SAICA
THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS
develop.influence.lead.

Ref #:773661

Submission File

7 November 2022

National Treasury
Private Bag
X115
Pretoria
0001

South African Revenue Service
Private Bag X923
Pretoria
0001

BY E-MAIL: 2022AnnexCProp@Treasury.gov.za
TaxIncentiveReviews@Treasury.gov.za
acollins@sars.gov.za

Dear National Treasury and SARS

COMMENTS ON THE DRAFT REFINEMENTS TO THE RESEARCH AND DEVELOPMENT INCENTIVE (SECTION 11D)

1. The South African Institute of Chartered Accountants (SAICA) welcomes the opportunity to make a submission to the South African Revenue Service (SARS) on the draft refinements to the research and development (R&D) tax incentive (in terms of section 11D of the Income Tax Act) for potential inclusion in the 2023 Budget and draft 2023 Taxation Laws Amendment Bill for public comment

2. We set out below our general and specific comments in this regard.

COMMENTS – GENERAL

3. A 2019 article by Mariana Mazzucato1 articulates Innovation (funded by research) drives value creation and consequently the creation of wealth for a country and its citizens. She also states that the real driver of innovation isn't lone geniuses but state investment. She sets out the importance of the role of governments over the last 100 years in either the direct creation of innovation or through indirect means by funding innovation that did not meet the corporate risk appetite.

4. She looked deeper into the early history of some of the world's most innovative companies and found that the development of Google's search algorithm, for instance, had been

[1] https://www.wired.co.uk/article/mariana-mazzucato

NPO-020-050 VAT No. 4570104366
17 Fricker Road, Illovo, Sandton, Johannesburg, 2196 POSTAL ADDRESS Private Bag X32, Northlands, 2116
TEL +27 11 621 6600 FAX +27 11 622 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za
WEB saica.co.za | accountancysa.org.za

supported by a grant from the National Science Foundation, a US public grant-awarding body. Electric car company Tesla initially struggled to secure investment until it received a $465 million loan from the US Department of Energy. In fact, three companies founded by Elon Musk — Tesla, SolarCity and SpaceX — had jointly benefited from nearly $4.9 billion in public support of various kinds. Many other well-known US start-ups had been funded by the Small Business Innovation Research programme, a public venture capital fund. “It wasn’t just early research, it was also applied research, early stage finance, strategic procurement,” she says. “The more I looked, the more I realised: state investment is everywhere.”

5. It is thus important to consider the government’s role in driving innovation as part of budgeted expenditure. As Mazzucato concludes: “History tells us that innovation is an outcome of a massive collective effort – not just from a narrow group of young white men in California,” She continues: “And if we want to solve the world’s biggest problems, we better understand that.”

6. Submission: Overall, we are pleased with the proposed amendments and the extension of the R&D incentive for a further 10 years. This extension is excellent for business certainty and we believe it will encourage more applications and possibly encourage business to set up R&D hubs in South Africa.

7. Policy consistency is fundamental to any incentive being able to operate effectively.

8. The R&D incentive has unfortunately been one of the incentives that has been prone to constant “tinkering”. Unfortunately, these changes are not always due to anti avoidance or abuse but rather lack of clarity of what government wants to incentivise or achieve.

9. Treasury have seemingly always applied the approach of narrow entry and broaden over time.

10. However, this approach does not consider that businesses take decisions at a point in time and each time a particular incentive is not available at a given point in time, the less businesses will be able to take business decisions based on it and invariably invest elsewhere where the incentive was material.

11. Though we accept that nothing is cast in stone forever, constant changes seldom imbue confidence.

12. Submission: The R&D incentive has been around for quite some time. We hope that Treasury and SARS have been able to refine both their policy intent and operational procedures sufficiently to avoid constant changes.

COMMENTS – SPECIFIC

Section 11D(1) – Definition of R&D: Test by professional in the field

13. Section 11D(1) sets out a definition for “research and development” that determines eligibility for the R&D tax incentive. The definition contains a purpose test that requires not only an understanding of the concept of R&D, but also an understanding of various

NPO-020-050 VAT No. 4570104366
17 Fricker Road, Illovo, Sandton, Johannesburg, 2196 POSTAL ADDRESS Private Bag X32, Northlands, 2116
TEL +27 11 621 6600 FAX +27 11 622 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za
WEB saica.co.za | accountancysa.org.za

intellectual property statutes and the associated intellectual property characteristics, such as novelty and non-obviousness. In addition to this, several of the purposes focus on the end result of the R&D, which is difficult for taxpayers to explain or prove upfront and equally difficult for the adjudication committee to evaluate. This stands in contrast to the approach taken by many other countries in the design of their R&D tax incentives.

14. The 2002 Frascati Manual explicitly refers to a person skilled in the art (someone familiar with the basic stock of common knowledge). This criterion is implied in the most recent Frascati Manual. To ensure this is explicit in the legislation and to ensure that R&D activities are non-obvious or inventive to qualify for the R&D tax incentive, it is proposed that the revised definition should include the test of whether a professional in the field with appropriate knowledge and skills, and having access to publicly available information, would resolve that scientific or technological uncertainty without undertaking any R&D activities (i.e. systematic investigative or systematic experimental activities).

15. Submission: It is our understanding that this test is already applied in determining whether something would qualify, both by the taxpayer and the Department of Science and Innovation (DSI). This test is applied through the adjunction committee, so we do not understand the benefit of adding it to the definition of R&D. This may create the impression that there could be a redetermination of this amount by a SARS assessor.

16. Clarity is also sought as to the interaction between section 11D(9), which provides that the Minister of Higher Education, Science and Innovation must approve any R&D being carried out, and this proposed amendment.

Section 11D(1)(a) – Definition of R&D: "Non-obvious" versus "new"

17. The discussion paper has suggested that the "non-obvious" requirement for scientific or technological knowledge in section 11D(1)(a) should be replaced with "new" in line with the proposal that a test for non-obviousness be included in the definition (to ensure that research and development does not include an activity if knowledge to resolve the scientific or technological uncertainty is deducible by a person skilled in the relevant scientific or technological field, having regard to information that is publicly available to such professional).

18. Submission: The change from "non-obvious" to "new" requires clarity, although we believe the meaning of "new" is that it must be something that does not yet exist. It is recommended that a clear and unambiguous definition of the term "new" be provided in the legislation.

Section 11D(1)(b) proviso – Internal business processes

19. The discussion paper proposes that the part of the exclusion for internal business processes relating to the for-sale requirement and granting of right/use to a non-connected party be deleted, so that the activities are measured against the requirements set out in the definition of R&D, rather than whether they are intended for sale/licensing or not.

NPO-020-050 VAT No. 4570104366
17 Fricker Road, Illovo, Sandton, Johannesburg, 2196 POSTAL ADDRESS Private Bag X32, Northlands, 2116
TEL +27 11 621 6600 FAX +27 11 622 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za
WEB saica.co.za | accountancysa.org.za
Member of the International Federation of Accountants (IFAC), Pan African Federation of Accountants (PAFA), Global Accounting Alliance (GAA), Chartered Accountants Worldwide (CAW) and Investors in People.
Proudly South African

20. An exclusion will remain for management and administrative business process to ensure clarity that these types of activities are not eligible for this incentive.

21. Submission: The softening of the internal business process exclusion is appreciated but remains ambiguous. It is inconceivable how any business process would not have some form of management or administrative process attached to it. The proposed change would mean that all internal processes would be tainted.

22. Ideally, the exclusion for internal business processes should be removed, as it is difficult to interpret (what falls in and what does not).

23. However, if the exclusion is to remain, a definition of "management" and "administrative" would be necessary to ensure appropriate interpretation of what is covered by these terms.

Section 11D(1)(i) proviso – Agrochemical products exclusion

24. It is proposed to specifically exclude research activities undertaken solely in preparation for the registration of products as required by the Department of Agriculture, Land Reform and Rural Development (DALRRD) from the incentive.

25. Submission: The exclusion of the testing of agrochemical products done purely for the registration of such products is understood but quite narrow.

26. Testing for product registration would not qualify as R&D so it is unclear why there is a specific exclusion for agrochemicals. The question that thus arises is 'Why specifically agrochemical products?' That is, what makes testing for purposes of registration for agrochemicals different from any other products?

27. Clarity on this would be appreciated.

Effective date of amendments

28. The proposed amendments will come into effect on 1 January 2024 and will apply in respect of amounts incurred on or after that date.

29. When initially reading the proposed amendments, it appears as if everything is to be back-dated to when the R&D incentive was introduced, which is understood not to be the case.

30. Submission: The draft legislation should be clear that the amendments are forward-looking (other than the new sunset date).

SARS Interpretation Note and DSI Guidelines

31. Submission: An updated SARS interpretation note and DSI guidelines are critical for proper understanding of the changes, but the National Treasury document does not mention anything in this regard.

International Federation of Accountants
NPO-020-050 VAT No. 4570104366
17 Fricker Road, Illovo, Sandton, Johannesburg, 2196 POSTAL ADDRESS Private Bag X32, Northlands, 2116
TEL +27 11 621 6600 FAX +27 11 622 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za
WEB saica.co.za | accountancysa.org.za
Member of the International Federation of Accountants (IFAC), Pan African Federation of Accountants (PAFA), Global Accounting Alliance (GAA), Chartered Accountants Worldwide (CAW) and Investors in People.
Proudly South African
Chartered Accountants Worldwide Member

32. It is recommended that an updated interpretation note and DSI guidelines be issued in conjunction with the amended legislation.

Should you wish to clarify any of the above matters please do not hesitate to contact us.

Yours sincerely

Pieter Faber
Executive: Tax

Dr Sharon Smulders
Project Director: Tax Advocacy

The South African Institute of Chartered Accountants

NPO-020-050 VAT No. 4570104366
17 Fricker Road, Illovo, Sandton, Johannesburg, 2196 POSTAL ADDRESS Private Bag X32, Northlands, 2116
TEL +27 11 621 6600 FAX +27 11 622 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za
WEB saica.co.za | accountancysa.org.za