BUDGET 2017 – OVERVIEW OF TAX CHANGES

On 20th February 2017, the Singapore's Budget 2017 was presented by the Minister for Finance, Mr. Heng Swee Keat. The 2017 budget aims to provide near-term support for businesses, strengthen the competitiveness of the financial sector, and to simplify Singapore's tax regime.

The takeaways on the changes operated by the 2017 budget are the following:

1. Enhancement and extension of the corporate income tax (CIT);
2. Introduction of a BEPS-compliant patent box regime;
3. Introduction of a safe harbor for tax deductions of payments made under a R&D Cost Sharing Agreement;
4. Extension of existing tax incentive schemes.

1. Enhancement and Extension of the Corporate Income Tax (CIT) Rebate

Enhancement of the CIT Rebate for Year of Assessment 2017

Currently, companies benefit from a CIT rebate of 50% with respect to their taxable income derived in 2016 and to be declared in 2017 (Year of Assessment 2017). The CIT rebate is currently capped at S$20,000. The budget 2017 will enhance the CIT rebate for Year of Assessment 2017 by raising its cap from S$20,000 to S$25,000.

Extension of the CIT Rebate to Year of Assessment 2018

The CIT rebate was supposed to end in Year of Assessment 2017. The budget 2017 will extend the CIT rebate for another year to Year of Assessment, to income derived in 2017 and to be declared in 2018. The new CIT rebate will be as follows:

- The rate of the CIT rebate will be reduced from 50% to 20% of tax payable, and
- The cap of the CIT rebate will also be lowered S$10,000.

2. Introduction of a BEPS-Compliant Patent Box Regime

To encourage the use of Intellectual Properties ("IP") arising from Research and Development (R&D) activities conducted in Singapore, the "IP Development Incentive (IDI)" will be introduced. The IDI will provide a tax incentive on income generated through the exploitation of IPs resulting from qualifying R&D activities ("IP income").

Even though the details of this new IDI scheme will be disclosed by the Economic Development Board of Singapore ("EDB") in May 2017, it has been announced that the IDI will be compliant with the minimum requirements set out in the Action 5 Report ("Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance") of the OECD Base Erosion and Profits Shifting ("BEPS") project. It is therefore expected that the "nexus approach" developed under the Action 5 Report of the BEPS project will be used in order to determine the amount of IP income entitled to the incentive under the IDI.

The nexus approach uses R&D activities as a proxy to determine the proportion of the overall IP income to be incentivized. Under this approach, the proportion of the overall IP income entitled to the incentive is the same proportion as that between qualifying R&D expenditures and overall expenditures. In other words, the proportion of overall IP income to be incentivized under the IDI should obey the following formula:

$$\frac{\text{Qualifying R\&D Expenditures}}{\text{Overall expenditures}} \times \text{Overall IP Income} = \textbf{Incentivized IP income}$$

Following the Action 5 Report of the BEPS project, the following features of the IDI are to be expected:

- *Qualifying IP*
  The only IP assets qualifying for the IDI scheme would be patents and other IP assets that are functionally equivalent to patents (e.g. copyrighted software) if those IP assets are both legally protected and subject to similar approval and registration processes. However, marketing-related IP assets (e.g. trademarks) would be excluded.

- *Qualifying Expenditures*
  Only expenditures that are incurred for the purpose of actual R&D activities, whether outsourced to an unrelated party or not, would be considered qualifying R&D expenditures. Interest payments, building costs, acquisition costs of IP, outsourced R&D expenditures to related parties, or any costs that could not be directly linked to a specific IP asset should not be included in qualifying R&D expenditures.

- *Overall Expenditures*
  Overall expenditures would include the abovementioned qualifying expenditures plus two other types of expenditures: expenditures for related-party outsourcing and acquisition costs of IP.

- *Overall Income*
  The overall income should be determined on a net basis (after deduction of IP expenditures

allocable to IP income) and only include income that is derived from the IP asset. IP income is likely to include royalties and embedded IP income from the sale of products and the use of processes directly related to the IP asset.

IP income previously incentivized under the existing Pioneer Services incentive (Headquarters Incentive) and the Development and Expansion Incentive (Services or Headquarters) will be r exclusively covered by the new IDI. Existing incentive recipients will continue to have such income covered under their existing incentive awards until 30th June 2021.

The IDI is expected to take effect on or after 1 July 2017 and it will be administered by EDB.

3. Introduction of a Safe Harbor Rule for Tax Deductions of Payments Under Cost Sharing Agreements (CSAs) for R&D Projects

Taxpayers who incur R&D expenditures and are the beneficiaries of the R&D activities may claim R&D tax deductions. A taxpayer may undertake R&D work directly, outsource it to an R&D service provider or participate in an R&D cost sharing agreement.

The tax deductions for qualifying R&D expenditure under 14C of the Income Tax Act are subject to specific restriction rules for certain categories of expenses (such as R&D expenses made under a CSA). Therefore, taxpayers are required to breakdown the R&D expenses to exclude any disallowable expenditure, when claiming R&D tax benefits.

To ease compliance, a safe harbor rule has been introduced in Budget 2017 for tax deduction of R&D expenditures made under a CSA on and after 21st February 2017. Taxpayers making payments under a qualifying R&D CSA may elect to claim a tax deduction for 75% of such payments instead of examining and providing the cost breakdown covered by the CSA payments. Taxpayers who wish to claim a deduction for more than 75% of their payments made under an R&D CSA would still need to examine and provide the cost breakdown of their CSA payments.

The election for the safe harbor rule is to be made at the time of filing of the income tax return.

4. Extension of Existing Schemes

The following schemes will be extended:

- Withholding tax exemption on payments made to non-resident non-individuals for structured products offered by financial institutions due to end on 31st March 2017 will be extended to 31st March 2021.

- Tax incentive schemes for Project and Infrastructure Finance due to end on 31st March 2017 will be extended to 31st December 2022 (to the exception of the stamp duty remission).

- The Integrated Investment Allowance scheme due to end on 28th February 2017 will be extended to 31st December 2022.

Whereas, the PIC (Productivity and Innovation Credit scheme) has not been extended and will expire in 2018.

For further guidance, information and assistance please feel free to contact us anytime.

Luther LLP

Alexandre Gourdan, LL.M. (New York University)
Avocat au Barreau de Paris (France) / Attorney-at-law (New York)
Registered Foreign Lawyer Singapore
Accredited Tax Practitioner (Income Tax & GST) (Singapore)

Phone: +65 6408 8104
Mobile: +65 9772 6288

alexandre.gourdan@luther-lawfirm.com

Heike Riesselmann, German Certified Tax Advisor
Manager – International Tax Services

Phone: + 65 6408 8067
Mobile: +65 9489 0338

heike.riesselmann@luther-services.com

Copyright
These texts are protected by copyright. You may make use of the information contained herein with our written consent, if you do so accurately and cite us as the source. Please contact the editors in this regard.
Please contact the team for further information. All contact details can be found on our website www.luther-lawfirm.com
Disclaimer
Although every effort has been made to offer current and correct information, this publication has been prepared to give general guidance only. It will not be up-dated and cannot substitute individual legal and/or tax advice. This publication is distributed with the understanding that Luther, the editors and authors cannot be held responsible for the results of any actions taken on the basis of information contained herein or omitted, nor for any errors or omissions in this regard.

If you do not want to receive this newsletter in future, please send an e-mail to haslinda.hamid@luther-lawfirm.com