# Tax Excellence Decoded

## Think About Tax As You Innovate

*Understand the Essentials of R&D and IP Tax Planning*

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*Accredited Tax Advisor (Income Tax) Tan Ching Ne, Partner at PwC Singapore, discussed the essentials of R&D and IP tax planning.*

A company conducts Research and Development (R&D) to create a new product and improve existing products. After a successful R&D project, the company seeks to protect the Intellectual Property (IP) created and thereafter, sets out to commercialise its IP. This typical scenario may appear straightforward, but is it really? Unknown to some, each corporate decision at every juncture – from the choice of R&D location to the IP structure – could lead to a different tax consequence.

A myriad of tax incentives are offered by various countries. Some incentives are volume-based where the tax credits depend on the amount of R&D expenditure, while others are based on incremental R&D spending over a base figure. There are also countries that require R&D activities to be performed locally to qualify for R&D tax incentives, and yet others that do not have such a requirement.

To cut through layers of complexity, the Singapore Institute of Accredited Tax Professionals organised a *Tax Excellence Decoded* session facilitated by Accredited Tax Advisor (Income Tax) Tan Ching Ne, Partner at PwC Singapore. At the fully-subscribed session, Ms Tan discussed the essentials of R&D and IP tax planning, and shared her practical experiences of R&D tax claims in Singapore.

### RESEARCH AND DEVELOPMENT

#### R&D Incentives

In Singapore, R&D tax measures were first introduced in 2008 and effective from year of assessment (YA) 2009. The tax deduction of qualifying R&D expenditure was further enhanced with the Productivity and Innovation Credit (PIC) Scheme from YA 2011 and available through YA 2018.

Many countries provide R&D incentives to encourage businesses to innovate and carry out high-value R&D activities, which in turn create economic spinoffs. Such R&D incentives can largely be grouped into two categories.

The first category is R&D Credit which can be found in jurisdictions such as Australia, Japan, Korea and the United States. An R&D Credit is essentially a direct tax offset for eligible R&D activities. Australia, for example, provides a 45% refundable tax offset for eligible entities with an aggregated turnover of less than A$20 million per annum, or a 40% non-refundable tax offset for all other eligible entities.

The second category is R&D Super Deduction. Unlike R&D Credit which is a direct tax offset, R&D Super Deduction refers to an additional tax deduction given on eligible R&D expenses over and above the base tax deduction. Notable jurisdictions providing R&D Super Deduction include China, India and Singapore.

If a Singapore company carries out qualifying R&D activities in Singapore, it may claim 400% tax deduction for the first S$400,000 of staff costs and consumables and 150% tax deduction for staff costs and consumables in excess of S$400,000. A 100% tax deduction will be given for the remaining R&D expenditure (other than staff costs and consumables).

If the Singapore company carries out qualifying R&D activities overseas, it may still claim 400% tax deduction for the first S$400,000 of staff costs and consumables and 100% tax deduction for the remaining R&D expenditure provided the R&D is related to its existing trade or business. Otherwise, no claim is allowed.

**R&D tax claims in Singapore**

Prior to YA 2009, businesses could only claim a base tax deduction of 100% on R&D expenditure in Singapore. This changed in YA 2009, when companies are allowed to claim an additional enhanced tax deduction of 50% on the R&D expenditure. From YAs 2011 to 2018, businesses could enjoy a further enhanced tax deduction of 250% on qualifying R&D expenditure under the PIC Scheme (subject to conditions).

Singapore taxpayers should be mindful that detailed documentation is required by the Inland Revenue Authority of Singapore (IRAS) in justifying their R&D tax claims. IRAS has set up a Technical Advisory Panel (the Panel) to assist its officers in assessing the applications for R&D tax incentives. Currently, the request for the Panel's review could be initiated by IRAS. Upon request, the Panel will review the company's R&D claim and provide an independent view to IRAS. IRAS will make the final decision based on the technical advice from the Panel.

A common mistake Singapore taxpayers make is to indicate the business objective as the technical objective in their R&D tax claim. To illustrate, a home appliance company wants to increase its oven sales by 20% and believes that the sales target can be achieved by having a new oven which halves the cooking time. Here, the company's business objective is to increase oven sales by 20% while its technical objective is to produce an oven that can halve the cooking time.

Another area of note is the start date of a qualifying R&D project. An R&D project starts when the technical objective of the project is identified, and the expenditure incurred from the start date would then be eligible for claim.

## INTELLECTUAL PROPERTY

### IP-Box

An IP-box (also called Patent-Box or Innovation-Box) is an incentive regime that lowers the effective tax rate on income derived from prescribed IP. Korea, for example, has a headline tax rate of 24.5% but its effective tax rate for qualifying IP income, in this case royalties, ranges only from 7.5% to 16.5%. Other jurisdictions with an IP-Box regime include Switzerland and the United Kingdom.

It is noteworthy that there are changes in the horizon against the backdrop of the Organisation for Economic Cooperation and Development (OECD)'s Base Erosion and Profit Shifting (BEPS) project. For example, United Kingdom has announced changes to its IP-Box regime.

### IP Planning

It is important for businesses to consider the following when deciding where to create, own and commercialise their IP:

<u>Policy on IP Ownership</u>
To start off, companies need to establish if they will be acquiring IP or if they will be creating their own IP. Only after the policies are established will companies then be able to consider a suitable country for their R&D activities.

<u>Alignment of IP Ownership and R&D Expenses</u>
Next, companies should ensure that IP ownership and R&D expenses are aligned to the same entity. For example, if a Singapore entity owns the IP but the R&D activities carried out to create the IP are performed by a related entity, the Singapore entity should be paying for the R&D activities performed.

<u>Maximising Reliefs and Incentives</u>
Businesses should also review the reliefs and incentives offered by the various countries to optimise benefits based on their specific needs.

<u>Implementation of a Robust Transfer Pricing Policy</u>
Finally, businesses need to ensure that transfer pricing policies mirror the substance and intent of their organisations. The functions, risks and assets employed by the respective entity must be clearly defined.

### IP Structures

Different IP structures are adopted by businesses depending on their specific needs. For example, a Parent Company that originally created IP may transfer this IP to another company to own and manage the IP (IP Company). The IP Company could in turn license the rights to regional hub companies to manufacture and sell the products. To substantiate such IP structures, robust transfer pricing policy and documentation cannot be further emphasised.

Innovation is the name of the game in this knowledge economy. As businesses innovate, it is useful to think through the possible tax consequences of R&D activities and IP.

**About Ms Tan Ching Ne**

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An Accredited Tax Advisor in Income Tax, Ching Ne has over 20 years of tax experience in Singapore and the region which includes 10 years working in multi-national corporations as their Asia Pacific tax director.

Ching Ne has been involved in tax advisory services to multinationals and local corporations, supply chain transformation, tax disputes resolution, bilateral and unilateral advance pricing agreements applications and negotiation of country tax incentives. She has experience interacting with Singapore EDB, Singapore IRAS, Australian Tax Office, China SAT, State Government of India, Japan NTA, Korea NTS, Taiwan Tax Authorities, Taiwan Ministry of Finance, Malaysia IRB etc.

*This technical event commentary is written by SIATP's Tax Manager, Felix Wong. Felix has over seven years of experience in corporate and international tax. Previously from PwC, he now leads various tax initiatives in Singapore's first dedicated professional body for tax specialists to enhance Singapore's position as a centre of excellence.*

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