



Singapore Business Tax developments

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Greetings from your Tax & Legal team at Deloitte Singapore. We hope that you and your loved ones are staying safe and healthy despite these challenging times. As we navigate ourselves through this trying period, we are committed to giving you the support you need.

We are pleased to share the following with you.

Subsidiary legislation issued for the Intellectual Property Development Incentive

The Intellectual Property Development Incentive (IDI) was first introduced in 2018, around the same time when Intellectual Property (IP) income was excluded from the scope of two existing incentives—the Pioneer Service Companies Incentive (PC-S) and the Development and Expansion Incentive (DEI). The IDI is designed to encourage the use and commercialisation of intellectual property rights (IPRs) arising from research and development (R&D) activities and confers a concessionary tax rate of 5% or 10% on a percentage of qualifying IP income determined by the modified nexus approach.

To operationalise the IDI, the Income Tax (Concessionary Rate of Tax for Intellectual Property Income) Regulations 2021 (Regulations) came into operation on 22 January 2021 and the salient features of the Regulations are summarised below.

Qualifying IP income and IP right

Qualifying IP income refers to royalties or other income receivable by the approved IDI company as consideration for the commercial exploitation of an elected qualifying IPR. A qualifying IPR means:

- A patent;
- An application for a patent;
- A copyright subsisting in software; or

- A family of qualifying IPRs (more information on this provided below)

The above definition is aligned with the allowable IPR under Base Erosion and Profits Shifting (BEPS) Action Five Final Report.

Family of qualifying IPRs

Two or more IPRs can be grouped into a “family” if either the expenditure or the income of the IPRs cannot be reasonably identified or separated from each other (i.e., interlinked). A “chain rule” further applies where two IPRs are part of a chain of three or more qualifying IPRs each of which is interlinked with another. The grouping of the family of IPRs is critical in the computation of the nexus ratio.

While elections into IDI are irrevocable, an election for IPRs to be in the same family can be subject to changes as new IPRs join the family or old IPRs ceases. Hence, there may be a need to add or remove members of the family of qualifying IPRs. The nexus ratio will be computed based on the final composition of the family at the end of the basis period.

It should be noted that IPR cannot be removed from a family once elected unless the IDI company ceases to have the IPR or if the IPR ceases to be interlinked with any IPRs in the family. If the family of qualifying IPRs ceases entirely before the entire basis period, the nexus ratio will be adjusted and will be based on the final composition before cessation.

Nexus ratio

The percentage of qualifying IP income from an elected qualifying IPR is determined below by the nexus ratio:

$$\frac{C \times 130\%}{C+D}$$

C: Qualifying expenditure: Includes R&D carried out directly by the IDI company and it includes qualifying outsourced R&D and cost-sharing agreements (CSA) payments.

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D: Non-qualifying expenditure: Includes acquisition cost, licensing, amalgamation, buy-in payments for CSA and non-qualifying outsourced R&D etc.

The above nexus ratio focuses on establishing a nexus between cumulative expenditure, the family of IPR and its associated income as it apportions overall qualifying income from the family of qualifying IPRs according to the ratio of expenditures above.

Transitional nexus ratio

The nexus ratio requires tracking and tracing of R&D expenditure to individual or groups of IPRs. Hence, there is an obligation to keep such tracked and traced records and this will begin on the approval date (i.e., date of Letter of Award) of the IDI. The requirement to track and trace records will commence from the approval date but it includes any periods preceding it where the company has expenditure records tracked to the elected qualifying IPR or family of elected qualifying IPRs.

Where an IDI company does not have at least three full years of actual tracked data in relation to an IPR or a family of IPR as at the end of the basis period, a transitional nexus ratio can be used for the basis period. In the event that the R&D project started less than three years ago, the transitional nexus ratio will be used if the IDI company does not have actual tracked data for the entire period.

Deemed income

As IPR protection in a patent or a copyright subsisting in software typically has a finite lifespan, complication may arise when there is a cessation of such IPR protection. Specifically, income from such IPRs can no longer be covered under IDI if it can be separately identified and will cease to be part of a family of qualifying IPRs; when a patent application is withdrawn or abandoned; the patent under application is disposed by the IDI company before approval was given such that the IDI company no longer has the right to the pending patent; or when the application is rejected. In instances where the income can be separately identified to a patent application or with other qualifying IPRs, deemed income may be triggered and chargeable to tax under the prevailing corporate tax rate.

Deloitte Singapore's views

The IDI is a complex incentive with nuances in implementation, as seen from the time taken to finalise and issue the subsidiary legislation—over two and a half years since the scheme first took effect on 1 July 2018.

With the new IDI regulations, there are now three definitions of IPR in Singapore's legislations, specified in the Income Tax Act and the Economic Expansion Incentives (Relief from Income Tax) Act. While the definition of IP income under the IDI mirrors the IP income exclusion from PC-S and DEI, the scope of qualifying IPR is narrower. As such, an IP income stream that was incentivised and grandfathered under the PC-S or DEI scheme may not necessarily be covered under the IDI. Given that the grandfathering provision for IP income exclusion from PC-S and DEI will soon be coming to an end on 30 June 2021, it is timely for companies with the PC-S or DEI award to evaluate whether the IP income to be carved out could qualify under the IDI and start applying for the scheme.

Businesses may note that the form of IP ownership is not prescribed in the regulations; hence the IDI can be applicable in the absence of legal ownership, so long as there is income derived from a qualifying IPR.

Family of qualifying IPRs

It is critical to understand the importance of identifying a family of qualifying IPRs and establishing its composition accurately as the income and nexus ratio will be based on the final composition at the end of the basis period. While companies are not expected to justify the interlinkage every year of assessment if there are no circumstances that suggest a change, it is still important to prepare justification when one or more individual IPR(s) enters or leaves a family of IPRs on a timely manner.

Added consideration may be applicable for companies who cease to have an IPR, or with pending patent application that are withdrawn or abandoned. The framework may require deemed income to be charged in the event of a disposal or termination of the above, depending on the type of IPRs and/or whether the same is separable from the family.

Transitional nexus ratio

As compared to the nexus ratio, the transitional nexus ratio allows rolling three years of expenditure to be used (shorter if the entire R&D period was less than three years). All R&D expenditure will be included in aggregate, including all acquisition/licensing cost

for any qualifying IPR regardless if it is related to the elected qualifying IPR. However, it is important to note that an IDI company should not enjoy more than three years of transitional nexus ratio unless the commencement date of the IDI is earlier than the approval date. In view of the above, companies should be encouraged to track and trace their R&D expenditure accurately prior to the application as even incomplete cost would be included in the nexus ratio.

Further complications may arise when an IDI company has more than one IPR/family of IPRs using the nexus ratio and some other IPR/family of IPRs using the transitional modifications. It should also be noted that income that enjoyed grandfathering under DEI or PC-S cannot benefit from the transitional nexus simplifications.

It is timely for companies who are interested in applying for the IDI to carefully evaluate the potential impact of the finalisation of the IDI legislation. Companies should adopt a robust methodology in tracking data from day one (even prior to application) and understand how to identify a correct family of IPRs, including reviewing its composition, when to apply transitional nexus ratio, and its associated impact to the income enjoying concessionary tax rate under the IDI scheme.

Record-keeping requirements

It is equally important that IDI companies ensure they have the right supporting contemporaneous documentation to establish and substantiate the qualifying IPR (including family of IPRs), relevant income, expenditure incurred and its R&D activities.

IDI companies should note that R&D in this context is defined under Section Two of the Income Tax Act, and it must be connected to the elected qualifying IPR. In light of this, IRAS is likely to necessitate IDI companies to adopt the same robust documentation requirements as companies claiming R&D enhanced deduction under Section 14D/DA.

How Deloitte can help

It is crucial that companies understand the fundamentals of the IDI scheme and get started early given that the correct identification, management of the family of IPRs, tracking of R&D expenditure and documentation of R&D activities is likely to play a pivotal role.

Deloitte's Global Investment and Innovation Incentives (*Gi³*) team can assist you in this process, and we would be pleased to have a deeper discussion should you be interested to do so. Please reach out to us on our contact details below.

We hope that you find this newsletter useful and we welcome your feedback.

Contacts

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