Budget 2012 Enhancements:

Maximising the PIC Scheme Grant

By Ho Soon Wing and Chris Loh

The Government has been focusing on helping small and medium enterprises (SMEs) in recent years. From Budget 2010 to the current Budget 2012, schemes such as Special Employment Credit and SME cash grant have been introduced, but none of these captures the imagination of the Productivity and Innovation Credit (PIC) Scheme (which allows 400% tax claims or cash grants), which is perhaps uniquely Singapore.

The evolution of PIC so far

When the PIC was introduced in February 2010, the two ways SMEs would benefit were to claim enhanced deductions/allowances of 250% or a cash grant option of 7% of qualifying deductions. In February 2011, PIC was enhanced, allowing SMEs to claim enhanced deductions/allowances of 400% or a cash grant conversion of 30% of qualifying expenditure. However, at the same time, the expenditure cap of the cash grant option was reduced from $120,000 to $100,000.

With the latest enhancement to the cash grant option, SMEs can look forward to a conversion rate of 60% and with the option scheme extended from the year of assessment (YA) 2013 to the sunset YA 2015.

Maximising the tax benefit on the cash grant payout

Before any SME jumps into the cash grant conversion option instead of the deductions/allowances claim, there are perhaps some considerations to determine if the choice is wise.

Effective tax rate

Based on the current tax regime, once a business chooses to claim the cash grant option, the same amount of expenditure would then not qualify for normal tax deductions or allowances. From a tax angle, this would mean a tax adjustment of its tax computation and an increase in tax burden of 17% (for companies) and other rates (for sole-proprietorships and partners of partnerships). Using the enhanced rate of 60%, it would mean that a company would typically be subsidised $0.43 for every dollar of spending on qualifying expenditure.

Meanwhile, with the other option of claiming deductions/ allowances of 400%, the same company would be subsidised $0.68 for every dollar of spending ($1 × 4 × 17%).

If there are no cash flow constraints, businesses would definitely benefit more from the latter option. This is unless the business is in years of tax losses and a recovery from the red is not expected in the near future, or it is currently enjoying concessionary tax rates from incentive schemes such the pioneer manufacturing or service incentive.

Combined cap

When the PIC was introduced for YA 2011, the Government allowed businesses which incurred qualifying expenditure to combine their cash grant claims for YAs 2011 and 2012 to a total of $200,000. The reason was to allow businesses to plan their acquisition or spending so as to maximise the cap per year. However, it was announced that there would be no combined cap for YAs 2013 to 2015.

This means that businesses have to plan and time their acquisition and spending on qualifying expenditure so that the quantum does not exceed the cap of $100,000 per year. Otherwise, the current regime would forfeit the excess over the capped amount and this would be a tax benefit leakage.

Using an example below, we illustrate how businesses can maximise the tax benefit under the PIC.

Facts

- A newly incorporated medical company leased a qualifying automation equipment for $10,000 per annum over six years starting in financial year 2012 (YA 2013).
- The management projected an adjusted profit of $90,000 for the first YA (2013).

Start-up tax exemption

Generally, the option of claiming deductions would be preferable but if the intention is to maximise its tax benefits, this company should not claim enhanced tax deductions under Section 14T of the Income Tax Act.

Newly incorporated companies enjoy a start-up tax exemption for the first three years (subject to certain conditions), which is an effectively nil tax on its first $100,000 of chargeable income. As a result, the company in question would be indifferent to claiming enhanced tax deductions on the leasing expenditure versus not claiming any. Hence claiming the cash grant option would yield a healthy bonus of $6,000!

Option 1: Claiming 400% deductions	
Adjusted profit	= $90,000
Less: enhanced deductions under PIC	($30,000)
Net chargeable income	= $60,000
Start-up tax exemption	($60,000)
Tax payable	Nil
Tax refund	Nil
Option 2: Claiming 60% cash conversion	
Adjusted profit	= $90,000
Add: deductions converted to cash under PIC	$10,000
Net chargeable income	= $100,000
Start-up tax exemption	($100,000)
Tax payable	Nil
Tax refund	$6,000

Tenure of the leasing

As the PIC scheme sunsets in YA 2015 (or financial year ending 2014), this company should consider shortening the leasing period to end in the year 2014. The reason is to capture the full amount of PIC benefits within the leasing period. Otherwise, lease payments after 2014 do not qualify for PIC claims.

Conclusion

The above demonstrates that the business management's clear understanding of the PIC scheme and tax treatment of the relevant lease, would reap tax savings under the PIC.

Ultimately, companies seeking to maximise their benefits under the PIC are strongly encouraged to assess and take their own accounting and tax position, as best as they can, with advice from their independent advisers. SMA

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