

Budget 2025

Corporate tax windfall provides cushion, but strengthening the base is key

A diversified tax strategy and creative solutions are needed amid global uncertainties and unpredictable market conditions.

Simon Poh

Amid the flurry of giveaways, Prime Minister Lawrence Wong left one significant announcement late in his Budget 2025 statement on Tuesday.

A Budget surplus of \$6.4 billion or 0.9 per cent of Singapore's gross domestic product is expected for financial year 2024. This very comfortable fiscal position is expected to continue with a similar projection of \$6.8 billion surplus in FY2025.

The remarkable result means that an overall surplus of \$10 billion or more can potentially be transferred to our country's foreign reserves by the end of the term of the current Government. This compares favourably with the target set by our Constitution for the government of the day to balance the Budget over its full term.

A closer look at the key drivers of operating revenue tells the story. For both FY2024 and FY2025, corporate income tax revenues are expected to surpass Net Investment Returns Contribution (NIRC) as the top contributor to total revenue. Prior to FY2022, NIRC used to occupy the top spot until the trend started to reverse in FY2022 and FY2023.

At \$30.9 billion for FY2024, corporate income tax comprises 26.5 per cent of the total operating revenue, or projected, a significant 4.1 per cent of GDP.

This trend of significant increase in corporate income tax revenue happened only in the last two years. Before that, it used to be hovering at about 3.2 per cent of GDP.

Can we expect this upward trend to continue?

CAUTION AMID SURPLUS

Though revenue from corporate income tax was significant, as PM Wong mentioned, the upside was an "unexpected change".

There is no clear indication whether this recent favourable trend of increasing revenue will last or is just a temporary boost. PM Wong attributed part of it to industry-specific cyclical factors and suggested that it could be due to multinational enterprises (MNEs) deciding to shift more of their high-end activities to Singapore.

Regardless of the reasons behind this welcome windfall, the focus must remain on the long term as Singapore steers on in an increasingly uncertain global landscape. And this requires a calibrated approach to strengthening the broader base of our revenue.

Looking beyond FY2027, there is scope for more corporate income revenue once Singapore starts collecting the domestic top-up tax for MNEs that need to comply with the new global tax rules.

This arises from Pillar Two of the Base Erosion and Profit Shifting 2.0 project spearheaded

by the Organisation for Economic Cooperation and Development (OECD) that requires them to pay an effective tax rate of 15 per cent for the financial year starting from Jan 1, 2025.

But this is on the premise that these MNEs that are currently operating in Singapore continue to do so and pay the domestic top-up tax in Singapore, rather than relocate to another jurisdiction and pay the minimum tax in that location.

Here is where it is important that the Government continues to double down in its efforts to attract MNEs to either remain in or relocate to Singapore based on various non-tax factors that Singapore has been renowned to have as a competitive edge over other economies.

This list includes its strategic geographical location, global connectivity, political stability, pro-business environment, diverse talent pool, reliable legal system and strong infrastructure.

Briefly, Pillar Two proposes to introduce a global minimum effective tax rate of 15 per cent for large MNE groups with global annual revenue of at least €750 million (\$1.05 billion). Two components of Pillar Two will be implemented in Singapore from Jan 1, 2025.

First, an Income Inclusion Rule will subject the overseas profits of MNE groups that are parented in

Singapore to a minimum effective tax rate of 15 per cent, regardless of where they operate.

A second component, the domestic top-up tax, will ensure that MNE groups must pay a minimum effective tax rate of 15 per cent on their Singapore profits.

But the world has undergone significant changes since these tax rules were mooted. Even as they are being implemented, there are major headwinds caused by uncertainties about the international tax landscape that may pose a threat to our continued reliance on corporate tax as a reliable source of sustainable revenue.

The new Trump administration has already cancelled the US involvement in the OECD's inclusive framework agreement for international tax reform involving both Pillar One and Pillar Two.

This casts a cloud over the outcome of the reform. And it is early days to assess the impact on Singapore continuing to attract US MNEs to base their operations here.

Our experience with the catastrophic effects of the Covid-19 pandemic shows how the fiscal position of world economies can be drastically shaken overnight. Singapore was not spared either and we had to draw down our past reserves to

engineer a gradual recovery.

SHORING UP THE BASE

As it stands, Singapore cannot afford to narrowly focus on corporate income tax revenue or, for that matter, any single or dual source to generate the next tax dollar.

While tax hikes are often unpopular, the Government needs to constantly explore broader and better strategies to increase revenue so that we are not too reliant on any one source.

On this note, I believe the Government is already doing that in its annual Budget process and has options up its sleeve. Though Budget 2025 did not feature major tax announcements, we have seen a few significant moves to shore up the revenue base in recent years.

The Government made a very bold decision with the goods and services tax which was increased from 7 to 9 per cent in two stages, in 2023 and 2024.

GST revenue has overtaken individual income tax to be the next highest contributor to government operating revenue after corporate income tax. It is projected to increase from \$20.6 billion in FY2024 to \$21.7 billion in FY2025.

But given the extensive debate leading up to the hike, there is little scope to work on any further

increases in the immediate horizon, at least up to the end of the current decade. PM Wong also said there was no need for further increases till 2030 when he wrapped up his Budget 2024 statement a year ago.

Individual income tax is now the third major contributor after corporate tax and GST. In the last FY2024, individual income tax collections were also higher than expected at \$19 billion, making up 16.3 per cent of the total operating revenue.

With the highest tax bracket recently raised from 22 per cent to 24 per cent, there is limited room for further hikes without risking competitiveness and Singapore's ability to attract and retain top talent.

Singapore does not have a pure wealth tax that taxes the rich based on their net wealth. Based on feedback from other jurisdictions that have implemented such tax regimes, it would be challenging and not cost-effective to implement such a system in Singapore.

Instead, the Government has been taxing the wealth mainly through property tax and stamp duty as these are low-hanging fruits which are more cost-effective to implement.

However, these sources of revenue are inherently volatile. When the property market is strong, tax revenues can be significantly higher. But we cannot expect these revenues to be sustainable given the volatility of the property market in certain years.

Similar to individual income tax, recent hikes in both property tax and stamp duty have already made these taxes more progressive, leaving little room for further increases without significant pushback.

Any unexpected upside in tax revenue brings needed relief to address the immediate concerns of the country. At the same time, the Government is not putting all its eggs in one basket.

Boosting the revenue from each tax type is, however, fraught with challenges as the Government will have to decide on the scope, deal with the volatility and manage the perception of fairness by the taxpaying population all at the same time.

Nevertheless, this diversified approach remains crucial for ensuring long-term fiscal sustainability in the face of rising government expenditure.

Given all these limitations, it is of paramount importance that we should constantly be on the lookout for creative tax strategies to solve this perennial problem.

• Simon Poh is Associate Professor (Practice) of the Department of Accounting at NUS Business School.



Boosting the revenue from each tax type is fraught with challenges as the Government will have to decide on the scope, deal with the volatility and manage the perception of fairness by the taxpaying population, says the writer. ST FILE PHOTO