Agenda

• R&D tax concession
• New R&D tax credit
• Common problems relating to accessing R&D benefits
• Questions
• R&D tax concession

• New R&D tax credit

• Common problems relating to accessing R&D benefits

• Applicability to medical device industry

• Questions
What is the R&D Tax Concession?

• Entitlement program and broad definition of R&D

• Introduced in July 1985 to encourage business expenditure on R&D in Australia

• Federal Government initiative to promote R&D in Australian Industry and improve Australia’s competitiveness worldwide

• A ‘base rate’ deduction of up to 125% of expenditure incurred on eligible R&D activities, enhanced premium rate of 175%

• R&D tax offset for tax loss companies with R&D less than $1m and revenue less than $5m

• Benefit example:
  • $1m R&D spend = $75k tax savings, or
  • $375k tax refund for R&D tax offset companies
What is “Research & Development”?

• Three key tests (core R&D):

• Development of something New or Improved (eg product, process, device, knowledge)

• Which involves Innovation OR High Levels of Technical Risk

• And is undertaken in a Systematic, Investigative & Experimental way

• Software – multiple sale

• Support activities – currently very broad other activities that are carried on for a purpose directly related to the carrying on of core activities

Proposal to change to Innovation AND high technical risk

May be tightened significantly
Examples of R&D Expenditure

• Salary, including for management and support staff
• Other direct expenditure (excludes plant hire)
• Contracted expenditure
• Eligible feedstock/trial expenditure
• Core technology (100%)
• Interest (100%)
• Overheads
How to Obtain the Benefit

• Self-assessment

• Initial R&D scoping of eligible activities (brainstorming to assess eligibility) – do you have a claim?

• Completion of the R&D Plan ‘up-front’ with CEO/Board sign off

• Expenditure analysis and calculation

• Lodgement of Application for Registration form with Innovation Australia

• Must register R&D activities with Innovation Australia within 10 months of the end of the year of income

• Deductions claimed in income tax return
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Policy Drivers

• Questions remain about the effectiveness of the program
• Australia’s R&D spend is low
• R&D tax might fund projects with low R&D content and that would be undertaken regardless - does not incentives
• Shift in support from large to small / medium business
• Discomfort regarding the current law
• Complexity regarding 175% Premium
Headlines

• 40% tax offset ( > $20m turnover)
• 45% refundable tax offset for SME’s
• 175% premium removed
• Definition changes
• Supporting activities – “dominant purpose”
• ‘Augmented’ feedstock rules
• Expenditure not at risk
• Software – tightened
• Foreign residents eligible (in theory)
## New R&D Tax Credit Regime - Summary

<table>
<thead>
<tr>
<th>Current System</th>
<th>New System</th>
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<tr>
<td><strong>Tax Concession System</strong> - below the line</td>
<td><strong>Credit system - above the line?</strong></td>
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<tr>
<td><strong>125% R&amp;D tax concession</strong> - Available to all, value 7.5c/$1</td>
<td>Large Companies - 40% - value 10c/$1</td>
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<tr>
<td><strong>175% Premium deduction</strong> - available to companies with a three year history, value 22.5c/$1</td>
<td>Small Companies - 45% - value 15c/$1</td>
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<td><strong>R&amp;D Cash Offset</strong> - tax loss companies: &lt; $5m turnover</td>
<td><strong>Abolished</strong></td>
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<td>R&amp;D spend capped at $1 million - value 37.5c/$1</td>
<td><strong>Transitional rules re: R&amp;D Cash Offset</strong></td>
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<tr>
<td><strong>Definition has existed for &gt;20 years</strong></td>
<td><strong>2009/10</strong> - R&amp;D spend capped at $2m</td>
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<td>2010/11 - No R&amp;D spend cap! &amp;</td>
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<td>&lt; $20m turnover</td>
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<td>Available Cash refund available - value 45c/$1</td>
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<td><strong>Tightening of R&amp;D definition</strong></td>
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Benefits: Small Company (< $20m turnover)

- Refundable 45% Tax Credit for companies with less than $20m group turnover
  - 15% permanent benefit, double current benefit
- Tax loss companies to ‘cash out’ the credit
- R&D spend uncapped
- $5m turnover threshold raised to $20m
- BUT, no 175% premium!
- Grouping rules apply
Example - Small Company (< $20m turnover)

- R&D spend of $100,000

- Tax Credit of 45% = $45,000

- Subtract tax deductible costs @ 30% = $30,000

- Benefit = $15,000 (15%)

- $45,000 is refundable in cash for companies with sufficient tax losses (similar to current cash-offset)
Benefits: Large companies

• 40% Tax Credit for companies with greater than $20m group turnover
  • 10% permanent benefit

• Credits can be carried forward

• R&D spend of $100,000
  • Tax Credit of 40% = $40,000
  • Subtract tax deductible costs @ 30% = $30,000
  • Benefit = $10,000 (10%)
  • ‘Carry forward’ benefit if company in tax losses
Proposed R&D Definition

• Systematic, investigative & experimental activity

• Involves both considerable innovation AND high levels of technical risk

• For the purpose of producing new knowledge or improvements

• Spillover/additionality – regime will target R&D that:
  • Is in additional to what otherwise would have occurred
  • Provides spillover benefits – shared by other firms and the community – that are relative to the associated subsidy
Supporting Activities Narrowed

- “Dominant purpose” – previously “directly related”
- Narrows quantum of eligible R&D costs – particularly large scale claims, process trials, prototypes etc
- Substantiation and specific identification of costs now required (previously all treated in lump sum)
Risk Management

• Increased incentives / increased cost to revenue

  • Increased audit activity by ATO / AusIndustry – especially for ‘cash out’ claimants

• Issues to consider:

  • Identification of core versus supporting activities

  • Supporting documentation
• R&D tax concession

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• Common problems relating to accessing R&D benefits

• Applicability to Energy Suppliers

• Questions
Common Problems

• Not claiming any R&D

• Failure to claim all eligible R&D activities and expenditure

• Claiming ineligible projects

• Failure to understand key issues: on own behalf, clawback etc

• Poor compliance documentation

• Inadequate systems and procedures

• Result is either an under claim or over claim (risk), or perhaps inadequate cost-benefit
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Applicability to Medical Device Industry

• Very broad opportunities for R&D tax: eg products for diagnosis, therapy and surgery

• Relevant activities also very broad:
  • Feasibility work
  • Preliminary planning
  • Design and prototyping
  • Rapid prototyping
  • Experimental testing
  • Clinical trials
  • Process development
  • Feedback R&D
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