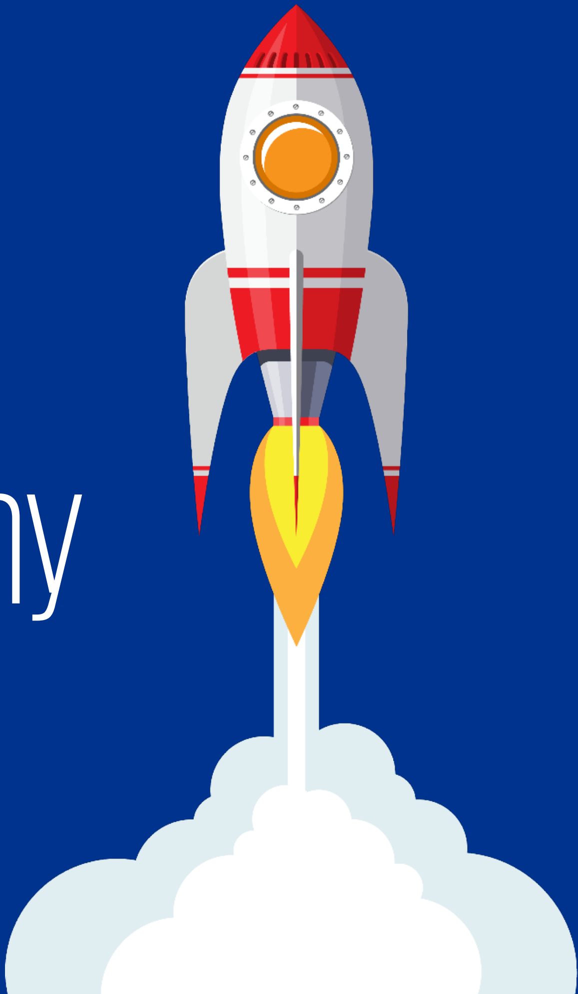
Accelerating growth in the future economy

KPMG'S PRE-BUDGET 2018 REPORT



Foreword

2018 is projected to be a positive year for Singapore's economic growth, with the manufacturing sector taking the lead in economic activity.

Nevertheless, businesses continue to face challenges on a broader scale. Technological disruption in particular continues to be a cause of concern, and geopolitical uncertainty has emerged as a key risk to overall growth.

Towards the end of 2017, we conducted our annual pre-Budget poll for Budget 2018, which garnered responses from 126 companies based in Singapore. These include multinationals, listed and privately-owned companies and SMEs, who shared what challenges they face and how they plan to move forward.

At the same time, we reflected on the views of Singapore CEOs from among the 1261 CEOs surveyed in KPMG's 2017 Global CEO Outlook report, which discussed the challenges and opportunities that they face.

The insights we have gleaned indicate that in the years to come, companies' growth will hinge upon their ability to digitalise, adopt new and relevant technology, and successfully transform their business models.

Disruption and continuous innovation will increasingly be a source of both competitive advantage and competition. Companies recognise this, and they seek support for their efforts to thrive in the digital economy.

We hope that our perspectives from this research will provide you insights in the lead up to Budget 2018, and also valuable feedback to the Government.

Chiu Wu Hong
Head of Tax
KPMG in Singapore

Overview

01

Challenges to growth

05

Our proposals

- Supporting businesses in the digital economy
- Accelerating the growth of enterprises
- Strengthening our fiscal position and competitiveness
- Achieving inclusive growth

17

Poll findings

Challenges to growth

After some years of caution, we are now seeing an economic uptick in Singapore. The Republic's GDP increased to 3.5% for 2017. This strong showing is boosting confidence among the business community.

Nevertheless, the broader environment continues to affect companies. Insights from KPMG's 2017 Global CEO Outlook shows that geopolitical trends and disruptions such as election outcomes and international conflicts have emerged as a major source of strategic and operational challenges.

In the coming years, technology-related sectors will increasingly be a key area for Singapore's future growth, and innovation will be front and centre as a competitive strategy.

While this presents significant opportunities for companies that are able to stay abreast of the wave, it also presents major challenges in terms of competition and remaining relevant.

Challenges to growth

41% cited the global economic outlook as their top business concern over the next 3 years.

Rising labour and rental costs cited as the second major concern over the next 3 years.

RENEWED OPTIMISM AMIDST UNCERTAINTY IN THE GLOBAL ECONOMY

In our pre-Budget poll this year, 41% of respondents cited the global economic outlook as their top business concern. This is down from 60% last year.

Separately, in our 2017 Global CEO Outlook report, many CEOs indicated that last year's political events have had an unusually great impact on their businesses. CEOs are devoting increasing resources to managing geopolitical risk, from recruiting new skills to scenario planning.

RISING COSTS

While the economic turn-around story continues to unfold worldwide, here at home rising rental and labour costs continue to weigh on companies, particularly smaller enterprises that have yet to see their business pick up. Our pre-budget poll shows that rising costs is the second major concern for the next few years.

An especial cause for concern among poll respondents is the simultaneous lapse of the **Productivity and Innovation Credit (PIC)** scheme and this year's potential increases in tax. Taken together, these are a double whammy for companies that may already be struggling with the cost of dealing with technological disruption.

49% keep an eye on the environment and adopt new technology as soon as possible.

40% cited continuous innovation, as opposed to once-off innovation (12%), as key to addressing disruption

DISRUPTION AND DIGITALISATION

Our respondents are keenly aware of the importance of digitalisation and embracing new technology. Close to half are looking to adopt new technologies, including smaller businesses. This is in contrast to last year when the poll suggested that they are struggling to adopt new technologies.

Sustained and continuous innovation, as opposed to once-off innovation, is also key to addressing disruption.

Businesses also make considerable effort to keep up, with CEOs placing very high priority on emerging technology. However, the cost of innovation and adopting new technologies continues to be a key challenge.

55% believe that investing in technology, driving greater business innovation and creating new products and services should be the top key business strategy for the next three years.


25

Our proposals

As Singapore transitions towards an economy that focuses much more heavily on technology, businesses and employees alike will require support to adjust to new models of growth.

Based on feedback from the poll, and discussions we have had with businesses, we have therefore themed our proposals around four key pillars.

We believe these will position companies well for the long term. The key proposals are discussed in the next sections, and a more detailed list of KPMG's Budget 2018 proposals is available at www.kpmg.com.sg

While there are many areas that need to be considered for Singapore's future growth, we believe that four key areas are particularly important to Singapore's growth.

AT A GLANCE: FOUR KEY THRUSTS TO ACCELERATE THE GROWTH OF BUSINESSES IN THE FUTURE ECONOMY

Supporting businesses in a digital economy

Accelerating the growth of enterprises

Achieving inclusive growth

Strengthening our fiscal position and competitiveness

Our proposals

SUPPORTING BUSINESSES IN THE DIGITAL ECONOMY

OUR PROPOSAL: ENHANCED TAX INCENTIVES TO ENCOURAGE BUSINESS TRANSFORMATION

If companies are to thrive in the digital economy, it is critical that they transform their business models. But the cost barriers are significant, especially for smaller enterprises, which tend to have limited resources and a comparative lack of knowledge.

Some companies have indicated that they wish to innovate or adopt new technology, but lack the capabilities or inclination to make the large upfront investments needed. Many others feel that with the high costs involved and uncertain return on investment, there is no incentive to take the risk.

We therefore propose **enhanced tax deductions and capital allowances to encourage investments in new technology and innovation development** as follows:

- 400% for the first $200,000 of expenditure; and
- 200% beyond the first $200,000 of expenditure.

Such enhanced capital allowances and tax deductions should be extended to expenditure relating to the following:

- Cost on capital assets (including software development) for digital adoption,
- Digital skills training and up-skilling employees to acquire new skills and capabilities such as data analytics, and
- Professional help to identify appropriate technology and process reengineering.

"Provide subsidies or further tax incentives for companies that embrace innovation and new technology in their business processes."

66% cited one of the top three areas that require more support is the transformation of business processes and models in the digital economy.

OUR PROPOSAL: SUPPORT NEW BUSINESSES WITH AN INNOVATION TAX CREDIT

Innovation comes in many ways, and for companies of all sizes. We therefore propose an **Innovation Tax Credit to support promising new businesses undertaking innovative R&D and other value creation activities.**

In particular, we believe that start-ups with the potential for innovation and value creation should be nurtured as they are a potential source of future growth.

58% hope that the Government will support their efforts in innovation, R&D and value creation, and more schemes to strengthen Singapore enterprises

Such a tax credit could be set at 50% of eligible expenditure (such as salaries of staff involved), and could be made further relevant by paying it out in cash to create a direct incentive for companies at a time when start-up capital may be hard to come by.

Our proposals

SUPPORTING BUSINESSES IN THE DIGITAL ECONOMY

OUR PROPOSAL: IMPROVED R&D TAX INCENTIVES TO HELP BUSINESSES ACHIEVE COMPETITIVE ADVANTAGE

Despite the importance of R&D in enhancing a company's competitiveness and resilience, many smaller enterprises are reluctant to invest in R&D due to the high costs.

At the same time, Singapore's R&D tax incentives are beginning to lag behind its competitors. With the expiry of the PIC scheme this year, Singapore will become one of the least attractive countries in the world to undertake R&D.

To encourage sustained and continuous innovation, we need to ensure that our businesses are not at a disadvantage compared to their counterparts in more competitive countries. We propose that:

- **Singapore's R&D tax incentive needs to be enhanced**, with an increase of a 150 to 300 percent deduction for R&D expenditure incurred in and outside Singapore.
- **Companies should be allowed to claim the enhanced R&D tax deductions** in the year of assessment that they incurred the qualifying expenditure on R&D, with a cash payout on the amount where there are no taxable profits.

The current criteria to commence business before a company can claim enhanced tax deductions penalises companies which require a longer time to develop and commercialise products.

66% feel that they need to continuously innovate, or transform their existing business models, in order to address disruption in their industry or market.

"[Give businesses] more tax breaks for adoption of technology and R&D costs, even if the technology does not work [out]."

ACHIEVING INCLUSIVE GROWTH

OUR PROPOSAL: INCENTIVISE THE RE-SKILLING AND UP-SKILLING OF THE WORKFORCE

The increasing focus on technology and innovation potentially renders the skills of many workers obsolete. Combined with sometimes high costs involved in bringing in foreign talent, this frequently leaves companies groping for the skillsets they need to adapt and grow.

Companies are willing to retain and retrain their employees where possible, but they hope for financial support in doing so. We propose:

- **enhancements to schemes for re-skilling and up-skilling workers**, and to help individuals retrain for employment in sectors with growth potential.

  For example, by undertaking studies at a task level of current jobs, similar skills can be identified in other sectors that people working in sunset industries can be more easily retrained to work in.

  In addition, the scope of existing government schemes could be extended to incentivise businesses to re-skill and up-skill employees (e.g extending current Workforce Development Agency schemes such as the WorkPro grants, or realigning the Wage Credit Scheme to incentivise the hiring and re-skilling of displaced workers).

- **enhance incentives for businesses to invest in the upgrading of their workforce.** This is especially so for encouraging local businesses to adopt not just technology, but in driving the mind-set change and culture needed for continuous innovation and digitisation.

  Not everyone is technically inclined but this does not mean there is no new digital future for their careers. Examples of complementary skills that can be learnt by some people in newer areas include: training in data & analytics, user-centric design and possibly gamification or app creation.

  Enhanced tax deduction should be provided for companies which put in place comprehensive training progammes to re-skill or up-skill employees every 3 to 5 years as part of the inclusive employment initiative.

68% believe that incentivising businesses to retrain and up-skill existing employees, and supporting businesses promoting inclusive employment is very important for encouraging inclusive growth.

Our proposals

ACHIEVING INCLUSIVE GROWTH

OUR PROPOSAL: STIMULATE THE HEALTHCARE INFRASTRUCTURE FOR AN AGEING WORKFORCE

As Singapore's population ages, the healthcare infrastructure is under strain. We propose:

- **support for the development and enhancement of healthcare facilities and infrastructure**, and for the implementation of new methods of remote care. This could include offering funding or subsidies to encourage more collaboration between the Government and private healthcare providers.
- **measures to enable private healthcare providers** to take up more of the patient load. For example, the amount of space allocated for private hospitals should be increased in order to cater to the growing demand for medical services.
- **offer tax relief** to those who support the elderly and unwell, through for example tax deductions for medical expenses.
- **extend the Foreign Maid Levy Relief** to unmarried taxpayers caring for aged parents.

ACCELERATING THE GROWTH OF ENTERPRISES

OUR PROPOSAL: GREATER SUPPORT FOR SINGAPORE ENTERPRISES AND START-UPS

SMEs are the growth engines of Singapore's economy, comprising 99% of registered local businesses, contributing more than 50% of our GDP, and employing 70% of our workforce.

However, their small size and limited resources leaves them vulnerable to business shocks.

With the merger of IE Singapore and SPRING, there is room for the new agency, Enterprise Singapore, to not only maintain but strengthen support for SMEs. Many SMEs have also indicated that they hope for more comprehensive support and a simplified process of obtaining it.

Our proposal is to offer:

- **enhanced support for SMEs.** This should include funding that will help them build their brands and internationalise, incentives for investors to back them, and cost mitigation measures to help them tide over periods of downturn.
- **introducing incentives to support the building of local brands** and encouraging them to retain ownership of these brands. This could include allowing tax amortisation of the expenditure incurred in developing and growing local brands.

  For administrative expediency, the amortisation could be allowed on the basis of the higher of $200,000 or 5% of revenue for 5 years, and restricted to SMEs which have registered a brand under the company.

Our proposals

STRENGTHENING OUR FISCAL POSITION AND COMPETITIVENESS

OUR PROPOSAL: TWEAK THE TAX SYSTEM

There has been much speculation surrounding the probability of a GST increase in 2018. While Singapore's GST rate is undeniably lower than that of many other countries, the GST regime is broad based with very few exemptions, meaning that it is more broadly applied to proportionately more consumers. In the event there is a GST rate increase, we propose:

- **increasing the income tax relief for individual taxpayers**, to reflect the fact that Singapore's cost of living has substantially increased over the years and is today comparable to other developed countries. For example, spouse relief should be revised to S$4,000, as with child relief, or higher. The amounts of earned income and child reliefs to taxpayers should also be increased.
- **introducing measures to offset the impact of the GST increase** especially on the low income groups. This should include GST vouchers, utility bill rebates, increasing Workfare payouts and other offsets.

As an alternative to increasing GST across the board, there is already a movement globally to tax e-commerce and digital services. Given that the value of online spending is set to increase as consumers make a sweeping shift from brick and mortar shopping to online buying, the taxation of e-commerce and digital services makes for far better math.

OUR PROPOSAL: ENHANCING SINGAPORE'S COMPETITIVENESS

As a mature, high-cost economy, Singapore needs to maintain its attractiveness to global investments while encouraging the internationalisation of its own companies.

Singapore's corporate income tax (CIT) rate has remained static at 17% since 2010, while other countries have been gradually reducing their tax rate.

While continuously monitoring global and regional trends in CIT rates is necessary, there is no immediate need to reduce CIT rate in Singapore.

However, tax competitiveness remains an important 'trump card' for influencing investment decisions. We therefore propose:

44% feel that enhancing tax incentives is the most important way to make Singapore more competitive as a HQ location.

- **adjustments to several specific aspects of our tax system** that relate to attracting foreign investments and talent. These should include enhancing our tax treaty framework, expanding the scope of the foreign-sourced income exemption, harmonising the tax treatment of equity-remuneration, and tailoring our HQ incentives to especially attract Asian MNCs.
- **making our manpower framework flexible**. Many global businesses set up headquarters (HQs) in Singapore but find it difficult to find the right talent, especially for new skills across the digital spectrum such as cyber-security, artificial intelligence, creative design etc.

"Many global digital / tech companies set up their HQ here through EDB's support but they find difficulty in getting the right talent across the digital spectrum – cyber security, AI, design thinking etc. The employment pass framework needs to be more flexible."

Our proposals

STRENGTHENING OUR FISCAL POSITION AND COMPETITIVENESS

OUR PROPOSAL: ENHANCED SUPPORT FOR SPECIFIC SECTORS

Alongside the focus on new-growth sectors, there is a need to strengthen key sectors vital to Singapore's economy, such as Financial Services and Real Estate.

Financial Services

Governments around the world are aware of the need to deepen financial markets to improve efficiency and make growth more sustainable. In ASEAN, the banking sector is relatively well developed and capitalised, and large infrastructure spending across the region is helping to create further growth opportunities.

Singapore is actively pushing fintech as part of the CFE agenda, forming cooperation agreements with London, the leading fintech hub in Europe. MAS has enacted several regulations last year to expand the industry, such as a sovereign digital currency pilot scheme and a fintech regulatory sandbox.

In order to support the growth and advancement of the industry, we propose:

- **extending the tax exemption and concessionary tax rate in respect of Qualifying Debt Securities** (QDS) and QDS+ by another 10 years. These schemes remain relevant in promoting Singapore's status as a financial hub. In addition, we propose expanding the existing schemes to cover "Green Bond" and "SGD Credit Rating Bond".
- **that MAS should issue guidance on the taxation of digital token offerings** as soon as possible, given the increase in such activities in the market.

  While MAS has issued guidance on such offerings and on the trading of virtual currencies, no guidance has been issued on the taxation of digital token offerings to-date.

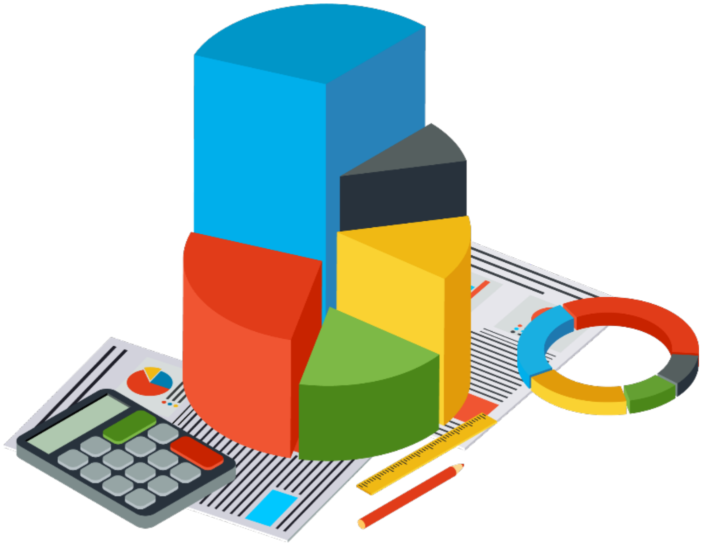
OUR PROPOSAL: ENHANCED SUPPORT FOR SPECIFIC SECTORS

Real Estate

Across ASEAN, the real estate sector is going through a period of reform. Many ASEAN countries have taken steps to liberalise their real estate markets by easing foreign ownership restrictions, and foreign players are now able to participate as investors and developers.

To make Singapore more attractive to investors, we propose:

- **introducing safe harbour rules** (similar to those accorded to gains arising from disposal of shares) for the taxation of gains from the disposals of the direct holding of properties to provide investors with tax certainty.
- **allowing tax transparency treatment to wholly owned subsidiaries of REITs** to ensure parity with approved sub-trusts which enjoy transparency.
- **introducing commercial building allowances** on the cost incurred in the construction of office, commercial and similar properties. This will make Singapore a more competitive location for real estate development.



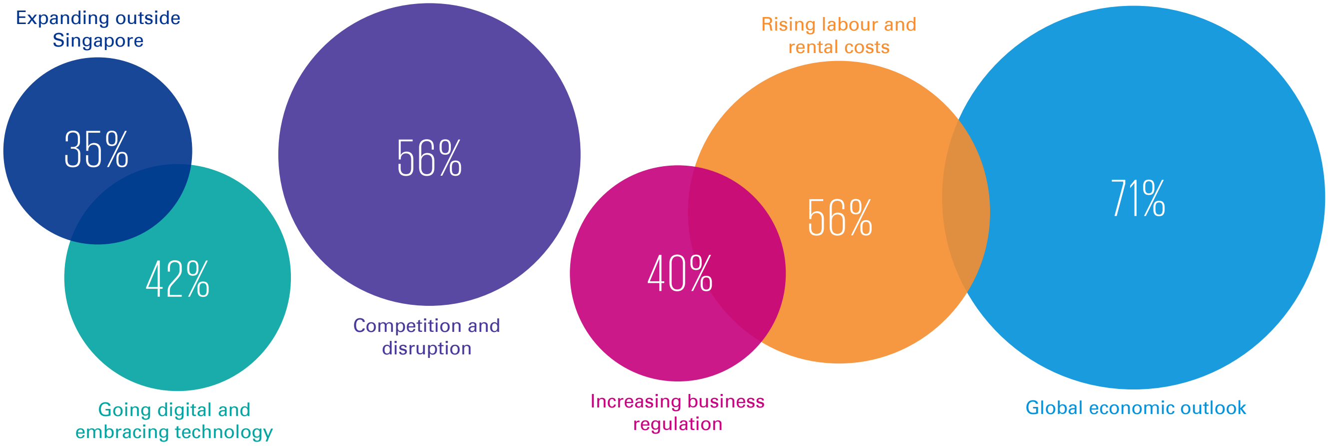
Poll findings

Poll findings

UNCERTAIN ECONOMIC OUTLOOK

Global economic outlook continues to be our respondents' key business concern, with 71% citing it as one of their top 3 concerns. Meanwhile, 41% cited global economic outlook as their top business concern.

CHOSEN BY BUSINESSES AS THE TOP 3 BUSINESS CONCERNS OVER THE NEXT 3 YEARS

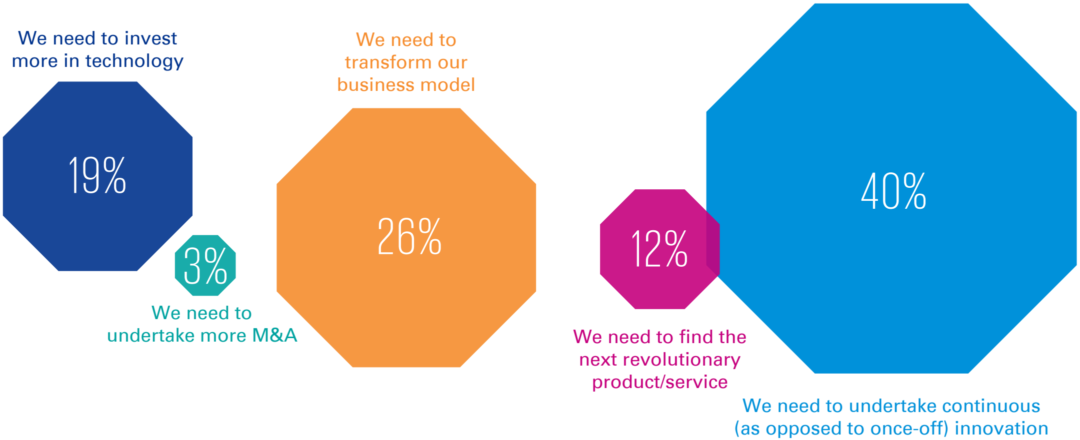


**Please note that respondents can choose only 3 options and rank them in order of importance. To explain the figures above, 71% indicated global economic outlook as one of the top 3 concerns, while 29% (i.e. the remainder) did not think it was one of the top 3 concerns.*

MORE SUPPORT FOR CONTINUOUS INNOVATION

About 40% in the pre-Budget poll has engaged in continuous innovation (as opposed to one-off) to address disruption in their industry. They would also like to see more government support in investments for continuous innovation and R&D, with 53% citing this as a priority (see next page).

CHOSEN BY BUSINESSES AS THE MOST IMPORTANT STRATEGY TO ADDRESS DISRUPTION IN THEIR INDUSTRY/MARKET

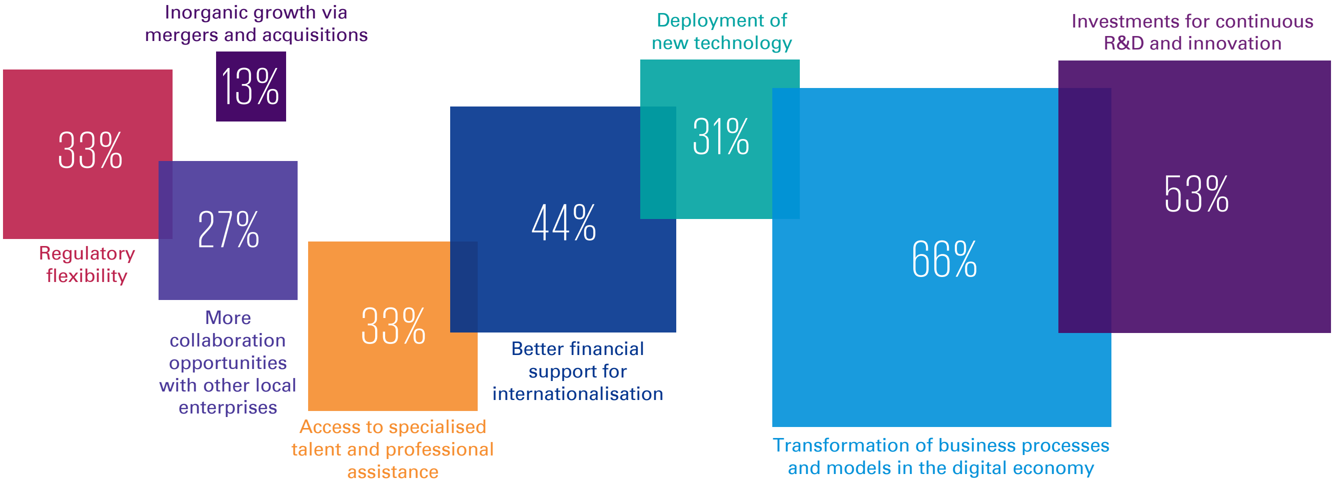


Poll findings

MORE SUPPORT TO TRANSFORM BUSINESS MODELS

Many businesses polled in Singapore believe that investing in technology and innovation as their most important business strategy. A similar proportion (66%) hope for more Government support to transform their business models.

CHOSEN BY BUSINESSES AS THE TOP 3 AREAS WHICH LOCAL BUSINESSES WOULD REQUIRE MORE SUPPORT FROM THE GOVERNMENT

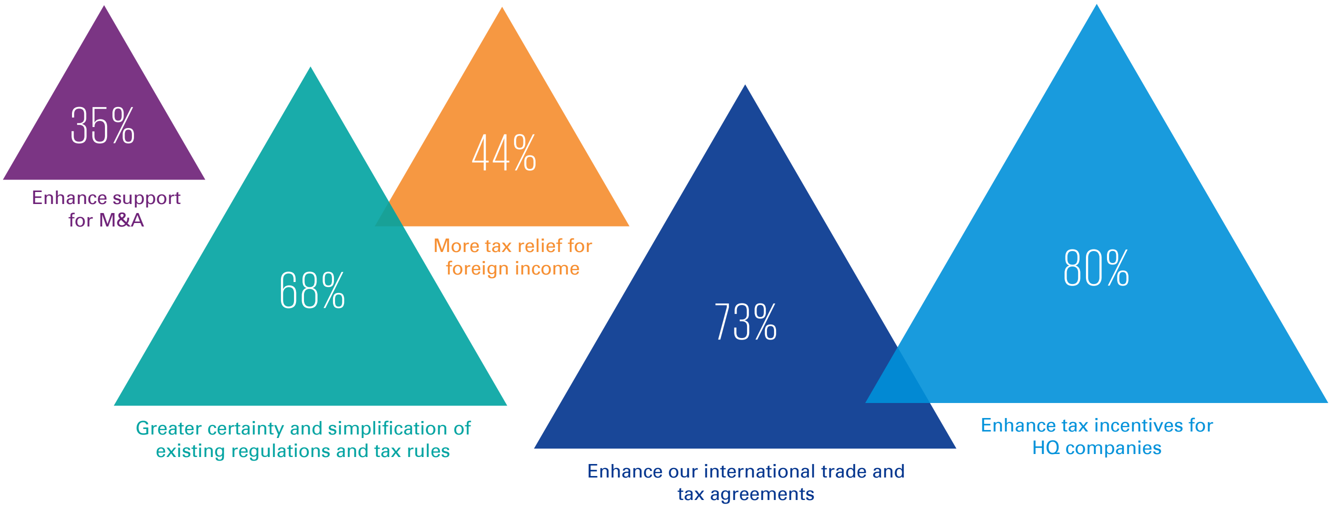


**Please note that respondents can choose only 3 options and rank them in order of importance. To explain the figures above, 66% indicated that transformation of business processes and models in the digital economy as one of the top 3 areas requiring more support from the government, while 34% (i.e. the remainder) did not think it was one of the top 3 areas.*

ENHANCING SINGAPORE'S COMPETITIVENESS

Beyond policy, it is also necessary to create a conducive environment for Singapore businesses to take root and flourish. A large 80% of respondents agreed that tax incentives should be enhanced for headquarters (HQ) companies, in order for Singapore to stay competitive as a HQ location for Singapore businesses and MNCs, with 44% citing it as a top priority.

CHOSEN BY BUSINESSES AS TOP 3 WAYS ON HOW SINGAPORE CAN BE MORE COMPETITIVE AS A HQ LOCATION FOR BOTH SINGAPORE BUSINESSES AS WELL AS MNCS



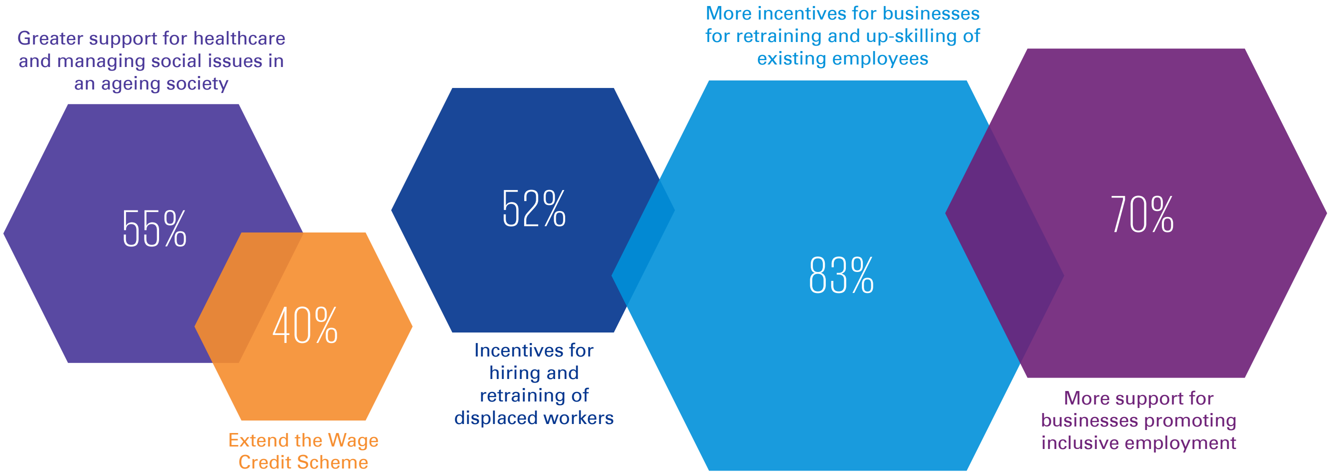
Please note that respondents can choose only 3 options and rank them in order of importance. To explain the above figures, 80% indicated enhancing tax incentives for HQ companies as one of the top 3 areas to make Singapore more attractive, while 20% (i.e. the remainder) did not think it was one of the top 3 areas.

Poll findings

ACHIEVING INCLUSIVE GROWTH

The Government's recent push to equip our workforce with digital skills help to ensure that businesses can remain competitive and incorporate new technologies into daily processes. In fact, 83 percent of our respondents hope that there will be more incentives to retrain and up-skill their employees as one of the top three ways to encourage inclusive growth in the digital economy.

CHOSEN AS TOP 3 WAYS OF HOW SHOULD SINGAPORE ENCOURAGE MORE INCLUSIVE GROWTH



**Please note that respondents can choose only 3 options and rank them in order of importance. To explain the above figures, 83% indicated more incentives for businesses for retraining and up-skilling of existing employees as one of the top 3 areas to encourage more inclusive growth, while 17% (i.e. the remainder) did not think it was one of the top 3 areas.*

ACKNOWLEDGEMENTS

Contributors to the report:
Head of Tax, Chiu Wu Hong
Tax Partner, Harvey Koenig
Senior Tax Manager, See Wei Hwa

The contributors would also like to thank all Partners for their input and the following:

Editing:
Kelvin Lee & Yasmin Quek

Art Direction and Design:
Quentin Joseph

kpmg.com.sg

Contact Us

Ong Pang Thye
Managing Partner
T: +6213 2035
E: pong@kpmg.com.sg

Chiu Wu Hong
Head of Tax
T: +65 6213 2569
E: wchiu@kpmg.com.sg

kpmg.com.sg/socialmedia

kpmg.com/app