



RESEARCH AND DEVELOPMENT TAX INCENTIVE PROGRAMME

Report to Parliament

2015/16



science
& technology

Department:
Science and Technology
REPUBLIC OF SOUTH AFRICA



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ACRONYMS

FEB	February
DST	Department of Science and Technology
EC	Eastern Cape
FS	Free State
GDP	Gross Domestic Product
GT	Gauteng
ICT	Information and Communication Technology
IPAP	Industrial Policy Action Plan
ITA	Income Tax Act
KZN	KwaZulu-Natal
LP	Limpopo



MP	Mpumalanga
NC	Northern Cape
NOV	November
NW	North West
OCT	October
R&D	Research and Development
SARS	South African Revenue Service
SIC	Standard Industrial Classification
SMEs	Small and Medium Enterprises
TLAA	Taxation Laws Amendment Act
WC	Western Cape



FOREWORD



The Research and Development (R&D) Tax Incentive programme is aimed at promoting private sector R&D investment in the country. R&D is required in order to advance innovation, especially through the development of new products and processes, as well as improving existing ones. Section 11D of the Income Tax Act, 1962 (Act No. 58 of 1962), as amended, under which the R&D Tax Incentive programme is offered, requires the Minister and the Department of Science and Technology (DST) to report annually to Parliament and stakeholders in general on the performance of this programme.

The publication of the Annual Report is intended not only to highlight the progress made in the implementation of the programme, but also to allow transparency by making data and facts available in relation to the lessons learnt in the implementation of the incentive for stakeholders to assess for themselves. This Annual Report provides evidence regarding the number of companies participating in the R&D Tax Incentive, the number of applications processed, participation in terms of company size and economic sector, R&D expenditure, information on tax revenue forgone, R&D personnel involved and contribution to the Industrial Policy Action Plan (IPAP) priority areas.

In 2015, I established a joint government-industry task team to make recommendations on possible improvements to the administration of the R&D Tax Incentive. This process was valuable in further enhancing the partnership between government and the private sector in promoting R&D and innovation in the country. The findings and recommendations of the task team are being processed by both the DST and its implementation partners, namely the South African Revenue Service (SARS) and the National Treasury, in order to determine the way forward. Innovation is recognised globally as a fundamental driver of economic growth; it drives productivity, promotes sustainable development and redefines jobs and the nature of work. All these are crucial for a nation's competitiveness.

The aim of the R&D Tax Incentive programme is to promote increased private sector R&D investment and the economy's capacity for employment creation, as well as to increase positive spillovers through knowledge transfer and skills development. It is crucial that we have a long-term view of the impact of this programme to ensure that its implementation is effective and that it is allowed time to mature and have the desired impact on the economy.

We encourage the private sector to continue to make use of this opportunity to invest in scientific and technological R&D in order to improve South Africa's innovation performance and competitiveness.

A handwritten signature in black ink, reading 'Naledi Pandor'.

MRS GNM PANDOR, MP

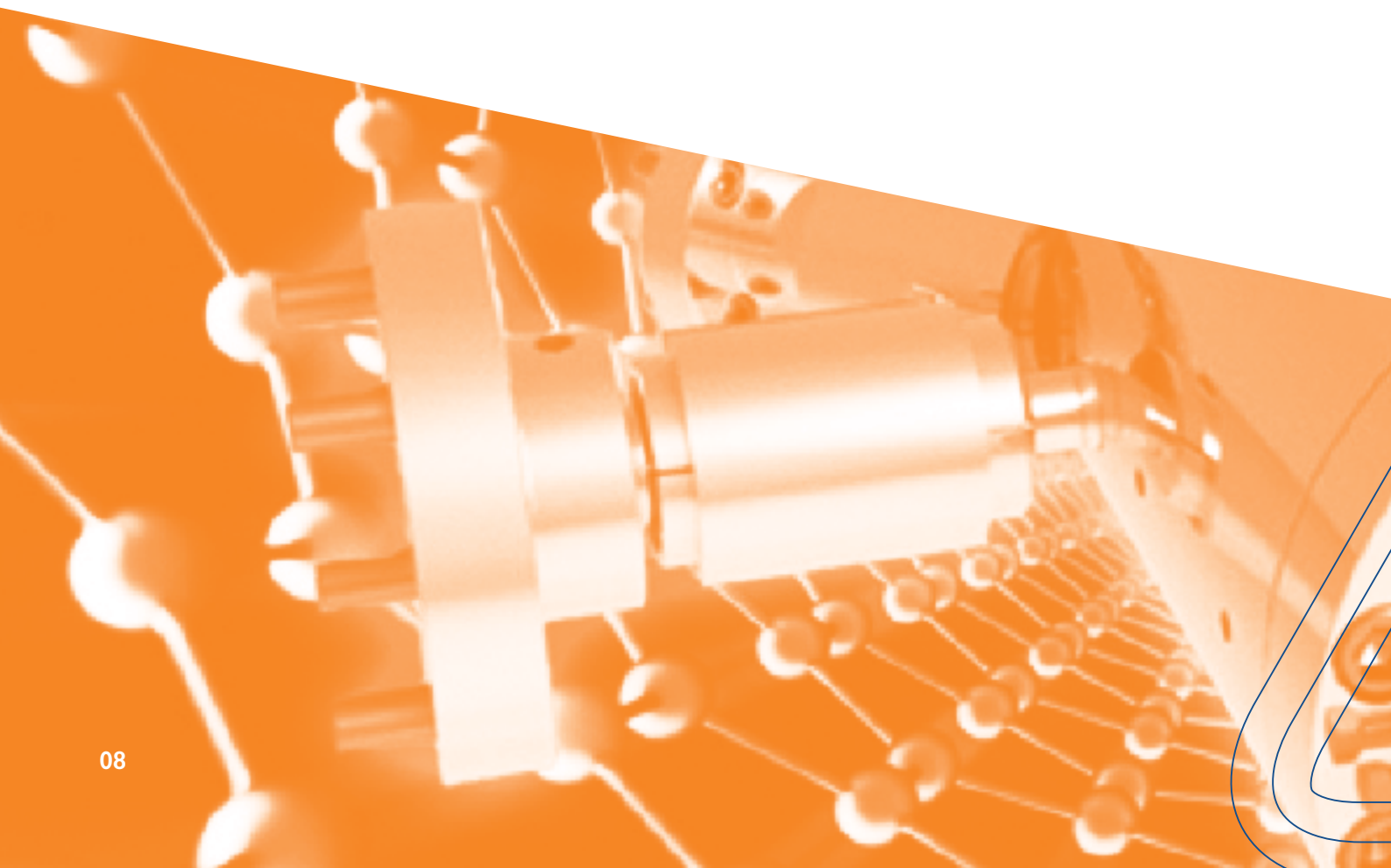
MINISTER: SCIENCE AND TECHNOLOGY

EXECUTIVE SUMMARY

This Annual Report presents information on the performance of the R&D Tax Incentive programme for the period March 2015 to February 2016 (hereinafter 2015/16) in line with the requirements of section 11D(17) of the Income Tax Act (1962), as amended. The report presents activities of the incentive based on performance indicators such as the uptake and profile of participating companies, amounts of R&D expenditure involved, tax revenue foregone, and R&D personnel involved in the supported R&D.

For the period under review (2015/16), the DST received a total of 189 applications from 147 companies. These applications contained 953 projects with an estimated R&D expenditure of R3,9 billion. Of these, 86 companies applied for the first time, increasing the total number of companies participating in this incentive since its inception in November 2006 to 962.

The 2015/16 performance adds to the cumulative contribution of the incentive since its inception in November 2006. Where appropriate, the information is presented in cumulative terms in order to show the overall uptake and contribution of the incentive since November 2006. Two periods are distinguished in the way information is presented: Firstly, it is information declared to the DST about the retrospective claims that companies have submitted to SARS (as retrospective claims). Secondly, it is the information on applications submitted to the DST under the pre-approval system.



By the end of the reporting period, 749 (73,9%) of the 1 013 pre-approval applications that had been received since October 2012 were adjudicated. A total of 367 (49%) applications were approved, covering 292 companies that would access the incentive. The approved applications amount to R10,7 billion in estimated R&D expenditure that would be supported. When combined with the R25,4 billion reported under the retrospective system, this adds up to an estimated R36,1 billion of estimated R&D expenditure supported by the incentive since November 2006.

Cumulative figures from November 2006 to February 2016 indicate that the R&D tax incentive supports the priority focus areas of the current IPAP, with about 60% of the approved applications addressing those areas, accounting for about 72% (R26.2 billion) of the supported R&D expenditure.

The trend of uptake per industry sector in 2015/16 indicates that most (68%) of the applications come from two sectors, namely, manufacturing (49%) and the financial and business services sector (19%), the latter dominated by information and communication technology activities. Companies reported an estimated 19 445 in R&D personnel that are directly involved in the R&D activities for the period between November 2006 to February 2016. Of these, 64% are core research personnel (i.e., scientists, engineers, technologists and technicians), while 36% are support personnel (i.e., R&D managers and other technical staff).

The primary purpose of the incentive is to encourage companies to increase investment in scientific and technological R&D, with the aim to promote R&D-led innovation and competitiveness in South Africa. The incentive strengthens capabilities of local companies to develop new value-added products, processes, technologies, services and/or improve existing ones.

The data presented in this report shows how the incentive is gradually contributing to its policy objectives. There is, however, a need to establish the impact of the incentive on the South African economy, employment creation and other broader government objectives. To measure the impact of this programme, the DST is in consultation with the National Treasury about an impact evaluation plan.



HIGHLIGHTS

2015/16 IN NUMBERS

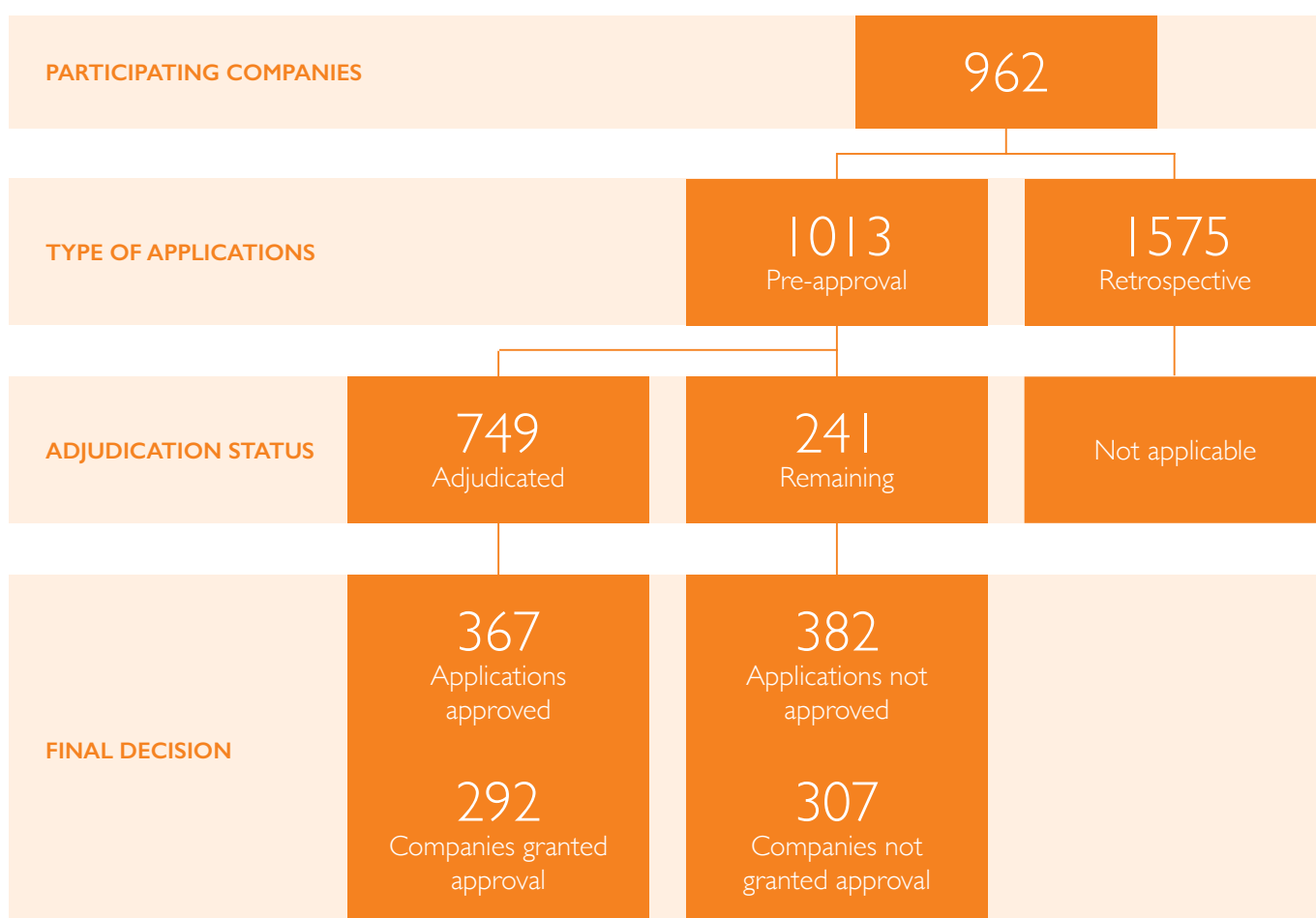
Applications
received
189

Companies
applying
147

Companies
applying for the
first time
86

Estimated R&D
expenditure on
2015/16 applications
R3.9 Billion

CUMULATIVE CONTRIBUTION (NOVEMBER 2006 TO FEBRUARY 2016)



R36,1 billion

*Estimated R&D expenditure supported (under both the retrospective claims and the pre-approval systems)

R6 billion

*Foregone tax revenue due to R&D tax incentive (2005/06 to 2013/14)

01

OVERVIEW OF R&D TAX INCENTIVE

1.1 LEGISLATIVE MANDATE

The research and development (R&D) Tax Incentive programme was introduced in 2006 to encourage private sector R&D investment in South Africa. It is implemented in terms of section 11D of the Income Tax Act, 1962 (Act No. 58 of 1962), as amended (hereinafter called “the ITA”), supported by regulations published in Government Gazettes 38729, 38730 and 38732 of 23 April 2015 and the relevant amendments to the Act that came into effect from October 2012, January 2014 and January 2015.

TABLE 1: SYNOPSIS OF LEGISLATIVE AND REGULATORY CHANGES

YEAR	DESCRIPTION
2006	The 150% R&D Tax Incentive deduction was introduced in 1 November 2006. Companies had to submit retrospective R&D Tax Incentive claims directly to the South African Revenue Service (SARS) and only report to the Department of Science and Technology (DST) about their R&D activities.
2012	The pre-approval process was introduced on 1 October 2012. Companies are required to obtain approval for R&D activities from the Minister of Science and Technology before claiming for a tax deduction from SARS.
2014	New amendments to section 11D became effective on 1 January 2014, in terms of Taxation Laws Amendment Act (TLAA) No. 39 of 2013. Refinements to section 11D, including adjustments to the definition of R&D, were done to streamline and simplify the regime to ensure that only genuine R&D is supported.
2015	<p>Refinements to section 11D, including amending the definition of R&D in respect of qualifying “innovative” functional designs, as well as including multisource pharmaceutical products and clinical trials in the definition of R&D. These amendments became effective on 1 January 2015, in terms of the Taxation Laws Amendment Act (TLAA) No. 43 of 2014.</p> <p>Regulations on the additional criteria for multisource pharmaceutical products and for clinical trials were published in Government Gazettes No. 38729, 38730 and 38732 on 23 April 2015.</p>

1.2 ELIGIBILITY FOR THE R&D TAX INCENTIVE

The tax deduction allowed through this incentive is an indirect financial support for the private sector which is accounted for by tax revenue foregone. The incentive offers a 150% tax deduction from the income of the taxpayer for approved operational R&D expenditure. The incentive can be accessed by South African registered companies of all sizes in all sectors of the economy.

For a company to benefit from the incentive, its R&D activities must be approved by the Minister of Science and Technology or a person appointed by the Minister. Approval is granted on the basis of the recommendation by the R&D Tax Incentive Adjudication and Monitoring Committee (hereinafter called "the Committee") which assesses each application according to the definition of R&D in terms of section 11D of the ITA. The Committee is made up of members from the Department of Science and Technology (DST), the South African Revenue Service (SARS) and National Treasury. The Committee members are appointed by the Minister of Science and Technology and the Minister of Finance. Section 11D(17) of the ITA requires the Minister of Science and Technology to report to Parliament on the direct benefits of the R&D activities through the incentive programme in terms of economic growth, employment, aggregate expenditure and other broader government objectives.

1.3 OBJECTIVES OF THE R&D TAX INCENTIVE

The purpose of the R&D Tax Incentive is to –

- encourage business to increase investment in scientific and technological R&D.
- advance scientific knowledge and achieve technological advancement aimed at creating new or significantly improved materials, devices, products or processes.
- increase the positive spillover to the rest of society through knowledge transfer and skills upliftment.

The incentive offers a 150% tax deduction from the income of the taxpayer for approved operational R&D expenditure.

I.4 ACTIVITIES TO RAISE AWARENESS AND INTERACTIONS WITH INDUSTRY

The R&D Tax Incentive is seen as one of the portfolio of policy instruments to promote R&D investment.

The DST has embarked on a number of activities to raise awareness and assist applicants to understand information requirements and the eligibility criteria. Opportunities that arose through invites to relevant stakeholder events and industry meetings have also been used appropriately for information sharing and awareness. These steps, and others that are being explored, are meant to enhance and improve guidance provided to applicants, particularly for small, medium and micro enterprises (SMEs) and prospective applicants to the incentive.

The joint government-industry task team on the R&D Tax Incentive task team that the Minister established in November 2015 has completed its work. The final task team report was presented to the Ministers of Science and Technology and Finance. This process was valuable in further enhancing the partnership between government and the private sector on efforts to promote R&D and innovation in the country.

The task team report noted that the rationale for government support for private sector R&D through the tax-based incentive is still as relevant today as it was when the 150% R&D tax deduction was introduced in 2006. Business sector R&D investment needs to increase if South Africa is to enhance its competitiveness and growth potential. The R&D Tax Incentive is seen as one of a portfolio of policy instruments to help achieve this objective. Among other issues, the report raised concerns about the difficulties of companies in meeting the information requirements related to the pre-approval procedure and the long turnaround times which created uncertainties on R&D claims on the part of companies and challenges for tax administration on the part of SARS.

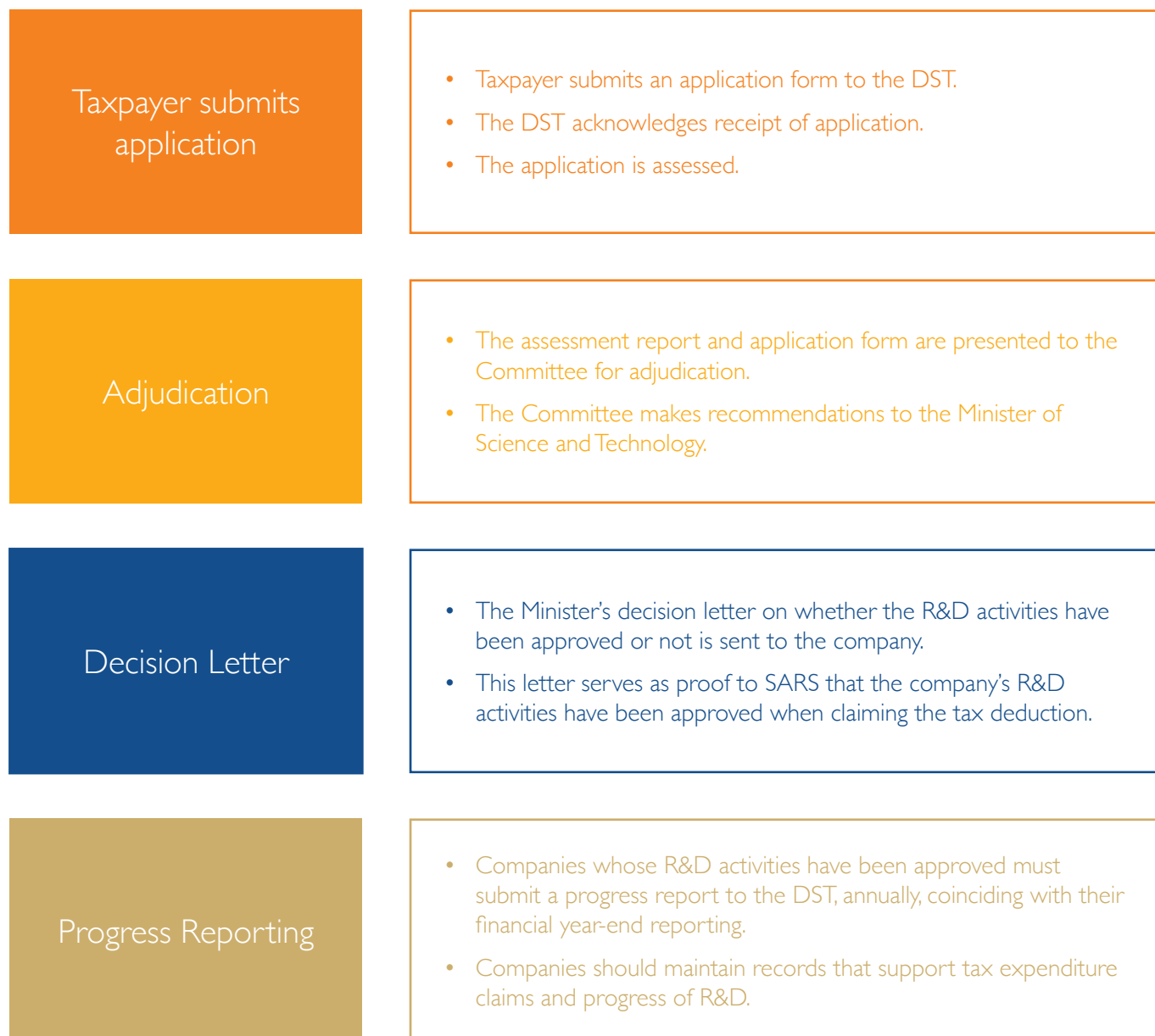
The findings and recommendations of the task team are being processed by both the DST and its implementation partners, namely the National Treasury and SARS, in order to determine the way forward. By the time of compiling this report, the DST had made some progress in implementing measures to simplify administrative processes and improve turnaround times in providing decisions to applicants.

Among the measures are the publication of new versions of guidelines and application forms, which are user-friendly and easily accessible. Presentation of information about the R&D Tax Incentive on the DST website has also been updated to enhance user friendliness. The new form will now allow applicants to submit applications online. This will also assist in reducing the turnaround time in the processing of applications.

02

R&D TAX INCENTIVE APPLICATION PROCESS

FIGURE 1: THE APPLICATION PROCESS



03

PARTICIPATION IN THE R&D TAX INCENTIVE

This section provides a summary of the uptake of the R&D Tax Incentive in terms of the number of applications received, profile of participating companies (by turnover size and industry sector) and estimated amounts of R&D expenditure. The indicators covered below comprise those from the period under review (hereinafter 2015/16), cumulative estimates since October 2012 (when the pre-approval system was introduced), and, in certain instances, retrospective claims since November 2006 (when the 150% tax deduction was introduced).

3.1 NUMBER OF APPLICATIONS RECEIVED BY THE DST

For the period under review, the DST received a total of 189 applications containing 953 projects from 147 companies (Table 2). Of these, 86 companies applied for the first time, thus bringing the total number of companies participating in the incentive from November 2006 to February 2016 to 962.

TABLE 2: NUMBER OF APPLICATIONS RECEIVED BY THE DST

	RECEIVED IN 2015/16	CUMULATIVE (NOV 2006 TO FEB 2016)
Number of applications received	189	2 588
Number of companies that submitted applications	147	962
Number of projects contained in the applications	953	5 319
Estimated R&D expenditure in the applications	R3,9 billion	R53,8 billion

The 189 applications received in the reporting period contain an estimated R3,9 billion in R&D expenditure at the application stage, while the cumulative figure from 2006 stands at R53,8 billion. Among the participating companies are both locally owned companies and multinational companies from a range of economic sectors.

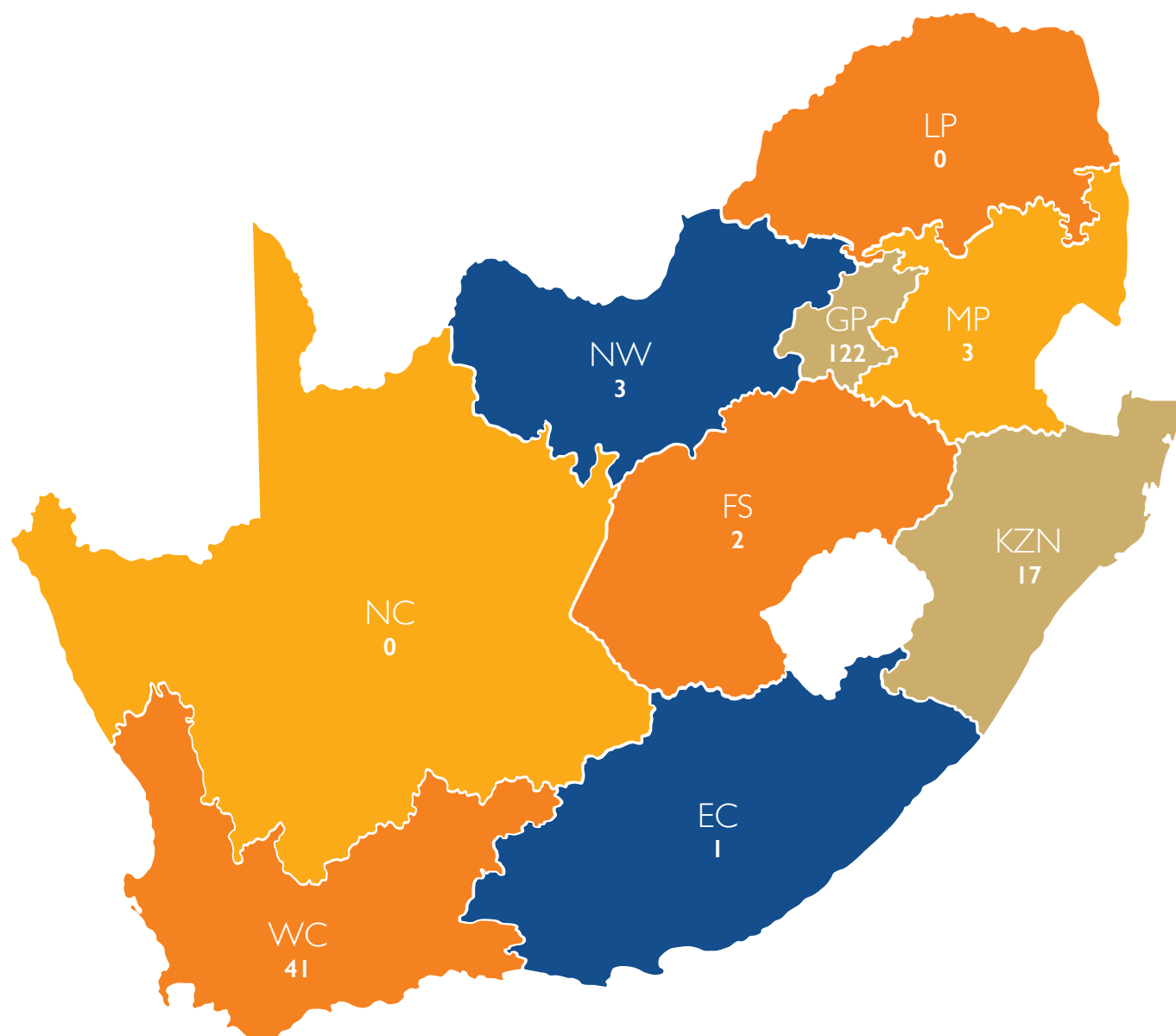
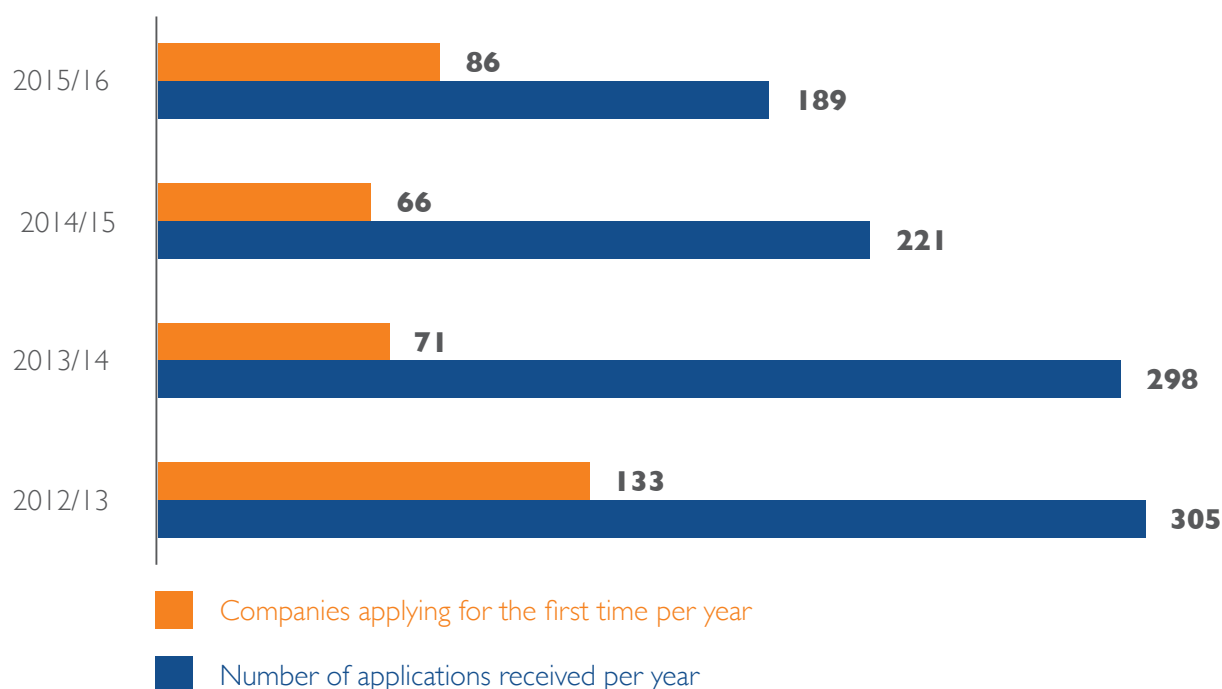
FIGURE 2: PROVINCIAL DISTRIBUTION OF APPLICATIONS RECEIVED IN 2015/16

Figure 2 shows that the geographical distribution of applications received in 2015/16 originated from seven of the nine provinces. Gauteng and the Western Cape make up 163 or 86,2% of the applications received in 2015/16, which corresponds with the high economic density of the two provinces. This information could also mean that the headquarters of these companies, most of which are located in Gauteng, are the ones that are applying for the incentive, as opposed to it being indication of provinces or locations where the R&D activities are being conducted.

FIGURE 3: YEARLY NUMBER OF FIRST-TIME APPLICANT COMPANIES (OCT. 2012 - FEB. 2016)

An average of 89 companies were applying for the first time for the four years 2012/13 to 2015/16 (Figure 3). It is important to have a growing number of companies taking part in this programme, given the need to have as many companies as possible undertaking R&D in the country.

The number of applications received may appear to be declining annually, from 305 in 2012/13 to 189 in 2015/16 – but this is not necessarily the case considering that 20.6% of applications received contain multiyear R&D projects. Legislative amendments of 2012 allowed applicants to apply once and receive approval for a number of years in which R&D is undertaken. In this case, companies do not need to re-apply on a yearly basis, but merely apply for new R&D projects. This was not the case prior to October 2012, as companies had to submit retrospective claims every year when claiming the R&D tax deduction. Some companies submit applications every year due to their regular R&D activities, while others submit only in certain years, depending on their strategies.

It is important
to have a
growing number
of companies
taking part in this
programme.

There is also an established pattern of certain companies undertaking R&D on an ongoing basis, hence the repeat applicants. Such companies tend to be larger in size and are found in industries that dominate participation in the incentive. Companies that did not come back as repeat applicants can be categorised as either simply not undertaking R&D every year, or having applied the previous year for multi-year R&D, or just not keen to apply in that period.

Another reason for the decrease could be due to companies having a clear understanding of what is required by the DST when submitting an application in terms of the eligibility criteria. It has been observed that the quality of applications received has improved significantly, indicating that companies have a better understanding of the required criteria.

3.2 PARTICIPATION PER INDUSTRY SECTOR

The DST has received R&D Tax Incentive application forms from all industry sectors of the economy. Table 3 shows that the trend of companies submitting application forms per industry sector in 2015/16 was similar to that observed over the previous years, with 68% of the applications coming from two sectors, namely, Manufacturing (49%) and the Financial Intermediation, Real Estate and Business Services sector (19%). The Financial Intermediation, Real Estate and Business Services sector is dominated by the information and communication technology (ICT) industry, which tends to submit application forms on a frequent basis. The proportion of applications from this sector has declined to 19% in 2015/16, compared to a nine-year aggregate of about 34%. Participation of companies in the Agriculture, Hunting, Forestry and Fishing sector, as well as those in the Wholesale and Retail Trade sector was similar, at 6,1%, followed by the Transport, Storage and Communication sector at 5,4%.

TABLE 3: PARTICIPATION PER INDUSTRY SECTOR

SECTOR	RECEIVED IN 2015/16		CUMULATIVE (NOV 2006 TO FEB 2016)	
	Number of companies	% of total	Number of companies	% of total
10000 – Agriculture, Hunting, Forestry and Fishing	9	6,1%	48	5,0%
20000 – Mining and Quarrying	14	9,5%	51	5,3%
30000 – Manufacturing	72	49,0%	434	45,1%
60000 – Wholesale and Retail Trade	9	6,1%	14	1,5%
70000 – Transport, Storage and Communication	8	5,4%	42	4,4%
80000 – Financial and Business Services	28	19,0%	328	34,1%
*Others	7	4,8%	45	4,6%
TOTAL	147	100,0%	962	100,0%

*Others include 40000 - Electricity, Gas and Water Supply; 50000 – Construction; and 90000 – Community and Social Services

3.3 PARTICIPATION PER COMPANY TURNOVER SIZE

Of the 147 companies participating in the incentive in 2015/16, 59 (40,1%) are very large enterprises (turnover > R100 million), 50 (34,0%) are small and medium enterprises (SMEs) (turnover < R40 million), 21 (14,3%) are large enterprises (turnover R40 million < R100 million) while 17 (11,6%) did not disclose their latest year turnover (Table 4).

TABLE 4: PARTICIPATION PER COMPANY TURNOVER SIZE

SECTOR	RECEIVED IN 2015/16		CUMULATIVE (NOV 2006 TO FEB 2016)	
	Number of companies	% of total	Number of companies	% of total
Turnover not indicated	17	11,6%	84	8,7%
10 and below	25	17,0%	257	26,7%
10 to 15 SMEs	7	4,8%	63	6,5%
15-20 SMEs	6	4,1%	42	4,4%
20-30 SMEs	6	4,1%	54	5,6%
30-40 SMEs	6	4,1%	33	3,4%
40-50 large	8	5,4%	32	3,3%
50 – 100 large	13	8,8%	86	8,9%
100 and above very large	59	40,1%	311	32,3%
TOTAL	147	100,0%	962	100,0%

FIGURE 4: APPLICATIONS RECEIVED PER COMPANY TURNOVER SIZE (OCT 2012 TO FEB 2016)

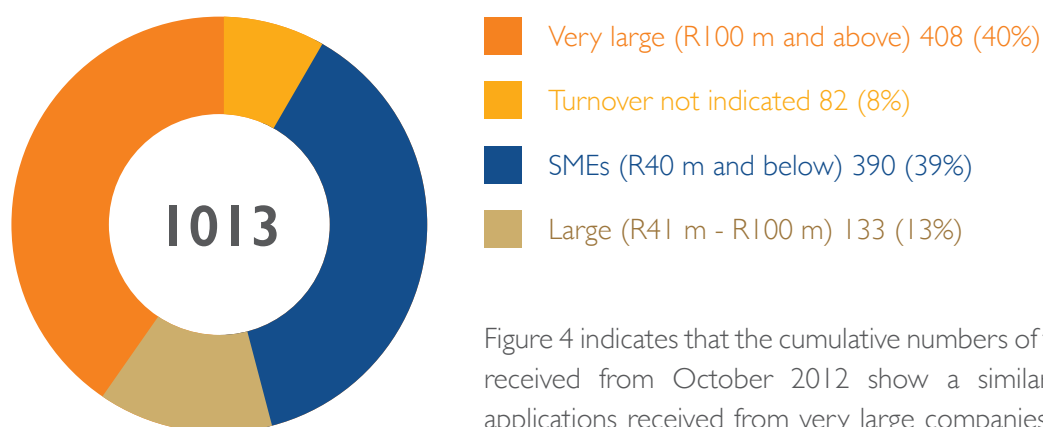


Figure 4 indicates that the cumulative numbers of the pre-approval applications received from October 2012 show a similar pattern, with 408 (40%) applications received from very large companies and 390 (39%) from SMEs, while large companies make up 133 (13%) of the applications.

04

PROCESSING OF APPLICATIONS

The performance or efficiency of the R&D Tax Incentive programme can be measured in terms of the number of applications processed and finalised during the reporting period, as well as the turnaround times in providing decisions to applicants. The DST has adopted a performance target to provide final decision within 90 days of receiving an application.

The Department has managed to reduce the turnaround time but not yet achieved the set target for a critical number of applications. Due to the historical backlog of applications awaiting the Committee, the time for processing of applications was too long, but it has improved significantly by the end of the reporting period to less than 250 days on new applications. The turnaround time is mostly dependent on the quality of information provided in the application and the steps taken in processing the applications. Ways to simplify the procedures are being explored. Applications that have the required information are processed and finalised within shorter turnaround times.

4.1 STATUS OF PRE-APPROVAL APPLICATIONS AS AT FEBRUARY 2016

Of the 1 013 pre-approval applications received between 1 October 2012 and 29 February 2016, 749 (73,9%) were adjudicated and finalised by the Committee, of which 367 (49%) were recommended for approval (Table 5). Approval status allows applicants to claim the 150% tax deduction for the operational R&D expenditure. This deduction, allowed through the R&D Tax Incentive, is accounted for as tax revenue foregone, and therefore is regarded as indirect financial support for private sector R&D and innovation. The aim is to help local companies to build capabilities and innovations by creating new products, processes, devices, techniques and/or significantly improving existing ones.

Close to half of the total applications received, 432 (42,6%) were from the Manufacturing sector; while 355 (35%) of applications were received from the Financial and Business Services sector. Of the applications adjudicated and finalised from the Manufacturing sector, 181 (58,6%) were recommended for approval, in contrast to 84 (29,8%) approved in the Financial and Business Services sector.

The Department has managed to reduce the turnaround time but not yet achieved the set target for a critical number of applications.

**TABLE 5: NUMBER OF APPLICATIONS ADJUDICATED PER INDUSTRY SECTOR
(OCT. 2012 TO FEB. 2016)**

	NUMBER RECEIVED	ADJUDICATED AND FINALISED PER SIC	NUMBER OF APPROVALS PER SIC	STIMATED R&D EXPENDITURE ON APPROVED APPLICATIONS
10000 – Agriculture, Hunting, Forestry and Fishing	46	29	26	413 810 733
20000 – Mining and Quarrying	71	51	35	2 547 532 766
30000 – Manufacturing	432	309	181	5 072 648 140
60000 – Wholesale and Retail Trade	18	16	14	123 739 187
70000 – Transport, Storage and Communication	53	42	19	476 148 355
80000 – Financial and Business Services	355	282	84	1 979 649 558
*Others	38	20	8	68 214 963
TOTAL	1 013	749	367	10 681 743 701

*Others include 40000 - Electricity, Gas and Water Supply; 50000 – Construction; and 90000 – Community and Social Services

About 90% of the estimated R&D expenditure of the approved applications is from the top three industry sectors, Manufacturing (47,5%), Mining and Quarrying (23,9%) and Financial and Business Services (18,6%). The Manufacturing sector comprises a number of applications from a diversity of sub-sectors such as software-related R&D, green-economy related R&D and health-related R&D activities.

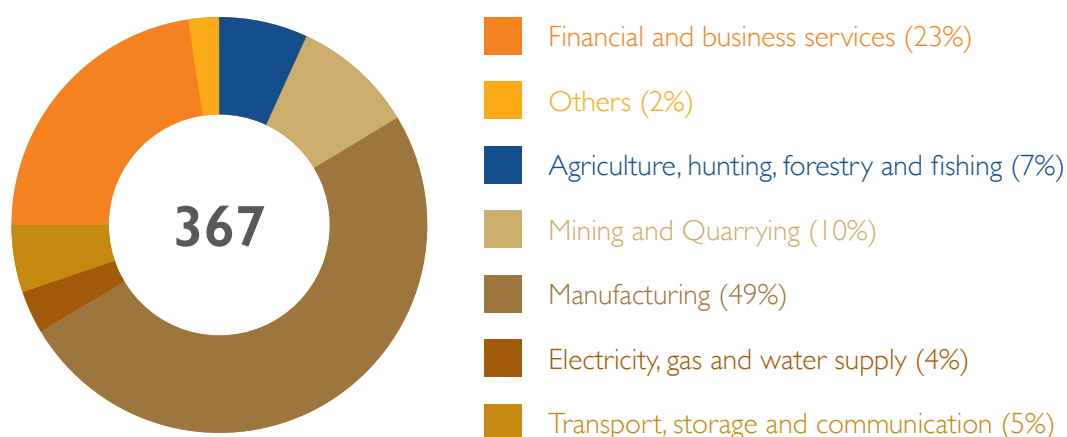
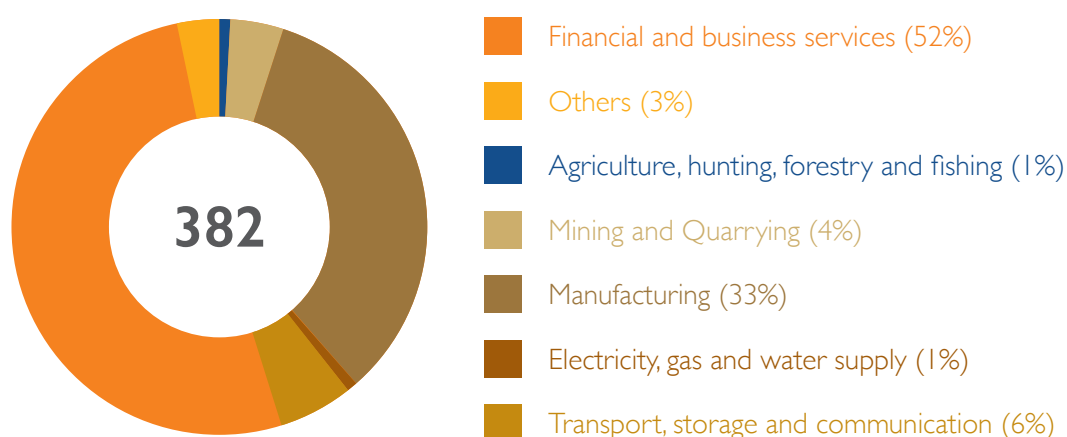
FIGURE 5: PERCENTAGE OF APPROVALS PER INDUSTRY SECTOR (OCT. 2012 TO FEB. 2016)**FIGURE 6: PERCENTAGE OF NON-APPROVALS PER INDUSTRY SECTOR (OCT. 2012 TO FEB. 2016)**

Figure 5 above shows that almost half (181 or 49%) of the applications that have been granted approval to access the incentive are from the Manufacturing sector, followed by the Financial and Business Services sector (84 or 23%); Mining and Quarrying (25 or 10%); Agriculture, Hunting, Forestry and Fishing (26 or 7%); Transport, Storage and Communication (19 or 5%); as well as Electricity, Gas and Water Supply (14 or 4%). Figure 6 shows that The Financial and Business Services sector make up more than half (52%) of the applications that have not been granted approval to access the incentive, followed by Manufacturing (33%). The remaining sectors makes up 15% of non-approved applications.

A higher percentage of applications from the Agriculture, Hunting, Forestry and Fishing sector, as well as the Electricity, Gas and Communication sector is approved to access the R&D Tax Incentive. This is in contrast to the applications received from the Financial and Business Services sector, in which the percentage of applications that have received approval is less than that of non-approved applications (Figure 7).

FIGURE 7: PERCENTAGE OF APPROVALS AND NON-APPROVALS OF TOTAL APPLICATIONS ADJUDICATED PER INDUSTRY SECTOR (OCT. 2012 TO FEB. 2016)

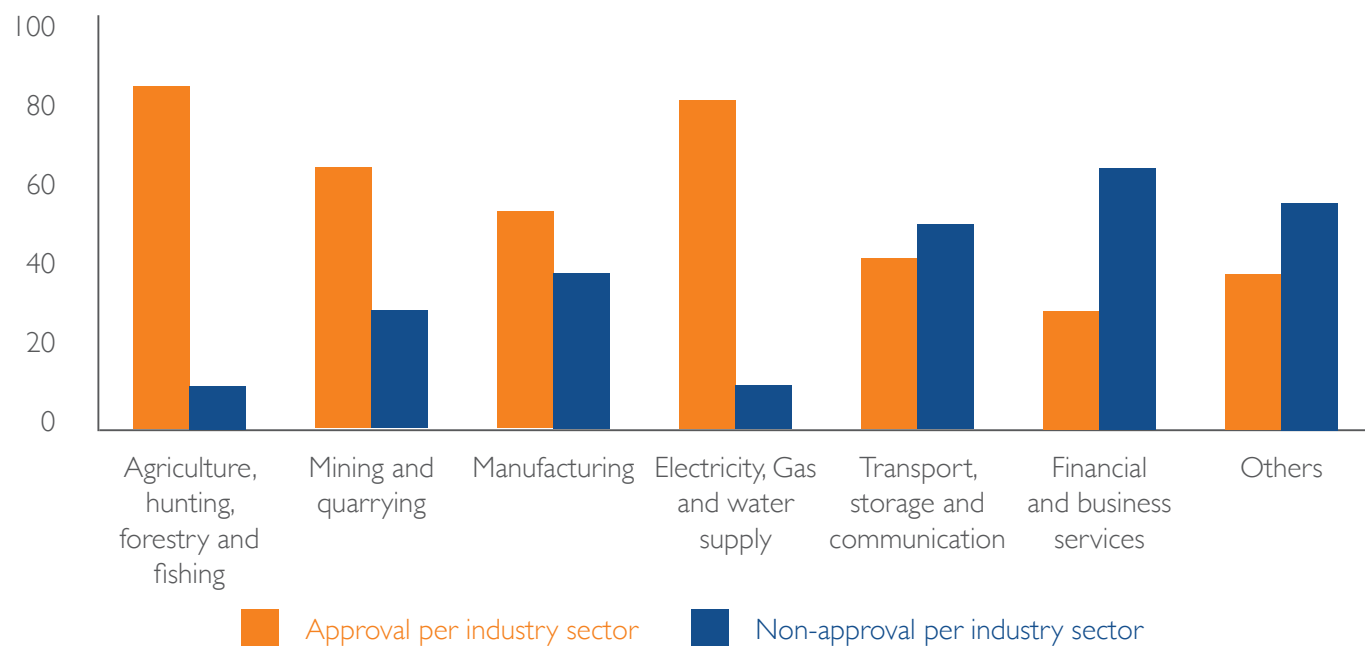


TABLE 6: NUMBER OF APPLICATIONS ADJUDICATED PER TURNOVER SIZE (OCT. 2012 TO FEB. 2016)

TURNOVER SIZE (IN R MILLION)	NUMBER OF APPLICANTS RECEIVED	ADJUDICATED AND FINALISED PER SIZE CATEGORY	NUMBER OF APPROVALS PER SIZE CATEGORY	ESTIMATED R&D EXPENDITURE ON APPROVED APPLICATIONS
Turnover not indicated	82	55	36	553 194 549
10 and below	202	160	60	176 216 661
10 < 15	58	43	10	47 012 746
15 < 20	43	33	10	478 972 354
20 < 30	56	42	20	177 192 553
30 < 40	31	21	10	108 229 149
40 < 50	42	22	6	32 059 680
50 < 100	91	73	43	297 446 933
Above 100	408	300	172	8 811 419 076
TOTAL	1 013	749	367	10 681 743 701

As indicated in Table 6 above, larger companies have higher rates of approval than SMEs and are dominant in terms of the number of applications received and the estimated amount of R&D expenditure. The approval rate of applications received from very large companies, i.e. companies with latest year turnover of above R100 million, is 57% and higher than that of applications from other size categories. The approval rate of large companies (i.e. with turnover from R40 million to R100 million) is 52% and the approval rate of SMEs (i.e. turnover of below R40 million) is 37%. The approval rate of those that did not disclose their turnover size was 65%. These figures indicate that SMEs may not be conducting R&D as defined in section 11D(1) and that they need support in terms of the preparation of applications and understanding the eligibility criteria of the incentive. Furthermore, the profile of SMEs participation in the incentive programme is also indicative of the fact that many SMEs are involved with innovation activities, without necessarily engaging in R&D.

EXAMPLES OF SUPPORTED PROJECTS

The purpose of this section is to showcase the impact of the R&D tax incentive at a company level and provide examples of some of the projects that are benefiting from the program. Although the DST has been given permission from these companies to publish their projects in this report, their names and other details will remain anonymous for confidentiality purpose. This is in accordance with Section 11D(17), which restricts this report from disclosing identity of any applicant.

The R&D activities of Company X involve a new generation carbon efficiency cobalt based gas-to-liquids catalyst, that was scaled-up from laboratory through pilot plant to demonstration trials. The company had to overcome retrofitting new catalyst preparation procedures into an existing commercial facility, which required both scientific and engineering expertise. The cobalt based catalyst was improved in terms of activity, selectivity and longevity which resulted in the improvements of carbon efficiency of the process. Furthermore, the company successfully developed and implemented a world-leading technology involving novel integration of Near Infra-Red spectroscopy with a catalytic reforming reactor system. This project allowed company X for the first time to perform laboratory scale catalysis at constant octane number, in order to overcome the issues relating to a rapidly deactivating catalyst. Lastly, this company made significant improvements to its current hydrogen sulfide technology, which was realized through the research work motivated by the R&D tax incentive programme.

Company Y's R&D activities involve development of an embedded sensor devices that would be installed in orientations or places otherwise not possible in vehicles and trucks for easier recovery of stolen vehicles. As a result of benefiting from this incentive, the company was able to buy further equipment needed for R&D and employ additional three people.

The R&D activities of Company Z involve the development of augmented reality applications that enable users to view real world environment that is enhanced by overlaying computer generated layer of information through a screen such as phone or ipad. As a result of these projects, the company has grown and has become more competitive, globally, attracting business from overseas. The incentive has enabled the company to host internships and contribute to human capital development of interns over the years.

4.2 ESTIMATED R&D EXPENDITURE REPORTED

Information reported under this section is based on the data declared to the DST by companies on the claims submitted to SARS on retrospective claims, at application stage and at approval stage.

Figure 8 below indicates that, by the end of the reporting period, an estimated R36,1 billion in R&D expenditure has been supported by the incentive since November 2006. This amount comprises R10,7 billion in estimated R&D expenditure indicated on approved applications (under the pre-approval system) and R25,4 billion reported under the retrospective system. The data may be revised, based on the actual value of claims that companies declare to SARS when they claim the deductions.

FIGURE 8: OVERALL R&D EXPENDITURE FROM NOV. 2006 TO FEB. 2016



4.3 ESTIMATES OF FOREGONE TAX REVENUE DUE TO THE INCENTIVE

The National Treasury Budget Review (2016) estimated that the foregone tax revenue due to the R&D Tax Incentive for the period 2005/06 to 2013/14 is R6 billion (Table 7).¹ These figures represent deductions allowed by SARS on claims by companies for each particular tax year and are revised annually as companies submit their claims. The figures also include claims that have been made under section 11B which was applicable before November 2006.

Foregone tax revenue represents part of the government financial support for business sector R&D activities that is meant to attract international and multinational companies to invest in the country. South Africa has other forms of support for R&D and innovation, through direct funding grants, loans and equity funds, etc. Promotion of the R&D Tax Incentive programme often raises the question of the effectiveness of this policy instrument in stimulating investment in R&D, especially in the current climate of slow global economic growth. It is important to balance expenditure on policies related to the R&D Tax Incentive against expenditure on other policies in order to determine whether a drop in economic activity could lead to new sources of economic growth, such as innovation.

¹ The National Treasury Budget Review (24 February 2016).

The foregone tax revenue peaked in 2010/11 at R1,2 billion, but decreased thereafter (Figure 9). The decrease is attributed to the administrative delays and backlogs associated with the pre-approval system. At a peak, South Africa expended about 0,04% on the R&D Tax Incentive as a percentage of gross domestic product (GDP)². By comparison, this ranks at a bottom six of the 37 countries with R&D Tax Incentives tracked by the Organisation for Economic Co-operation and Development (OECD)³.

TABLE 7: FOREGONE TAX REVENUE DUE TO THE R&D TAX INCENTIVE

REPORTING PERIOD	FOREGONE TAX REVENUE (R'000)
2005/06	183 000
2006/07	449 000
2007/08	358 000
2008/09	594 000
2009/10	966 000
2010/11	1 216 000
2011/12	1 131 000
2012/13	360 000
2013/14	745 000
2014/15 and 2015/16	Information not available
TOTAL	6 002 000

² Tax Statistics 2015 (November 2015), Published jointly by the National Treasury and SARS.

³ OECD (2016:170). OECD Science, Technology and Industry Scoreboard 2015: Innovation for growth and society. OECD, Paris.

FIGURE 9: FOREGONE TAX REVENUE AS A PERCENTAGE OF OVERALL TAX REVENUE AND OF GDP

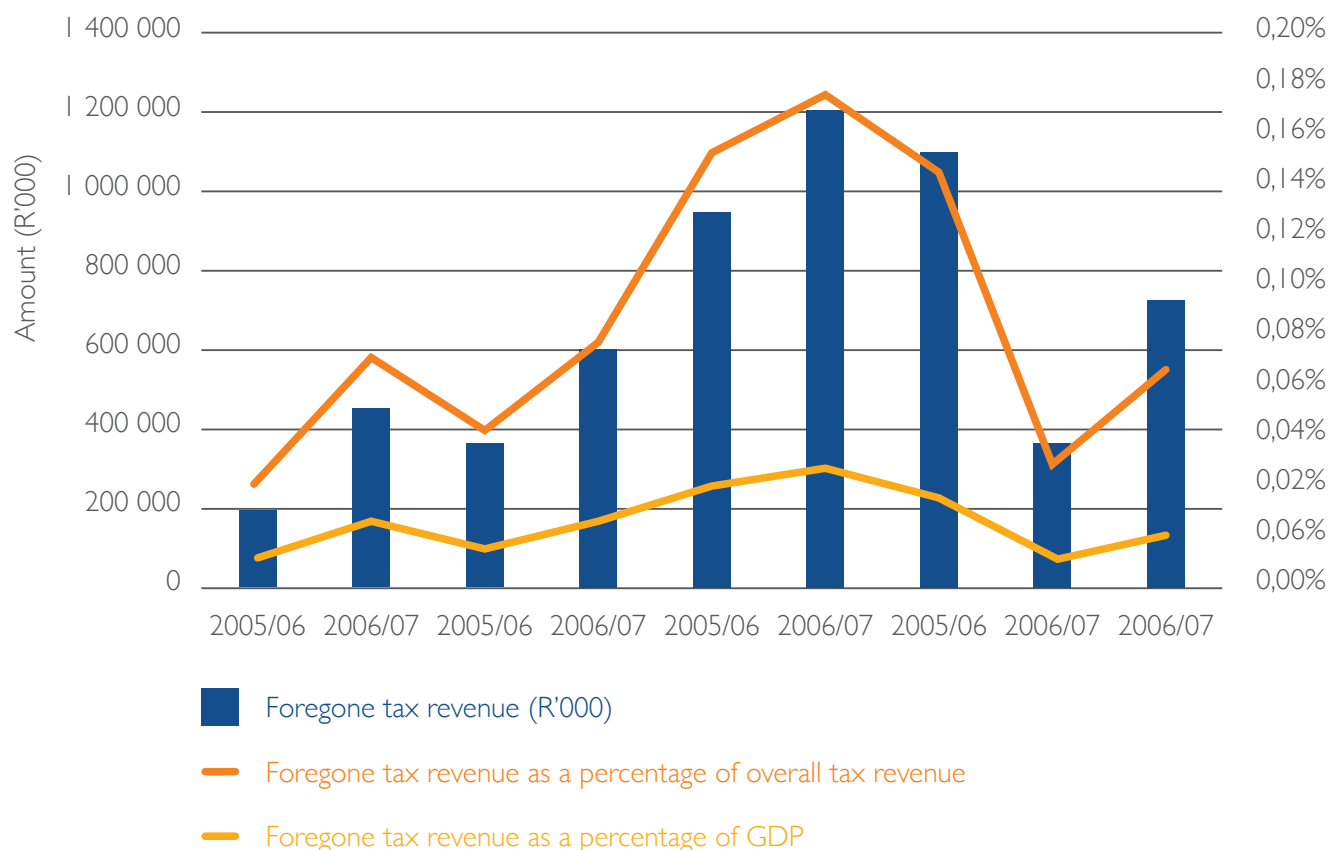
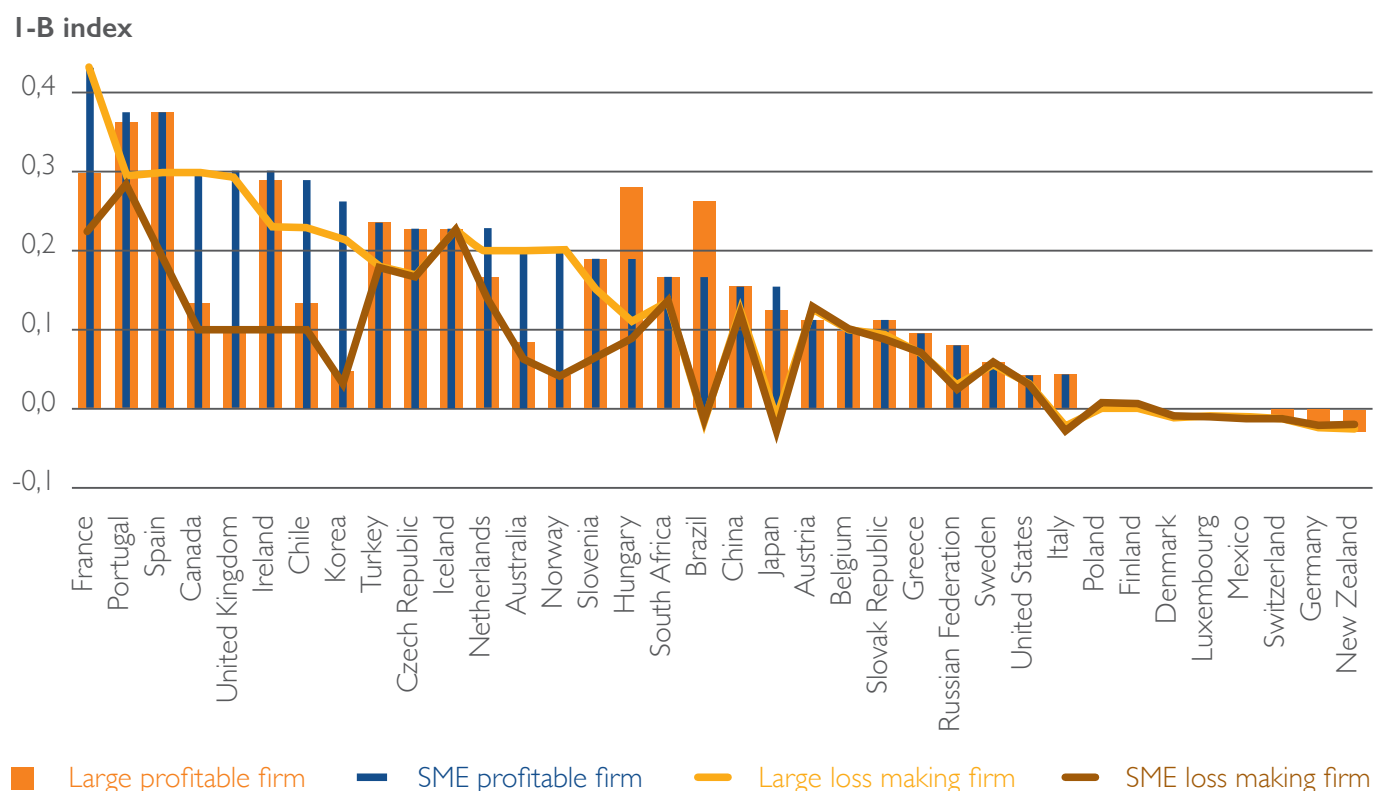


Figure 10 presents the B-Index estimates of countries tracked by the OECD. This is one of several ways to measure the generosity of R&D Tax Incentives.⁴ B-Index enables the analysis of relative attractiveness of R&D tax systems across countries by estimating the thresholds at which a company would be able to undertake R&D and still be profitable. A positive B-Index is considered attractive for companies performing R&D, and a negative one is considered unattractive.

Using the data provided by the National Treasury and the DST, the OECD estimated that South Africa's B-Index was 0,16 for profitable firms and 0,13 for loss-making firms in 2013. These are comparable to countries such as Austria, Belgium, China, Canada, Chile, Netherlands, Slovakia and the United Kingdom. Among the BRICS countries, Brazil is found to be the most attractive to profitable firms, but most unattractive for loss-making firms, while China is comparable to South Africa in terms of attractiveness to both the profitable firms than loss-making large firms and SMEs. It is encouraging to note that South Africa has maintained its B-index over time at a positive level of 0,1.

⁴ The OECD used the B-Index as an indicator for generosity of R&D tax environments. The indicator can also be used to assess the impact of tax policy changes over time. OECD cautions that international comparability must consider different country contexts.

FIGURE 10: B-INDEX ESTIMATE OF TAX SUBSIDY ON R&D EXPENDITURES


4.4 R&D PERSONNEL INVOLVED

Figure 11 indicates that the total number of R&D personnel reported in approved applications is 19 445, while the total personnel indicated at application stage that is involved in the R&D since November 2006 is 27 838. About 60% of this number are core research personnel (i.e., scientists, engineers, technologists and technicians), while 40% are support personnel (i.e., R&D managers and other technical staff).

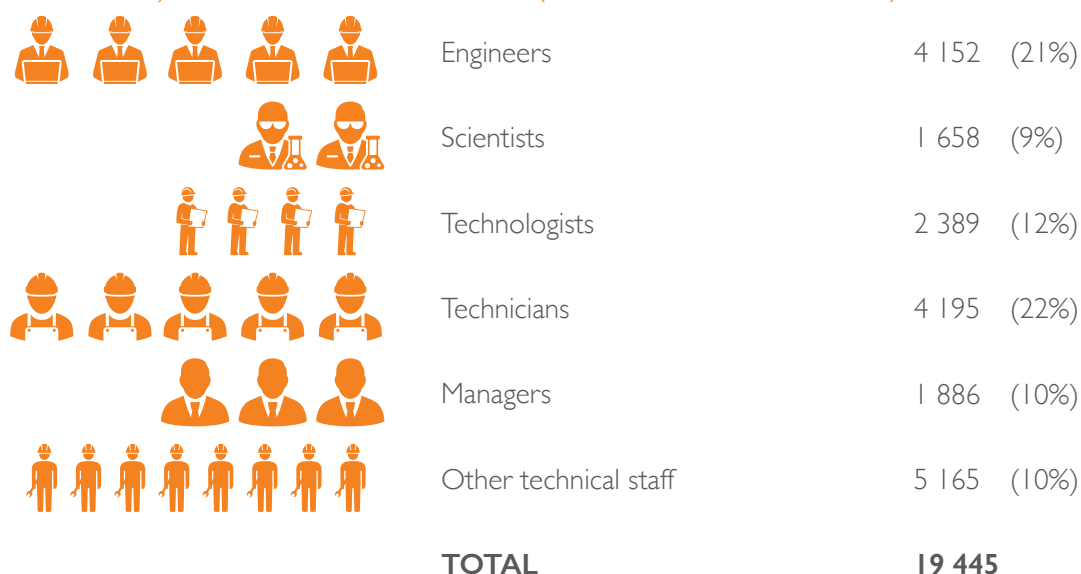
FIGURE 11: R&D PERSONNEL INVOLVED IN TOTAL APPLICATIONS RECEIVED (NOV. 2012 TO FEB. 2016) AND SUPPORTED R&D (OCT. 2012 TO FEB. 2016)


TABLE 8: REPORTED R&D PERSONNEL PER ECONOMIC SECTOR (NOV. 2006 TO FEB. 2016)

INDUSTRY (BY SIC CATEGORY)	TOTAL	SCIENTISTS	ENGINEERS	TECH- NOLOGISTS	TECH- NICIANS	MANAGERS	OTHER TECHNICAL STAFF
10000 – Agric & related	1074	185	87	112	129	71	490
20000 – Mining and Quarrying	1205	26	208	75	90	75	731
30000 to 39000 – Manufacturing	9641	917	2194	930	2606	1001	1993
40000 – Electricity, Gas & Water Supply	305	8	120	8	23	33	113
50000 – Construction	203	42	26	0	94	5	36
60000 – Wholesale & Retail Trade	75	5	18	26	8	9	9
70000 – Transport, Storage & Comms	476	2	120	69	81	76	128
80000 – Finance & Business Services	5892	377	1372	1164	825	558	1596
90000 – Community & Social Services	574	96	7	5	339	58	69
TOTALS	19445	1658	4152	2389	4195	1886	5165

Table 8 above indicates that there is a concentration of R&D personnel in larger size companies at application stage and in the two dominant sectors, namely, Manufacturing and Financial and Business Services. This partly indicates the importance of larger companies in facilitating knowledge spillovers, assisted mainly by their ability to engage in large-scale projects, requiring more R&D personnel and possibly, partnerships and knowledge transfers across industries. This phenomenon can present an opportunity for learning by other companies, particularly the SMEs. The incentive, therefore, has the potential of generating knowledge spillovers; researchers (i.e., engineers, scientists, etc.) move from one company to another and take former companies' knowledge with them – thus the rate of return on investment on R&D is not entirely accrued to the company, but more broadly to society.

4.5 CONTRIBUTION TO IPAP PRIORITY AREAS (OCT. 2012 TO FEB. 2016)

The IPAP priority areas are identified to enhance policies or programmes to strengthen the ability of manufacturing and other value-adding sectors to create decent jobs and increase value-addition and competitiveness in domestic and export markets. The R&D Tax Incentive programme supports the priority focus areas of the current IPAP, with about 60% (219) of the approved applications addressing those areas, accounting for about 72% (R26,2 billion) of the supported R&D expenditure since November 2006 (Table 9). The top five IPAP sectors in terms of cumulative R&D expenditure are: electro-technical and ICT; upstream oil and gas; chemicals, cosmetics, pharmaceuticals and plastics; automotive, components, medium and heavy commercial vehicles; as well as metal fabrication and capital equipment.

TABLE 9: CONTRIBUTION TO IPAP PRIORITY AREAS (NOV. 2006 TO FEB. 2016)

IPAP SECTOR DESCRIPTIONS	R&D EXPENDITURE UNDER RETROSPECTIVE SYSTEM (IN R'000)	R&D EXPENDITURE FOR APPROVED APPLICATIONS UNDER PRE-APPROVAL SYSTEM (IN R'000)	CUMULATIVE (NOV. 2006 TO FEB 2012) (IN R'000)	% TOTAL CONTRIBUTION TO IPAP SECTORS
Upstream oil and gas	4 669 185	1 258 300	5 927 485	22,6%
Electro-technical and ICT	3 873 476	2 301 066	6 174 542	23,5%
Chemicals, cosmetics, pharmaceuticals and plastics	3 909 221	1 245 620	5 154 841	19,7%
Automotives, components, medium and heavy commercial vehicles	3 321 901	71 900	3 393 801	12,9%
Metal fabrication, capital and transport equipment sectors	1 217 985	1 044 320	2 262 305	8,6%
Business process services	1 172 476	37 789	1 210 265	4,6%
Aerospace and defence	497 888	201 329	699 217	2,7%
Agro-processing, linked to food security and food pricing imperatives	384 937	44 042	428 979	1,6%
Forestry, paper; pulp and furniture	256 300	331 224	587 524	2,2%
Advanced materials	243 761	-	243 761	0,9%
Nuclear	62 516		62 516	0,2%
Green and energy-saving industries	35 057	-	35 057	0,1%
Boat building	-	37 200	37 200	0,1%
Clothing, textiles, footwear and leather	355	2 300	2 655	0,0%
TOTAL	19 645 058	6 575 090	26 220 148	100,0%

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CONCLUSION

The R&D Tax Incentive is aimed at encouraging the private sector to undertake scientific and technological R&D in South Africa. This is because private sector R&D is considered a crucial element of national innovation performance, competitiveness and economic growth. The incentive is available to companies of any size in all sectors of the economy.

The incentive attracts new participants every year and, in the period under review, 86 companies applied for the first time, bringing the number of companies that have participated in the incentive programme to a total of 962 over the period November 2006 to February 2016.

The indicators contained in this report are encouraging as they show how the incentive is gradually contributing to its objectives. The actions underway to improve the administration of the incentive, including implementation of the joint government-industry task team, are envisaged to enhance the impact of the incentive. The delays in the processing of applications has impacted negatively on the programme's objectives. A priority, in terms of the DST's Strategic Plan, is to work towards the realisation of a 90-day turnaround time in providing the decision on applications.

There are plans to undertake an impact evaluation to gauge how the incentive contributes to the economy, employment creation and other broader government objectives. At the time of finalising this report, discussions were underway between the DST and the National Treasury about appropriate timing for the evaluation.

There are plans to undertake an impact evaluation to gauge how the incentive contributes to the economy, employment creation and other broader government objectives.

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APPENDIX A: DEFINITIONS OF SCIENTIFIC FIELDS

Agricultural science is a broad multidisciplinary field that encompasses parts of exact, natural, economic and social sciences that are used in the practice and understanding of agriculture.

Animal science can be described as a study of the biology of animals that are under the control of humankind.

Biological science is a branch of science that is defined as the study of life. It provides the fundamental study for the biotechnology industry. Biological science has a great impact on our lives and stands to have an even bigger impact in the future.

Chemical science consists of a diversity of disciplines in pharmaceuticals, polymers, paints and coatings, and household and personal care products, etc.

Environmental science is an interdisciplinary academic field that integrates physical and biological sciences (including but not limited to ecology, physics, chemistry, biology, soil science, geology, atmospheric science and geography) into the study of the environment and the solution of environmental problems. Environmental science provides an integrated, quantitative and interdisciplinary approach to the study of environmental systems.

Food science is concerned with all the technical aspects of food, beginning with harvesting or slaughtering and ending with cooking and consumption; it is a science that is commonly referred to as “from field to fork”.

Forestry science is the scientific management of forests for the production of lumber and other resources. It is the science of cultivating, maintaining and developing forests.

Geographical information systems (GIS) science includes the design of systems to capture, store, manipulate, analyse, manage and present all types of geographically referenced data.

Geological science is the science comprising the study of the Earth, the rocks of which it is composed and the processes by which it evolves. It is commercially important for mineral and hydrocarbon exploration and for evaluating water resources.

Industrial science is made up of multidisciplinary fields, e.g. combining information technology, physical science and the science of machinery to advance industries.

Materials science is an interdisciplinary field that applies the properties of matter to various areas of science and engineering. It investigates the relationship between the structure of materials at atomic or molecular scale and their macroscopic properties. It incorporates elements of applied physics and chemistry.

Mathematical science refers to disciplines that are mathematical in nature. It includes fields like computer science, computational science, statistics, theoretical physics and actuarial science.

Metallurgical science includes disciplines concerned with the science and technology of metals and alloys. It includes fields such as process metallurgy, physical metallurgy and mechanical metallurgy.

Physical science is any of the sciences, such as physics, chemistry, astronomy and geology, which analyse the nature and properties of energy and non-living matter

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APPENDIX B: DESCRIPTION OF STANDARD INDUSTRIAL CLASSIFICATION (SIC) CODES

SIC OF ECONOMIC ACTIVITIES DESCRIPTION

MAJOR DIVISION	SUB-DIVISION	
10 000	10 000	Agriculture, Hunting, Forestry and Fishing
	11 000	Agriculture, hunting and related services
	12 000	Forestry, logging and related services
	13 000	Fishing, operation of fish hatcheries and fish farms
20 000	20 000	Mining and Quarrying
	21 000	Mining of coal (hard) and lignite (brown coal)
	22 000	Extraction of crude petroleum oils and natural gas; service activities incidental to oil and gas extraction, excluding surveying
	23 000	Mining of gold and uranium ore
	24 000	Mining of metal ores, except gold and uranium ore
	25 000	Other mining and quarrying activities
	29 000	Service activities incidental to the mining of minerals
30 000	30 000	Manufacturing
	30 000	Manufacture of food products, beverages and tobacco products
	31 000	Manufacture of textiles, clothing and leather goods
	32 000	Manufacture of wood and products of wood and cork except (furniture); manufacture of articles of straw and plaiting materials; manufacture of paper and paper products; manufacture of publishing, printing and reproduction of recorded material



	33 000	Manufacture of coke, refined petroleum products and nuclear fuel; manufacture of chemicals and chemical products; manufacture of rubber and plastic products
	34 000	Manufacture of non-metallic mineral products
	35 000	Manufacture of basic metals, fabricated metal products, machinery and equipment and of office, accounting and computing machinery
	36 000	Manufacture of electrical machinery and apparatus (not elsewhere classified)
	37 000	Manufacture of radio, television and communication equipment and apparatus for medical application, precision and optical instruments, watches and clocks
	38 000	Manufacture of transport equipment
	39 000	Manufacture of furniture; manufacturing (not elsewhere classified); recycling
40 000	40 000	Electricity, Gas and Water Supply
	41 000	Electricity, gas, steam and hot water supply
	42 000	Collection, purification and distribution of water
50 000	50 000	Construction
	50 000	Construction
60 000	60 000	Wholesale and Retail Trade; Repair of Motor Vehicles, Motor Cycles and Personal and Household Goods; Hotels and Restaurants
	61 000	Wholesale and commission trade, except of motor vehicles and motor cycles
	62 000	Retail trade, except of motor vehicles and motor cycles; repair of personal household goods
	63 000	Sale, maintenance and repair of motor vehicles and motor cycles; retail trade in automotive fuel
	64 000	Hotels and restaurants
70 000	70 000	Transport, Storage and Communication
	71 000	Land transport; transport via pipelines
	72 000	Water transport
	73 000	Air transport
	74 000	Supporting and auxiliary transport activities; activities of travel agencies
	75 000	Post and telecommunications
80 000	80 000	Financial Intermediation, Insurance, Real Estate and Business Services
	81 000	Financial intermediation, except insurance and pension funding
	81 000	Insurance and pension funding, except compulsory social security
	83 000	Activities auxiliary to financial intermediation
	84 000	Real estate activities

	85 000	Renting of machinery and equipment, without operator; and of personal and household goods
	86 000	Computer and related activities
	87 000	Research and experimental development
	88 000	Other business activities
90 000	90 000	Community, Social and Personal Services
	91 000	Public administration, compulsory social security and defence activities
	92 000	Education
	93 000	Health and social work
	94 000	Sewage and refuse disposal, sanitation and similar activities
	95 000	Activities of membership organisations (not elsewhere classified)
	96 000	Recreational, cultural and sporting activities
	99 000	Other service activities

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APPENDIX C: CATEGORIES OF R&D PERSONNEL

Scientists or researchers are professionals engaged in the conception or creation of new knowledge, products, processes, methods and systems, as well as the management of the projects concerned. They typically hold a basic university degree, a postgraduate degree or a PhD.

Technicians and technologists are people whose main tasks require technical knowledge and experience in one or more fields of engineering, physical or life sciences. They participate in R&D by performing scientific and technical tasks involving the application of concepts and operational methods, usually under the supervision of researchers.

Managers are involved in the planning and management of scientific and technical aspects of the researchers' work. Their rank is usually equal or superior to those of the researchers and they are often former or part-time researchers.

Directly supporting technical staff include associate professionals in physical and engineering sciences whose tasks include –

- carrying out bibliographic searches and selecting relevant material from archives and libraries;
- preparing computer programmes;
- carrying out experiments, tests and analyses;
- preparing materials and equipment for experiments, tests and analyses;
- recording measurements, doing calculations and preparing charts and graphs;
- carrying out statistical surveys and interviews.

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APPENDIX D: METHODOLOGY

The report presents information on the performance of the R&D Tax Incentive Programme for the period March 2015 to February 2016. It is based on the information submitted to the DST by companies that participated in the programme.

The report relies on information available at the DST and the published data by National Treasury. All the information that companies declared to the DST about the claims they submitted to SARS (as retrospective claims) is taken as relating to R&D supported. For the preapproval system, data available at the DST at two stages is used, namely application stage and approval stage.

There is no data that was sourced from SARS. Data is collected in accordance with the requirements of section 11D(11) of the ITA through an application form and progress report form (for approved activities) prescribed by the Department of Science and Technology (DST). The taxpayer completes the application form and progress report form manually or electronically and submits it to the DST. Data is captured in the R&D Tax Incentive Programme database at the DST.

For the applications, companies have to report on their annual R&D budget and the estimated R&D planned expenditure, which in many companies span a period of two to three years. Data on tax revenue foregone due to the R&D Tax Incentive programme is estimated by SARS, based on the deductions made against the claims for the R&D Tax Incentive. These figures are published by National Treasury in its annual budget review as part of the estimates for tax expenditure. Available figures are for the years 2005/06 until 2013/14 and are inclusive of deductions for both section 11D and section 11B of the ITA. Annual figures are revised from time to time based on retrospective claims.

Annual data stated in the report represent the totals that were available at the time of compiling the report.

Application and progress report forms collect information on the following:

- Particulars of the taxpayer, including the principal industrial activity in which they are involved.
- Summary of projects and R&D activities, in terms of the nature of the R&D, its classification in terms of fields of science, SIC, and supporting information such as R&D documentation and research outputs for the projects.
- R&D expenditure and which components of R&D activities are contracted out.
- Information on sources of funds for R&D activities, the nature of government grants received and the personnel involved in the R&D projects.

The ITA requires that the information be presented in an aggregated and anonymous form. The DST makes certain that the tables and graphs in the report do not unintentionally reveal the details of individual companies and their R&D activities.



+27 12 843 6300

DST Building (Building No. 53)
(CSIR South Gate Entrance)
Meiring Naudé Road,
Brummeria

Private Bag X894
Pretoria
South Africa

www.dst.gov.za