The Future of the S11D Research & Development Tax Incentive in South Africa

Feedback from a recent workshop with the Department of Science & Innovation

On Thursday the 7th of April, the Department of Science and Innovation (DSI) and the National Treasury (NT) hosted a workshop to provide industry and other stakeholders with feedback based on their own analysis and submissions made to date by business on the Section 11D R&D Tax Incentive. It had been announced in this year's Budget Speech that this tax incentive would continue in its current form until December 2023, so these sessions were to discuss the changes from 2024 onwards.

We have summarised the key points discussed and added some of our insights on the matters that were discussed.

State of the R&D incentive

- Both the DSI and NT agree that the R&D tax incentive is important and has to be maintained in South Africa.
- However, there has been a downturn in South African R&D investment and this has pushed South Africa further away from its 1.5% target ratio of R&D investment to GDP.
- Government support for business R&D in South Africa is 14 times lower than the OECD average. This is a real concern for a country that is aiming to be involved in the 4IR. We believe that drastic changes are required to increase R&D investment.
- Has the incentive increased R&D spending? Local evidence has revealed that for every R1 tax revenue foregone, there is an additional R&D spend of R1.83.
- Except for a few cases, the application backlog has been resolved within the DSI.

Potential areas of change

- Based on the feedback provided by the DSI, the R&D tax benefit rate is one area that is unlikely to change due to the current constraints on the fiscus. However, we believe that this alone could be the single biggest factor in accelerating investment in R&D expenditure. The DSI's anticipated increased marketing efforts or introducing a new online application portal alone will not result in accelerated uptake of the R&D incentive.
- The DSI has taken a firm stance in maintaining the pre-approval application process and this is expected to form part of the future design of the R&D tax incentive.
    - Currently, applicants can only claim the R&D incentive from the date of approval of an R&D application.
    - At the onset of any R&D project, it is difficult to give a full picture of the activities and uncertainties of any project. You would first need to have actually undertaken some of the R&D activities.

    - The DSI understands this is a challenge for some companies, and is exploring the potential to introduce a window to allow companies to claim for expenditure on some activities that are undertaken before the submission date of an application.
    - The rationale for expanding the window is that it may allow applicants to better understand their R&D activities before they need to submit their application, thus allowing them to potentially claim for activities prior to submission.
- Alterations to the definition of the R&D tax incentive are also being considered. In particular, these cover intellectual property (IP) requirements and the constraints derived from the word “innovation”. No conclusion on any alterations to the definition was reached.
- Furthermore, the DSI welcomes inputs from industry on those activities relating to software development that could potentially be classed as R&D activities. Specifically, written examples of innovation in software development were requested from all stakeholders.

EY Cova recommendations

- It is now clear that the S11D incentive will continue beyond 2024, so business does need to ensure it submits applications that will cover activities after 2024.
- Ideas for amending the R&D tax incentive are currently under consideration, and we encourage all companies to provide inputs on changes that they would like to see in the next iteration of the R&D tax incentive.
- We recommend to the NT and the DSI that the S11D incentive needs to be more generous, to radically increase SA business investment in R&D and the consequent GDP increase.

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