TAX TALKS

Australia's Tax News Podcast - The Podcast for Australian Tax Professionals

The following information is only of a general nature and should not be taken as professional advice.

34 | R&D Tax Incentive

If you have clients involved in research and development, the R&D Tax Incentive will give them a leg up – it might even save them from insolvency. But to point our clients in the right direction, we need to understand what the R&D tax incentive is about.

R&D Tax Incentive

The Research & Development Tax Incentive (RDTI) provides a tax offset to help companies engage in research and development. The incentive is easy to access and open to entities of all sizes in all sectors who are conducting eligible R&D.

To listen while you drive, walk or work, just access the episode through a podcast app on your mobile phone.

Components

The R&D Tax Incentive has two core components, which are:

- a 43.5 percent refundable tax offset for entities with an annual turnover of less than $20m and not under the control of an income tax exempt entity;
- a 38.5 percent non-refundable tax offset for all other eligible entities (unused offset amounts can be carried forward to future income years).

These two components are an either/or offer. So an entity can claim either the refundable or the non-refundable tax offset but never both.

Objectives

The R&D Tax Incentive aims to:

- Boost competitiveness and improve productivity in Australia
- Encourage industry to conduct research and development activities
- Provide businesses with more predictable and less complex support and
- Improve the incentive for smaller firms to engage in R&D

Administration

AusIndustry (on behalf of Innovation Australia) and the Australian Taxation Office (ATO) jointly administer the R&D Tax Incentive.

Legislation

The R&D Tax Incentive is administered under two sets of legislation:

- Division 355 of the Income Tax Assessment Act 1997; and
- Part III of the Industry Research and Development Act 1986.

The Tax Laws Amendment (Research & Development) Bill 2010 Explanatory memorandum provides guide to the interpretation and intent of the sections of those acts that relate to the R&D Tax Incentive.

Two legislative Instruments and their accompanying explanatory statements have been developed to support administration of the R&D Tax Incentive:

- Industry Research and Development Regulations 2011
- Explanatory Statement to these regulations
- Industry Research & Development Decision-making Principles 2011
- Explanatory Statement to these principles

Eligibility

To be eligible, the applying entity, the activity and the expense must meet the relevant conditions. So there are three criteria to go through – applicant – activity – and expenditure. While the activity falls into AusIndustry's domain, the other two sit with the ATO.

Criteria 1 Applicant

First of all you check whether the applicant is a:

- Company incorporated in Australia and an Australian tax resident;
- Foreign corporation doing R&D through a PE in Australia and an Australian tax resident; or
- Corporation acting as the trustee of a public trading trust.

The applicant must undertake the R&D on their own behalf, meaning they must:

- Bear the technical and financial risk
- Be able to influence or control the conduct and direction of the R&D and
- Either own or have effective ownership of the R&D results, including the right to exploit the results.

The applicant must also incur expenses of at last $20,000. Entities smaller than that are just not cost-effective to administer. The cost to register, review and audit this entity would be greater than the actual tax offset.

And last but not least the applicant must be a for-profit entity. A not-for-profit entity does not qualify for the R&D tax incentive. So a cancer charity could not set up a company and run research through this entity, claiming the R&D tax incentive.

Criteria 2 Activity

The next step is to see whether the activity qualifies.

The R&D incentive distinguishes between core and supporting activities. And not just in theory, but the entire reporting framework is based on this distinction. So you report core and supporting activities separately.

Core Activities

Core R&D activities are experimental activities where it is not possible to know or determine the outcome in advance on the basis of current knowledge, information or experience. They involve a systematic progression of work, using principles of established science. And proceed from hypothesis over experiment, observation and evaluation to a logical conclusion.

Core activities aim to acquire new knowledge (including knowledge or information concerning the creation of new or improved materials, products, devices, processes or services).

Some activities, however, are specifically excluded from qualifying as core R&D activities.

Supporting Activities

Supporting R&D activities are activities directly related to core R&D activities. If they also support the general running of the business, they only remain eligible where the dominant purpose for conducting them is to support core R&D activities.

Australia

The activity must take place within Australia. To claim overseas expenses, you must make a separate submission to the Board and receive an Advance Overseas Finding. This finding must be in place at the start of the income year of incurring the overseas expenses.

Criteria 3 Expenditure

And the last step is to see whether the actual expenditure qualifies. There is no expenditure cap as such. However, for any R&D expenditure above $100 million, companies can only claim a tax offset at the company tax rate, reducing the offset to nil.

Most expenditure for R&D activities is eligible, including salaries, overheads, contractors, materials and depreciation.

The expenditure must be at least $20,000, but this threshold is waived if the entity contracted a registered research provider to conduct the R&D on their behalf.

Self-Asssessment

The R&D tax incentive is self-assessed all the way from registration to the actual claim of the incentive. So the applicant determines what activities and what expenditure qualifies for the tax incentive. However, registration as well as the offset claimed might be subject to an audit later on.

Registration

You register R&D activities by lodging an application with AusIndustry. AusIndustry administers registration for the R&D Tax Incentive on behalf of Innovation Australia. The registration works on self assessment. The applicant is responsible for ensuring that the registered research and development (R&D) activities meet the program’s eligibility criteria.

A formal R&D plan is not mandatory under the R&D Tax Incentive. However, as part of a compliance review, AusIndustry may ask for evidence about whether the company’s R&D activities were carried out and were eligible.

AusIndustry must receive the application for registration within ten months of the end of the company’s income year in which the entity conducted the activities. So to claim a tax incentive for R&D expenses incurred in the 2021 tax year, you would have to register by 31 April 2022.

Unless of course you want to claim overseas expenses. In that case you need to register earlier and get an advance overseas finding.

Review

While AusIndustry reviews any application to register, applicants actually self-assess whether they and their core and supporting R&D activities qualify for registration.

In the majority of cases AusIndustry accepts the accuracy of the information provided in the application form and registers the activities.

However, AusIndustry can choose to put a registration application under closer scrutiny and get Innovation Australia to issue a different finding.

Decision

AusIndustry generally makes a decision on the registration within 30 days of receipt of a hard-copy application, and 10 days when lodged electronically online.

When approved, AusIndustry sends a letter to all applicants. The date of this letter is the date of registration. The letter also includes a registration number, unique for each entity. You need to quote on the R&D Tax Incentive Schedule. This registration number is unique to the relevant R&D entity.

However, the registration does not, by itself, render the activities described in the registration as eligible R&D activities. Nor is it an indication of compliance with the requirements of the R&D tax incentive.

AusIndustry might examine the registration in more detail and this may lead to a formal finding by Innovation Australia about the eligibility of all or some of the registered activities.

Records

Your client must keep adequate records to demonstrate to the ATO and AUSIndustry that they did carry out eligible R&D activities and that they did incur eligible expenditure.

The records must be sufficient to verify the nature of the R&D activities, expenditure incurred and the relationship of the expenditure to the activities.

Claim

You claim the R&D tax incentive through the company's tax return. To achieve this, you list the R&D expenses in the R&D Tax Incentive Schedule and then claim a refundable tax offset of 43.5% of these expenses in the tax offset section. However, the listed R&D expenses will then be added to the taxable income, reducing the actual economic benefit from 43.5% to around 13%.

Example

Let's say your client incurred R&D expenses of $1m and had a taxable income of $1m. If they don't claim an R&D Tax Incentive, they pay tax of $300,000 for that year assuming a tax rate of 30%.

But if they do claim the RDTI, then you add the R&D expenses back to taxable income, resulting in a taxable income of $2m and a theoretical tax liability of $600,000. But the R&D tax offset of $435,000 reduces the net tax liability to from $600,000 to $165,000. So instead of $300,000, your client only pays $165,000. A windfall of $135,000 thanks to the R&D tax incentive.

MORE

[SIS Act NANI]

[Early Stage Innovation Companies]

[SIS v Tax Dependants]

Disclaimer: *Tax Talks does not provide financial or tax advice. This applies to these show notes as well as the actual podcast interview. All information on Tax Talks is provided for entertainment purposes only and might no longer be up to date or correct. You should seek professional accredited tax and financial advice when considering whether the information is suitable to your or your client's circumstances.*
