Changes in the Research and Development Tax Incentive

In the recent Budget 2012, the Singapore Government has put forth changes to the existing research and development (R&D) tax regime aimed at expanding the scope of the claims and facilitating the access to the benefits. In this issue of Tax alert, we give an overview of the changes and the possible impact to businesses in Singapore.

In November 2011, the Prime Minister highlighted in his speech at the launch of Singapore’s Agency for Science, Technology and Research’s (A*STAR) 20th anniversary commemorative publication the need for the country to increase the R&D expenditure to 3.5 percent of GDP by 2015.

The R&D incentive (as part of the Productivity and Innovation Credit (PIC) scheme) currently provides for a 400 percent tax deduction on the first $400,000 of qualifying expenditure for every Year of Assessment from 2011 to 2015. The qualifying expenditure in excess of $400,000 is entitled to a 150 percent tax deduction.

The recent changes proposed in Budget 2012 have enhanced the R&D incentive to further encourage companies to develop new knowledge or improvements, particularly in the areas of software development and collaborative R&D.

**Cash payout**

Currently, businesses may opt to convert up to $100,000 of qualifying expenditure from the PIC scheme into non-taxable cash payout for each Year of Assessment (YA) at a conversion rate of 30 percent. The payout is available anytime after the business’ financial year end.

For each YA from YA 2013, this cash payout will be enhanced with the increase of the conversion rate to 60 percent. In addition, businesses may claim the cash payout anytime after the end of each financial quarter.

The proposed changes to the cash payout rate, and the availability of the payout makes the conversion of the qualifying expenditure a more attractive option for businesses that:
- are experiencing financial difficulties
- have significant carry forward tax losses and capital allowances or
- enjoying concessional tax rates under tax incentives.

For further information, please refer to our Tax Alert issued earlier entitled “To Claim Enhanced Tax Deductions or Cash Out?”

**R&D Cost-sharing Agreements**

Before the Budget 2012 announcement, there was lack of clarity as to whether payments made under R&D cost-sharing arrangements could qualify for the enhanced R&D tax claims.

Under existing legislation, a R&D cost-sharing agreement refers to an agreement or arrangement made by two or more persons to share the expenditure of R&D activities to be carried out under the agreement or arrangement.

For specific R&D expenditure incurred under cost-sharing arrangements, such expenditure would qualify for writing down allowances only upon approval by the Economic Development Board (EDB).

With the Government’s push for greater involvement in R&D by the private sector, especially through industry collaboration, there was a greater need for the Government to relax their stance so that organisations entering into an R&D cost-sharing agreement can also enjoy the enhanced deductions.

The proposed changes to allow entities to claim enhanced PIC deductions for expenditure incurred on R&D cost-sharing agreements, and without applying to the EDB should help to reduce the distortion resulting from an organisation’s choice of how R&D is undertaken. The proposed treatment takes 60 percent of the R&D shared costs, similar to outsourced payments, as deemed qualifying expenditure and would count towards the PIC expenditure cap for R&D activity.

The detailed treatment for the R&D cost-sharing expenditure would be released by the IRAS by 30 June 2012. What is not clear at this stage is the transitional rules for existing claimants under Section 19C of the Act and also the definition of R&D shared cost before the application of the 60 percent deemed qualifying expenditure. For example, can payments made to access existing cost-sharing arrangements (i.e. buy-in payments) be considered as R&D shared costs?
Software development

Software development projects are often potential 'goldmines' for R&D claims. Although there are a multitude of standard software applications that cater to almost every purpose, businesses have different needs and software technologies are changing at a rapid pace. Making new software work with legacy systems, creating website functionality that caters to a wide range of users, and customising commercial off-the-shelf software to the needs of the business may all present complex technological challenges that could be regarded as R&D.

In the definition of what constitutes R&D for the Year of Assessment 2011 and earlier, there was a restriction placed on software developments. It excluded development of computer software that was not sold, leased, licensed to two or more persons who are not related to each other, commonly referred to as the "multiple sales requirement". This exclusion was adopted from the old Australian R&D legislation that was in place for a significant number of years.

However as technologies and industries have evolved, the exclusion did not reflect the changing operating environment or the proliferation of internet use. In particular, it disadvantaged the services sector, where information technology is increasingly being employed to provide new or improved customer service.

In view of this, this multiple sales requirement would be lifted, but with an exemption for the development of software for internal routine administration of businesses. This takes effect from the Year of Assessment 2012.

This change effectively takes into account the commercial reality present in cases where businesses may choose not to commercialise their software projects (meeting the R&D tests nonetheless) for a variety of reasons. The removal of the multiple sales requirement would especially assist businesses in the services sector, where the products being offered are not tangible goods but the nature of the work undertaken which nonetheless involves R&D. Quite often, this happens without a sale to two or more unrelated parties.

The open issue remaining is what constitutes the internal routine administration of businesses. Further questions include whether there would be a 'dominant purpose' test for projects that are undertaken for both internal and business-oriented purposes. Details would be released by the IRAS by 30 June 2012.

However, it is obvious the policymakers have an eye on encouraging businesses in the services sector to make greater use of the R&D incentive. These include retailers, banks and insurance companies.

Aside from the test surrounding the internal routine administration of a business, understanding how software development projects can qualify as R&D and reap significant tax benefits. Qualifying software development projects, whether undertaken by in-house software developers or together with software vendors, sometimes include software developed for specific purposes where no commercial-off-the-shelf solutions exist (e.g. new trading systems in financial institutions). Or, it may involve improving/customising existing software solutions to meet specialised needs (e.g. highly customised inventory management systems), amongst others.

While the new guidelines for software development projects are to be released later, businesses should immediately start assessing whether software projects undertaken in financial year 2011 can be regarded as R&D to reap the most benefit from the R&D tax incentive. An early start to the process provides sufficient time to review all significant projects and prepare the project description and internal project documentation to support these projects. This is taking into account that YA 2012 claims for the R&D tax incentive together with the project descriptions must be submitted to the IRAS by 30 November 2012.

How we can help

As a committed tax advisor to our clients, we welcome any opportunities to discuss the relevance of the above matters to your business. KPMG's Enterprise Incentive Advisory team has been assisting clients from a range of industries with their R&D claims since the Year of Assessment 2009, when the enhanced R&D tax deduction was first introduced. The team comprises members from technological, accounting and finance backgrounds to provide a complete service offering to help you access and improve your claims for the R&D tax incentive.

About Tax Alert

KPMG's Tax Alert highlights the latest tax developments, impending change to laws or regulations, current practices and potential problem areas that may impact your company. As certain issues discussed herein are time sensitive it is advisable to make plans accordingly.

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