of Singaporeans by income receives perhaps $800 million in retirement benefits annually.

To take these numbers in perspective, the Silver Support Scheme provides the bottom 20 per cent of elderly Singaporeans with more than $300 million in retirement benefits annually. But CPF tax relief now gives a much larger estimated benefit to the richest Singaporeans. There is room to improve progressivity in retirement policy.

Any effective tax increase on lower-income CPF contributors, could be offset through a modest flat tax credit for CPF contributions. There is precedent elsewhere for eliminating tax relief for mandatory retirement contributions. Social security taxes in the United States are not tax deductible. Contributions to the AustralianSuperannuation retirement scheme are taxed, but at a concessional rate. In some countries, general taxes fund pensions, so there is no tax deduction possible.

Many Organisation for Economic Cooperation and Development and European Union countries do provide tax advantages to encourage voluntary retirement contributions under schemes similar to Singapore’s SRS. But these incentive schemes were based on arm’s-length assumptions that the broad middle class would respond to incentives to save for retirement.

Now that evidence is gradually accumulating in the policy domain, it may be time to reassess incentive policies that tend to benefit the rich more than the rest of society. We strongly recommend following our approach before raising GST.

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