

Supplementary Retirement Scheme



Tan Kin Lian

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About the author



Mr. Tan Kin Lian started work in 1966 and qualified as a Fellow of the Institute of Actuaries in 1975.

He joined NTUC Income in 1977 as the chief executive officer.

Under his leadership, NTUC Income became a leading life and general insurance co-operative in Singapore.

He teaches a course on risk management at a local university and runs a consulting and software development company.

He is the President of the Financial Services Consumer Association (FISCA), a non-profit organization formed to educate the public on financial planning.

Introduction

Singaporeans and permanent residents are required to contribute a part of their monthly earnings to the Central Provident Fund (CPF). The employer is also required to make a contribution.

They can make additional contributions to the Supplementary Retirement Scheme (SRS) and enjoy certain tax benefits.

Foreigners working in Singapore are exempted from contributing to the CPF. They can contribute to the SRS.

Contributions to the SRS are deductible from taxable income, reducing the tax payable by the contributor.

The savings in the SRS can be invested in several approved investments. They can accumulate free of tax until the time of withdrawal.

The contributor is allowed to make withdrawal from age 62 over a period of 10 years. Half of the amount withdrawn in each year is required to be declared as taxable income.

It is likely that the tax rate payable by retirees is lower than the tax rate payable while they were working, as the tax rate is a progressive rate that depends on the taxable income. The retiree is likely to have a lower taxable income, compared to a working person.

In the later chapters of this book, I will describe more about the features of the SRS and will explain the circumstances where it may benefit the tax payer.

More information about the SRS can be obtained from the website of the Inland Revenue Authority of Singapore (IRAS) and the Ministry of Finance (MoF) at

http://www.iras.gov.sg/irashome/page04_ektid138.aspx

<http://app.mof.gov.sg/TemSub.aspx?pagesid=20090918706656873718&pagemode=live&&AspxAutoDetectCookieSupport=1>

You can also refer to these websites for explanations of the procedures to carry out various activities under the SRS

Tan Kin Lian

Contributions to SRS

Who can contribute?

You (i.e. the SRS contributor) must meet all of the following criteria:

- A Singaporean, permanent resident or foreigner who earns any form of income (e.g. employment income including directors' fees, trade income, rental income);
- At least 18 years of age;
- Not an undischarged bankrupt AND
- Not mentally disordered and is capable of managing yourself or your affairs.

Your employer can also contribute to your SRS account but the contribution will be treated as your taxable income.

How to open SRS account?

You can open an SRS account at the participating branches of any of the three SRS operators:

- DBS Group Holdings Ltd
- Overseas-Chinese Banking Corporation (OCBC) Ltd
- United Overseas Bank (UOB) Ltd

You are allowed to have only one SRS account at any point in time. It is an offence to have more than one account

However, you may transfer your SRS account between different SRS operators.

How much can you and your employer contribute?

You and your employer can contribute any amount up to the maximum allowed, which is:

- \$12,750 for a Singaporean or permanent resident
- \$29,750 for a foreigner

This limit is based on 15% and 35% of the absolute annual base, which is currently at \$85,000 (i.e. 17 months of \$5,000).

Prior to 2011, the maximum contribution was lower, as the base was calculated on a monthly salary of \$4,500.

When to contribute?

The SRS contribution can be made at any time of the year and as often as you wish, subject to the maximum allowed in each year.

Withdrawal from SRS

When can you withdraw from SRS

You can make withdrawal from the SRS at any time. The withdrawal will be subject to tax as explained below:

- If the withdrawal is made on or after age 62, only 50% of the withdrawn amount will be treated as taxable income.
- If the withdrawal is made before age 62, i.e. early withdrawal, 100% of the withdrawn amount will be treated as taxable income, and in addition a 5% penalty is levied on the amount withdrawn.

Example

If you withdraw \$8,000 from your SRS account on or after age 62, only \$4,000 of the withdrawn amount will be regarded as part of your income and subject to tax based on the tax rate applicable to you.

Example

If you withdraw \$5,000 from your SRS account before age 62, the full \$5,000 will be regarded as part of taxable income. In addition, you have to pay a penalty of \$250 (5% of the withdrawn amount).

The SRS operators will withhold the penalty amount (to transmit to IRAS) and give you the net balance of \$4,750.

Withdrawal through an annuity

You can make withdrawal through an annuity. 50% of the annuity payment will be treated as taxable income.

Penalty free early withdrawal

You are allowed to make early withdrawal, free from penalty, on medical grounds. This is defined as physical or mental incapacity that prevent you for continuing your employment.

In the event of death, your estate can make an withdrawal free of penalty.

In both cases, 50% of the withdrawn amount is treated as taxable income.

Bankruptcy

In the event of bankruptcy, the total SRS can be withdrawn without penalty, but 100% of the withdrawn amount treated as taxable income.

Withdrawal by a foreigner

A foreigner is allowed to withdraw the SRS in a lump sum only after having contributed for at least 10 years as a non-Singaporean. (This is quite confusing and need to be studied carefully).

Period of withdrawal

You can withdraw your SRS over 10 years from the date of your first penalty-free withdrawal. Withdrawals are penalty-free only if they take place after age 62

If you start your first withdrawal at age 62, you are allowed to spread your withdrawals until age 72. If you start at age 64, you are allowed to spread your withdrawals up to age 74.

End of withdrawal period

The amount (except for life annuities) in the SRS account will be deemed to be withdrawn immediately after the end of the withdrawal period.

The SRS operator will report 50% of such balance to IRAS and this is subject to tax in the following year.

For investments in life annuities, the withdrawal period does not apply. So long as you continue to receive your annuity streams in perpetuity, 50% of the annual stream will be subject to tax.

Withholding Tax

If you are a foreigner or permanent resident apply to withdraw the SRS accounts, 50% or 100% of the withdrawn amount will be subject to a withholding tax.

The SRS Operator will hold back tax at the rate of 20% and any penalty and transmit it to IRAS.

There is no withholding tax for Singaporean.

The tax withheld will be credited to offset the tax liability of the taxpayer.

Recap

You can withdraw your SRS monies over 10 years from the date of your first penalty-free withdrawal. Withdrawals are penalty-free only if they take place after the statutory retirement age that was prevailing at the time of your first SRS contribution (currently at 62).

Spreading out your withdrawals will generally result in greater tax savings.

Under the Income Tax Act, where an SRS member dies, any sum standing in his SRS account shall be deemed to be withdrawn on the date of death even though no physical withdrawal may have been made on that day.

Income Tax

The attractiveness of the SRS to the taxpayer depends on the rate of income tax payable during the working years and the rate payable after retirement.

Due to the progressive tax rates, a working person is likely to have a higher income and to pay a higher tax rate, compared to a retiree.

Contributions to SRS are deductible from taxable income and withdrawals are subject to tax at 50% of the withdrawn amount.

It is relevant to look at the rates of income tax payable by residents:

There is no tax payable on the first \$20,000 of taxable income. The tax rate applicable for each band of taxable income (applicable in 2012) is:

Income	Rate
\$20,000	2.0%
\$30,000	3.5%
\$40,000	7.0%
\$80,000	11.5%
\$120,000	15.0%
\$160,000	17.0%
\$240,000	18.0%
\$320,000	20.0%

A working person who has a taxable income of \$80,000 will save tax at 11.5% on the contribution to SRS.

If the taxable income on retiree is \$30,000, the retiree pays tax at 3.5% on the 50% of the amount withdrawn from SRS.

The difference of 8% in tax rate represents the saving in income tax obtained by participating in the SRS.

Simulation

Here is an example for a Singaporean who contributes \$12,750 a year to SRS over 20 years from age 45 and invests the savings to earn a return of 5% per annum. From age 65, he withdraws \$54,598 a year over 10 years.

Age	Contribution	Interest	Balance	Age	Withdrawal	Interest	Balance
45	12,750	0	12,750	65	-54,598	21,080	388,072
46	12,750	638	26,138	66	-54,598	19,404	352,878
47	12,750	1,307	40,194	67	-54,598	17,644	315,924
48	12,750	2,010	54,954	68	-54,598	15,796	277,122
49	12,750	2,748	70,452	69	-54,598	13,856	236,380
50	12,750	3,523	86,724	70	-54,598	11,819	193,601
51	12,750	4,336	103,811	71	-54,598	9,680	148,683
52	12,750	5,191	121,751	72	-54,598	7,434	101,520
53	12,750	6,088	140,589	73	-54,598	5,076	51,998
54	12,750	7,029	160,368	74	-54,598	2,600	-1
55	12,750	8,018	181,137				
56	12,750	9,057	202,943				
57	12,750	10,147	225,841				
58	12,750	11,292	249,883				
59	12,750	12,494	275,127				
60	12,750	13,756	301,633				
61	12,750	15,082	329,465				
62	12,750	16,473	358,688				
63	12,750	17,934	389,372				
64	12,750	19,469	421,591				

The total contribution over 20 years is \$255,000 and the total withdrawal over the next 10 years is \$545,980. As 50% of the withdrawal is taxable, he has to pay tax on \$272,990, which is slightly higher than the contribution.

He will enjoy a tax benefit mainly from the difference in the tax rates applicable during the working years and the retirement years.

The annual withdrawal of \$54,598 is quite large, so that tax payable may be at 7% or higher.

Compared to the tax rate during the working years, the difference in tax rate would probably be less than 10%.

Different periods of contribution

The following table summarizes the impact for different periods of contribution to SRS, based on the maximum contribution allowed for locals (\$12,750) and foreigners (\$29,750).

Year	Yearly		Yearly		Taxable	Ratio
	Contribution	Total	Withdrawal	Total		
30	12,750	382,500	109,703	1,097,027	548,514	1.4
20	12,750	255,000	54,598	545,980	272,990	1.1
10	12,750	127,500	20,768	207,684	103,842	0.8
30	29,750	892,500	255,973	2,559,730	1,279,865	1.4
20	29,750	595,000	127,395	1,273,952	636,976	1.1
10	29,750	297,500	48,460	484,596	242,298	0.8

It is important to take note of the ratio between the taxable withdrawal (i.e. 50% of the withdrawal) and the total contribution. A ratio higher than 1.0 indicates that the tax payable on withdrawal is higher than the tax saved on the contribution, assuming the same rate of tax applies in both cases.

As the amount of withdrawal is high, the retiree may have to pay quite a high rate of tax on the withdrawal, even though the retiree may not have any earned income at that time.

The SRS is more beneficial for contributors who join the same at an older age, say after 45 years, compared to younger contributors. The younger contributors have a longer period of contribution and will get a ratio that is much higher than 2.0 and may have to incur a larger tax payout (although the tax is payable at a later date).

Tax free accumulation

The SRS scheme allows the contributions to be invested free of tax. This tax advantage is more apparent than real.

If the taxpayer invests outside of SRS, the taxpayer does not have to pay tax on capital gains. The tax on dividend and interest earned is treated in the same way for both SRS and non-SRS investments, i.e. the dividend is final and the tax deducted at the company level was not credited back to the SRS scheme.

I am not clear if interest payable on bonds is treated differently, but as this is not likely to be a major source of investment, I shall ignore this impact.

Recap

Based on these simulations, it is likely that the SRS scheme is more attractive to a contributor who starts at an older age. Under the current structure, it is better for younger contributors to invest outside of SRS.

Invest the SRS

The SRS contributor may invest in a wide range of financial assets, including those offered by financial institutions (product providers) other than your SRS operator.

Your product providers will be able to provide information on the products that they are offering for SRS.

You are allowed to make a wide variety of investments, including share, insurance, bond, unit trust and fixed deposit. However you are not allowed to make direct investment in property and certain insurance products.

Life insurance products

As for life insurance products, the following conditions shall apply:

- Only single premium products are allowed (including recurrent single premium products, encompassing both annuity and non-annuity plans).
- Life cover (including total and permanent disability benefits) will be capped at 3 times the single premium.
- Plans can allow for a contribution continuation feature/benefit upon disability.
- Other types of life insurance e.g. critical illness, health and long-term care are excluded.
- Trust nomination is not allowed for life insurance products purchased using SRS funds.

Choice of investments

Your investment in the SRS is likely to be for the long term, i.e. up to age 62 and for 10 years beyond.

In selecting your investments, you should opt for investments that are likely to give an attractive yield over the long term. You should aim for a yield that is at least 2% higher than inflation rate.

It is important for you to diversify your investments so that you will not be severely impacted when a particular investment turned out to be bad.

As you do not have much money to invest in many shares or bonds, it is advisable to invest your SRS in an insurance policy, unit trust or exchange traded fund, which collects the investments of many people and invest them collectively.

In choosing a particular fund or policy, you have to pay attention to the charges imposed by the fund manager or the insurance company.

Your aim is to have the charges, including the fund management fee, to be less than 1% per annum.

If the underlying investments of the fund earn 6%, and the charges take away 1%, you will get a net return of 5%.

If the underlying charges take away 3%, you will get a return of only 3%.

The following table shows the impact of investing your savings to earn a yield of 3% and 5% over a period of 10, 20 or 30 years.

		3%	5%	Ratio
10	12,750	146,164	160,368	110%
20	12,750	342,597	421,591	123%
30	12,750	606,587	847,095	140%

The difference in the accumulated savings can be as much as 40%, by investing in a low cost fund that gives a higher net return.

The charges of the various financial products are as follows:

- Life insurance policies: 2% to 4%
- Unit trusts: 1.5% to 3%
- Exchange traded fund: 0.3%

For a long term investor, it is advisable to invest in a low cost exchange traded fund, which offers diversification of risk and levies a charge of only 0.3% per annum.

Straits Times Index ETF

I wish to give an explanation of this ETF, to be used as a benchmark for you to measure with other types of investment choices available for your SRS.

The STI ETF is invested in the 30 leading companies that form the stock market index in Singapore.

They are mostly the blue chip companies, i.e. large, well-managed companies with a long track record of profitable business results.

The components shares are in various industries, e.g. banking, manufacturing, transport, telecommunications, shipyards, media and property. They are well known names.

These blue chip shares earned an average yield of 9.2% over a period of 20 years up to 2006. I do not have the figures up to 2012, but it is likely to be more than 8% per annum.

Diversification

The STI ETF provides diversification over 30 shares. It reduces the risk of making the wrong investment in bad shares.

Market cycles

The stock market can go up and down in cycles and can suffer a large loss in some years.

This should not concern the long term investor. By investing for the long term, the investor will get the average return over this period. This return was 9.2% over 20 years.

Low expenses

The STI ETF has a low expense ratio of 0.3%. If the average return in the future from the underlying shares is 6%, the net yield to be investor is 5.7%.

Dividend

The STI ETF provides pays a dividend twice a year. The annual dividend is about 2% to 2.5%.

The remainder of the yield comes from the long term appreciation of the underlying shares.

Fund managers

Two fund managers offer the STI ETF. They are State Street, trading under the SPDR brand and Nikko AM. They are quite similar.

These ETF are invested in the underlying shares and are not invested in derivatives. They do not have any leverage or borrowing.

Best Age to join the SRS

I wish to present a table to show the best age for a resident employee to join the SRS.

The following table is calculated on the following assumptions:

- An annual contribution of \$12,750 to the SRS
- The SRS savings earn a yield of 5% per annum
- The tax rate during the contribution period and withdrawal period is 10%
- Total withdrawal is made at 62 years.

Age	Years	Annual contribution	Accumulated at 62	Total contribution	50% of withdrawal	Tax saving at 10% rate
32	30	12,750	847,095	382,500	423,548	-4,105
33	29	12,750	794,615	369,750	397,307	-2,756
34	28	12,750	744,633	357,000	372,316	-1,532
35	27	12,750	697,031	344,250	348,516	-427
36	26	12,750	651,697	331,500	325,848	565
37	25	12,750	608,521	318,750	304,260	1,449
38	24	12,750	567,400	306,000	283,700	2,230
39	23	12,750	528,239	293,250	264,119	2,913
40	22	12,750	490,941	280,500	245,471	3,503
41	21	12,750	455,420	267,750	227,710	4,004
42	20	12,750	421,591	255,000	210,795	4,420
43	19	12,750	389,372	242,250	194,686	4,756
44	18	12,750	358,688	229,500	179,344	5,016
45	17	12,750	329,465	216,750	164,732	5,202
46	16	12,750	301,633	204,000	150,817	5,318
47	15	12,750	275,127	191,250	137,563	5,369
48	14	12,750	249,883	178,500	124,941	5,356
49	13	12,750	225,841	165,750	112,920	5,283
50	12	12,750	202,943	153,000	101,472	5,153
51	11	12,750	181,137	140,250	90,568	4,968
52	10	12,750	160,368	127,500	80,184	4,732
53	9	12,750	140,589	114,750	70,294	4,446

54	8	12,750	121,751	102,000	60,876	4,112
55	7	12,750	103,811	89,250	51,905	3,734
56	6	12,750	86,724	76,500	43,362	3,314
57	5	12,750	70,452	63,750	35,226	2,852
58	4	12,750	54,954	51,000	27,477	2,352
59	3	12,750	40,194	38,250	20,097	1,815
60	2	12,750	26,138	25,500	13,069	1,243
61	1	12,750	12,750	12,750	6,375	638

The table shows that the best age to start the contribution is 47 years, and the tax saving (i.e. tax saved on the contribution less tax payable on the withdrawal) is \$5,367.

For a foreigner working in Singapore, a higher contribution is allowed under SRS. The tax saving is increased proportionately.

The tax saving shown above is calculated on an average tax rate of 10%. The tax saving will change in proportion to the tax rate.

It assumes that the same tax rate applies to contribution and withdrawal. If there is a difference in the tax rate, e.g. if the tax payable during retirement is lower than the tax payable during the working years, the tax saving will be higher.

This table illustrates that the SRS scheme works better for someone joining the scheme at a later age.

Conclusion

The Supplementary Retirement Scheme allows you to make additional savings for your retirement. The contributions can be deducted from your taxable income, and 50% of the withdrawals are subject to tax.

The tax benefit that you enjoy depends on your average tax rate during your working years and your retirement years, and also the ratio between the total contribution and total withdrawal.

It is likely to be more beneficial for contributors that start at an older age, than at a younger age.

The SRS allows a wide choice of investments, but it is preferable for the investor to invest in a diversified fund with a low expense ratio.

It is preferable to invest in blue chip shares that is likely to earn a better return over the long term and to reduce the risk through diversification and investing for the long term.

Tan Kin Lian

What others say

This is a simple, straight forward explanation of SRS scheme to compliment the CPF scheme. Well written and ideal for layman

Isabel, Operations Manager