

PUBLIC CONSULTATION ON CHANGING TO CURRENT YEAR BASIS OF TAX ASSESSMENT

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MINISTRY OF FINANCE

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AIM

1. The Ministry of Finance is considering the merits of replacing the preceding year basis of assessment with a current year basis of assessment for taxation of income. The macroeconomic merit of a current year basis of assessment is that it enhances the role of the tax system as a counter-cyclical fiscal tool to help smoothen income and expenditure. However, there may be cost and implementation issues involved in adopting a current year basis of assessment which may outweigh its macroeconomic merit.

2. The Ministry of Finance is therefore inviting your comments on the adoption of a current year basis of assessment for taxation to assess its benefits and costs. A new basis of taxation will impact on everyone who pays, or who could potentially pay, income tax. Your views will be crucial in shaping our decision on whether to adopt a current year basis of assessment and, if the current year basis were to be adopted, how it could be implemented.

BACKGROUND

Preceding Year [PY] Basis of Assessment

3. Our current income tax system has the following characteristics:
- Basis Period of Assessment: The incomes derived by individuals and companies are assessed for tax on a *preceding year* basis. In other words, income tax payable this year is based on income earned in the previous year.
 - Method of Assessment: Singapore currently operates an Official Assessment System (OAS). This means that the legal onus is on IRAS to assess the tax liability based on the taxpayer's declaration of income. IRAS will then issue a Notice of Assessment on the amount of tax payable.
4. In addition, companies are required to file an Estimated Chargeable Income (ECI) within 3 months from the end of the accounting year. Hence, a company whose accounting year ends on 31 Dec is required to file an ECI by 31 Mar of the following year. The tax computed based on the ECI can be paid in installments.

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5. Companies need only submit their final income tax return (Form C) together with their accounts and tax computation by 31 Jul of each year. The final tax liability will be determined based on the return filed.
6. Individuals are required to report their incomes earned in the previous year by filing the income tax return (Form B or Form B1) by 15 Apr of the following year. IRAS then assesses the tax payable and issues a Notice of Assessment to taxpayers. Tax is payable within 1 month from the date of the Notice of Assessment.
7. Taxpayers who are paying income tax via GIRO start paying their income tax based on estimated taxes before their actual tax liability is assessed by IRAS. However, upon the filing of income tax returns and after IRAS has assessed the actual tax payable and issued the Notice of Assessment, the outstanding installments will be adjusted to reflect the actual tax payable.

Current Year [CY] Basis of Assessment

8. Under the CY basis of assessment, the income earned by individuals and companies is assessed to tax on a *current year* basis i.e. tax is paid based on the income for that year, rather than income of the preceding year. For salaried individuals, the tax amount may be withheld by the employers on a monthly basis from their salaries and then paid to the tax authority. For companies, tax may be paid in installments.

BENEFITS OF CURRENT YEAR BASIS OF ASSESSMENT

9. Taxing income earned in the current year means that individuals will be paying taxes based on their current income rather than their income in the previous year. This ensures better matching of their incomes and tax expenditures. It also helps to smooth out their disposable income (i.e. income net of tax) and expenditure in the face of economic cycles. Further, individuals who are retrenched or suffer a pay cut in the course of the year will not have to pay taxes on the higher income earned in the previous year, unlike the case now.
10. For companies, CY assessment could improve their cash flow. In particular, where companies make lower profits or losses during a downturn,

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they would not need to pay taxes based on their previous year's profits. Companies whose profits fluctuate from year to year will benefit most from CY assessment. As with individuals, CY assessment would contribute towards a better matching of the company's income and tax expenditure.

11. Take for example an individual earning an income in year 1 but was retrenched in year 2. Under PY assessment, he would have to pay the tax on income earned in year 1 in year 2 when he was retrenched. However, if CY assessment were adopted, the tax will be paid in year 1 and the individual need not worry about his tax liability in year 2 when he has no income. The same applies to companies as well.

12. From a macroeconomic perspective, a CY basis of assessment provides better counter-cyclical stabilisation for the economy. In a year when the economy is growing strongly, taxing on a current year basis will help dampen demand and rein in cost pressures. Conversely, in a recession year, a CY tax system will provide support for the economy in a more timely manner, and the reduced tax collections will provide a boost to consumption and investment spending. This counter-cyclical feature of the CY system is not present in the current PY system, where the amount of taxes to be collected is determined in the year *after* the incomes are earned and may not always be most appropriate under the prevailing economic conditions. A more detailed assessment of the macroeconomic impact of the switch to a CY basis of assessment is provided in the Annex.

Questions for Companies

C1: Would switching to a CY basis of assessment improve the cash flow of your company? In what way?

C2: Would the improved cash flow influence your company's investment decisions? In what way?

Questions for Individuals

I1: Would switching to a CY basis of assessment smooth out your disposable income and expenditure patterns? In what way?

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I2: How would switching to a CY basis of assessment impact your consumption? In what way?

COSTS OF CURRENT YEAR BASIS OF ASSESSMENT

13. CY assessment would likely result in increased frequency of filing and contact with IRAS, which in turn would lead to an increase in compliance costs for taxpayers. This is because unlike the preceding year basis of assessment where the tax is payable only *after* the taxpayer’s income for the year has been established, the CY basis of assessment entails an initial estimate of the income at the start the year, with subsequent filings to calculate the actual tax liability at the end of the basis period. The costs to taxpayers may differ depending on the design of the CY assessment system, but some additional compliance effort is unavoidable.

POSSIBLE DESIGNS OF THE TAX SYSTEM UNDER A CURRENT YEAR BASIS OF ASSESSMENT

14. There are alternative approaches we can adopt for individuals and companies if we were to switch to a CY basis of assessment. For corporate tax, IRAS could adopt either an *upfront estimation method* under which companies file an estimate of their chargeable income and tax payable at the *start* of the year, or a *periodic filing method* under which companies file their returns periodically. Details of the two approaches are in Table 1:

Table 1: Options for Companies

Option (I) Upfront Estimation Method	Option (II) Periodic Filing Method
Reporting of Income	Reporting of Income
Companies file an estimate of chargeable income and tax payable for the <i>current year</i> at the <i>beginning</i> of the accounting year based on, for example: <ul style="list-style-type: none">• Forecast of future chargeable income, taking into account the economic environment or business plans;• Chargeable income of the previous year; or• Average of chargeable income for the past 3 years.	Companies file a return periodically, (e.g. at the end of each quarter) for income earned in the preceding period (e.g. preceding 3 months). IRAS will work out the tax payable and notify the company.

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Option (I) Upfront Estimation Method	Option (II) Periodic Filing Method
IRAS will work out the tax payable and notify the company.	
<i>Frequency of Payment</i>	<i>Frequency of Payment</i>
Companies pay tax on monthly or quarterly installments.	Companies pay tax periodically (e.g. every quarter) upon filing of the return.
<i>Adjustments</i>	<i>Adjustments</i>
Companies adjust their estimates as and when there are changes in the business environment that affect their tax liabilities by notifying IRAS. The installment plan will be adjusted accordingly.	Any adjustment will be made in the final return after the accounting period has ended.
<i>Final Return</i>	<i>Final Return</i>
Companies file final tax return after their accounting period has ended to take into account other adjustments e.g. capital allowances and Group Relief.	Companies file final tax return after their accounting period has ended to take into account other adjustments e.g. capital allowances and Group Relief.

Questions for Companies

C3: What are the compliance issues your company would face for each of the systems: (i) Upfront Estimation Method and (ii) Periodic Filing Method? How will it impact compliance costs?

C4: Which option poses a higher compliance cost?

C5: Balancing compliance costs and the benefits of aligning tax payable to the current state of the company’s business, what is the reasonable frequency of filing under the Periodic Filing Method? Quarterly? Half-yearly?

C6: How much time would your company require to modify your systems to cater for the switch to CY assessment?

C7: What is a reasonable time period for your company to furnish your returns (audited accounts & tax computation) after your accounting period ends?

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15. There are similarly two alternative models to adopt with regard to income taxes on individuals. The first is an employee declaration method under which the employee informs IRAS of his salary details for the year ahead, IRAS makes an assessment of the tax payable, and the employee makes regular payments by installment. The alternative is an employer withholding method under which employers to report to IRAS and withhold the taxes by deducting them from the salaries of its employees. Employees would then receive their salaries net of taxes. Both methods are elaborated in Table 2.

Table 2: Options for Employees

Option (I) Employee Declaration Method	Option (II) Employer Withholding Method
<i>Reporting of Income</i>	<i>Reporting of Income</i>
Employee to inform IRAS of his salary details i.e. estimate of annual salary and other personal details necessary for the claim of income tax reliefs at the beginning of the year. IRAS will work out tax payable & notify the employee.	Employer to report to IRAS the salary details and other personal details necessary for the claim of income tax reliefs of all employees at the beginning of the year. IRAS will work out tax payable & notify the employee.
<i>Payment Method</i>	<i>Payment Method</i>
Employee pays tax to IRAS by installments through GIRO, or as a lump sum through GIRO or other payment modes e.g. AXS, e-payments.	Employer deducts the amount of tax from employees' salary and makes monthly remittance to IRAS.
<i>Adjustments</i>	<i>Adjustments</i>
Employee updates IRAS on any changes in his circumstances that will impact his tax liability and adjustments to the installment plan can be made accordingly.	Employer updates IRAS on any changes in employees' circumstances that will impact his tax liability and adjustments to the installment plan can be made accordingly.
<i>Final Return</i>	<i>Final Return</i>
A final tax return is filed after the end of the year to take into account other adjustments e.g. changes in circumstances, additional bonuses.	A final tax return is filed after the end of the year to take into account other adjustments e.g. changes in circumstances, additional bonuses.

Questions for Employees

EE1: If Singapore were to move to CY basis of assessment, which option would you prefer: (i) Employee Declaration Method or (ii) Employer Withholding Method? Why?

EE2: As many employees would receive their bonuses at year-end, should we have a system where the estimated tax liability for the current year is computed based on monthly basic salaries only, and the tax is adjusted accordingly when bonuses are received (usually year-end)?

Questions for Employers

ER1: What are the compliance issues you would face if the Employer Withholding Method is adopted? How does it impact compliance costs?

16. For the self-employed, the two options again are for them to make an upfront estimation or to file periodically. These are elaborated in Table 3.

Table 3: Options for Self-Employed

Option (I) Upfront Estimation Method	Option (II) Periodic Filing Method
<p data-bbox="228 1301 501 1335"><i>Reporting of Income</i></p> <p data-bbox="228 1335 727 1476">The self-employed files an estimate of chargeable income and tax payable for the <i>current year</i> at the <i>beginning</i> of the accounting year based on, for example:</p> <ul data-bbox="256 1480 756 1771" style="list-style-type: none"> • Forecast of the year’s chargeable income, taking into account the economic environment or business plans; • Chargeable income of the previous year; or • Average of chargeable income for the past 3 years. <p data-bbox="228 1805 707 1912">He also informs IRAS of his personal details necessary for the purpose of claiming income tax reliefs.</p>	<p data-bbox="828 1301 1102 1335"><i>Reporting of Income</i></p> <p data-bbox="828 1335 1326 1585">The self-employed files a return periodically, (e.g. at the end of each quarter) for income earned in the preceding period (e.g. preceding 3 months). He also informs IRAS of his personal details necessary for the purpose of claiming income tax reliefs.</p> <p data-bbox="828 1621 1267 1691">IRAS will work out tax payable & notify the taxpayer.</p>

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Option (I) Upfront Estimation Method	Option (II) Periodic Filing Method
IRAS will work out tax payable & notify the taxpayer.	
<i>Frequency of Payment</i>	<i>Frequency of Payment</i>
The self-employed pays tax on monthly or quarterly installments.	The self-employed pays tax periodically (e.g. every quarter) upon filing of the return.
<i>Adjustments</i>	<i>Adjustments</i>
The self-employed adjusts his estimates as and when there are changes in the business environment or his circumstances that affect his tax liabilities by notifying IRAS. The installment plan will be adjusted accordingly.	Any adjustment will be made in the final return at the end of the year.
<i>Final Return</i>	<i>Final Return</i>
The self-employed files final tax return after their accounting period has ended to take into account other adjustments e.g. capital allowances and income tax reliefs/rebates.	The self-employed files final tax return after their accounting period has ended to take into account other adjustments e.g. capital allowances and income tax reliefs/rebates.

Questions For Self-Employed

SE1: What are the compliance issues you would face for each of the systems: (i) Upfront Estimation Method and (ii) Periodic Filing Method? How will it impact compliance costs?

SE2: Which option poses a higher compliance cost?

SE3: How much time would you require to modify your systems to cater for the switch to CY assessment?

SE4: Balancing compliance costs and the benefits of aligning tax payable to the current state of your earnings, what is the reasonable frequency of filing under the Periodic Filing Method? Quarterly? Half-yearly?

Question for both Companies and Individuals

Q1: Do you think Singapore should switch from preceding year to current year basis of assessment? Why?

Q2: If you think that Singapore should remain on a preceding year basis of assessment, do you have any suggestions to improve the present tax system to improve its responsiveness in an increasingly volatile economy?

TRANSITIONAL ISSUES

17. If a decision is made to switch to a CY basis of assessment, one of the problems the Government will face is having to assess two years of income to tax in the year of transition. However, these transitional issues will be considered only after the study on whether the switch to CY basis is deemed desirable and feasible. This current study will therefore focus primarily on the long-term benefits and disadvantages of the CY system, rather than on one-off, transitional issues.

18. The various options are put forward only for the purpose of discussion as part of an ongoing study on how the tax assessment system may be improved. They do not represent a policy decision or policy position on the part of the Government. All comments received will be studied thoroughly before any decision is made as to whether to consider a switch to CY basis of assessment.

CONSULTATION DETAILS

19. We seek your support to ensure that the consultation exercise is productive and focused. Respondents are requested to follow these guidelines:

- a. Please identify yourself as well as the organisation you represent (if any) so that we may follow up to clarify any issues, if need be.
- b. Make your comments clear and concise.
- c. Please use the template we have provided.

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- d. Please explain your points with illustrations, examples or data as far as possible.

Period of Consultation

20. The period for public consultation is from 15 September to 30 October 2004. Comments sent after 30 October 2004 will not be considered.

Feedback Channel

- 21. Please send us your comments, using the prescribed template, by:
 - a. email to mof_pc@mof.gov.sg; or
 - b. fax to 6337 4134; or
 - c. post to: Ministry of Finance
100 High Street, #10-01
The Treasury
Singapore 179434

We particularly encourage comments through email as they will reach us faster and speed up the review process.

Summary of Response

22. We will publish by 31 December 2004 on this website a summary of the main comments we receive together with our responses. The summary will not disclose the identity of respondents, and will not separately address or acknowledge every comment received.

Documents to Download

23. For your convenience, the relevant documents relating to this public consultation exercise can be downloaded for further reference. Please click [here](#).

Macroeconomic Impact of Current Year Basis of Assessment

Taxing on the basis of income earned in the current year instead of the previous year enhances the automatic stabilisation effect of the tax system. When individuals pay tax according to their current wages, their disposable income net of tax becomes less volatile in the face of wage fluctuations. This in turn helps to smoothen their income and spending patterns. For companies, CY assessment could improve their cash flow as they will not be paying taxes based on previous year's profits. More stable household disposable incomes and corporate cash flows provide in aggregate a counter-cyclical macroeconomic stabilisation effect by supporting consumption and investment in a downturn, and holding back such expenditures in an upturn.

2. Table 1 compares the personal income tax (PIT) revenue collected under the PY assessment with what would have been collected under CY assessment for the period 1997-2002. If CY assessment were adopted, PIT collections during the recessionary period of 2001-2002 would have been 4.6-8.9% less than under the current PY system. In other words, CY assessment would have led to a smaller contraction in disposable incomes than PY assessment, and thereby provided greater support to the economy during the recession. Likewise, during 1997 and 1999-2000, when the economy was growing above potential, a CY basis of assessment would have dampened the rise in disposable incomes and exerted an appropriately dampening effect on the economy.

Table 1: Historical Simulation of Effect of CY Assessment (of PIT) \$m

PIT collection	1997	1998	1999	2000	2001	2002
Current System	2,615	3,262	3,368	4,024	4,503	4,015
CY Assessment	3,233	3,302	3,918	4,216	4,294	3,659
Difference	618	40	550	192	-209	-356
(% in dev in levels)	(23.7%)	(1.2%)	(16.3%)	(4.8%)	(-4.6%)	(-8.9%)

Source: MAS

3. We have also performed counter-factual simulations to shed further evidence on the counter-cyclical effects of CY assessment. We simulated a recession year followed by a boom year under both CY assessment and PY assessment, as shown in Table 2 and Table 3. Under CY assessment, PIT revenue is \$112m lower in the recession year (Table 2), while corporate income tax (CIT) collection is \$218m lower (Table 3). In the boom year, individuals and companies' tax liabilities would have increased by \$300m and \$1.18b respectively.

Table 2: Effect of CY Assessment on PIT Revenue & Private Consumption

	Recession Year	Boom Year
GDP	0.02	-0.02
Pte Consumption	0.04	-0.05
Pte Disposable Income	0.20	-0.49
PIT Revenue (diff. in \$m)	-2.4 (-112)	6.2 (300)

Table 3: Effect of CY Assessment on CIT Revenue & Private Non-Residential Investment

Year	Recession Year	Boom Year
GDP	0.05	-0.05
Pte Non-Res Investment	0.37	-0.33
CIT Revenue (diff. in \$m)	-3.8 (-218)	19.0 (1180)

Source: MAS

4. The model also estimates that disposable income will increase by 0.2% in the recession year and fall by about 0.5% in the subsequent boom year if we move to CY assessment. As a result, consumption would be 0.04% higher in level terms in the recession year and 0.05% lower in the boom year (Table 2). Likewise, private non-residential investment would increase by 0.37% in the recession year and fall by 0.33% in the boom year (Table 3). These results validate the stabilising effects of CY assessment.

5. In addition to the first order effects described above, a switch to a CY basis of assessment may also produce second order stabilising effects. For example, an individual who receives his income net of tax may lower his level of precautionary savings as he has greater certainty over his tax liabilities. In a downturn, this helps to reduce the incidence of over-savings and sustain consumption spending.