Employer-sponsored retirement schemes in Singapore: The need for change

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In 2030, one in five Singaporeans will be aged 65 and above. This aging population will create a groundswell of needs for health care, elderly support services, continued employability, financial security and active aging policies. This silver tsunami will be upon us in less than two decades.

At the present rate of saving for retirement – whether through the Central Provident Fund (CPF) or voluntary savings – there is a real risk that Singaporeans will not have enough to see them through their twilight years, and certainly not in the healthy, active fashion that most are anticipating.

The pressing need for many Singaporeans to save for retirement above and beyond what they are setting aside in their CPF accounts cannot be overemphasized. The reality is that voluntary saving in dedicated retirement vehicles is limited on either a collective or an individual basis. There are very few such vehicles in Singapore.

Supplementary employer-sponsored retirement plans are an important component of the solution and are the focus of this paper, which outlines the current approaches used by employers to provide retirement savings in addition to the CPF, highlights the limitations related to these approaches, and makes a proposal for change that might encourage more employers in Singapore to support additional retirement provisions for their employees.

This paper has been drafted for submission to the relevant authorities under the auspices of the Singapore government on behalf of the Singapore Actuarial Society.

Current employer-sponsored approaches to retirement savings

In Singapore there are two approaches available to employers to fund supplemental retirement savings locally on behalf of employees: retirement plans established under Section 5 of the Income Tax Act (Section 5 plans) and the Supplementary Retirement Scheme (SRS).

The key features of the two approaches are listed below.

Key features of Section 5 plans

- Introduced in 1994 as a means for employers to fund retirement savings in addition to the CPF. Operates as a collective savings vehicle.
- Where a scheme is introduced, all employees must be covered by the scheme and the same benefits must apply to all.
- A Section 5 plan can only be funded by employer contributions. Employee contributions are not allowed.
- Plans may be either defined benefit (where benefits are determined by a formula, typically based on salary and service) or defined contribution (where benefits depend on the accumulation of contributions paid).
- The trust deed and rules of the scheme must be approved by the Inland Revenue Authority of Singapore (IRAS). Half-yearly investment returns, an annual tax filing and an annual actuarial certificate must be submitted to IRAS.
- There are no investment restrictions, but investments are subject to the Trustees' duty of care.
- Tax treatment:
  - Employer contributions are tax deductible for the employer.
  - Employer contributions are not a taxable benefit-in-kind for employees.
  - No tax on investment returns during the accumulation phase.
  - Retirement benefits (inclusive of investment returns) are taxable for employees, though the tax charge may be mitigated by spreading the benefits over up to five years, or through a lifetime annuity from a life insurance company.
  - Retirement benefits are subject to an overall defined benefit ceiling (2.25 × last monthly drawn salary × years of service *less* the total employer contributions to the CPF).

Prevalence of Section 5 plans in Singapore is very low. There is no public data available on the number of such plans, but based on our market knowledge, it is estimated at around 20. Most plans – and all recently implemented plans – are defined contribution in nature. There is limited employer awareness and understanding of Section 5 plans in Singapore.

Key features of SRS

- Introduced in 2001 as a means for individuals to fund retirement savings in addition to their CPF savings. Operates as an account in the individual's name.
- Opened up to allow employer contributions from Oct. 1, 2008.
- Savings made via one of three SRS providers: DBS, UOB and OCBC banks.
- A wide range of investment options are available.
- Carries an early withdrawal penalty.
  - 5 percent of the amount withdrawn.
  - Waived for early withdrawals on medical grounds, on death, and for a foreigner who has held his account for at least 10 years and withdraws the full account.
- Tax treatment:
  - Employer contributions are tax deductible for the employer.
  - Employer contributions are tax neutral for the employee (added to income but may then be deducted by the employee).
  - Employee contributions are tax deductible for the employee.
  - No tax on investment returns during the accumulation phase.
  - 50 percent of the benefit (inclusive of investment returns) is taxable on withdrawal; on or after statutory retirement age, on medical grounds, on death, or for a foreigner who has held his account for at least 10 years.
  - For withdrawals at or after statutory retirement age or on medical grounds, tax may be mitigated by spreading the withdrawals on the taxable portion over up to 10 years.
  - Contributions are currently subject to a total cap of SGD 12,750 for Singapore citizens / permanent residents and SGD 29,750 for foreigners per tax year.

Few employers use the SRS as a means of supplementary retirement savings for Singapore citizens or permanent residents. There is some limited use by employers in respect of foreign employees, for whom typically an employer would make contributions that are equivalent to the notional employer CPF contributions that would have been made on the employee's behalf. However, the majority of employers that grant notional retirement contributions to foreigners do so in cash.

Issues with the current approaches

The key issues with the two retirement savings approaches are described below:

Key issues relating to Section 5 plans

1. *Tax treatment of retirement benefits.* Retirement benefits that have been accrued over many years of service are taxed as if the benefit were generated only in the year of receipt.

   Lower-income employees who have not paid income tax at all during their working careers may therefore be subject to a significant tax on the benefit. While there is ability to spread the payment (and therefore utilize tax allowances over a number of tax years), tax may still be borne by retirees, even though they may have paid no tax previously.

2. *Tax treatment of the investment return component of retirement benefits.* For defined contribution schemes, the retirement benefit consists of the sum of the employer contributions plus the investment return on those contributions. The investment return accrued on the contributions is therefore ultimately taxable when the benefit is paid at retirement. This is inconsistent with the approach to investment income, which is generally tax-free in Singapore.

3. *Employee contributions.* Employees are not able to contribute to their employer's Section 5 plan, even on a voluntary basis. A valuable opportunity for convenient retirement savings by employees is therefore being missed. Payroll deduction can facilitate the habit of regular monthly savings by employees. Moreover, the corporate investment terms available under a Section 5 plan are generally more attractive than the investment terms an individual could secure directly from an investment provider on a personal basis (including through the SRS).

   Most multinational companies would anticipate some level of employee contributions for retirement saving plans as part of their global benefits policies. The Section 5 plan does not accommodate this standard approach.

4. *Cashing out on leaving.* Section 5 plans enable an employee to cash out her retirement benefits if she leaves her company before retirement (provided she meets any vesting criterion). Since the primary purpose of Section 5 plans is to save for retirement, it seems logical for regulations not to allow employees to receive their retirement benefits in monetary form when they leave a company before retirement. It would be better if payment of such benefits were deferred until retirement, either through the plan itself or elsewhere.

5. *Approval process.* The current approval process takes a long time, with little apparent encouragement for those employers who do wish to make supplemental retirement savings for their employees. Consideration should be given to the clarity of the regulations (and their application), standardization of trust deed and rule wordings, and service standards for the approval process.

A consequence of these issues is that some employers are utilizing offshore vehicles, in particular international pension plans, as an alternative approach. From a tax perspective, while employer contributions to such vehicles are a taxable benefit-in-kind for employees, investment returns are generally tax-free and benefits are tax-free on repatriation of the monies to Singapore. This may actually be more advantageous than the Section 5 approach, since the investment return element of the benefit is not taxed. Employee contributions are allowed and benefits are generally preserved until retirement on leaving service. The implementation time for an international pension plan is much quicker than seeking IRAS approval for a Section 5 plan.

Key issues relating to SRS

1. *Tax treatment of retirement benefits.* Similar to Section 5 plans, the tax treatment of SRS benefits offers little attraction to lower-income employees, since 50 percent of the accumulated fund is taxable. However, the 50 percent tax break on benefits does represent a meaningful benefit for higher-income employees.

2. *Contribution limits.* The contribution limits are based on the CPF contribution limits, and are therefore based on the CPF salary ceiling of SGD 5,000 per month. For higher-income individuals, only limited savings may therefore be made through SRS, reducing its overall attractiveness.

SRS does provide a useful additional avenue for retirement savings, but is more geared towards individual savings. Employers are not able to establish SRS accounts on behalf of their employees, which often slows the process of facilitating employer SRS contributions for new hires.

Proposal

The paper has highlighted the key issues with both Section 5 plans and SRS. For those employers looking at making supplementary retirement savings, only Section 5 plans allow an employer to brand the scheme as its own and make the arrangement a key part of its benefits package and wider employee value proposition.

Our proposal therefore focuses on Section 5 plans. We would see SRS continuing to play its current role, as well as having some integration with Section 5 plans.

We propose the following:

1. Modify Section 5 provisions, including integration and alignment with SRS, as outlined below.

2. Permit employer contributions to defined contribution plans up to a defined maximum limit and remove the current defined benefit test on emerging benefits. We would suggest a percentage of uncapped compensation less employer CPF contributions based on the current CPF rates for those under age 50: 16 percent. Contributions would continue to be a tax-deductible corporate expense and not be treated as a benefit-in-kind for employees (as currently). The existing benefit-based contribution rules would continue for defined benefit plans.

3. Permit employee contributions up to a maximum limit. We would suggest a percentage of uncapped compensation less employee CPF contributions based on the current CPF rates for those under age 50: 20 percent. Such contributions would be allowable expenses against income tax. Employee contributions may be mandatory, voluntary or both.

4. The plan benefit may not be accessed prior to retirement age, other than upon death, permanent disability or on leaving Singapore permanently.

5. On death in service, the plan benefit would continue to be paid to the employee's estate (as currently).

6. On permanent disability, the plan benefit would continue to be paid as a lump sum, and not subject to income tax (as currently).

7. On leaving Singapore permanently, the plan benefit may be paid directly to the employee and would be subject to income tax in the year of leaving (as currently). Alternatively, the benefit may be treated as per leaving service below, subject to the employer's option.

8. On leaving service, the plan benefit would either be deferred until retirement age or transferred to an SRS account. The amount transferred to SRS would not be subject to income tax in the year of transfer. The transfer amount would not be treated as a regular contribution to SRS and therefore not reduce the SRS contribution limit in the year of transfer.

9. On retirement, the benefit should be treated similarly to SRS:

   a) 50 percent of the benefit tax-free, 50 percent taxable.

   b) Part or all of the retirement consideration may be spread over up to 10 years (in line with SRS and increased from five years currently). This may be used to mitigate tax on the taxable portion.

   c) Part or all of the consideration may be used to purchase a lifetime annuity (including allowance for options such as contingent benefits and/or pension increases). This may be used to mitigate tax on the taxable portion.

10. Upon death in retirement, any fund that had not been drawn would continue to be paid to the individual's estate (as currently).

11. A review of the Section 5 approval process should be commissioned as outlined above.

CPF aside, retirement schemes are a missing item in the typical Singapore employee benefits program when compared to many other countries. We would welcome the opportunity to discuss the issues in this paper further and help make supplementary retirement provision a more attractive option for employers in Singapore. ♦