Corporate Tax Alert

Research & Development (R&D) Tax Incentives

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Greetings from your tax team at Deloitte Singapore. We are pleased to enclose the latest Deloitte Tax Alert on:

Updated e-Tax Guide on R&D Tax Measures

The Inland Revenue Authority of Singapore (IRAS) has published the 3rd Edition of its e-Tax Guide on "Research and Development (R&D) Tax Measures" on 30 October 2014. This comes shortly after the 2nd edition of the guide which was published on 22 August 2014. You can read our alert on the earlier guide here.

What has changed

This 3rd edition incorporates Annex G, which contains further information and clarifications on R&D projects relating to application software.

More queries raised for application software projects

The IRAS does not define the term 'application software' but describes such software as enabling users to carry out their specific tasks more efficiently and effectively. Examples of application software include accounting software, word processing software, customer relationship management software and trading platform software.

The IRAS revealed that it generally requests more information from taxpayers making R&D claims on application software projects due to the following reasons:

- Insufficient information on the scientific or technological objectives of the software projects
- Insufficient information on the systematic, investigative and experimental studies in the field of science or technology they conducted for the application software projects.
- Whether the entire application software project is a qualifying R&D project and

whether it includes the development of standard components commonly used in the IT industry.

- Clarification on how integration works in an application software project meet the R&D requirements
- Clarification on the scope of engagement with software firms to ascertain the technical risk requirement.

Eligibility of Application Software as R&D

Similar to any R&D project, a project relating to application software will qualify as a R&D project if: -

- the project's objective is to acquire new knowledge, create new products or processes, or improve existing products or processes;
- the project involves novelty or technical risk; and
- the project is a systematic, investigative and experimental (SIE) study in a field of science and technology.

Annex G contains additional clarifications on these requirements in the context of an application software project: -

Objective

IRAS emphasised the need for taxpayers to explain the scientific and technological challenges in the project, e.g. there is no known solution to achieve the outcome or the existing solution is inadequate or inefficient.

Novelty

IRAS clarified that the novelty requirement is satisfied if the taxpayer is able to show that there is no effective solution to resolve the problem before the commencement of the project. A project will not meet the novelty requirement if the application performs similar functions as those which already existed in the Singapore market or if it involves only minor or routine changes or simply brings the knowledge of the company in line with current knowledge or capability. However, a software application whose performance surpasses the industry norm at the time it was developed may qualify under the novelty requirement.

Technical Risk

IRAS clarified that technical risk refers to specific scientific or technological uncertainty existing in the projects that cannot be readily resolved by competent IT professional. In cases where the taxpayer outsources the application software development to software firms, the taxpayer has to find out how the functionalities are developed and identify the

technological uncertainties for the purpose of making software R&D claims. IRAS also clarified that in large scale application software projects, typically involving the development of many functionalities (i.e. sub-functions, components and interfaces), technological or scientific uncertainties may affect only certain parts of the software project. Consequently, only those parts of the project may be considered for R&D tax incentives. However, where the taxpayer is able to demonstrate that the scientific or technological uncertainties relate to the core[1] functionalities developed for software projects, the entire project may qualify as R&D, subject to meeting the other R&D qualifying requirements.

Systematic, Investigative and Experimental (SIE) study in the field of science or technology

IRAS clarified that "investigative" and "experimental" activities are carried out to discover and test out potential solutions to the scientific or technological problems identified. Activities that are performed merely to confirm that something works as it is designed and intended to be or that is already known or to demonstrate a known fact are not investigative or experimental in nature. IRAS informed that it is a common mistake to regard all software testing activities such as unit testing, system testing, user acceptance testing, load testing etc. as SIE works for R&D tax measures. Testing works that are carried out to validate that the software is programmed as it is designed to be or to confirm that the coding of the software has been correctly carried out are not SIE works for R&D tax incentives, as these testing activities are not directed at resolving the technical or scientific challenges through a series of investigative and experimental works to find a process or method or to develop an alternative solution.

Examples of qualifying and non-qualifying application software projects

Annex G also provides useful examples of application software projects that are qualifying and others that are non-qualifying for R&D purposes.

Conclusion

The clarifications from IRAS emphasise the need for taxpayers to substantiate the scientific and technological work carried out when claiming R&D tax benefits for application software.

To assist in identifying eligible R&D activities for tax purposes and prepare robust technical substantiation for R&D tax claim, Deloitte Singapore has an experienced and dedicated R&D tax team comprising of R&D specialists with tax expertise.

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[1] The core refers to the significantly substantial and key component of the entire application software, e.g. if the design, development and implementation of a platform with a high processing power is the significantly substantial and key component of the entire project (i.e. "core engine"), the peripheral functionalities developed to run the core engine, without which the core engine cannot function, will also form part of the core engine.

Please feel free to approach us for a free "health-check" of your R&D tax claims or simply an opportunity to share how this new e-Tax guide might affect you.

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