# The Benefits of SRS

Financial planning expert David Choo unravels some of the benefits of the elusive Supplementary Retirement Scheme.

As 2005 kicks off, taxpayers are likely to continue to mull over whether they should contribute to the Supplementary Retirement Scheme (SRS) or not.

The SRS was slow in taking off and now questions are being raised about whether it will ever take off because of the reduction of the monthly salary ceiling cap for CPF from $6,000 previously to $5,500 in 2004, $5,000 in 2005 and $4,500 in 2006.

This reduction translates to a lower qualifying amount for SRS and resultant tax savings. It is reckoned that the maximum contribution will be reduced from about $18,000 when SRS was first introduced to $14,000 last year and less than $12,000 in 2006.

Every taxpayer who stands to save on his income tax each year should consider SRS. The reduced amount to $12,000 per year eventually still represents $1,000 tucked in for retirement each month. There are few who are disciplined enough to set aside this amount for retirement without a scheme like SRS with its tax savings feature and "semi-compulsory" nature.

The tax savings feature derives from the deduction from assessable income of any amount contributed to SRS for the year of assessment in question. The tax savings depend on the marginal income tax rate and can be in the few thousands for people in the high-income brackets.

The "semi-compulsory" discipline is affected by the taxability of withdrawals before age 62 and a five per cent penalty. In addition, for withdrawals after age 62, the 50 per cent treatment for tax purposes does encourage staggered withdrawals to age 72.

The key question is whether a potential saver/investor can see the benefit of "locking" his money in SRS because of the tax savings. The first issue is to consider setting aside a sum of money regularly for your retirement. The required amount will be quite substantial for some, depending on their age, needs, financial net worth and income.

The more challenging issue is to tuck a sum of money aside regularly for retirement. Generally, the younger a person is, the harder the challenge. Also, generally, the tighter someone is financially, the steeper the challenge.

## OBVIOUS CANDIDATES FOR SRS

The obvious candidates for SRS are those who are putting large sums of money in fixed deposits or single premium short-term policies and reinvesting these continually. If they are still paying income tax, SRS will be a good way to save on taxes and they are still able to invest the SRS amounts in the same or even better investments. In fact, with SRS, they are likely to

choose longer- term investment, maturing at age 62 or up to 72 and obtain better returns.

The second group of people who must consider SRS seriously comprise the self-employed – the sole proprietors, the partners and commissioned agents. The basic decision, which the self-employed must make, is whether to contribute to CPF on a voluntary basis or to contribute to SRS or to do both.

Assuming the self-employed have money they can set aside for retirement and that they are unlikely to need this until then, they can compute the tax savings for CPF voluntary contributions and SRS. This one-time tax savings will add to the "investment return" on their contributions.

Generally, CPF voluntary contribution is preferable because the Ordinary Account can be used to pay for property; the withdrawal age is earlier at 55 without tax and the range of investment is not much less restrictive.

But rules for CPF are stricter. Furthermore, the guaranteed returns from CPF are also appear to be more attractive at this stage compared to private investments. What the wealthy self-employed with high income taxes should consider is to add SRS to their voluntary CPF to enjoy further tax savings (see table).

For those who do not have the extra savings each year to contribute to SRS, there are some ways to generate this: For instance, by adding to income with a second or part-time job, reducing expenses or achieving some tax savings from other tax-reducing or avoidance measures. Any additional tax savings will generate money that can be invested in SRS to achieve even further tax savings.

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## WHO'S DRAWN TO SRS SO FAR?

Who then are the people who have been attracted by the features of the SRS so far? Anecdotal evidence shows that SRS is favoured by those above the age of 45 and who are paying relatively high income taxes. They already have retirement in their sights and have taken care of the big-ticket items like housing and children's education. Since the tax savings are for one year, the contribution to overall return is more significant for those with fewer years to reach the age of 62. For example, if the marginal tax rate is 20 per cent and the SRS contributor is age 52, he has ten years to age 62 and the average additional return is two per cent per annum, not including the gain that can be obtained from the investment itself. Considering today's low interest returns, this figure is quite significant.

The tax liability for withdrawals after age 62 can be minimised if withdrawal is staggered from age 62 to 72. This can be achieved by staggering the maturity of single premium products. In the case of unit trusts, sales can be spaced out. The five per cent penalty for withdrawing before age 62 is not really a big problem for one who needs the money due to unforeseen circumstances. The alternative is borrowing from a bank with interest likely to exceed five per cent per annum. At least, SRS allows for withdrawal, whereas CPF has strict rules for withdrawal before 55.

## LACK OF UNDERSTANDING

The relatively low take-up rate for SRS is likely more due to a lack of understanding of its benefits, rather than the actual benefits of the scheme. Once the scheme is presented as a valuable component for retirement planning, the response is always positive, especially if cash is available without affecting current lifestyles and there are no foreseeable needs for the cash before age 62.

Although the maximum contribution will decrease to $12,000 per annum in 2006, the tax savings is still significant. Individuals who want to further enhance their retirement benefits shouldn't let this opportunity slip. **si**

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**COMPARISON OF CPF VOLUNTARY CONTRIBUTION FOR SELF-EMPLOYED AND SRS**

| Factors | Voluntary Contribution | SRS |
|---|---|---|
| Maximum contribution deductible for tax | 33% of earnings up to $21,780 | About $14,000 in 2004 reducing about $12,000 in 2006 |
| Age of official withdrawal of cash | Age 55 | Age 62 |
| Early withdrawal | Only death, TPD, or relinquish citizenship | Can withdraw but sum withdrawn taxable and 5% penalty |
| Tax rule on contribution | All self-employed contributions tax deductible | Amount contributed tax deductible |
| Tax rule on official withdrawal | Non-taxable | 50% of amount deemed taxable |
| Investments | Ordinary: Housing scheme, shares, trust, unit trust, single premium insurance<br>Special: Selected investments<br>Medisave: Reserved for medical and Medisave approved insurance | Selected investments, e.g. unit trust, single premium, shares |