Publication: The Business Times, p 9
Date: 19 June 2012
Headline: Maximising tax-related cashflows for SMEs

Maximising tax-related cashflows for SMEs

Q: Is it better to claim the cash payout or the Productivity and Innovation Credit deductions if my company, an SME, is incurring (tax) losses?

A: For each Year of Assessment (YA) from 2013 to 2015, companies that incur expenditure on any of the six qualifying activities under the Productivity and Innovation Credit (PIC) scheme can have a choice of either:

◆ a non-taxable cash payout (CP) based on 60 per cent of their total expenditure (up to a maximum of $100,000) incurred on any of the six qualifying activities, ie up to a maximum of $60,000 cash payout; or

◆ a PIC deduction/allowance of up to a maximum of $1,600,000 based on 400 per cent (comprising a base deduction/allowance of 100 per cent and an enhanced deduction /allowance of 300 per cent) of the annual expenditure cap of $400,000 per qualifying activity (note that the annual expenditure cap can be pooled to give a combined cap of $1,200,000 for YA 2013 to YA 2015 for each qualifying activity).

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If a company is not in a tax-paying position (for example, incurring losses), an issue to ponder would be whether it is better to claim the CP option (which is restricted to 60 per cent of $100,000) or the PIC deduction/allowance.

Among other considerations, it also depends on the prevailing corporate tax rate. As the CP is 60 per cent of the base expenditure whereas the PIC deduction is four times the base expenditure of $100,000 ie $68,000 (ie 100,000 x 4 x 17%) assuming a tax rate of 17 per cent, it may not be better to claim CP.

Let us assume the following scenario for a limited company, X with a financial year-end of 30 June:

YA 2013 (relating to the financial year-end 30 June 2012)

a) a training expenditure of $100,000 was incurred, which qualifies for PIC deductions; and

b) an adjusted tax loss of $2,000,000 which is arrived at after deducting the base training expenditure of $100,000 in (a) above, but before the enhanced deduction of $300,000.

YA 2014 (relating to the financial year-end 30 June 2013)

c) an adjusted profit of $3,600,000; and

d) there is no substantial change in the shareholders and their shareholdings (as the carried forward loss can only be utilised provided there is no substantial change in the shareholders and their shareholdings).

Assume CP is elected

Assuming company X elects to convert the training expenditure of $100,000 into a CP for YA 2013. The amount of CP and the loss to be carried forward to YA 2014 will be as shown in Figure 1.

Fig 1: Assume CP is elected

Assuming company X elects to convert the training expenditure of $100,000 into a CP for YA 2013. The amount of CP and the loss to be carried forward to YA 2014 will be as follows:

	$
PIC CP (60% x $100,000 of qualifying expenditure)	60,000

Tax Computation for YA 2013

	$
Adjusted Tax Loss	(2,000,000)
Add: training costs converted to CP#	100,000
Loss carried forward	(1,900,000)

#As the training expenditure has been converted to CP, it will no longer be eligible for tax deductions.

Tax Computation for YA 2014	$
Adjusted Profit	3,600,000
Less: Loss carried forward (for the year ended 30 Jun 2012)	(1,900,000)
Chargeable income (before exempt amount)	1,700,000
Less: Partial tax exempt amount	(152,500)
Chargeable income (after exempt amount)	1,547,500
Tax thereon at 17%	263,075

The tax-related cashflows over the two years with the election of CP are as follows:

	$
YA 2013 – CP inflow	60,000
YA 2014 – tax payable	(263,075)
Net cash outflow over the two years	(203,075)

Assume no CP is elected

If no CP is elected, the loss to be carried forward for YA 2013 is shown in Figure 2.

Fig 2: Assume no CP is elected

If no CP is elected, the loss to be carried forward for YA 2013 is as follows:

	$
Loss	(2,000,000)
Less: enhanced training costs of $100,000 x 3	300,000
Adjusted loss carried forward	(2,300,000)*

*The difference between the adjusted loss of $2,300,000 (CP not elected) and the adjusted loss of $1,900,000 (CP elected) is $400,000, the amount allowed as a PIC deduction when CP is not elected.

The tax payable in YA 2014 will then be

	$
Profit	3,600,000
Less: Loss (for the year ended 30.6.2012) carried forward	(2,300,000)
Chargeable income (before exempt amount)	1,300,000
Less: Exempt amount	(152,500)
Chargeable income (after exempt amount)	1,147,500
Tax thereon at 17%	

A summary of the cashflows, with and without CP, is as follows:

	$	
	With CP	Without CP
YA 2013 – CP inflow	60,000	-
YA 2014 – tax payable	(263,075)	(195,075)
Net cash flows over the 2 years	(203,075)	(195,075)

Hence the difference in cashflows between CP and no CP in the above table is $8,000 ($203,075 less $195,075).

With the election of a CP, it has resulted in an additional cash outflow of $8,000 than when the CP option was not elected in YA 2013. The reason for the higher cash outflow of $8,000 in the CP scenario is that the total training expenditure of $400,000 (both base and enhanced portions) in the no-CP scenario qualifies for tax deduction at a tax rate of 17 per cent (cash inflows of $68,000), as compared with the conversion of $100,000 base training expenditure at a conversion rate of 60 per cent (cash inflows of $60,000).

Change in assumption for the profit for YA 2014

If the assumption for the profit for YA 2014 is changed from $3,600,000 to $2,400,000, then it is better to elect CP, as the tax payable with CP for YA 2014 will be as shown in Figure 3.

Fig 3: Change in assumption for the profit for YA 2014

	$	
	With CP	Without CP
Profit	2,400,000	2,400,000
Loss carried forward	(1,900,000)	(2,300,000)
Chargeable income (before exempt amount)	500,000	100,000
Less: PTE	(152,500)	(52,500)
Chargeable income (after exempt amount)	347,500	47,500
Tax thereon at 17%	59,075	8,075

A summary of the cashflows with and without CP is as follows:

	$	
	With CP	Without CP
YA 2013 – CP inflow	60,000	-
YA 2014 – tax payable	(59,075)	(8,075)
Net cashflows over the two years	925	(8,075)

With CP there is an inflow of $925 but without a CP there is an outflow of $8,075. Hence, in this example, company X would be better off claiming the CP.

In conclusion, whether a company should claim CP when it is not in a tax-paying situation would depend on, among other considerations, its expected profitability in the future years.

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