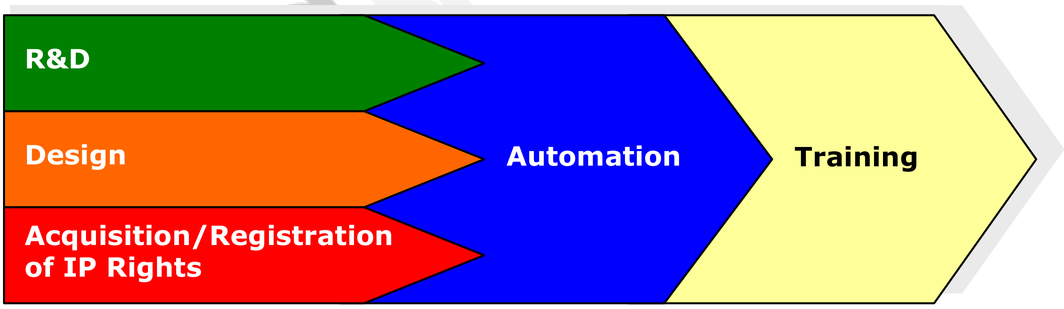
Understanding Tax Incentives from a **Business** Perspective

- Productivity and Innovation Credit

> ***"Because the purpose of business is to create a customer, the business enterprise has two—and only two—basic functions: marketing and innovation."***
>
> *~ Peter Drucker*

How can your business be innovative? In the Singapore Budget 2010 and 2011 statements, the government introduced a new tax benefit for investments in a range of activities along what is called the innovation value chain. This tax benefit is known as the Productivity and Innovation Credit ("the Credit"). From the Budget announcements, we can therefore adopt a practical definition for "productivity and innovation" as investments in the following five activities (Figure 1):



R&D: Research & Development   *IP : Intellectual Property*

Figure 1 –Being productive and innovative with these 5 activities

What are the benefits of investing in these activities? From a tax planning point of view, this is answered by understanding how the Credit can benefit you.

Productivity and Innovation Credit in dollars and cents

Simply said, in the next five years, for every $1 spent on any of the five activities, a business is given a further $3 as tax deduction. What this means is that for every $1 spent, you are effectively getting up to **51%** “discount” because you can get back:

- EITHER 51¢ in the form of a tax saving (off the income tax bill)
- OR 30¢ in the form of a cash payout

Figure 2 illustrates.

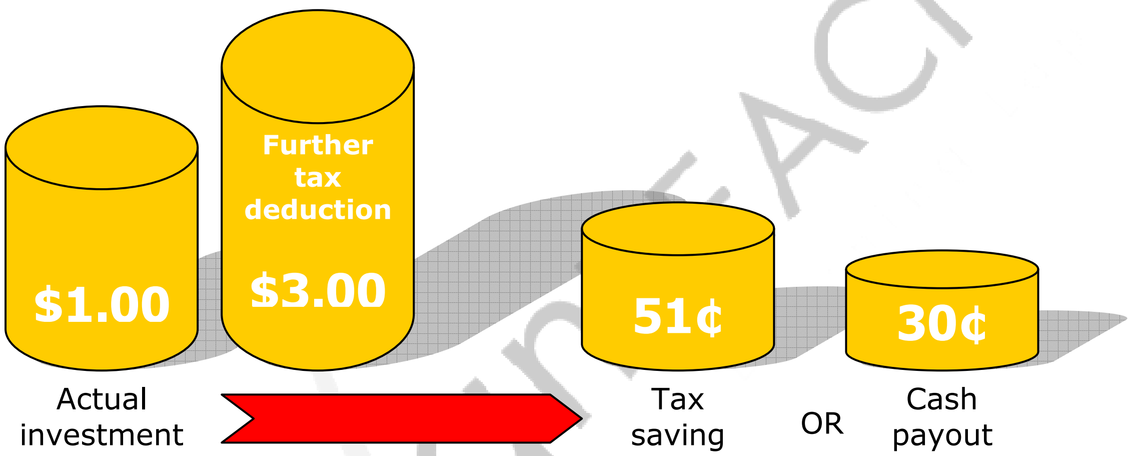


Figure 2 – Enjoy savings from your investments in productivity and innovation

Notes: Based on marginal tax rate of 17%. Qualifying conditions apply for the investment expenditure, claim for tax credit and claim for cash payout.

Details of the Credit are available at IRAS’ website www.iras.gov.sg .

In what ways are these five activities relevant to most business? After all, not all small and medium-sized enterprises (SMEs) engage in R&D, design or acquisition/registration of IP rights.

This is where the other two broad activities will help most SMEs: automation and training.

Investments in automation through technology or software

Qualifying investments in automation is based on a list of automation equipment in the "Income Tax (Automation Equipment) (Amendment) Rules 2010." Let us look at an abstract of the first four (out of 29) categories of equipment listed.

Category	Examples
Image or graphics processing equipment	display, facsimile, optical character reader, laser printer, plotter, image setter, digital printing, direct imaging equipment and scanner
Data processing & information technology equipment	mainframe, minicomputer, microcomputer, desktop, laptop, mobile phone, personal digital assistant and other information technology devices and peripherals
Data communications & networking equipment	modem, multiplexor, network processor, servers, interface converter, routers, switches, networks, cabling infrastructure, IP telephony systems, broadband connectivity equipment and security and authentication infrastructure
Information technology software	customer relationship management, inventory management, record management, human resource and payroll management, financial information and business management such as accounting and assets management

Figure 3 – Automation can be as simple as buying basic office equipment

You will see that the current list includes basic office equipment from a fax machine to a laptop. In other words, the definition of automation is intentionally set to be broad. This means that you could consider evaluating your office equipment now and invest in new ones or upgrade old ones, if necessary. Ultimately, more suitable and functional equipment will result in better performance and productivity.

Automation on its own may not be enough. When automation is supported by proper training, employee productivity will potentially improve.

Training of employees

An old Chinese proverb says: "When planning for a year, plant corn. When planning for a decade, plant trees. When planning for life, train and educate people."

With the Credit, employee training is effectively "subsidised." You should note that you are also entitled to get direct subsidies from the various schemes of the Workforce Development Authority (WDA). WDA currently supports a wide range of employee training courses. In other words, "double subsidy" is explicitly allowed.

Relevance of accounting system

The Credit is not only unprecedented, it is also broad-based. As such, almost all businesses will benefit from it. For example, automation and training are common expenditures for most businesses. Therefore, you should ensure that your accounting system separately classifies qualifying expenditures like automation and training from other operating expenses.

The rationale is simple. From the accounting point of view, $1 spent on, say training or automation, is $1 in the accounting books. However, with the broad-based Credit, every $1 spent on a qualifying expenditure is not just $1 tax deduction, but rather a total of $4 tax deduction. The accounting system should therefore properly separate all major expenditures so that tax claims are not unwittingly omitted in the future.

You should therefore review your chart of accounts and accounting procedures now to ensure that qualifying expenditures are meaningfully recorded. If you are still using manual bookkeeping, you should consider automating your accounting system now.

Conclusion – a means, not an end

The Credit is not meant to be an end in itself for businesses to enjoy tax benefits. Rather, it is a means to an end. Businesses should take this opportunity to identify and invest in activities that will make them more productive and innovative in the long term. Otherwise, they may find themselves gradually being left behind in a re-structured economy of higher-value and more innovative players.

Appendix – Two ways to save money from the Productivity and Innovation Credit

SCENARIO I: BUSINESS WITH TAXABLE INCOME

	$	Remarks
Taxable profit *(before investments in productivity & innovation activities)*	1,000	
Less: Investment in… Training (actual)	(100)	
Profit before tax	900	153 Original tax payable (17%)
Productivity & Innovation Credit: Further tax deduction on… Training (+300%)	(300)	(51) ← **Tax saving**
Profit for tax purpose	600	102 Lower tax payable

SCENARIO II: BUSINESS WITH NO TAXABLE INCOME

Taxable profit *(before investments in productivity & innovation activities)*	Nil	
Less: Investment in… Training (actual - $100)	-	*Elect to convert to cash payout*
Profit for tax purpose	Nil	No tax payable
Convert actual training expenses of $100 to cash payout @ 30%	30	← **Cash payout**

Note: This is not an actual income tax computation. It is presented in this format for illustration purpose only. In addition, qualifying conditions apply for the investment expenditure, claim for credit and claim for cash payout.

Footnote: For easier reading, the information provided in this article is generalised and simplified. You are advised to do further research in order to make your own informed decisions. It is also hoped that this article will help you to have a more fruitful discussion should you consult your tax advisors.