

IMPLEMENTATION DETAILS OF THE ANNOUNCED CHANGES TO THE TAX TREATMENT OF RETIREMENT BENEFITS FOR EMPLOYEES

INTRODUCTION

1. The Minister for Finance announced in the 1993 Budget on 26 February 1993 that all retirement benefits, other than CPF benefits, from private employers, including gratuities and pensions, will be taxable at the time when the benefits are received. This change takes effect from the year of assessment 1994 and applies to retirement benefits paid on or after 31 December 1992. Death gratuities and compensation for disabilities will continue to be exempt from tax.
2. For employees participating in existing approved pension and provident funds, the retirement benefits accrued in such funds up to 31 December 1992 will remain tax-exempt when they are paid out.
3. The change announced by Minister is intended to rationalise the existing tax treatment of retirement benefits and remove certain inequities. The existing tax treatment is complicated and inequitable in certain respects because changes were made at various times to achieve different objectives. One of the features of the existing tax treatment, effective from the year of assessment 1990, is the capping of contributions to CPF and other approved pension and provident funds at the compulsory contribution level specified by CPF. An employee is taxed on any contribution to these funds by his employer which exceeds the compulsory CPF contribution. The excess is taxed as the income of the year in which the contribution is made. This was done to prevent the use of these approved funds as tax shelters.
4. The capping rules effectively curbed excess contributions to the CPF and most approved pension and provident funds. However a loophole for avoidance of tax as well as the capping rules remained because retirement gratuities and commutated pensions paid out of unapproved retirement plans continued to be tax-exempt. The taxing of the excess contributions on the employees could not be effected in certain instances where the contribution was made not by reference to individual accounts like the CPF because the excess attributable to each employee cannot be accurately determined. In the case where an employee is taxed on the excess contribution, an anomalous situation will arise if the employee should leave the company before retirement and in so doing have his benefits forfeited. Through the change announced by Minister, these shortcomings of the existing tax treatment will be removed. The capping rules will still apply to CPF contributions but the provision of retirement benefits which are outside of the CPF will no longer be driven by the purpose of obtaining a tax advantage.
5. The purpose of this Practice Note is to clarify the manner in which the change will be implemented.

ADMINISTRATIVE PRACTICE

6. For pension and provident funds or plans approved under section 5¹ or 13(1)(x) of the Income Tax Act, the quantum of tax-exempt retirement benefits accrued up to 31 December 1992 for each employee will be computed as follows:
- (a) where the fund or plan provides for contributions to be made based on actuarial or other acceptable basis to enable a level of defined benefits to be paid, the last drawn salary on the date of retirement is used;
 - (b) where the fund or plan provides for contributions to be made to the individual accounts of the employees, the amount standing in the account as at 31 December 1992 plus interest accrued at CPF interest rates until the date of retirement.

This tax-exempt amount can be paid out on the date of retirement. Any amount paid before retirement will not be eligible for tax exemption.

7. The taxable portion of any lump sum retirement benefit payable to an employee from a pension and provident fund or plan approved under section 5¹ or 13(1)(x) of the Income Tax Act can be converted into a pension for life or paid in equal amounts over a period of up to 5 years. If the latter option is elected, the employee will only be allowed earned income relief in the year of retirement. No earned income relief will be allowed for the amounts received in the subsequent years because earned income relief will only have been available for one year if staggered payments were not given as a concession.
8. The concession set out under paragraphs 6 and 7 above will be extended to benefits from unapproved retirement benefits plans if the following conditions are satisfied:
- (a) the plan must have existed prior to the 1993 Budget announcement;
 - (b) the retirement benefits must be available to all staff, both bargainable and executive;
 - (c) the same formula for computing the retirement benefits is used for all staff; and
 - (d) the benefits provided are no more generous than the most generous benefits provided by a pension and provident fund approved under the Income Tax Act.

Employers with unapproved retirement benefits plans which satisfy the conditions can apply to the Comptroller of Income Tax for the concessions under paragraphs 6 and 7 above to be extended to their plans.

¹ Section renumbered by Income Tax Act (Revised Edition 2004)

9. Following the change announced by Minister, employers with pension and provident funds approved under section 5¹ of the Income Tax Act will be allowed a deduction of the contributions made from 1 January 1993. The income of such funds will remain tax exempt. Existing employees who are required under the present rules of the approved funds to make contributions will be allowed a deduction of their contributions. All benefits paid out of the funds to the employees upon retirement, other than the amount of tax-exempt benefits accrued up to 31 December 1992, are taxable at the time of receipt. Employers who wish to set up approved pension or provident funds under section 5¹ of the Income Tax Act as a means to retain staff may apply to the Comptroller of Income Tax for approval with details of their proposed funds.

10. Presently, contributions to unapproved pension and provident funds by employers for their employees are not deductible to the employers. As part of the rationalisation of the tax treatment of retirement benefits, the Income Tax Act will be amended to allow the employer a deduction of the amount contributed and to tax the employee on the same amount at the time of the contribution.