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Tax Alert

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Intevac Asia v Comptroller of Income Tax (CIT) [2020] SGHC 218

This is an appeal against the decision of the Income Tax Board of Review (ITBR) affirming the decision to disallow the taxpayer's claims for deductions on Research and Development (R&D) expenses incurred under a cost-sharing agreement.

Background

The taxpayer, Intevac Asia Pte Ltd, is a Singapore-incorporated company, and a subsidiary of Intevac, Inc. (Intevac US), a US-listed company. Both companies are engaged in the business of manufacturing, repairing and trading in electromechanical systems and equipment.

The taxpayer entered into a Research and Development Services Agreement (RDSA) with Intevac US on 1 October 2008; Intevac US would undertake R&D activities in the US for the benefit of the taxpayer.

The taxpayer and Intevac US subsequently entered into a Cost-Sharing Agreement (CSA) on 1 November 2009, which superseded the RDSA. The purpose of the CSA was to allow the companies to combine their R&D efforts and to share the costs and risks of R&D, where both companies would acquire the right to exploit any Intellectual Property (IP) and intangible property rights developed under the CSA.

Pursuant to the CSA, the taxpayer made payments to Intevac US in its financial years 2009 and 2010 and claimed tax deductions under Section 14D(1)(d) read together with Section 14D(3) for Years of Assessment (YAs) 2010 and 2011.

The Issue

The issue in dispute is whether the payments to the CSA qualify as a tax deduction under Section 14D(1)(d) and satisfy the requirement under Section 14D(3)(a) of the Singapore Income Tax Act (ITA or the Act). In particular, Section 19C, explicitly provides for the circumstances under which writing-down allowances can be made for CSAs for R&D activities approved by the Economic Development Board (EDB). It should be noted that in 2012, the Section 19C regime was discontinued and replaced by Sections 14D(1)(e) and (f), which provide for the deduction of payments under CSAs from the YA 2012 onwards.

Taxpayer's Basis

The taxpayer reasons that Section 14D(1)(d) can also apply to CSAs, as overlapping provisions are not uncommon within the ITA. The taxpayer also argues that Section 14D(3)(a) merely imposes a procedural requirement on the taxpayer to make an undertaking that it will obtain the benefit of the IP that it has paid for, if any.

CIT's Basis

The CIT took the view that relief for R&D expenses incurred under CSAs was governed exclusively by Section 19C until YA 2012, and the payments by the taxpayer to the CSA are not deductible under Section 14D of the Act.

Relevant Sections of the Act

The case discussed several sections of the Act, in particular the following sections:-

Section 14D(1) provides that "For the purpose of ascertaining the income of any person carrying on any trade or business and subject to subsection (4), the following expenditure incurred (other than any amount which is allowable as a deduction under section 14) by that person shall be allowed as a deduction:

(d) payments made by that person to a research and development organisation for undertaking on his behalf outside Singapore research and development related to that trade or business."

Section 14D(3) provides that "For the purposes of subsection (1)(d), a claim for deduction shall be allowed to a person only if —

(a) there is an undertaking by the person that any benefit which may arise from the conduct of the research and development shall accrue to the person; and

(b) the claim is made by the person in such manner and subject to such conditions as the Comptroller may require."

Section 19C(1) provides that "**Subject to this section**, where a person carrying on a trade or business has incurred expenditure under **any cost-sharing agreement** entered into and approved on or after 17th February 2006, in respect of research and development activities for the purposes of that trade or business (referred to in this section as the relevant trade or business), he shall, subject to such conditions as may be imposed by the Minister or such person as he may appoint, be entitled to a writing-down allowance of 100% of that expenditure in the year of assessment relating to the basis period in which that expenditure was incurred." [emphasis added]

Decision

The judge agreed with the ITBR's analysis that the right approach is to adopt the year 2008 as the reference point for ascertaining the ordinary meaning and legislative purpose of Section 14D(1)(d), when the provision was enacted.

He added that Section 14D(1)(b) of the 1980 ITA is not in pari materia with the current Section 14D(1)(d) even though both provisions share the phrase "for undertaking on his behalf". As the former applied to payments made to "approved" R&D organisations and the word "approved" is omitted in the latter, given the clear textual differences, the year 2008 should act as the reference point for ascertaining the ordinary meaning and legislative purpose of Section 14D(1)(d), when the provision was enacted.

The judge agreed with the counsel for the Comptroller that the phrase "for undertaking on his behalf" imports a concept of agency, and refers to arrangements where the taxpayer outsources the R&D to an organisation which undertakes R&D wholly and exclusively for the taxpayer's benefit.

With year 2008 as reference point, he held that of particular relevance is Section 19C of the ITA, which explicitly provides for the circumstances under which writing-down allowances can be made for approved CSAs for R&D activities. The Parliament intended to create a differentiated scheme for CSAs is evident from the fact that taxpayers had to satisfy a specific set of conditions to qualify for writing-down allowances under Section 19C. These conditions were not prerequisites to deduction under Section 14D(1)(d). Therefore, it could not have been the Parliament's intention to allow CSA expenditure to be claimed under Section 14D(1)(d), circumventing the conditions required under Section 19C.

In his view, the legislative framework created a clear demarcation between CSAs where the costs and benefits of undertaking R&D are to be shared amongst two or more parties, and arrangements in which the benefits of undertaking R&D accrue solely to the taxpayer. He concluded that Section 19C was specifically enacted to provide relief for CSAs payments, whilst Section 14D(1)(d) must refer to an arrangement where payments are made by the taxpayer to an organisation which has undertaken R&D outside Singapore for the exclusive benefit of the taxpayer only.

In view of the above, it was unnecessary to consider whether the taxpayer has satisfied Section 14D(3)(a) of the Act. Nevertheless, for completeness on the issue, the judge views that the interpretation of the word 'any' must mean 'all', and the word 'may' must mean that all benefit must accrue to the taxpayer.

In conclusion, the CSA payment made to Intevac US did not fall within the ambit of Section 14D(1)(d), and accordingly were not deductible under this section.

Our Comments

With the discontinuation of the Section 19C regime and enactment of Sections 14D(1)(e) and (f), CSA payments were henceforth allowed as a tax deduction (as well as enhanced tax deduction) instead of a writing down allowance from the YA 2012 onwards. Further, there was no longer a requirement to obtain approval from EDB for the CSA payments to be deductible.

Notwithstanding the above, the case highlighted important principles that would be relevant in variety of situations that involves interactions between the different sections of the Income Tax Act. In particular, when encountering such interactions, it is important to consider the intention of Parliament in enacting the relevant sections.

Other than the above, in view of the discontinuation of Section 19C, with regard to R&D activities, the case does not lend any significant guidance for taxpayers planning to undertake R&D activities and claim the enhanced tax deductions for the R&D expenditure to be incurred. It is nevertheless worth noting that with increasing need for collaboration in R&D and the benefit of the enhanced tax deductions under Section 14DA, taxpayers should take note of the circumstances under which CSA payments can be deductible. For example, certain payments related to a CSA (e.g. buy-in payments to participate in a CSA) would not be deductible, and there should be valid agreements in place to demonstrate how the taxpayer would benefit from the arrangement.

How we can help

KPMG would be able to assist with the analysis of the expenditure incurred for the R&D projects, including of any agreements with external parties, and provide our recommendations on the potential eligibility for the R&D enhanced tax deductions.

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