Tax Bulletin

High Court rules on tax treatment of expenses made under cost sharing arrangements

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The High Court of Singapore affirmed the decision of the Income Tax Board of Review[1] (ITBR) in *Intevac Asia Pte Ltd v Comptroller of Income Tax* [2020] SGHC 218, that the expenses incurred by the taxpayer in the basis period for Years of Assessment (YAs) 2010 and 2011 for research and development (R&D) activities under a cost sharing arrangement (CSA) are not deductible under section 14D of the Income Tax Act (the Act).

Prior to YA 2012, relief for expenses incurred on approved CSA for R&D activities was provided under section 19C of the Act. The section 19C regime was discontinued and replaced by section 14D of the Act from YA 2012 onwards. Hence, the High Court's decision is no longer relevant for CSA payments incurred in or after the basis period for YA 2012 as the legislation has since been amended.

Background

- The taxpayer is a Singapore company whose principal activities are to act as a service company for its ultimate holding company (Intevac US) in the manufacture, repair and trade in electromechanical systems and equipment.
- The taxpayer entered into a Research and Development Services Agreement (RDSA) with Intevac US on 1 October 2008. It was provided under the RDSA that Intevac US would undertake R&D activities in the US for the benefit of the taxpayer.
- The taxpayer and Intevac US later entered into a CSA on 1 November 2009, which superseded the RDSA. The purpose of the CSA was to allow the parties to combine their R&D efforts relating to technologies for the production of products, and to share the costs and risks of R&D for all such intellectual property (IP) rights, technology and other intangible property rights developed by either party pursuant to such R&D.
- Pursuant to the CSA, the taxpayer made payments to Intevac US during its financial years ended 31 December 2009 and 2010 and claimed deductions in its tax returns for YAs 2010 and 2011. Tax deductions were claimed pursuant to Section 14D(1)(d) of the Act. It should be noted that section 14D(1)(e) and (f) had not yet been enacted at the time.
- The Comptroller of Income Tax disallowed the deductions. The appeal to the Income Tax Board of Review was dismissed, and the taxpayer further appealed to the High Court of Singapore.

The legislative provisions in question

The provisions being considered are as follows:

Section 14D

[1] *GCJ v Comptroller of Income Tax* [2020] SGITBR 2

(1) 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;*

…

(3) For the purposes of subsection (1)(ba) or (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....*

High Court's purposive interpretation of these provisions

The judge agreed with the ITBR's analysis that the appropriate timeframe to discern the ordinary meaning and legislative intent of section 14D(1)(d) is 2008, when the provision was enacted. He added that the 1980 version of section 14D, where the expression 'for undertaking on his behalf' was also used, is not in *pari materia* with the section 14(1)(d) under consideration, as the former applied to payments made to 'approved' R&D organisations and the word 'approved' is omitted from the latter provision. He accepted that the legislative history of section 14D is relevant but only to the extent it informs the understanding of Parliament's intention in enacting section 14D(1)(d) in 2008. He noted, however, that legislative amendments after the enactment of section 14D(1)(d) are irrelevant in ascertaining the purpose of that provision.

'for undertaking on his behalf'

He agreed with counsel for the Comptroller that the phrase '*for undertaking on his behalf*' under section 14D(1)(d) imports a concept of agency. Hence, it must refer to an arrangement where payments are made by the taxpayer to an organisation which has undertaken R&D for the exclusive benefit of the taxpayer.

Section 19C enacted to create a different scheme

Having considered the extrinsic materials accompanying the introduction of the law, the judge held that it was the Legislature's intention to create a differentiated scheme for CSA when section 19C of the Act was enacted in 1993. This is because taxpayers must satisfy a specific set of conditions under section 19C in order to qualify for the writing down allowance. He explained that it could not have been Parliament's intention to allow taxpayers to claim the same expenses under section 14D whilst circumventing the conditions required under section 19C. As such, it was his view that the legislative framework created a clear demarcation between CSAs where the costs and benefits are shared among the parties to a CSA, and arrangements where the benefits of undertaking R&D accrue solely to the party that appoints the R&D organisation to undertake the work. He concluded that relief for payments under the former was governed exclusively by section 19C, whereas relief for the latter was governed exclusively by section 14D and its related provisions.

Consequently, the judge held that the payments to Intevac US did not fall within the ambit of section 14D(1)(d) as the arrangement involved the pooling of resources to undertake R&D for the joint benefit of the parties.

"any benefit which may arise from the conduct of the [R&D] shall accrue to the [taxpayer]"

In view of the above, it was not necessary to consider the operation of section 14D(3)(a) referred to above. Nonetheless, for completeness the judge noted that given the distinction of the section 14D and section 19C regimes, the interpretation of the word '*any*' in section 14D(3)(a) must mean 'all', and the word '*may*' must mean that the benefit - however slight - must accrue to the taxpayer.

PwC's comments

From a policy perspective, it would not be desirable if legislation on tax concessions is interpreted in a way that would result in the State subsidising private costs without requiring some commensurate economic benefits to the country - such an approach would lead to the risk of revenue leakage and that could not have been the outcome intended by Parliament.

Tax rules can be complex and changes are often made over time to cater for evolving economic (and social) goals. Knowing the context in which they were introduced is invariably helpful to understanding their intended operation. Although the law has since been amended and CSA payments may now be deductible under section 14D of the Act, this High Court decision is still useful in illustrating how a purposive interpretation is to be applied, particularly on the relevant timeframe to discern the meaning of the legislative intent and the use of extrinsic materials to evidence this intent.

For a deeper discussion of how the above might affect your business, please feel free to contact:

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