

## MAURITIUS REVENUE AUTHORITY

### STATEMENT OF PRACTICE (SP 20/20)

### DEDUCTION FOR RESEARCH AND DEVELOPMENT

*(section 161A(55) of the Income Tax Act)*

#### 1.0 Objective

This Statement of Practice is intended to clarify, for the purpose of section 161A(55) of the Income Tax Act, certain terms used in the definition of qualifying expenditure such as “research and development”, “innovation”, or “improvement” and thereby shed light on the type of expenditure that would qualify for the tax deduction. While the objective of this Statement of Practice is to promote certainty and predictability by providing useful information to companies self-assessing their research and development (“R&D”) activities, it cannot cover every situation and is limited to general advice guidance only.

#### 2.0 Introduction

The Finance (Miscellaneous Provisions) Act 2017 introduced a new deduction under section 161A(55) of the Income Tax to incentivize businesses to perform research and development (R&D). Under this scheme, a person incurring expenditure on qualified research and development, in direct relation to its existing trade or business, is entitled to a double deduction (i.e. an additional 100%) of the amount of expenditure incurred, only if the research and development is carried out in Mauritius.

However, if the qualifying expenditure incurred is not directly related to the existing trade or business of the person, then the person is allowed a deduction of 100%.

In both cases, the deduction of the expenditure claimed must be in the income year in which the expenditure is incurred.

#### 3.0 Relevant period

The deduction will apply in respect of qualifying expenditure incurred during the period 1 July 2017 to 30 June 2022.

#### 4.0 Relevant provisions of the law

##### *Section 161A(55)*

- (a) Where, during period 1 July 2017 to 30 June 2022, a person has incurred any qualifying expenditure directly related to his existing trade or business, he may, in the income year in which the qualifying expenditure was incurred, deduct twice the*

*amount of the expenditure, provided the research and development is carried out in Mauritius and no deduction has been claimed under Section 24.*

(b) *Notwithstanding Section 18, where, during the period 1 July 2017 to 30 June 2022, a person has incurred qualifying expenditure which is not directly related to his existing trade or business, the Director-General allow a deduction of the expenditure in the income year in which the expenditure was incurred.*

(c) *In this subsection-*

*“Qualifying expenditure” –*

- (a) *means any expenditure relating to research and development and*
- (b) *includes –*
  - (i) *expenditure incurred on innovation, improvement on development of a process, product or service;*
  - (ii) *staff costs, consumable items, computer software directly used in research and development and subcontracted research and development.*

## 5.0 Definitions

The terms “research and development” (R&D), “innovation” or “improvement” are not defined in the Income Tax Act and, although certain of the sources cited below are not authoritative or binding, guidance may be sought from, *inter alia*:

- The Oxford Dictionary;
- The International Tax Glossary published by the International Bureau of Fiscal Documentation (IBFD);
- The Mauritius Research and Innovation Council (MRIC) Act;
- International Accounting Standard (IAS 38); and
- The Frascati Manual issued by the OECD in 2015

### The Oxford Dictionary

**R&D** is defined “(in industry etc.) as work directed towards the innovation, introduction, and improvement of products and processes” (underlining ours)

**Innovative** is defined as “featuring new methods; advanced and original.” (underlining ours)

**Improvement** is defined as “something that improves ...on” that is “achieve or produce something better than”.

### IBFD

**R&D** is defined as “any systematic or intensive study carried out in the manufacturing and industrial fields, the results of which are to be used for the production or improvement of products and processes. As a general proposition, R&D only extends from the laboratory or drawing board to prototype status, i.e so long as an activity still contains an element of uncertainty/technical risk it is within the realm of R&D.” (underlining ours)

## **Mauritius Research and Innovation Council Act**

**Research and development** is defined as “systematic, investigative and experimental activities which involve innovation and are carried out, wholly or partly, within Mauritius for the purpose of creating new or improved materials, products, devices, processes or services” (underlining ours)

**Innovation** is defined as

- (a) radical and incremental changes to a product, process or service; and
- (b) includes the implementation of –
  - (i) a new or significantly improved product, process or service;
  - (ii) a new marketing method or a new organisational method in business practices, workplace organisation or external relations” (underlining ours)

## **International Accounting Standard (IAS 38)**

In IAS 38, research is defined as “original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding” and development is “the application of the research findings or other knowledge to plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use”. (underlining ours)

## **Frascati Manual**

Basic research is defined as theoretical or experimental work done to advance scientific knowledge without specific practical application or use in mind;

Applied research is defined as original investigation undertaken to advance scientific knowledge with a specific practical application in mind; and

Experimental development is defined as systematic work on knowledge gain on research to achieve technological advancement for the purpose of creating new or significantly improving (including incremental improvements) existing materials, devices, product or processes.

## **6.0 Projects / activities qualifying as R&D**

Projects and/or activities may be deemed to qualify as R&D where they satisfy the following conditions:

- the projects / activities should be systematic, investigative and experimental;
- the projects / activities should involve novelty or technical risk; and
- the objectives of the projects / activities should be the creation of new or improved materials, products, devices, processes or services.

### **6.1 Systematic, investigative and experimental (SIE) study**

A SIE study refers to a series of planned activities to test or find out something that is not known or readily deducible in the appropriate field prior to the commencement of the study. It comprises all of the following characteristics:

- (a) **Systematic**
  - A planned and orderly approach of the activities to be undertaken in this study.

- Proper documentation of activities undertaken such that another person in the same field can reproduce the results by following the same procedures.

**(b) *Investigative***

Activities / enquiries undertaken to:

- Unearth secret, hidden or obscure information for a better understanding of the problem; and
- find out how to close the gap between the desired outcome and the state of scientific, technical or other knowledge prior to the commencement of the study.

**(c) *Experimental***

- A series of structured steps undertaken to test the potential solution for solving a technical problem or creating something new.
- Iterative process is often needed as outcome is unknown and results from each round of testing would provide new knowledge.

In short, a SIE study is undertaken to test a potential solution, to generate new knowledge to overcome the unknown. If there are publicly known ways to overcome the challenges, then it is unlikely that the study will qualify as a SIE study.

## **6.2 Novelty**

Novelty exists where there is something new in relation to the creation or improvement of products, processes or knowledge. New knowledge (and its use) is expected to be the outcome of R&D, therefore the nature of innovation considered for the purpose of the R&D tax incentives must contain some degree of novelty.

Where a product, process or knowledge is already available outside Mauritius, the mere importation of that product, process or knowledge into Mauritius without undertaking a SIE study, would not qualify as R&D.

On the other hand, if the project involves SIE and is aimed at resolving scientific or technological uncertainty, the project may still be eligible under the ‘‘Technical Risk’’ requirement as explained in the following paragraphs.

## **6.3 Technical risk**

A project involves technical risk if there is scientific or technological uncertainty that cannot be resolved by a competent professional based on current knowledge in the relevant field of science or technology at the time of commencing R&D activities.

## **6.4 Improvement**

Qualifying expenditure includes improvement and the improvement referred to here should not only be innovative, but it should also be extensive or important enough to merit attention.

## **6.5 Staff Costs**

Staff costs means any salary, wages and other benefits paid or granted in respect of employment (excluding director's fees), whether in money or money's worth, to any employee for carrying out R&D activities.

The costs include training and certification costs in areas of specialisation relevant to a qualifying R&D activity and/or project, as well as airfare and per diem incurred to sponsor an employee to attend relevant overseas training.

Where a staff member does not engage in qualifying R&D activities and/or projects on a full time basis, only that part of the staff costs attributable to the time spent by the staff on the qualifying R&D projects and/or activities, is eligible for the deduction under section 161(55) of the Income Tax Act.

## **6.6 Consumables**

Consumables mean any material or item used in an R&D activity and/or project which upon such use, is consumed or transformed in such manner that it is no longer useable in its original form. Examples of consumables are:

- a laboratory chemical which is used up or converted into an unusable product in an R&D process.
- an electronic component that is integrated into a prototype and is no longer available for use for another purpose.

The term does not include items of expenditure such as utilities, rent and other overheads which may be incurred directly or indirectly in connection with the R&D activity.

## **7.0 Taxpayer conducting R&D activities on behalf of the other companies**

Qualifying expenditure also includes expenditure incurred on subcontracted research and development. A taxpayer will not be entitled to a deduction under this section when the product of that taxpayer's R&D activities and/or projects is developed on behalf of someone else, since the person on whose behalf the R&D activities and/or projects are being conducted, will be able to claim the deduction under section 161A(55) of the Income Tax Act, subject to meeting all the other criteria.

## **8.0 Taxpayers' obligations to maintain adequate and proper documentation**

The onus is on the taxpayer to demonstrate the innovative nature of the research and development undertaken and the significant improvement made. Adequate and proper documentation of all R&D projects and/or activities should therefore be maintained to substantiate the R&D claims to MRA when requested. The taxpayer should keep contemporaneous documentation from the start of the R&D project and/or activity, rather than as an after-event as he will be expected to show that current knowledge was not available at the time R&D was performed.

Whilst the precise records kept will vary, a taxpayer's records must be sufficient to show that the claimed R&D activities and/or projects took place and that they meet all aspects of the definition for R&D as highlighted in Paragraph 6 above.

## 9.0 **Exclusions**

Research and development should be distinguished from routine improvements. The R&D extra deduction is not intended to apply to improvements of products and processes that are in any event incurred in the ordinary course of the persons trade. Thus, an activity will **not** qualify for R&D if it falls within the list of activities stated below:

- (a) Complying with statutory requirements or standards including one or more of the following:
  - (i) routine testing, analysis, collection of data or information or quality control in the normal course of business;
  - (ii) maintaining national standards; or
  - (iii) calibrating secondary standards.
- (b) development of internal business processes (e.g. development of websites, internet sales system, software packages developed for administration, human resources or accounting purposes) unless those internal business processes are mainly intended for sale or for granting the use or right of use or permission to use thereof to persons who are not connected persons in relation to the person carrying on that research and development;
- (c) market research, market testing and development or sales promotion;
- (d) oil and gas or mineral exploration or prospecting except research and development carried on to develop innovative technology used for that exploration or prospecting;
- (e) the creation or development of financial instruments or financial products;
- (f) the creation or enhancement of trademarks or goodwill;
- (g) management studies or efficiency surveys;
- (h) research into social sciences, arts or humanities;
- (i) patenting, licensing or other activities;
- (j) reproduction of a commercial product or process;
- (k) software development for use in internal administration;
- (l) modifications including routine modifications, stylistic or changes to materials, devices, products, processes or production methods; or
- (m) activities conducted outside Mauritius even if funded from within Mauritius, are not eligible for the deduction under Section 161A(55).

## 10.0 **Expenditure not qualifying under Section 161A(55) of the Income Tax Act**

Where a project does not meet the requirement for the R&D tax deduction under section 161A(55) of the Income Tax Act, the relevant expenses may still qualify for normal tax deduction, subject to the tax deduction rules under sections 18 and 26 of the Income Tax Act.

## **11.0 Conclusion**

The information contained in this Statement of Practice provides broad principles for the application of the statutory provisions pertaining to the deduction for R&D.

The deduction of the 200% is subject to the requirements of section 161A(55) of the Income Tax Act. The onus is on the taxpayer to prove to the MRA that it complies with the requirements of the said section.

**Mauritius Revenue Authority**

**15 June 2020**