

Retirement Savings in Singapore

A comparison of three plans

Introduction

Singapore-based employers are constantly looking for ways to reward and retain staff in cost-effective manner. Also, it is general knowledge that the Central Provident Fund (CPF) is inadequate for worry-free retirement. Additional retirement savings are essential to live out one's golden years in comfort. The solution to both concerns is for employers to contribute to a retirement savings plan for their employees on top of the CPF. In this document, we set out a comparative analysis of three approaches that can help employers tailor a tax efficient mechanism to attract and retain both their local and foreign talent.

The plans we have chosen for comparison are:

- (i) A savings plan approved by the Inland Revenue Authority of Singapore (IRAS) under Section 5 of the Singapore Income Tax Act (a "Section 5 plan")
 - This is a Singapore trust fund approved by the IRAS and to which only an employer can contribute.
- (ii) Supplementary Retirement Scheme (SRS)
 - This is an individual employee account with an approved SRS operator to which both employer and employee can contribute.
- (iii) An offshore trust fund in a suitable jurisdiction
 - This is a trust fund established in a suitable location outside Singapore to which both employer and employee can contribute.

Comparison

The table below sets out the main features of each of these plans.

	Section 5 Plan	SRS	Offshore trust fund
Structure	Trust fund	Individual employee account	Trust fund
Set up by	Companies registered in Singapore	Employees in Singapore	Any company
Who can contribute?	Employer only	Employer and employee	Employer and employee

Contribution restrictions	<p>Same contribution formula for all employees</p> <p>Maximum contribution at any time is limited to the amount actually computed to produce no more than the following benefits on retirement:</p> <p>2.25 x last drawn total salary x years of service less total employer contributions to CPF</p> <p>Using conservative assumptions, this will likely allow a contribution rate of at least 10% of salary (without salary ceiling)</p>	<p>Maximum contribution rate is 15% for Singaporeans/ Singapore permanent residents (PRs), and 35% for foreigners, with a salary ceiling of \$76,500 (correct as at 30 June 2009). This is the same as the CPF salary ceiling</p>	None. Unlimited contributions
Taxation			
Employer contributions	<p>Deductible for employer</p> <p>Not taxable for employee</p>	<p>Deductible for employer</p> <p>Effectively not taxable for employee</p>	<p>Deductible for employer</p> <p>Taxable for employee</p>
Employee contributions	N/A	Deductible for employee	Not deductible for employee
Income and gains of fund	Exempt	Exempt	Exempt/out of scope
Benefits on retirement	<p>Taxable</p> <p>Can be mitigated by purchasing an annuity or spreading the benefits over a period of up to five years</p>	<p>Taxable</p> <p>Only 50% of benefits are taxable at statutory retirement age. This can be mitigated further by spreading the benefits over a period of up to 10 years</p> <p>Taxable with 5% penalty for withdrawal before statutory retirement age or before 10 years for foreigners</p>	Exempt

Retention tool	Can apply vesting schedule to encourage retention	Does not encourage retention i.e. amount contributed is fully vested	Can apply vesting schedule to encourage retention
Investment limit	Some limits but sufficiently wide	Some limits but sufficiently wide	No limits
Typical cost	<p>Borne by employer and the trust fund</p> <ul style="list-style-type: none"> • Establishment cost e.g. drafting of trust deed, obtaining approval from IRAS etc • IRAS quarterly investment return • Annual tax filing • Annual actuarial certificate • Investment cost e.g. unit trust fund sales charge <p>Can negotiate with fund house/ distributor to significantly reduce cost of investment, compared to retail</p>	<p>Entirely borne by employee</p> <ul style="list-style-type: none"> • Charges as levied by SRS operator. Currently (as at 30 June 2009) at least one operator does not levy any charge • Investment cost e.g. unit trust fund sales charge at retail level 	<p>Borne by employer and the trust fund</p> <ul style="list-style-type: none"> • Establishment cost e.g. drafting of trust deed etc • Investment cost e.g. unit trust fund sales charge <p>Can negotiate with fund house/ distributor to significantly reduce cost of investment, compared to retail</p>

Comments

Comments on the features are as follows:

(a) Contributions

- Under an offshore trust fund, a company can contribute without any limit and receive tax relief for the contributions. Employees may also contribute if they wish.
- Under a Section 5 plan, employees cannot contribute and the maximum tax deductible company contribution is based on the maximum benefit set by the IRAS and would typically be greater than 10% of salary with no salary ceiling.

- Under the SRS, the maximum tax deductible contribution rate is 15% for Singaporeans and Singapore PRs, and 35% for foreigners but in both cases subject to a salary ceiling of \$76,500 per annum.
- Thus the maximum tax deductible contribution is greatest for the offshore trust fund while for higher salaried employees, a Section 5 plan is better than the SRS.

(b) Taxation

- Contributions are more tax effective for Section 5 plans and the SRS as they are both tax deductible for the employer and there is no tax liability on the employee at that point. However employer contributions to an offshore fund are taxable on the employee as income when they are made.
- All three schemes allow a tax free roll-up of income and gains while the assets are in the fund.
- However, only the offshore fund produces benefits that are completely tax free for the employee, as they represent foreign sourced income, which is now exempt for individuals.
- Benefits payable from a Section 5 plan are subject to tax but this tax can be mitigated or eliminated by either spreading the receipt of the benefit over five years, or by using it to purchase an annuity.
- 50% of the benefits payable from the SRS are subject to tax, with a 5% tax penalty on top if the benefit is taken before the statutory retirement age, or before 10 years for foreigners. The retirement age is currently 62 for Singaporeans and PRs. Tax on the benefit can be mitigated or eliminated by spreading receipt over 10 years.

(c) Employee Retention

- The benefits in the SRS vest immediately. This means that there is no penalty if employees decide to job-hop.
- The benefits from both an offshore trust fund and a Section 5 plan may be designed to encourage employee retention by vesting them only after certain loyalty milestones have been met. The vesting schedule design is completely up to the employer to decide, but a typical vesting schedule would be for 10% for each year of service, with maximum of 100% after, say, 10 years' service. In this case, employees who job-hop before the 10 years is up will receive only a percentage of their accrued benefit. For example, an employee who changes job after three years' service will receive only 30% of his accrued benefit.
- Thus, if one of the objectives of a retirement savings plan is to encourage employees to remain with a company, the SRS does not provide any incentive, whereas an offshore trust fund or the Section 5 plan may be designed to embed a loyalty bonus.

(d) Expenses

- Both a Section 5 plan and an offshore plan must be legally established under a trust fund. There is therefore a cost to the company in drafting the trust deed and rules. A Section 5 plan needs in addition to be approved by the IRAS. This usually involves cost depending on the questions raised by them. An offshore plan in a suitable jurisdiction does not require approval. Lower set-up costs therefore attach to an offshore plan than to a Section 5 plan.
- The SRS has no establishment costs.
- The SRS will normally have a sales charge of about 2% – 5% levied on each contribution, apart from the investment manager's usual fees. It is therefore relatively costly on an on-going basis.
- Both a Section 5 plan and an offshore plan benefit from the fact that they cover a number of employees. This is in contrast to the SRS which deals with each employee separately. Sales charges for the offshore and Section 5 plans can generally be negotiated down depending on the number of employees involved. They may even be negotiated to zero.
- With a Section 5 plan, there is a requirement for an annual actuarial certificate. There is no such requirement for the offshore plan or SRS.
- Thus there are both establishment and ongoing expenses for the company with a Section 5 plan. There are establishment costs only for the company with the offshore plan. There are no establishment or ongoing expenses for the company that uses the SRS.
- The benefits from the SRS will be less than the benefits from either a Section 5 plan or an offshore plan if the contributions and investment performance of all three arrangements were the same, as a result of greater sales charges that the SRS will suffer.

(e) Regulation

- With an offshore plan in a suitable jurisdiction, there should, by definition, be little by way of regulatory restriction. For example, the plan could apply to only senior executives in the company.
- A Section 5 plan must cover all employees with the same contribution formula. However, the IRAS will approve a contribution formula which is integrated with the CPF contribution rate, such as 10% salary less the employer CPF contribution rate. Since the employer CPF contribution rate has a salary ceiling which is currently S\$4,500 per month and there is no salary ceiling on the 10% salary piece of the integrated contribution rate, it is clear that the application of such an integrated formula to a Section 5 plan means that senior executives will benefit more in salary terms than lower level employees.

Contacts

PricewaterhouseCoopers has extensive experience in assisting clients in establishing and maintaining Section 5 plans and offshore trust funds in a suitable jurisdiction. We are available for discussion on how we can best help you. Our contact details are as follows:

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