GST in Singapore: Policy Rationale, Implementation Strategy & Technical Design[1]

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Introduction

Goods and Services Tax (GST) was introduced in Singapore on 1st April 1994, at a low 3%. The rate has since increased to 4% wef 1.1.2003 and 5% wef 1.1.2004. Singapore's GST a broad-based consumption tax levied on import of goods, as well as nearly all supplies of goods and services. The only exemptions are for the sales and leases of residential properties and most financial services. Export of goods and international services are zero-rated.

Policy Rationale for GST Introduction

The GST was introduced as part of a larger tax restructuring exercise, to enable Singapore to shift its reliance from direct taxes to indirect taxes. GST also enabled Singapore to sustain a lower income tax rate.

With an aging population, Singapore's income tax base was expected to decline. It was estimated that in 1993, there were 8 working persons supporting each aged person. By year 2020, there would be 3 working persons supporting an aged person. If our tax infrastructure does not change, the tax burden on the working population would be too onerous in order to maintain or enhance the level of social and health services. With a broad-based GST, the taxation burden will be more evenly spread among the population.

Hence, even though the country did not need the revenue then, GST was introduced as part of a larger exercise to put in place a tax structure to see the country into the future.

A value-added tax like GST also has several features that make it attractive. Being a tax on consumption, and not on income, the tax system inherently encourages savings and investments instead of consumption. The tax also has a self-policing mechanism that discourages evasion, unlike in a retail sales tax system or an income tax system where it would be relatively easier to scheme to evade taxes.

Strategic Objectives and Actions

On 2nd April 1994, a day after the new tax was introduced, the Straits Times cited the Minister for Finance saying that the tax implementation was a `total non-event'. Implementation of the new tax had taken place smoothly. There were no hiccups nor

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difficulties. What were the strategies adopted that contributed to the smooth implementation of the tax?

Long-Term Vision and Timing

The key strategy behind GST implementation is to introduce the tax as a part of a tax reform exercise to broaden the tax base, and not for the purpose of raising revenue. It was with a long-term vision that the Government introduced the tax – to put in place a tax structure that would stand the country in good stead for future economic development.

The tax was introduced at a time when Government did not require the additional revenue. Government has been having healthy budget surpluses. The economic outlook in 1993 and 1994 was good. Growth has been strong. Singapore could therefore afford to introduce the tax at a low rate of 3%.

The Government also expressly stated that in the initial years of the GST, the tax collected from the GST would be lower than the revenue loss from the package of tax changes and offsets to assist the lower income group. Indeed, the Minister for Finance announced during the FY 95 Budget Speech in March 1995 that the GST collection and offset package totalled $1.5 billion and $1.7 billion respectively.

Generous Offsets

It was expected that GST would be criticised as a regressive tax, and that it would affect the lower income group more adversely than the higher income group. To counter this, GST was introduced with a generous package of tax cuts and rebates to nullify the impact of GST on the lower income group. Much care and effort went into designing a wide-ranging package of offsets, which included lower income taxes, lower property taxes, rebates on rental and service & conservancy charges for public housing, and additional subsidies for health, education and community services. The White Paper communicated that for most households, income tax would be reduced by more than the amount of GST they had to pay. In fact, after the income tax cuts, additional tax reliefs and rebates in 1994, about 70% of individuals that used to pay income taxes need not do so anymore.

Business Education and Public Communication

The implementation of the tax was well supported by a massive communication exercise to engage the business community and the general public.

GST was first communicated through the release of the White Paper in Feb 1993. The draft GST legislation was soon released thereafter. Representations were invited on the proposed tax system, and ample opportunities were given for public discussion of the proposed tax system.

At the same time, IRAS set in motion a series of dialogues and meetings with the business community to explain the tax and to obtain feedback on how the proposed tax system would affect business practices. These meetings also provided the tax administration with useful insights into the tax impact on the various industry segments, and enabled IRAS to fine-tune the tax system to facilitate compliance by businesses. A series of GST seminars and education programmes were conducted by IRAS to systematically reach out to almost every trade and industry in Singapore.

Besides preparing businesses for GST, IRAS also had to explain the rationale for the new tax to the general public. The public communication exercise was needed to dispel any misunderstanding of the reasons why GST was being introduced. The focus was on communicating the 2 most important messages – the rationale for GST and tax offsets for GST.

Technical Considerations

Singapore's GST system was designed to incorporate several key features for better effectiveness and efficiency in compliance and administration for both the businesses and the tax authority. Much attention was also given to designing a system to facilitate compliance. The guiding principle adopted by IRAS when operationalising the tax was that GST should not have any adverse impact on businesses.

A Simple Tax System

The White Paper made it clear that with a wide tax coverage, a relatively lower tax rate would be needed to collect the same amount of revenue.

Singapore had learnt from the experience of other countries that operate VAT systems with multiple rates and multiple exemptions. These administrations had encountered many difficulties arising from countless disputes with the businesses on the scope of tax. Multiple rates and exemptions also pose higher compliance burden on the businesses. It was also recognised that a complex system with multiple rates could potentially lead to more abuses.

High Exemption Threshold

A high annual turnover threshold of S$1,000,000 was set for the compulsory GST registration of businesses. This ensures that only large businesses which should already have in place a proper accounting and record-keeping system are required to register and they should not find compliance burdensome. At this threshold, only 20% of all the businesses in Singapore needed to compulsorily register for GST. Notwithstanding, GST would be collected on a significant portion of the value add created by these businesses. This makes for an effective system as tax can be efficiently collected from a relatively small number of businesses.

Businesses with annual turnover of less than S$1,000,000 include small retailers and the neighbourhood shops and hawkers located in public housing estates. Their exemption from registration helps mitigate the impact of GST on the lower income groups, many of whom purchase their daily necessities from these neighbourhood shops.

Special Features and Schemes in Singapore's GST System

Singapore's GST system is also characterized by several schemes that were put in place to minimise or alleviate any adverse effect the tax might have on the business community. These schemes include the waiver of import GST for major exporters.

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Summary and Conclusion

The timing for implementing a new tax was well chosen. Government had been having budget surpluses and it could afford to give away sufficient tax and non-tax offsets to cushion the effects of GST. There was also the political will to adhere to a broad-based tax system, and not give in to pressures for multiple exemptions or rates that would complicate the tax system.

Although the time frame for introducing the tax was extremely short, IRAS worked with several agencies rigorously to prepare the business community as well as the general public. Underpinning its work with the business community is the philosophy that GST ought not adversely affect business – that Singapore's international competitiveness should not be compromised as a result of GST. This helped IRAS build trust with the business community and contribute in no small way to the smooth implementation of the new tax.