

Taxation of Small and Medium Enterprises (SMEs) in Singapore

1 Introduction

- 1.1 SMEs are the lubricant of Singapore economy, without which, Singapore economy may not survive. There are about 148,000¹ SMEs in Singapore, making up 99%² of all enterprises. They contribute 46% to Singapore's Gross Domestic Product and employ 63% of the workforce³. While we want each SME to pay his fair share of taxes, we are aware that most SMEs are most concerned with the viability of the businesses, and compliance with tax law is usually among the last things on their minds.
- 1.2 The most commonly adopted definition for SMEs within Singapore is one that has:
- ✓ at least 30% local equity and
 - ✓ either
 - fixed assets not exceeding S\$15 million (for manufacturing); or
 - employment size not exceeding 200 (for services).
- 1.3 This means that there is wide diversity within the SMEs; they can be as small as a mom and pop store, a hawker, or as big as a manufacturing company serving multi-nationals corporations. Our observation is that many of the SMEs do not have professional staff to deal with their tax matters; their tax matters are usually handled by the business owners or an accounting staff whose primary responsibility is book-keeping.
- 1.4 This paper shares Singapore's experience in taxing SMEs, how we strike a balance between ensuring that SMEs pay their fair share of taxes while minimising their compliance costs.

2 IRAS' Philosophy In Dealing With SMEs

- 2.1 Our philosophy is to help all SMEs to pay their fair share of taxes. We believe that most taxpayers want to be compliant. The wide diversity within the SMEs calls for further segmentation and we have designed different programmes to help them. Our focus is to make it simple for them to comply, while being conscious not to introduce too many changes at any one time. We have also devoted resources to education programmes so that the SMEs are aware of their obligations and how to meet them. Overall, we want to keep the SMEs' cost of compliance low.
- 2.2 We are firm when dealing with SMEs that try to cheat the tax systems. We are cautious to differentiate those who run foul of their tax obligations due to ignorance from those who have the intention to cheat us and have instituted a range of penalties

¹ Source: "A strong SME 'leg' will help Singapore run faster" article published in The Straits Times (28 Jul 2007).

² Source: Speech by Mr Willie Cheng, Board Member of SPRING Singapore at the Standards and Accreditation Partners' Day on 19 October 2006. SPRING Singapore is the statutory board in charge of promoting the growth of SME in Singapore.

³ Source: "Why SMEs are like nuts: Philip Yeo" article published in The Straits Times (4 Aug 2007)

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according to the types of errors. We want our taxpayers to know that it is not worthwhile trying to cheat the tax system.

3 Key Taxes Affecting SMEs

3.1 SMEs in Singapore exist in different legal forms such as sole proprietorships, partnerships and companies. They are generally subject to the following taxes:

- ✓ **Income Tax** on income derived from Singapore or received in Singapore from outside Singapore.
- ✓ **Goods and Services Tax (GST)** on supplies of goods and services made in Singapore, and importation of goods into Singapore. GST-registered businesses can claim a credit for the GST paid on inputs, but need to charge and account GST on their outputs.

4 Our Actions

4.1 To achieve our goal of making it easy for SMEs to comply with their tax obligations while being firm with those that cheat the system, we formulate action plans in the following areas:

- ✓ Tax Policy – we work with the Ministry of Finance (MOF) to put in place a comprehensive set of tax policies that encourage SMEs to grow.
- ✓ Registration of taxpayers – we rely extensively on technology to register all SMEs for income tax, this ensures compliance and removes the need for SMEs to come forward to register for income tax.
- ✓ Services – we seek to understand the needs of SMEs and to fine-tune our processes to suit them. One key example is our education programme which is customized to suit the needs of each trade / industry association.
- ✓ Filing of Returns – we continuously simplify this process, as this is one of the main obligations of the SMEs.
- ✓ Record keeping – this is one of the factors that contribute to higher cost of compliance and we shorten it to lower the compliance costs.
- ✓ Accurate and complete declaration – we use risk assessment to detect the high risk industries and deploy our limited audit resources to address the risks. The public awareness that they are likely to be detected if they cheat the systems deters fraud and helps to improve the accuracy and completeness of each taxpayer's declaration.

5 Tax Policy

5.1 IRAS works with the Ministry of Finance to ensure that our tax laws encourage the growth of the SMEs and do not impose too high a compliance cost. The following are some initiatives that we have adopted.

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5.2 Income Tax

5.2.1 *Partial tax exemption scheme for companies*

Under this scheme, three-quarters of the first S\$10,000 of a company's chargeable income, and half of the next S\$90,000 is exempt from tax. Any chargeable income in excess of S\$100,000 is then taxed at the prevailing corporate tax rate. Although partial tax exemption scheme is available to all companies, it reduces the tax burden of SMEs the most.

To enhance our tax system for SMEs, the partial tax exemption threshold will be increased to S\$300,000⁴ with effect from year of assessment 2008. This will reduce the effective tax rate of almost 80% of taxable companies in Singapore to less than 10%.

5.2.2 *Full tax exemption scheme for companies*

The full tax exemption scheme for new companies was introduced in the year of assessment 2005 to provide new start-ups every opportunity to thrive and succeed. Under this scheme, qualifying⁵ new companies can enjoy tax exemption on the first S\$100,000 of their chargeable income derived in each of their first three years of assessment that fall within the year of assessment 2005 to 2009.

The 2009 expiry date was removed in the recent 2007 Budget to enable all new companies to enjoy a full three years of tax exemption. In addition, a further 50% exemption will be given on the next S\$200,000 of chargeable income derived by new companies from year of assessment 2008.

5.2.3 *Carry-back relief system*

The carry-back relief system was implemented in year of assessment 2006 as a means to provide more timely relief for SMEs to cope with cash-flow problems, especially in a cyclical downturn. With this scheme, companies can carry back unutilised losses and capital allowances to the immediate preceding year of assessment, subject to a cap of S\$100,000 and other prescribed conditions. Loss making companies will now be able to claim back some of the taxes paid in the preceding year if losses are incurred in the current year.

5.2.4 *Assessment of non-trade income and deduction of approved donations on an accounting year basis*

Previously, non-trade income was assessed and approved donations were deducted on a preceding *calendar* year basis while trade income was assessed on a preceding

⁴ From year of assessment 2008 onwards, 75% of the first \$10,000 of a company's chargeable income, and 50% of the next \$290,000 is exempt from income tax.

⁵ To qualify for the full tax exemption scheme, a company must satisfy the following conditions:

- i. it is incorporated in Singapore;
- ii. it is a tax resident of Singapore for that year of assessment;
- iii. it has no more than 20 shareholders throughout the basis period relating to that year of assessment; and
- iv. all its shareholders are individuals throughout the basis period relating to that year of assessment.

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accounting year basis. Hence, businesses with accounting year end other than 31 December had to separately track their non-trade income and approved donations for income tax purposes. Since the year of assessment 2005, we have aligned the tax and accounting treatments to allow non-trade income and approved donations to be taxed on an accounting year basis. This minimises the need for businesses to adjust their accounting records for tax purposes.

5.2.5 100% capital allowances for plant and machinery costing no more than S\$1,000

Capital allowances on assets acquired for the purposes of a trade, business or profession are granted over a number of years of assessment depending on the type of assets acquired. To reduce the compliance costs arising from the tracking of tax written down values of low value assets, we have allowed businesses to claim 100% of the costs of assets provided that they do not cost more than S\$1,000 each and the aggregate of such claims does not exceed S\$30,000 per year of assessment.

5.3 Goods and Services Tax

5.3.1 High exemption threshold for GST registration

GST registration imposes various compliance requirements on businesses including the filing of periodic GST returns, issuance of tax invoices and the maintenance of proper documents to support input tax claims. With lesser resources, SMEs face more difficulties to comply with these requirements. Hence, since GST was introduced in 1994, the registration threshold had been set at a high annual turnover limit of S\$1 million⁶ to minimise the impact of GST on smaller SMEs. Nonetheless, small businesses that wish claim back the GST incurred on business purchases are given the option to voluntarily register for GST.

When the GST rate was raised from 5% to 7% on 1 July 2007, a 2-year assistance scheme was introduced to help reduce the compliance costs for SMEs who choose to voluntarily register for GST. Under this scheme, SMEs will receive a subsidy to offset the costs⁷ incurred on GST registration, subject to a cap of S\$5,000.

6 Registration

6.1 We rely extensively on technology to register all SMEs for income tax. We gather information from government agencies and private institutions and match the collected information against our database to identify and register all new SMEs for income tax purposes. The various computer-matchings that we have done are:

6.1.1 ACRA (*Accounting and Corporate Regulatory Authority, which is responsible for the registration of new businesses in Singapore*)

⁶ This threshold is much higher than that found in most GST / VAT countries.

⁷ The costs include (i) hardware (50% subsidy); (ii) software costs (100% subsidy); (iii) internet connection costs (up to 1 year) (50% subsidy); and IT implementation consultancy and training costs (50% subsidy).

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We obtain details of all new companies registered in Singapore and create new income tax records for them. Once a company is registered in our database, we will automatically issue annual tax returns for them to complete.

6.1.2 NEA (National Environment Agencies, which is responsible for the licensing of all hawkers within Singapore)

We obtain details of all new hawkers that are operating in Singapore and create new income tax records for them.

6.1.3 CPF (Central Provident Fund Board, which is responsible for the administration of CPF, our nation wide social security savings plan)

All employers are required by law to make monthly CPF contributions for their employees directly to the CPF; this has the added advantage of the employees helping to police the system as the employees are the direct beneficiaries of CPF. We obtained details of all new employers in Singapore from the CPF and create new income tax records for them.

6.2 In short, we seek to understand how information is collected and stored within Singapore and adapt such information to our needs. This allows us to have a comprehensive database of taxpayers.

6.3 The threshold to register for GST is S\$1 million or more. While being GST registered allows the SMEs to claim back their input taxes, it also carries with it certain administrative and compliance costs, hence, we have shifted our focus to helping SMEs make an informed choice on whether to apply for voluntary GST registration. We work with various trade / industry associations to explain the pros and cons of GST registration to their members. We have relied on technology to detect those SMEs that are potentially liable to be compulsorily registered but did not so. We conduct periodic matching of turnover data obtained from our income tax database to detect and follow up with them to determine their liability to register.

7 Services

7.1 We recognise that servicing taxpayer is an important facet of tax administration and one that is crucial to encourage voluntary compliance. Hence, we have put in place several programmes to reach out to businesses. These serve to educate taxpayers on current tax treatments, and are important avenues through which we obtain feedback to facilitate the effective review of tax policies and procedures.

7.2 Education for SMEs

We conduct seminars and workshops to educate taxpayers on existing tax rules and explain new tax changes. For example, monthly GST classes are held to educate GST registered businesses, especially the new registrants, on the treatment of common transactions and to highlight the common errors and obligations of a GST registered business. Since introduced in 1998, these free classes have been popular with SMEs. Recognising the effectiveness of education in ensuring compliance, we have recently

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made GST classes compulsory for voluntary GST registrants. These will mainly be the SMEs who have lesser resources to engage professionals to help them with their GST matters.

Similar to the GST classes, we conduct seminars for corporate taxpayers annually. These seminars are targeted at newly incorporated companies and SMEs that are not represented by tax agents. We educate companies on basic tax principles and provide other essential information to help them comply with tax rules.

Other than on-going seminars, we also hold workshops on an ad-hoc basis when there is a need to reach out to a specific group of businesses. For instance, when our GST rate was increased in 2003, 2004 and 2007, seminars were held to educate businesses on the transitional measures. Some of the workshops were conducted in Mandarin to cater to those businesses, especially the SMEs, who were more conversant in Mandarin.

7.3 Feedback channels / Industry Dialogues for SMEs

We set up a Taxpayer Feedback Panel (TFP) in 1999 to serve as a more structured and regular channel to receive feedback from taxpayers. The purpose of the panel is to obtain taxpayer feedback to enhance our existing processes, policies and services, and to receive suggestions to initiate new services. The panel comprises of individuals from diversified background, and include businessmen and members of business associations. Discussions are held quarterly and cover matters affecting all taxes.

Over the years, we observed that many of our panel members, especially SMEs, were more comfortable providing feedback in Mandarin. To cater to this group of businesses, we set up a Mandarin Taxpayer Feedback Panel for SMEs in November 2004. Dialogues with this panel are also held quarterly and they cover specific tax issues that affect the SMEs.

Besides setting up formal feedback channels, we constantly seek to better understand the needs of various industries and their business practices. We have initiated high-level meetings with various business and professional groups to seek their inputs to our tax policies and processes, and to address their concerns. So far, our senior management had met up with key members of business associations such as the Singapore International Chamber of Commerce and the Association of Small and Medium Enterprises.

At the working level, industry dialogues are held to provide opportunities for taxpayers to seek information and clarifications. Through these dialogues, we are able to strengthen our relationship with professional bodies and trade associations. Our officers also visit businesses to better understand the practical aspects of their business operations.

7.4 Biannual Taxpayer survey

To obtain feedback from a wider group of taxpayers, we conduct surveys by mail every two years to determine taxpayers' satisfaction with our services. Since 2003, the survey has been extended to obtain feedback on the level of compliance costs

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incurred by taxpayers to fulfill tax obligations. The survey serves as a useful avenue for us to find out ways to improve our services to taxpayers and reduce their compliance costs. (See Section 11 below.)

7.5 Assistance in filing tax returns

Efforts have also been made to reach out to businesses that need help to file their tax returns. For example, to assist trading companies complete their income tax returns, we have made available an online tax calculator on our website. The online tax calculator contains a tax computation template with commonly used schedules. SMEs can use it to calculate the company's tax payable easily. Similarly, an online tax computation worksheet has been made available to sole-proprietors to calculate their 4-line statement and tax payable.

Besides providing online templates, we also provide e-filing assistance to those taxpayers who are less internet savvy. For example, during every tax filing period, we station our officers at community clubs to help individuals, including sole-proprietors and partners, e-file their income tax returns.

We have also made efforts to reach out to specific groups of SMEs who need help to e-file. Every year, leaflets containing self-help information, in both Mandarin and English, are distributed to taxi drivers via taxi companies. To encourage hawkers to e-file, we also started a new initiative in 2007 to provide training to the staff of one Hawker Association so that they can help members e-file.

Various assistance is also available to help businesses e-file their GST returns. This includes having dedicated help-lines and email to handle enquiries on e-filing, conducting workshops and visits to businesses to promote and resolve problems encountered when e-filing. To increase awareness of e-filing among the SMEs, we have also prepared Mandarin GST e-filing brochures for distribution. For those businesses without internet access, we provide e-filing facilities and personal coaching at the IRAS SurfCenter located in our office.

8 **Filing of Returns**

8.1 We review tax rules and procedures regularly to keep compliance costs low for taxpayers. Compared to larger businesses, SMEs benefit more from the simplification of tax filing and accounting as they have lesser resources. Some of the initiatives we have adopted are described below.

8.2 Income Tax

8.2.1 *Simplified returns*

Our tax returns are reviewed regularly to ensure that they are user friendly and easy to understand. For companies, the number of pages of Income Tax returns they have to complete was reduced from 8 to 6 and further reduced to 5 pages in 2004. The number of appendices to be completed was also reduced from 11 to 4.

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Sole-proprietors and partnerships with turnover less than S\$500,000 are only required to submit the following 4-line statement to report their trade income:

- ✓ Turnover;
- ✓ Gross profit / loss;
- ✓ Allowable business expenses; and
- ✓ Adjusted profit/loss.

They are also not required to submit certified statements of accounts unless requested.

The requirement for sole-proprietors with less than S\$100,000 in turnover was further simplified to require only (i) turnover and (ii) adjusted profit / loss.

8.3 Goods and Services Tax

8.3.1 *Six-monthly GST accounting*

Generally, a GST-registered trader is required to file their GST returns and pay the net GST collected to IRAS on a quarterly basis. To reduce the compliance cost of small businesses that voluntarily register for GST, filing of GST returns on six-monthly basis is available. With a longer filing cycle, these businesses will have more time to pay IRAS the net GST that they collect from their customers.

8.3.2 *Cash Accounting*

Smaller SMEs may not adopt proper accrual accounting system for their businesses, as such, we have allowed them to opt for accounting their GST on cash basis.

8.4 Electronic-filing (e-filing) of tax returns

E-filing of tax returns confers the dual benefits of reducing tax administration costs for IRAS and compliance costs⁸ for taxpayers. Cost savings in tax administration are reaped through system automation as the need for data-entry work is obviated. For taxpayers, e-filing is a fast, convenient and low-cost media to transact with IRAS.

Since introduced in 1998, the e-filing of tax returns has been a success with individual taxpayers. Today, 80% or 4 out of 5 individuals file their income tax returns on-line. Besides the e-filing of individual income tax returns, we have extended e-filing to other taxes:

- ✓ **Estimated Chargeable Income (ECI) for companies** – Since 2001, companies can furnish their ECI online, and 76% of companies have done so in 2006.
- ✓ **Goods and Services Tax for GST registered businesses** – E-filing of GST

⁸ In the 2006 annual ranking by the World Bank and its private-sector arm International Finance Corporation, Singapore is ranked as the easiest economy in which to do business. It was pointed out that a strong point that Singapore has is its use of technology to administer regulations, which saves time and makes it easier for businesses to complete transactions.

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returns has also been available since Dec 2004 and we have recently made e-filing of GST returns compulsory for all businesses⁹. Nonetheless, recognising that smaller businesses need more time to transit to e-filing, we have staggered the effective date for compulsory e-filing for different groups of businesses to allow SMEs more time to prepare for e-filing.

9 Record Keeping

- 9.1 As part of the Singapore Government's efforts to reduce regulatory burden on businesses, the record-keeping period was reduced from 7 to 5 years. This change affected 17 Singapore statutes including the Income Tax and GST Acts. Given that companies and GST registered businesses have ranked record keeping as the most time consuming activity in complying with tax rules¹⁰, the shortening of record-keeping period will go a long way to help reduce compliance costs.
- 9.2 Besides the overall reduction in record-keeping record, the Accounting and Corporate Regulatory Authority of Singapore has also exempted small companies¹¹ from the requirement to audit their accounts. This change was introduced in 2003, and helps to reduce the statutory costs of SMEs.
- 9.3 As a tax administrator, we have also explored the possibility of reducing the types of records to be maintained by businesses¹² and are currently waiting for the agreement from other government agencies to remove the need to maintain certain records.

10 Accurate and Complete Declaration

- 10.1 While we have introduced many measures to make it easy for SMEs to comply with their tax obligations, we know that if we do not have an effective system to detect and deter them from cheating on the tax systems, it will gradually erode the confidence in the tax systems. Once the confidence is lost, it will be difficult to recover it.
- 10.2 As such, we have specific divisions in our organisation that are tasked with the responsibility to ensure that all taxpayers make truthful declaration to us. Our compliance programmes are designed according to the taxpayer's risk profile, and not specific to SMEs.

10.2.1 Investigation and Intelligence Division

This division is responsible to investigate all tax fraud cases and to scan the entire economy for any abuse of the tax system. There are two main sources of leads: (i) informer allegations and (ii) active data-mining of databases to detect cases that have

⁹ E-filing has been made compulsory from 1 January 2007 for businesses with turnover of more than \$5 million, and from 1 April 2007 for businesses with turnover of between \$2 million to \$5 million

¹⁰ Source: 2007 taxpayer survey

¹¹ This applies to dormant companies and exempt private companies with turnover of not more than \$5million. Exempt private companies refer to those with no more than 20 shareholders and none is a corporation.

¹² This was one of the suggestions provided by the Chinese Taxpayer Feedback Panel.

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attributes that are not aligned with normal cases. This division has also developed the capability to conduct computer forensics investigation on data stored on computers.

10.2.2 GST Division

This division is responsible to ensure that all GST traders are compliant. Most of the staffs are assigned to audit functions according to industry. This helps them to build up good industry knowledge that is useful when auditing the traders. We have also developed different audit programmes to suit the different risk profile of the traders. Those traders who are assessed to be of low risk are subjected to low impact audit programme, which is to achieve the purpose of maintaining audit presence and not imposing high compliance costs to the traders.

10.2.3 Corporate Tax Division

This division is responsible for completing the assessments, servicing and encouraging the voluntary compliance of corporate taxpayers. There are 2 corporate tax branches, one dealing with the tax matters of large companies, and another responsible for the SMEs. We also have a third branch, the Corporate Tax Field Audit Branch, that is devoted to conducting field audits of SMEs. This branch will profile the SMEs and select the more risky cases for audit.

10.2.4 Individual Income Tax Division

This division is responsible to ensure that all individuals pay their fair share of taxes. We have assessed the sole-proprietors and partners to be of higher risk than employees. As such, we have one specific branch to audit them. This branch further segments the sole-proprietors and partners according to their risk profile and picks up the more risky cases for audit.

11 Outcome - Compliance costs incurred by traders

11.1 On the international front, Singapore scores well in terms of the ease of paying taxes. In a 2006 report “Paying Taxes – The Global Picture” by The World Bank and PricewaterhouseCoopers, we ranked among the top 10 countries where businesses find it easiest to pay taxes. Singapore taxpayers also spent the third least number of hours every year to comply with tax laws and regulations.

11.2 Reducing taxpayers’ compliance costs has always been high on IRAS’ agenda. In addition to obtaining feedback on the level of taxpayer satisfaction with our services, the biannual taxpayer survey is also designed to highlight areas that are perceived to require the most resources to fulfil tax obligations. With the results from the survey, we review our rules and procedures with the aim of reducing compliance costs.

11.3 Results from the 2007 taxpayer survey

11.3.1 Compliance Costs

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The 2007 taxpayer survey saw most of the respondents for corporate tax and GST coming from SMEs. For corporate tax, 67% of respondents had turnover not more than S\$5 million and 95% had 200 or less employees. More than 80% of the companies surveyed agreed that overall, the time and money spent to comply with income tax requirements were reasonable. The bulk of them (82%) had spent between S\$0 to S\$5,000 to comply and most (84%) have income tax liability of lesser than S\$250,000.

For GST, 73% of the respondents had turnover not more than S\$5 million, and 95% had 200 or less employees. A high proportion of them (about 90%) agreed that compliance costs were reasonable and about 81% of the businesses spent between S\$0 to S\$5000 to fulfil their GST obligations.

11.3.2 Attitude Towards Compliance

Results from the 2007 taxpayer survey also reflected that most of our companies and GST registered businesses maintain a positive attitude towards compliance with tax rules. An overwhelming majority of them (about 97%) believe IRAS was effective in dealing with non-compliance and that most businesses in Singapore declare their income / GST transactions honestly. This supports our belief that most taxpayers want to comply.

12 Moving Ahead

12.1 Given the importance of SMEs to the economy, the tax system must encourage SMEs to grow and be profitable. As such, we need to ensure that SMEs needs are well taken care of. We need to minimise their compliance costs where possible. We are also aware that fairness of the tax system is fundamental; we cannot allow people to cheat the systems and get away with it. If cheating becomes prevalent, then more and more taxpayers will begin to cheat and this will gradually bring down the system. Thus, it is a continuous balancing act that we need to do to reduce compliance costs while ensuring that all pay their fair share of taxes. We will continue with this balancing act by:

- ✓ Utilising technology and process re-engineering to improve our operational efficiency,
- ✓ Finding new ways to minimise compliance costs,
- ✓ Fine-tuning our audit programme such that we have different programmes to cater for different risk profile of our taxpayers, and
- ✓ Fine-tuning our risk assessment programme so that we know where to deploy our resources.