IP Income and Tax Incentives in Singapore

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Introduction

As of May 2018, Singapore has excluded intellectual property (IP) income from the Pioneer Service Incentive (PC-S) and the Development and Expansion Incentive (DEI), both of which are awarded by the Economic Development Board (EDB) to companies investing in Singapore.

This is a result of the recent changes under the Economic Expansion Incentives (Relief from Income Tax) (Amendment) Act 2018 (Amendment Act) and the Economic Expansion Incentives (Relief from Income Tax) (Intellectual Property Income) Regulations 2018 (Regulations).

These changes are part of a broader international effort to address concerns around tax planning practices that may lead to base erosion and profit sharing (BEPS). They not only demonstrate Singapore's commitment to fostering a conducive business environment in line with global tax trends, but may also incentivise companies with IP holdings in Singapore to shift more substantial business activities to Singapore.

Background on IP Income Exclusions

IP is frequently used in the tax planning of multinational corporations (MNCs) because it is mobile and valuable. With its favourable tax environment and robust business infrastructure, Singapore has proven to be an attractive destination for MNCs to house their IP. However, in recent years, there have been concerns that such practices, amongst others, give rise to opportunities for base erosion and profit shifting (BEPS).

Put simply, BEPS occurs when there is a mismatch between where profits are booked and where profits are generated, leading to a reduction of taxable base for certain countries. As such, certain practices of global tax planning, such as IP holding, have since faced greater scrutiny. Most notably, in 2013, the OECD and G20 countries have adopted a 15-point Action Plan to address BEPS (BEPS Action Plan). Singapore has accordingly committed to making amendments to its tax regime.

The BEPS Action Plan identified 15 actions along three key pillars, with the overarching goal of "aligning taxation with value creation". It involves changes to both domestic law and practice, and international treaty provisions. The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI) in 2017 is one key milestone of the BEPS Action Plan. With MLI, signatories can modify their existing double tax agreements (DTAs) to implement the BEPS minimum standards and other tax treaty measures. Singapore was one of the 67 countries which signed the MLI.

Changes to Singapore's Approach to Taxing IP

Income

On the international front, Singapore has thus far taken a cautious approach – making provisional commitments to adopt certain provisions, while reserving the right to not adopt others. Potential modifications to Singapore's DTAs may affect when Singapore taxes profits arising within its territory. Companies therefore need to keep up with upcoming changes to Singapore's DTAs and domestic laws, as they will affect tax planning.

Singapore is also reforming the current tax incentives pertaining to IP income. As mentioned, the new legislation excluding IP income from PC-S and DEI has taken effect. The Regulations consider royalties or other income to be received as IP income if they are receivable as consideration for the commercial exploitation of the IP right.

Transitional Provisions

As there are a large number of companies which have obtained existing tax incentives which grant concessionary tax rates for IP income, the new legislation includes transitional provisions for such companies.

Companies whose PC-S or DEI is approved or extended on or after 1 July 2018 would cease to enjoy the concessionary tax rate for its IP income from the date of the approval or extension onwards. For companies whose PC-S or DEI was approved before 1 July 2018, the transitional provisions would apply in the interim period from 1 July 2018 to 30 June 2021. Transitional treatment would depend on whether the income is derived from "New IP Rights" or "Existing IP Rights".

Existing IP Rights are those acquired before 1 July 2018 and are not a right under sub-section (b) of the following definition of New IP Right. New IP Right refers to:

a. IP that comes into the ownership of the company on or after 1 July 2018; or
b. IP acquired from related parties after 16 October 2017 but before 1 July 2018 where the main purpose or one of the main purposes of the IP acquisition is to avoid income tax in Singapore or elsewhere.

IP income derived from Existing IP Rights will be grandfathered and subject to the concessionary tax rate under the existing PC-S or DEI until 30 June 2021, while IP income derived from New IP Rights will not be.

Companies seeking to take advantage of the transitional provisions would need to track their IP income derived from Existing IP Rights and New IP Rights. The Regulations provide some guidelines as to how the tracking should be done.

The Amendment Act also gives the Minister power under the Economic Expansion Incentives (Relief from Income Tax) Act to amend the concessionary tax rates of companies that have been granted the DEI. The Minister can exercise such discretion on his own initiative or on application by the company.

IP Development Incentive

In place of these incentives, the IP Development Incentive (IDI) has been proposed in Budget 2017. It is expected to incorporate the modified nexus approach, which is essentially a substance-based test, and should therefore comply with the BEPS Action Plan. It is hoped that further details will be released soon.

Conclusion

As a small and open economy, Singapore has earned a reputation for being business-friendly. Committing to comply with the BEPS Action Plan is not only an act of international comity, but one which opens up new opportunities for the economy. In light of the changes in the global tax environment, it is likely that MNCs will take greater advantage of Singapore's conducive business environment and shift more substantial business activities here, in order to comply with the BEPS Action Plan, and to qualify for tax incentives.

If you are interested in understanding how these changes would affect your tax planning, please feel free to reach out to us.

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