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Tax: Case for 'pay as you earn'

Ivan Png

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Q: Would the Minister take the opportunity of the 2009 recession year to change the basis of tax assessment from the preceding year to current year?

(Singapore assesses income tax on a previous year basis. Advanced economies like Britain and the United States assess tax on a current year, 'pay as you earn' (Paye) basis. In 2000, Malaysia changed to current year assessment.)

A KEY reason in favour of Paye is macroeconomic. In theory, income tax is an automatic economic stabiliser. When the economy booms and incomes increase, tax collections increase, especially if tax rates are progressive. This automatically reduces the inflationary impact of the increase in income. Conversely, during recessions, when incomes fall, the reduction in tax collections would mitigate the impact of the falling income.

However, with a preceding year system of income tax assessment, the automatic stabiliser will not work properly. Imagine traffic lights programmed according to the previous hour's traffic conditions rather than the current situation!

When implementing the change from preceding year to current year assessment, the Government would have to waive one year of tax - corresponding to the preceding year. As we are now experiencing the deepest recession in the history of independent Singapore, the cost of the change would be low. This would be opportune time to make the change: In 2010, the Government should consider foregoing tax on 2009 incomes and switch to Paye.

The writer is Lim Kim San Professor at the NUS Business School and Professor of Information Systems and Economics at the National University of Singapore.