Proposed changes to R&D Tax Incentive: effect on the net benefit for R&D entities with turnover above $20m

10 March 2020

On 5 December 2019, the Government re-introduced its proposal to amend the R&D provisions via the *Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019*. The new bill includes the changes set out below (among others). The objective of the proposed changes is to “better target” the R&D Tax Incentive by encouraging additional R&D while also ensuring its integrity and fiscal affordability. If passed in its current form, these changes will be effective for income years commencing from 1 July 2019:

- For small R&D entities (i.e. aggregated annual turnover less than $20 million), the R&D tax offset will be the entity’s corporate tax rate for the income year, plus 13.5 percentage points. The amount of a refund that an R&D entity can receive will be capped at $4 million per annum, except for clinical trials, which will remain uncapped.
- The R&D tax offset for large R&D entities will be intensity-based, with the offset equal to the entity’s corporate tax rate plus marginal intensity premiums determined with reference to the entity’s R&D intensity, on an incremental basis as follows:

R&D Intensity Range	**Intensity Premium** *(percentage points above company tax rate)*
0 – 4%	4.5%
4 – 9%	8.5%
> 9%	12.5%

The impact of the rate changes

Under the current R&D Tax Incentive legislation, R&D entities with aggregated annual turnover of greater than $20 million are entitled to a 38.5% non-refundable offset. As the R&D offset rate is fixed, the net benefit arising from the R&D Tax Incentive is affected by the company’s tax rate. For the 2019 income year, the company tax rate for a base rate entity (broadly, those with aggregated annual turnover of less than $50 million) was 27.5% and the company tax rate for all other companies was 30%. Therefore, for the 2019 income year, the net benefit accruing to R&D entities ranged from 8.5% to 16%.

If the new bill is passed into law in its current form, entities with aggregated annual turnover between $20 million and $50 million, for which the current net benefit is 11%, will need to have an R&D intensity of 35% to obtain an effective R&D offset rate that is equivalent to existing legislation. For R&D entities with a company tax rate of 30%, an R&D intensity of 13% will be required to achieve a net benefit of 8.5%, equivalent to what is currently available. The R&D intensity will be determined by expressing the entity's R&D expenditure (notional deductions) as a proportion of its total expenses. Total expenses will be the R&D entity's total expenses reported in its company tax return.

Australia spends around 2.2% of GDP on R&D. Obviously, it is not a direct equivalent, but an Australian large R&D entity spending 2.2% of its sales on R&D would only be eligible to access the lowest tier of the R&D premium of 4.5% under the proposed bill. This compares to 11% currently available to base rate large R&D entities and 8.5% for all other large entities with turnover over $50m.

On 6 February 2020, the Senate referred the new Bill to the Economics Legislation Committee, which has recommended that the Senate defer consideration of the Bill until further analysis of the impact of the proposed changes to the R&D Tax Incentive. Submissions to the inquiry closed on Friday 6 March 2020 and the submissions made can be viewed here: *http://bit.ly/2PRMM9e*

The Economics Legislation Committee is due to issue its report by 30 April 2020.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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