

The New R&D Tax Incentive: Key actions for your business

Background

The Federal Government introduced the *Tax Laws Amendment Bill (Research & Development) Bill 2010* (Bill) into Parliament on 13 May 2010. The Bill proposes to introduce the new research and development (R&D) tax incentive (to replace the existing concession) and is due to take effect from 1 July 2010.

Below we have summarised the new Bill and provide some key action points to assist you in preparing your business for the new program. Our February 2010 edition of *TaxTalk* provided readers with an overview of the incentive based (at that time) on exposure draft legislation.

Main aspects of the new program

The Bill confirms that the new R&D tax offset will be two-tiered as follows:

- 45 per cent R&D tax offset (refundable) for companies with group aggregated turnover less than \$20 million, and

- 40 per cent R&D tax offset (non-refundable) for companies with group aggregated turnover of \$20 million or more.

Action One: Grouped turnover

Based on your anticipated group aggregated turnover for the 2011 year consider whether you will likely be eligible for the refundable R&D tax offset. The refundable R&D tax offset may be a significant source of funding for many start up operations since refunds can be obtained even even though no income tax may be payable.

Action Two: New definition of Core R&D Activities

A new definition of core R&D activities has been included, which does not refer to the existing terms 'innovation', 'novelty' or 'technical risk'. Under the new definition, core R&D activities as defined in the Bill:

- must be 'experimental activities whose outcome cannot be known or determined in advance'



- are to be determined by 'applying a systematic progression of work that is based on principles of established science', and
- are conducted for the purpose of generating new knowledge.

You should gain an understanding of the new definition to determine whether your R&D activities meet the criteria provided above, and to ensure that you maintain appropriate evidence on file to substantiate any R&D activities that you believe satisfy the new definition.

Action Three: Dominant purpose test

The new program includes a ‘dominant purpose’ test for supporting R&D Activities in some circumstances. Generally, supporting R&D activities will be eligible for the R&D offset concession where they are ‘activities directly related to core activities’. However, a stricter ‘dominant purpose’ applies to supporting core R&D activities if the activities:

- appear on the ‘exclusions list’ (e.g. market research, prospecting, management studies, and so on); or
- are (or directly related to) the production of goods or services.

The Bill provides claimants with greater clarity regarding eligible activities by removing quality control, pre-production activities (including demonstrating commercial viability, tooling-up and trial runs) as well as routine collection of information from the exclusions list.

You will need to delineate between core and supporting activities within your R&D projects. We recommend that appropriate protocols are implemented to ensure that R&D undertaken in a commercial setting (and the relating process and outcomes) is correctly documented and that clear evidence of a dominant R&D purpose can be provided.

Action four: Software R&D

Software R&D continues to be supported and will only be excluded from the program if developed for ‘internal administration’ use. However it may still qualify as supporting R&D if it is directly related to core activities, and it satisfies the ‘dominant purpose’ test. Software that is developed for sale or is embedded in other products or devices is not intended to be caught by the internal administration exclusion. Similarly, software developed to facilitate the on-line delivery of a company’s goods and services is also not intended to be caught by the exclusion.

The purpose of undertaking software R&D should be clearly documented, and additionally you will need to consider whether the activities are core or supporting R&D in relation to the overall R&D project. If software is developed for internal use but supports another core R&D activity, consider whether it satisfies the dominant purpose test.

Action Five: Registration requirements

Registration under the new program will require companies to differentiate projects between core and supporting R&D activities.

Ensure that you have the appropriate processes in place to clearly identify and document between core and supporting R&D activities.

Action Six: Administration

Innovation Australia will have greater powers in relation to registration of activities and has foreshadowed that it will subject applications to greater scrutiny prior to granting registration. It will also have the ability to provide private binding rulings, which is a major change and will provide an increased level of certainty to claimants.

Focus on preparing a robust R&D claim and consider whether it might be appropriate to seek a private binding ruling in relation to your R&D activities.

Action Seven: Changes from the second Exposure Draft

The main changes tabled in the Bill from the second Exposure Draft released on 31 March 2010 are as follows:

- The addition of the feedstock provisions (which were not previously released). The new rules are intended to act similarly to the existing program, however rather than limiting the amount of the R&D tax offset, the provisions act to instead increase a company’s tax liability when a company sells a feedstock output (or applies it for use), aimed to negate the benefit the company claimed under the R&D tax offset.



- A number of activities were removed from the 'exclusions list' as detailed above.

An understanding of the operation of new feedstock provisions will be required by companies to ensure that feedstock output and any increase in tax liability is correctly understood, calculated and applied.

Other aspects of the program

Other aspects affirmed in the Bill include:

- Foreign owned R&D will be able to access the program (regardless of cost reimbursement).
- The 'expenditure not at risk' provisions are contained in the Bill but do not apply to activities undertaken in Australia for foreign related companies.
- Overseas activities will be allowed at higher expenditure levels as costs will now be able to be included, as long as the overseas costs are less than the Australian R&D costs. However, companies will still be required to meet certain approval and other eligibility requirements.
- The receipt of R&D related grants does not affect the availability of the R&D tax offset. However similar to the new feedstock provisions, an extra tax liability applies to negate the benefit received from the grant related R&D tax offset.

- Core technology expenditure will no longer be eligible for support and the normal tax treatment to such expenditures will apply.

Action Eight: Other considerations

Companies should assess the impact of the new program upon their business, particularly in circumstances where there is:

- significant spending on R&D, especially where R&D claims involve work under contract or costs of production.
- R&D services undertaken for a foreign parent company.
- expectation of significant overseas R&D costs.

What happens now and what you need to do

The new legislation has been referred to a Senate Committee for its consideration. The Committee's report is due by 15 June 2010 ahead of the intended start date of 1 July 2010.

To prepare your business for the new program, we suggest you follow the eight actions outlined above. Please contact a member of the R&D team listed below if you require assistance with understanding the new program and related definitions, establishing your new R&D processes and the implementation of protocols.



For more information please contact your usual PricewaterhouseCoopers advisor or:



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