

A silhouette of a wind farm with several wind turbines against a blue and white sky. The turbines are arranged in a line across the horizon.

Technical update

Research & development

Changes to the R&D tax concession will enable Australian subsidiaries of foreign multinationals to access the R&D tax concession, therefore encouraging further R&D investment in Australia.

R&D tax concession

Access to the 175% premium deduction by Australian subsidiaries of multinational corporations

On the 16th August 2007, the Federal government introduced into parliament amendments to the R&D tax concession. The purpose of the proposed amendments is to give effect to the Prime Minister's budget announcement on 1 May 2007, to encourage foreign companies to invest in R&D in Australia by extending the operation of the 175% premium deduction to subsidiaries of multinational corporations. Traditionally, Australian subsidiaries of multinational companies have been prevented from accessing the R&D tax concession, due to the fact that the resulting Intellectual Property (IP) is not held in Australia or that the costs incurred by the subsidiary are reimbursed by the overseas parent company. The proposed changes will enable Australian subsidiaries of foreign multinationals to access the R&D tax concession at the premium rate, encouraging further investment in R&D in Australia by foreign companies.

Current provisions

It is common practice for Australian subsidiaries of foreign multinationals to conduct R&D activities in Australia. However, in many instances, subsidiaries are unable to access the R&D tax concession due to the fact that they fail one or more of the eligibility criteria. Two of the cornerstone eligibility requirements for a company seeking to claim the R&D tax concession are that firstly, the R&D activities are conducted 'on behalf of' the company seeking to claim the concession, and secondly, that the expenditure incurred by the company that is undertaking the R&D activities is not guaranteed (i.e. reimbursed) by a third party.

Due to the operation of these provisions, although a local subsidiary may otherwise be conducting eligible R&D activities, it is often precluded from claiming the concession because either the resultant IP from the conduct of the R&D activities vests with a foreign parent or it has entered into contractual arrangements whereby the foreign parent agrees to finance the R&D activities on a 'cost plus' basis. With respect to either one of these arrangements (i.e. ownership of IP not held by the Australian subsidiary or where the arrangement between the parent and subsidiary is a cost plus arrangement) the Australian

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subsidiary company is currently unable to claim the concessionary tax deduction. Thus there is currently little incentive for a multinational to invest in R&D in Australia.

Key changes

A number of changes to the legislation are currently before parliament, which aim to give effect to the federal government's budget announcements. The key changes proposed include:

- Australian subsidiaries of foreign multinationals will no longer be required to own or intend to exploit the IP resulting from the conduct of R&D activities. Activities that are undertaken in Australia but result in IP being held by the overseas multinational will now be referred to as 'foreign owned R&D';
- Reimbursement of R&D expenditure incurred by local Australian subsidiaries by a foreign multinational will not preclude the subsidiary from claiming the 175% premium amount;
- In order to access the 175% concession, there must be a direct agreement between the local subsidiary and foreign parent in respect of the performance of the R&D activities (although there is some ability to enter into subcontracted arrangements with third parties);
- Where a multinational has had a presence in Australia by way of an Australian subsidiary, but has not claimed the R&D tax concession in the past, then deeming provisions will create an R&D spend history for the 3 previous years. This will enable eligible companies to claim the 175% deduction immediately;
- Foreign companies that have had no prior presence in Australia will be deemed to have a 'nil' R&D spend history. This means that companies eligible under this provision will be able to claim the first years eligible R&D spend at the 175% rate;
- In relation to R&D conducted by Australian subsidiaries, any supporting activities undertaken by a local subsidiary must be 'principally for R&D purposes'. This is somewhat narrower than the current definition for supporting R&D activities for Australian owned companies conducting Australian owned R&D;
- Expenditure on foreign owned R&D by Australian subsidiaries under these provisions will not be eligible to be claimed under the tax offset provisions; and
- The provisions only apply to Australian subsidiaries of multinational companies where the multinational company is resident in a country that has a double tax agreement with Australia.

Opportunities

Perhaps one of the most significant opportunities that exists for foreign companies is in respect of immediately accessing the 175% premium by virtue of a 'nil' R&D spend history. Where a foreign multinational first establishes a local subsidiary in Australia and that subsidiary conducts R&D activities on behalf of the foreign parent, the local subsidiary may be able to access the premium rate for all eligible R&D spend in the first year of a claim. In other words, all expenditure incurred in the first year of establishing the local presence in Australia will be eligible to be claimed at 175%. Traditionally companies have had to wait until their fourth year

of registration for the R&D tax concession prior to being eligible for the premium benefit.

Foreign companies that already have a local presence in Australia, but have not been able to access the R&D tax concession due the 'on own behalf' or 'guaranteed return' provisions will also have an opportunity to access the 175% premium from the first year of making a claim. The premium will be based on a 'deemed' R&D historical spend, calculated as a percentage based on the first year's R&D claim. In some instances, this will allow a company to claim the concession at the 175% rate, when previously their claim had been limited to the 125% concession.

Traps in proposed changes

Arrangements entered into between local subsidiaries and foreign parents must be considered carefully to ensure that the arrangements satisfy the requirements of the new provisions. In particular, any agreement must be in writing and only be between the parent and local subsidiary. Agreements that are broad and encompass direct references to other parties may fail to satisfy the revised provisions, resulting in the expenditure on the foreign owned R&D being deemed as ineligible for the 175% premium. However, it should be noted that, in complying with this requirement, the provisions do not prevent sub-contracting agreements for the conduct of R&D activities.

Where foreign companies acquire or divest Australian subsidiaries, care must also be taken as to the potential impact such changes may have on the group's R&D expenditure history. For example, though a newly established Australian presence may be eligible to access the 175% premium for all eligible foreign owned R&D expenditure in the first year, the subsequent acquisition of a local company may change this eligibility, such that the group has an actual or deemed R&D spend history. This has the potential to reduce access to the R&D tax concession.

The provisions dealing with the calculation of a company's R&D tax deduction are complicated where the Australian subsidiary conducts both foreign owned R&D and Australian owned R&D. This can be further complicated where there have been acquisitions and divestments of entities in Australia, and where an entity may have been a grant recipient. As such, it is essential to ensure access to the maximum concession is taken into consideration when acquiring or divesting companies engaged in R&D.

What next?

There are a number of steps involved in determining the eligibility of a company to claim the premium deduction in respect of foreign owned R&D, including confirmation of the eligibility of agreements, ascertaining the appropriate R&D spend history and assessment of Australian owned R&D versus foreign owned R&D.

BDO Kendalls has a specialist R&D tax concession team that can provide tailored assistance to suit your business needs in this emerging area of R&D law.

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About BDO Kendalls

Success in business depends on many things. Most of all, it depends on you and your ability to recognise and grasp opportunities, anticipate issues before they become problems, distinguish the important from the urgent and motivate your team to share your vision. BDO Kendalls has provided business advisory and consulting services to the Australian business community for almost 100 years.

Our specialist services will provide the edge you need in your business to ensure exceptional delivery of results, through our unparalleled priority to service our clients. While we focus on local delivery of our services, it is reassuring to note that BDO Kendalls in Australia is part of an international network with over 625 offices in 109 countries combining local distinctiveness with global capability.

About the BDO Kendalls R&D tax concession team

The BDO Kendalls' R&D practice provides organisations with access to a dedicated team of specialists, who can assist your business with all aspects of your R&D claim. Our team, which includes ex-ATO and ex-AusIndustry officers, takes a hands on approach to the claim process, spending time to understand your business and how best to maximise your investment in innovation. Our realistic pricing, experience and Partner-led approach enables the BDO Kendalls team to deliver what our clients want - robust and sustainable R&D claims that deliver value.

For further information on how our Research & development team can assist with solutions for your organisation, please phone us on the number below or visit our website.

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