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Tax incentives for foreign investors: How effective?

By Ivan Png

ONE major way by which the Singapore Economic Development Board (EDB) seeks to attract foreign investors is the Pioneer Certificate Incentive. This exempts businesses that introduce substantially more advanced technology, skillsets, or know-how from corporate tax, or taxes them at a concessionary rate of 5 per cent or 10 per cent for five years. The Pioneer rate is a large discount relative to the normal corporate tax rate of 17 per cent.

After the pioneer period, a business may get the Development and Expansion Incentive for additional investments. This scheme provides tax concessions similar to those of the Pioneer Incentive.

Any tax concession imposes a loss of revenue. As Singaporeans know very well, losses of one source of revenue must be made up in other ways. This year, the Goods and Services Tax (GST) rose to 8 per cent, and is scheduled to rise again next year to 9 per cent. So, with any tax concession, we need to ask how cost-effective it is. Regarding the Pioneer and the Development and Expansion schemes, we actually do not know.

The EDB routinely publishes the amount of new foreign investment attracted to Singapore. However, the EDB does not tell us the counter-factual: How much would have come without any incentive? We do not even know the amount of revenue foregone. However, we do know that the tax incentives might not be very effective for particular foreign investors.

The United States is the largest foreign investor here. In 2020, its investment totalled S$529 billion, or about one-quarter of the total stock of foreign investment in Singapore.

The United States famously taxes both individuals and businesses on their worldwide income. Yet, to avoid double taxation of income, it allows a deduction or credit for taxes paid to foreign jurisdictions. This provision is called the Foreign Tax Credit.

Put simply, if say, Merck pays $1 million in tax to the Singapore government, it can offset that $1 million against the amount that it must pay in US tax. Equivalently, if the Singapore government relieves Merck from $1 million of tax, then it would pay $1 million more in US tax.

How substantial is this giveaway? The US Internal Revenue Service publishes statistics on the amount of foreign tax credit that businesses enjoy. (It would be good if our Inland Revenue Authority of Singapore published data on the amount of revenue lost in tax incentives, but that is a story for another day.) In 2018, the latest year for which the data is available, the pharmaceutical industry received credit of US$14.9 billion. That amounted to more than half of the corporate income tax that it would otherwise have paid. Across all businesses, the credit was US$103.5 billion, or almost one-third of their corporate income tax.

Given that we are raising GST, it would be good for the government to plug this leak.

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