ISSUE NO. 1 • 2011 A QUARTERLY PUBLICATION
BONDS & ISSUES

First Principal financial

SUPPLEMENTARY RETIREMENT SCHEME (SRS): POTENTIAL TAX PROBLEMS ARISING FROM CONTRIBUTIONS

BY **ALVIN FONG** CFA CHFC CPA
SENIOR ADVISER, PERSONAL FINANCIAL SERVICES
FIRST PRINCIPAL FINANCIAL

THIS IS A FOLLOW-UP discussion to my previous article in last quarter's newsletter on **Growing Your Retirement Funds with the Supplementary Retirement Scheme (SRS)**. *You can read it at http://static.webpaage.com/public/projects/firstprincipal/learning-center/newsletters/FP4Q2010/FP4NL2010article4.pdf.*

Based on my understanding, there are two issues worth highlighting:

1) **The SRS is a tax deferral scheme, meaning there exists a potential situation where investment gains will be taxed.**

2) **The maximum 10-year withdrawal period.**

SRS AS A TAX DEFERRAL SCHEME

To re-cap, Singaporeans and Singapore Permanent Residents can contribute a maximum of $11,475 annually, while the amount for foreigners is capped at $26,775. The SRS contribution enjoys 100% tax relief and only 50% of withdrawals are taxed upon reaching the statutory retirement age of 62.

Let's look at a few illustrations to better understand this issue.

EXAMPLE 1: A Singaporean/PR or foreigner contributes annually, a maximum of $11,475 and $26,775 respectively, from age 35 to age 61. Let's assume that the tax savings is 8.5% based on a net chargeable income of between $40,000 and $80,000 throughout this entire period. The contributions are made on 31st December and are invested on 1st January of the following year and earn an investment return. Upon reaching 62, the contributor stops all investments and starts to withdraw his funds equally over the 10-year period. No other income or interest is earned during these 10 years.

TABLE 1		Singaporean / PR	Foreigner
Total Yearly Contributions		$11,475	$26,775
Years of Contribution		27	27
Total Contributions		$309,825	$722,925
Total Tax Savings		**$26,335**	**$61,449**
Accumulated SRS contributions at age 62 based on a net investment return of:	5% p.a.	$627,328	$1,463,766
	7% p.a.	$854,702	$1,994,304
	9% p.a.	$1,178,748	$2,750,412
Yearly taxable income based on a net investment return of:	5% p.a.	$31,366	$73,188
	7% p.a.	$42,735	$99,715
	9% p.a.	$58,937	$137,521
Yearly / Total tax payable based on a net investment return of:	5% p.a.	$425 / **$4,251**	$3,721 / **$37,210**
	7% p.a.	$1,132 / **$11,325**	$7,060 / **$70,601**
	9% p.a.	$2,510 / **$25,097**	$12,353 / **$123,529**

From Table 1, one can see that it's possible to pay more in absolute taxes if the investment rate of return is about 7% p.a. for foreigners and above 9% p.a. for Singaporeans and PRs. Does this mean that we shouldn't aim for a higher rate of return? Absolutely not! Having more and paying a bit of tax on the extra is always better than having less and paying little or no tax.

MAXIMUM 10-YEAR WITHDRAWAL PERIOD

The withdrawal period ends 10 years from the statutory retirement age prevailing when you make your first penalty-free withdrawal, or 10 years from the prevailing statutory retirement age (currently prescribed at 62 although it's likely to be progressively raised to age 65 or later), whichever is earlier. In other words, the withdrawal period will end at age 72 based on current regulation. For those of us in our 30s, 40s or 50s, our withdrawal period should end by age 75 with the expected raising of the statutory retirement age to 65.

This 10-year window period may be a problem for those who work beyond the retirement age. Assuming that one works until age 70 and the statutory retirement age has been raised to 65 – all the SRS funds have to be withdrawn by age 75, over a 5-year period. This means a higher amount withdrawn leading to higher income taxes versus someone who has the choice of spreading his withdrawals over the full 10 years.

ISSUE NO. 1 • 2011 A QUARTERLY PUBLICATION
BONDS&ISSUES

First Principal financial

In Example 1, I have assumed that there is no other source of income, which I think, is unlikely given our national "obsession" with property ownership. I believe many people who regularly contribute to SRS either own or aspire to own another property to rent out for income during their retirement. Let's look at another case where we include a net rental income of $40,000 annually.

EXAMPLE 2: Same scenario as Example 1, except we include an annual net rental income of $40,000 which only begins at age 62.

TABLE 2		Singaporean / PR	Foreigner
Total Yearly Contributions		$11,475	$26,775
Years of Contribution		27	27
Total Contributions		$309,825	$722,925
Total Tax Savings		**$26,335**	**$61,449**
Accumulated SRS contributions at age 62 based on a net investment return of:	5% p.a.	$627,328	$1,463,766
	7% p.a.	$854,702	$1,994,304
	9% p.a.	$1,178,748	$2,750,412
Yearly taxable income based on a net investment return of:	5% p.a.	$71,366	$113,188
	7% p.a.	$82,735	$139,715
	9% p.a.	$98,937	$177,521
Yearly / Total tax payable based on a net investment return of:	5% p.a.	$3,566 / **$35,661**	$8,946 / **$89,463**
	7% p.a.	$4,683 / **$46,829**	$12,660 / **$126,601**
	9% p.a.	$6,951 / **$69,512**	$18,479 / **$184,786**

This example is not designed to discourage one from placing money in the SRS scheme. It is intended to show that there is a need to monitor and manage one's SRS funds to obtain tax efficiency. Despite the higher taxes in this illustration, one must note that there is a time value of money applied on the deferment of taxes not yet paid, on the contributions made into SRS over the years. All things being equal, one must note that these are taxes that should have been paid anyway, if SRS contributions were not made in the first place.

CONCLUSION

Hence there is a need to properly plan for your SRS funds in a manner that provides tax efficiency. The issues discussed highlight problems that can result in unwelcomed income tax expenses. There are too many different permutations relating to income, tax rates, working years, quantum of SRS contributions, investment rates of return, changes in legislation and tax regimes to deal with. There is also the issue of comparing the present value of income tax saved and invested now versus the future value of income tax payable. Future changes to income tax regulations will also impact the evaluation of the SRS scheme.

Other than regular reviews on your investment performance, you should review the future tax implications once you have made about 20 years of contributions or have reached your mid-50s. Talk to your First Principal adviser or consult your tax adviser regularly to ensure that you are up-to-date with current SRS regulations.

FIRST PRINCIPAL FINANCIAL PTE LTD
24 Raffles Place #14-02 Clifford Centre Singapore 048621
Tel: 6220 5333 Fax: 6220 5377
Email: enquiry@firstprincipal.com
www.firstprincipal.com