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Need to review R&D tax incentive scheme to boost innovation

Singapore will become one of the least attractive places in the world to undertake R&D with the expiry of the Productivity and Innovation Credit.

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With the advancements in technology, innovation in all industries will accelerate. Singapore has long foreseen the need to embrace innovation in all forms, but it is not alone in gearing up to be an innovative economy. Developed countries such as the United Kingdom, Australia and Ireland have long histories of promoting innovation. Closer to home, China has also made a strong focus and push towards innovation.

In its Global Innovation Index 2016, the World Intellectual Property Organisation (WIPO) says that innovation requires continual government investment. Key policy levers for governments to support innovation are a combination of direct subsidies and tax incentives (such as R&D credits).

The combination of direct subsidies (which are more targeted) and tax incentives (which are broad based) recognises that while certain types of innovation can be targeted, there is need for a broader policy to "let a hundred flowers bloom". Studies have shown that productivity and innovation capacity across all industries matter more than developing a few innovation champions, and a broad-based policy approach is therefore critical.

We offer another reason for broad-based policies: it is just impossible to predict new innovations that will come out next, so targeted measures risk missing out on the next big thing. Businesses, instead of policymakers, should therefore decide on the areas of innovation as they have better knowledge of market needs. These policies will not only enhance capabilities of domestic businesses, but also attract high value-adding Foreign Direct Investment (FDI).

Singapore offers a combination of targeted and broad-based policy tools to promote innovation. The broad-based policy tool is in the form of the research and development (R&D) tax incentive, which was later part of the Productivity and Innovation Credit (PIC). With the expiry of PIC in YA2018, the R&D tax incentive will continue, but with significantly reduced benefits and scope. There is an urgent need to review the R&D tax incentive.

The expiry date also means that some businesses will fall out of the PIC scheme as early as January 2017. When the PIC expires, Singapore's R&D tax incentive will lag behind other countries. The accompanying table compares Singapore's R&D tax incentive with other selected countries that are investing heavily in promoting innovation.

COUNTRY	TYPE OF INCENTIVE	BENEFITS (AS PERCENTAGE OF R&D EXPENDITURE) *	
		Large companies	SMEs
Canada	Tax credit	41.5%	61.5%
UK	Tax credit	31%	46%
Australia	Tax credit	38.5%	43.5%
Ireland	Tax credit	37.5%	37.5%
China	Enhanced deductions	37.5%	37.5%
Singapore	Enhanced deductions	25.5%	25.5%

** Benefits include tax deduction for R&D expenditure, calculated based on standard corporate tax rate of the respective countries.*

As the table shows, Singapore will become one of the least attractive places in the world to undertake R&D. For example, for S$100,000 of eligible R&D expenditure, Singapore companies will receive S$25,500 of tax savings, while the Ireland government will provide S$37,500 for the same amount of R&D expenditure. Previously, under the PIC scheme, Singapore companies could get tax savings of up to S$68,000.

Singapore has other subsidies available, including the Capability Development Grant, which tend to be project-specific and will not give incentives for continual innovation, which is critical for businesses' survival. Furthermore, the application process for grant support is a resource-intense process which slows down the developmental process of the R&D project in a fast-moving world.

Singapore also has some way to go when it comes to supporting smaller businesses. For example, if a startup company invests in R&D but has no profits in the early years, the benefit from the R&D tax incentive can be carried forward to future years but provides no immediate help.

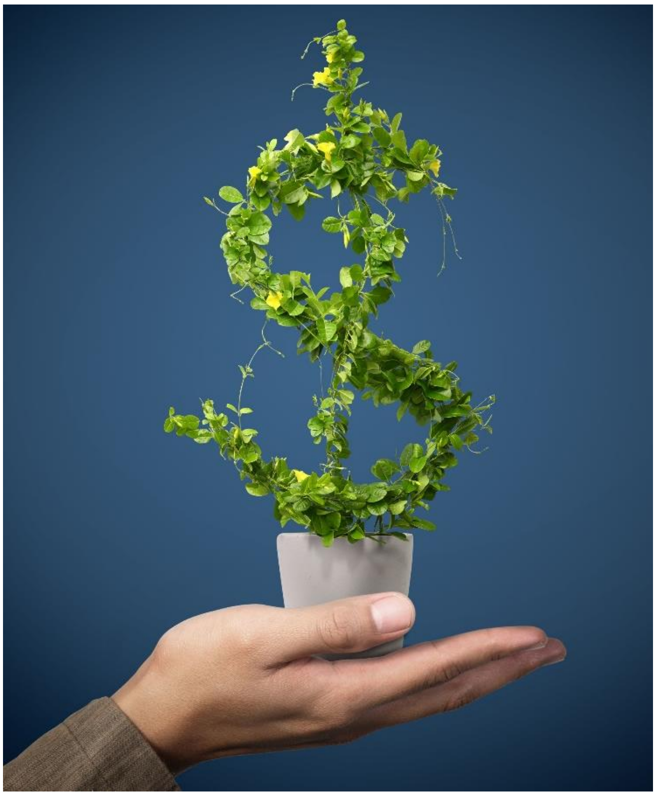
Small companies have shown that they can be highly innovative, and it is important to support these businesses that may not be seen as "winners" in the early stage which are being left out of the targeted schemes. Recognising this, other countries have introduced a "refundable tax credit" as part of the R&D tax incentive.

A refundable tax credit would provide a cash benefit or offsets against other government payments where a company is not profitable or has insufficient profits to absorb the benefits from the R&D tax incentive. Countries with refundable tax credits include UK, Ireland, Canada and Australia. The EU also recognises the importance of R&D tax incentives to support local entrepreneurship. Hence, while it does not allow member states to offer any form of state aids for businesses, R&D tax incentives are an exception. (State aid is defined as an advantage in any form that's selectively conferred by national public authorities.)

The Committee for Future Economy will release its report early next year. One of the key focus areas of the committee is how to help Singapore businesses prepare for the innovation economy.

Perhaps policymakers can take a hard look at our R&D tax incentive regime.

- Firstly, the current R&D tax incentive, which is given as a tax deduction, does not deliver equal benefits to all businesses. Smaller businesses pay lower effective tax rates, for example, due to tax exemptions for startups, and as such, may not receive the full benefits of the incentive. Some companies may also be subject to lower tax rates due to other incentives. The current incentive should therefore be replaced with an Innovation Tax Credit, so that the benefits are independent of the tax rate applicable to the company.
- Secondly, Singapore should increase the benefits under the R&D tax incentive to maintain our attractiveness. In addition, there should be higher benefits for SMEs as they need more support. Technology is lowering barriers to entry in many areas, more than at any other time in the past, providing opportunities for local entrepreneurship to thrive and grow. Helping SMEs innovate will help Singapore's next engine of growth.



- Thirdly, a refundable tax credit should be introduced to provide more relevant assistance for smaller companies, similar to what some other countries have done. This can be restricted to SMEs only. To address any potential for abuse, the claimants should be subject to higher scrutiny on their claims, similar to what countries like Australia and Canada do.

- Lastly, our policymakers should consider administering the new incentive under a central science body in the direction of the National Research Foundation (NRF) such as A*Star or the Economic Development Board. This gives NRF the opportunity to collate valuable information on technology development in Singapore and identify the needs of the companies undertaking R&D.

With rapid advancements in technology and the tsunami of digital disruption, being innovative is not an advantage but fairly essential for businesses. Countries around the world have identified innovation as the key engine of growth, and Singapore needs to ensure it does not fall behind in its support of businesses in their innovation drive.

With the Singapore economy at a critical juncture, it is timely to decisively enhance our R&D tax incentive scheme to let a "hundred flowers bloom".

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above matters to your business.

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