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KPMG
cutting through complexity

KPMG SINGAPORE PRE-BUDGET 2012 FORUM

Introduction

The global economy is currently sending mixed messages. The West is generally struggling, with troubling macroeconomic issues in the US tied closely to job losses and unemployment, and major sovereign debt and financial sector problems in Europe.

On the other hand, Asia is faring well, with economies functioning relatively efficiently with plenty of liquidity and credit. Asia's banking system is operating smoothly, corporates are healthy and people have high savings rates.

Based on discussions during the KPMG 2012 Pre-Budget Forum held on 27 October 2011, this paper looks at some of the key issues facing Singapore and highlights some of the ways in which they could be addressed in Singapore's Budget 2012.

KPMG would like to thank all guests who attended the forum, and in particular the following for taking part in the discussion:

- Mr Clinton Ang, Managing Director, Hock Tong Bee Pte Ltd
- Mr Brendan Egan, Tax Director, Chartis Asia Pacific Pte Ltd
- Ms Goh Mui Hong, President & Chief Executive Officer (CEO), ST Asset Management Ltd
- Mr Jimmy Koh, Head of Economic-Treasury Research, Global Markets & Investment Management, United Overseas Bank, who also presented his views on the global economy.

We would also like to thank Mr Melvin Yong, General Manager (Singapore), CPA Australia for chairing the discussion.

Tay Hong Beng
Head of Tax Services
KPMG in Singapore

Tay Hong Beng, Head of Tax Services, KPMG in Singapore

While Asia is doing seemingly well, this is not to say that there is no cause for concern. According to Mr Jimmy Koh, Head of Economic-Treasury Research, Global Markets & Investment Management, United Overseas Bank, the biggest risk for Asia is that problems in the US and Europe could transform into a global financial sector shock and cause banks to stop lending to each other. Aside from this, there are also more immediate issues facing companies in Singapore and around the region, such as rising costs, thin margins and intensifying competition.

What are the implications of this economic outlook for Singapore? And what are the measures that Singapore companies would most like to see to help them not just weather any storms that could blow in from the US and Europe, but also continue to grow and flourish?

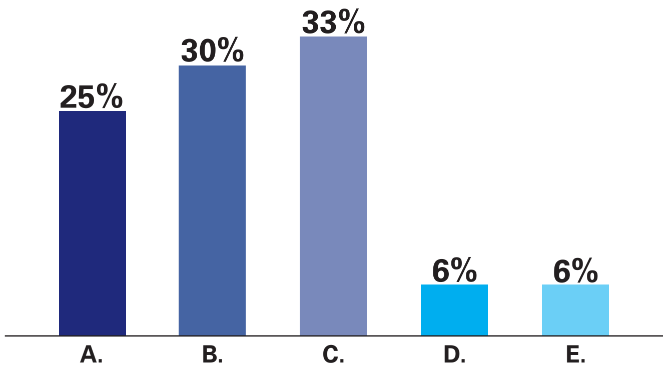
Addressing rising business costs

For business leaders, costs are almost always an area of concern as they strive to manage their spending and protect the bottom line. However, increasing cost pressures in Singapore have pushed the issue of business costs even higher up the list of priorities. Singapore's hot property market is responsible for the high office rental costs facing many businesses here, while tight supply in some areas of the labour market has been boosting manpower expenses.

Uncertain global demand can cause businesses to curtail spending. Further, faced with increasing costs, many companies are under pressure to contain or cut their expenditures. Commenting on the impact of rising business costs, Mr Brendan Egan, Tax Director, Chartis Asia Pacific Pte Ltd, said, "You're expected to do more with less. People are being given additional targets and additional responsibilities. But there's only so much cost you can cut."

1. Given more uncertainty in the economic climate, what is your one key short-term (one year) business challenge?

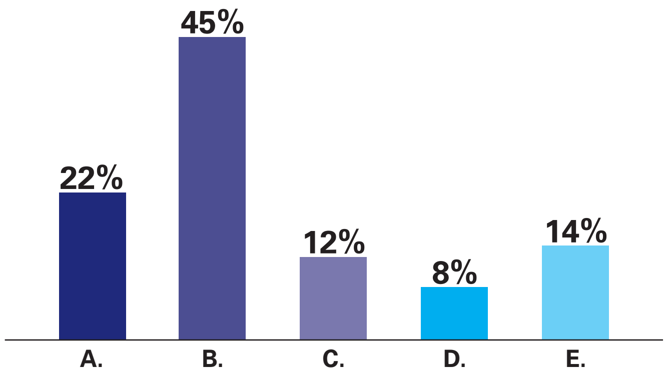
A. Operating costs (not including labour costs)
B. Labour costs
C. Uncertain global demand
D. Increasing regulation
E. Strong Singapore dollar



Given these concerns, it is not surprising that 45 percent of the poll participants identified efforts to keep business costs down as the most important short-term measure (see below) that they hope to see unveiled in Budget 2012.

2. Which is the most important short-term measure you hope to see unveiled in Budget 2012?

A. Help companies keep jobs
B. Keep business costs down
C. Continued focus on productivity and innovation
D. Help companies with cash-flow
E. Boost competitiveness



Agreeing with this assessment, Ms Goh Mui Hong, President & Chief Executive Officer (CEO), ST Asset Management Ltd, noted, "In the finance business, we have two key costs: rent and manpower. For both of these, locating in Singapore is very expensive."

Looking ahead to Budget 2012, many companies are hoping to see measures introduced to help them manage rising business costs, especially amidst an uncertain global outlook. An audience poll found that more than half of the forum's attendees consider high business costs to be the key short-term business challenge: 30 percent indicated labour costs as the key challenge facing their organisation over the next year, while 25 percent identified operating costs other than labour costs as the biggest challenge.

Companies also hope to see measures in Budget 2012 aimed at helping them keep jobs and avoid retrenchments. This issue was a focus of the Singapore Government in Budget 2009, when it introduced the Jobs Credit Scheme. Aimed at encouraging companies to keep their staff employed during the last financial crisis, the scheme provided cash rebates totalling more than $4.3 billion to over 100,000 employers based on their Central Provident Fund (CPF) contributions for Singaporean and Permanent Resident employees.

While the Jobs Credit Scheme ended in June 2010, it serves as an excellent example of how the government can help protect jobs in the private sector during times of economic upheaval.

Keen to see a similar initiative introduced in the upcoming budget, Mr Clinton Ang, Managing Director, Hock Tong Bee Pte Ltd, said, "In terms of helping companies keep jobs, I think that the Jobs Credit Scheme was a masterstroke, but I highly recommend that we tweak it a little bit because at the end of the day, Jobs Credit should be focused on Singaporeans first. I also think we should try to help more mature workers to retain their jobs. So perhaps the Jobs Credit Scheme could be expanded with the additional criteria of Singaporeans only and a focus on mature workers."

Echoing the importance of protecting jobs amid the current economic uncertainty, Mr Egan added, "The investment that you put into your employees is substantial, so enabling companies to keep their employees fully employed is one of the greatest opportunities that we're going to see over the next 12 to 24 months."

In addition to introducing initiatives to address rising business costs, the government can also help companies by ensuring that any policy changes with the potential to increase costs are phased in gradually to give corporates sufficient time to prepare and adjust. For example, Singapore's push to shift from a reliance on foreign labour towards greater use of technology is a sound strategy for boosting productivity.

Mr Clinton Ang, Managing Director, Hock Tong Bee Pte Ltd

However, the government's announcement in February 2011 that it would encourage this shift by increasing foreign worker levies between January 2012 and July 2013 has left many companies scrambling to cope with a significant change in their cost structure that will take effect over a relatively short timeframe.

"If you want to change the system from labour intensive to capital intensive overnight, it is not possible," said Mr Koh. While he agreed that a shift away from a heavy dependence on foreign workers is a good thing, he noted that many small and medium Enterprises (SME) feel the rapid transition to the higher levies gives them insufficient time to adjust.

Key proposals for Budget 2012: TACKLING RISING COSTS

- **Introduce a more focused Jobs Credit Scheme to encourage hiring of older workers and Singaporeans.** This would support businesses through the uncertain economic outlook and ease the transition from a reliance on foreign workers.

- **Implement measures to help businesses with rising costs.** These could include property tax rebates for commercial property owners, and rental rebates for tenants in JTC Corporation and Housing & Development Board properties.
- **Extend corporate and individual tax rebates and SME cash rebate.** The government should extend the corporate tax, individual tax and SME cash rebate to this year to help businesses cope with the cost pressures.

Supporting Singapore-based enterprises

SMEs represent a crucial segment of Singapore's economy, especially given their significant contributions to job creation. However, by virtue of their smaller size, SMEs are often much more vulnerable to economic uncertainty given their more limited resources compared to larger corporations. In light of the potential economic headwinds looming on the horizon, there is a broad need to provide SMEs with more assistance to help strengthen them in case the global economy takes a turn for the worse.

One area in which SMEs could use a helping hand is in taking their business to a higher level. Given the challenges involved in making the leap from SME to major player, Mr Koh said that there is a need to invest some of Singapore's substantial wealth in smaller local companies to help them achieve this transformation. "What we need is to be able to put some of this seed money into SMEs to make them into global companies. I think we're not doing enough of that."

Agreeing with this point, Mr Ang noted that local SMEs could benefit greatly from investments of both funds and know-how to help them branch out overseas and prove themselves on the global stage. Taking this idea one step further, he added, "I would propose that the Singapore Government start a Singapore-first fund to invest in promising Singapore companies and to bring them to Asia and beyond."

Unfortunately, when it comes to investing in local companies, Mr Koh noted that this is often done only at later stages once the businesses are already well established. "We only support companies when they become listed, but then they don't need you anymore."

Tweaks could also be made to Singapore's tax regime to support the growth of SMEs. For example, to make it easier for smaller companies to access equity markets, initial public offer (IPO) listing costs could be made tax deductible. This would help to reduce the tax burden on companies at a crucial time when they are trying to grow their business.

Key proposals for Budget 2012:
SUPPORTING SINGAPORE-BASED ENTERPRISES

- **Set-up a "Singapore-first" fund to invest in Singapore-based SMEs.** This is aimed at providing funds and know-how to help promising Singapore-based businesses become globally competitive companies.
- **Offer tax deductions for capital-raising expenditures.** Businesses can grow organically or through mergers and acquisitions (M&A). With Budget 2011 addressing M&A issues, Budget 2012 could address organic growth issues. One way companies grow is by raising capital through a stock exchange listing. However, IPO costs can be very substantial. To support the growth of SMEs, a concession making listing expenses (including restructuring costs related to the listings) tax deductible could be introduced.
- **Enhance the stamp duty relief scheme** for the transfer of assets between associated companies, and extending this to individual shareholders undertaking the restructuring and transfer of their direct shares.
- **Extending the corporate amalgamation scheme to** individuals. For example, by individual proprietors transferring assets and business into a company vehicle

Tweaking productivity and innovation measures

In recent years the Singapore Government has placed a renewed emphasis on its efforts to boost productivity in the private sector. One of its key vehicles for achieving this is the Productivity and Innovation Credit (PIC) scheme. Introduced in Budget 2010 and enhanced in Budget 2011, PIC provides incentives in the form of tax deductions and cash payouts to companies for making certain types of investments aimed at boosting productivity.

Mr Tay Hong Beng, Partner, Head of Tax, KPMG in Singapore, feels that despite the current economic uncertainty, it is important for companies to push ahead with investing in productivity as this will leave them better positioned to reap the rewards when conditions improve. "I feel that productivity and innovation initiatives are very important as they will see us through this difficult time. At the moment we are looking at rising costs, labour costs are higher, so how do we manage that? On the other hand, with the kind of resources that we have, the question is whether we can make better use of these resources to improve our capabilities."

However, despite the incentives on offer and the potential benefits of improved productivity, many companies are not actively making use of the PIC scheme. Based on preliminary figures released by the Ministry of Finance, about 20 percent of businesses that had filed their tax returns had made claims under the PIC scheme. When asked in the audience poll what had prevented their company from making fuller use of the incentives available via PIC, 44 percent of poll participants indicated that they were put off by the scheme's restrictive conditions. Some 19 percent felt the scheme was aimed towards SMEs and thus less relevant to larger companies, while another 19 percent pointed to the scheme's limited scope.

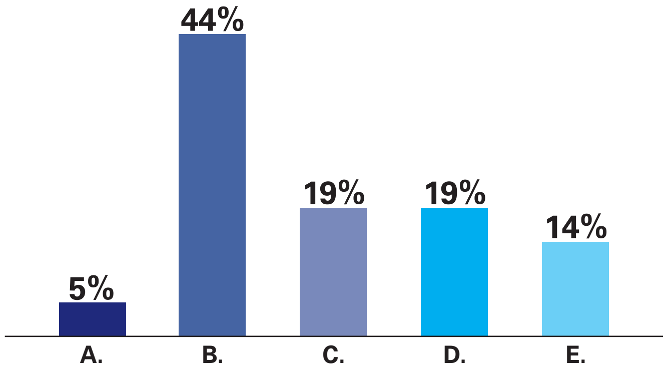
Mr Jimmy Koh, Head of Economic-Treasury Research, Global Markets & Investment Management, United Overseas Bank

To encourage greater use of the PIC, the Government could consider lifting some of the scheme's restrictions — such as raising the annual expenditure cap, for example — and broadening its scope so that it appeals to a wider audience.

Beyond making improvements to the existing productivity incentives, the issue of how best to incentivise companies also bears examination from a broader perspective. For instance, Mr Tay suggested that it may be better to reward companies for the value they create rather than the money they spend. One example includes the creation of intellectual property rights such as brands. He said, "When we talk about productivity and the incentives given to businesses, we are generally concerned about how much businesses spend. But what about the productivity increases that they generate without spending a single cent? Can we shift the focus from an expenses-based incentive to one that is based on the creation of value?"

3. What has prevented your company from making fuller use of the incentives?

A. Not attractive enough
B. Restrictive conditions
C. Limited scope
D. More relevant for smaller companies
E. Unsure of benefits



For instance, the PIC incentives apply only to annual expenditure up to a cap of $400,000 per qualifying activity. This relatively low cap means the scheme may not be overly attractive to larger companies, even though they are the ones that generally invest more in innovation and productivity.

Key proposals for Budget 2012:
PRODUCTIVITY AND INNOVATION MEASURES

- **Incentivise value creation activities.** Government incentives are traditionally given based on expenditure incurred. However, a knowledge-based economy thrives on value creation. Therefore, a tax incentive should be introduced that provides for tax deductions or writing down allowances for internally-generated intellectual property, based on an external valuation of the intellectual property, that would effectively serve as a tax incentive for promising Singapore enterprises.
- **Increase expenditure limits on the PIC claims.** To make the PIC scheme more beneficial for larger companies, the incentives could be enhanced by extending the deductions to expenditures above the current $400,000 annual cap. For expenditures above $400,000, lower enhanced deduction rates could apply.
- **Rebrand the R&D incentives as "innovation" incentives.** Many businesses, especially those in the service sector, are still unaware that they can access the R&D tax incentives, because of the impression that they must be involved in hi-tech or laboratory-based activities to qualify. To encourage greater interest in the incentive, the R&D incentive should be rebranded as an "innovation" incentive covering all types of industries.
- **Relax conditions for the R&D deductions to allow more IT innovations to qualify.** Many innovative processes in the service industry are undertaken with the use of IT, such as providing new or improved customer experiences. However, not all these development work result in a final product that can be licensed or sold to third parties. The multiple sale criteria should therefore be liberalised to cater for such software development projects.

Positioning Singapore as a gateway to Asia

Singapore is widely viewed as an attractive location for businesses wanting to expand throughout Asia — a point clearly reinforced by the high number of multinational companies with regional headquarters here. However, with several other key cities in Asia competing to attract corporate headquarters, it is important for Singapore to continually upgrade itself in order to maintain its attractiveness as a leading gateway city.

Improving its network of tax treaties is one of the key areas that Singapore needs to address in order to stay a step ahead of the competition. In the audience poll, 29 percent of poll participants identified double-taxation agreements — specifically, the need to increase the number of such agreements and negotiate better terms for existing ones — as the most important aspect of Singapore's tax system to be addressed in order to help Singapore boost its position as a key gateway to Asia. For another 25 percent, the most important change needed is to make all foreign-sourced income tax exempt.

Addressing the point of tax treaties as a competitive factor, Mr Egan noted that Singapore needs to ensure that its agreements remain relevant and attractive amid competition from other countries: "Hong Kong has gone through a process of rapidly negotiating an extensive number of treaties, and quite a few of them are much more beneficial than what they are in Singapore. For example, Hong Kong has a much better treaty with Thailand than Singapore does. So if Singapore wants to maintain its competitiveness, it may need to look at the number of treaties that are in place and how business has changed over the years since many of these treaties were first negotiated."

Ms Goh Mui Hong, President & Chief Executive Officer (CEO), ST Asset Management Ltd

The corporate tax rate is another important factor with regards to Singapore's ability to serve as a gateway to Asia. However, this does not mean that Singapore necessarily needs to cut its tax rate in order to remain competitive. Indeed, 38 percent of participants in the audience poll said that instead of lowering the corporate tax rate, the Singapore Government should focus on providing more tax deductions and incentives.

4. Which is the most important aspect of Singapore's tax system that should be addressed to achieve this strategy?

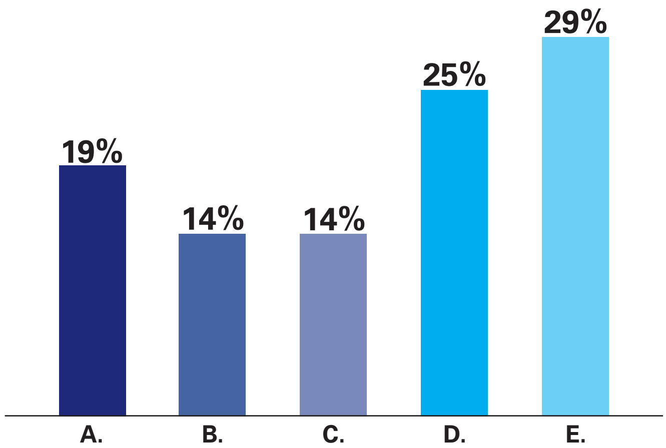
A. Reduce top personal tax rates

B. Certainty of exemption of gains from disposal of equity interests

C. Enhance the headquarter incentives

D. Tax exemption of all foreign-sourced income

E. Increase the number of double taxation agreements and renegotiate better terms for existing ones



5. Should the Government reduce the corporate tax rate?

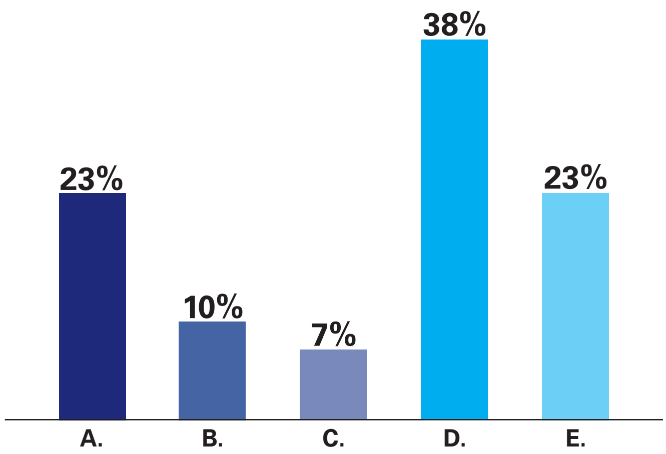
A. Yes, to 15% if possible

B. Yes, to lower than 15%

C. Remain as-is

D. No, but provide more deductions and incentives

E. No, but simplify the tax system and provide greater certainty



At the same time, it is important for Singapore to ensure simplicity and clarity in its tax regime if it wishes to enhance its position as a gateway to Asia. Ms Goh said that for the fund management industry, Singapore's current tax regime may create unnecessary complexity and pose additional risks when setting up certain types of investment vehicles. One critical issue that requires greater certainty is the determination of Singapore tax residency status of the investment vehicle and consequently, whether tax treaty benefits would be available to the investment vehicle.

To help Singapore remain relevant and attractive as a gateway to Asia, Mr Egan pointed out that it is also important for the government to maintain an open dialogue with the private sector. "From a tax administration point of view, the ability to work together with businesses, to understand what businesses are doing and what is happening in the business world, is something that can't be underestimated. It's an important process in good governance, both from a corporate and government perspective. So having more forums, more interaction and an open-door policy is something that I think would be a great plus for Singapore. If we don't do this we'll be left behind because other countries do have such programmes in place."

Mr Brendan Egan, Tax Director, Chartis Asia Pacific Pte Ltd

Key proposals for Budget 2012:
SINGAPORE AS A GATEWAY TO ASIA

- **Enhance Singapore's tax treaty network.** Singapore's tax treaty network should be enhanced by updating old tax treaties (such as Thailand, Indonesia and Australia) and expanding the network with new countries.
- **Retain corporate tax rate while providing more deductions and incentives.** Singapore's corporate tax rate is highly competitive, but more can be done in terms of providing for broader scope of deductions and incentives. For example, the land intensification allowance scheme should be reviewed, or alternatively, an alternative scheme be formulated, to address unique needs of particular industries such as air and sea port operators, telecommunications, shipbuilders and energy-related businesses where land intensification goals are impractical to apply, but yet continual investments in new structures are essential.

- **Enhance fund management incentives.** The designated investments list for the fund management incentives should be reviewed. The Enhanced-Tier fund management incentive should also be extended to LLP funds so as to allow more flexibility to taxpayers on choice of fund business structures. Another improvement would be to reduce the concessionary tax rate for fund management activities under the Financial Sector Incentive to 5 percent to encourage more fund management activities to be based in Singapore. In addition, the GST remission for input tax recovery could be extended to the life of the prescribed fund; currently, this expires on 31 March 2014.
- **Review existing tax incentives to ensure continued relevance.** One proposal is to reduce the concessionary tax rate for the Regional Headquarters incentive to 13 percent from 15 percent currently.

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