



Federal Budget Update

R&D tax credits

A fresh start.

The proposed changes to the Research and Development (R&D) tax concession, contained in Labor's second Budget, represent a fundamental shift in the Government's approach to rewarding businesses engaged in R&D activities. The announced changes, which coincided with the release of the Government's long awaited White Paper, *Powering Ideas: An Innovation Agenda for the 21st Century*, are geared towards providing Australian businesses with a simpler, more predictable and more equitable scheme to reward innovation, when compared to the current R&D program.

By introducing the new R&D tax credit program, the Government is clearly seeking to motivate Australian business with an additional incentive to dedicate increasingly scarce resources to R&D activities. At the same time, the Government's reforms also appear to be aimed at providing Australian businesses with clarity and certainty as to the financial benefits they can expect from their investment in innovation, something that is widely acknowledged as a weakness in the current R&D tax concession program.

BDO Kendalls' comment

The 2009/2010 budget has been presented in terms of setting a basis to assist Australia navigate its way through an increasingly bleak global economic environment.

It is our view that, faced with the challenges associated with keeping a burgeoning deficit under control, the Government's decision to commit to \$1.4 billion in spending on the R&D tax credit program over the next 4 years is a strong reaffirmation of the integral nature and pivotal role R&D plays in assisting businesses develop innovative ideas and products. These are the same innovative ideas and products that the Government hopes will enable Australian businesses from all industries and regions to prosper and develop a competitive advantage on a global scale.

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Key highlights

For income years commencing from 1 July 2010, the current 125% and 175% R&D tax concession scheme will be replaced with an R&D tax credit scheme. Key points in relation to the changes include:

- a 45% refundable tax credit (the equivalent to a 150% deduction) will be provided to small businesses with a turnover of less than \$20 million per annum;
- a 40% non refundable tax credit (the equivalent of a 133% deduction) will be provided to firms with a turnover of more than \$20 million per annum and to firms that undertake R&D on behalf of foreign parents; and
- the increased benefits to business are balanced by removal of the overly complex R&D tax concession premium provisions and a tightening of a number of key definitions in order to support only genuine R&D activities.

The detail

Groups with turnover less than \$20 million

A 45% refundable tax credit will be available to firms with a group turnover of less than \$20 million per annum. This change not only represents a doubling of the rate of support currently available under the tax concession, it also opens up the ability to access immediate funding, by way of a refundable tax credit, to a much wider range of businesses, when compared to the current tax concession program. Under the current tax offset provisions, only businesses with a group turnover of less than \$5 million and R&D expenditure of less than \$1 million are eligible to 'cash out' losses associated with their expenditure on R&D activities.

Under the new R&D tax credit scheme, the \$5 million turnover limit has been increased to \$20 million, and the upper R&D expenditure limit of \$1 million has been completely removed. This fundamental change should provide a significant economic advantage for small to medium Australian enterprises, rewarding their investment in innovation by freeing up cash reserves, in the form of the refundable tax credit.

As a transitional measure for the 2009/10 income year, the R&D expenditure cap associated with the R&D tax offset program will be increased to \$2 million. This measure should provide a significant number of additional businesses with access to the cash benefits under this program.

Groups with turnover greater than \$20 million

A 40% non-refundable tax credit will be available to businesses with a group turnover of more than \$20 million per annum. The 40% non-refundable tax credit equates to a saving of 10 cents for every dollar incurred on eligible R&D expenditure – an increase from the 7.5 cents in the dollar available under the current scheme.

In addition, the 40% non-refundable tax credit scheme will be extended to circumstances where Australian businesses are conducting R&D in Australia on behalf of a related overseas company, even though the overseas company may hold the results of the R&D activities.



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Additional proposed changes

The replacement of the R&D tax concession scheme with the new R&D tax credit scheme also brings to an end the 175% premium tax concession. This means that the 2009/2010 income year will be the last opportunity for companies to access the 175% concession.

As highlighted in the Cutler Review of Australia's innovation policy, the 175% concession was viewed as a particularly complex concession and, as such, it was difficult for businesses to predict the benefit they could be entitled to. The Cutler Review also came to the conclusion that the additional 175% concession did not materially influence business attitudes to the conduct of R&D activities and, as such, provided little or no incentive for companies to undertake additional R&D activities. In recognition of Cutler's findings, the 175% premium concession no longer forms part of the Government's innovation policy.

The other major change alluded to in the Budget is that the eligibility criteria for the R&D tax credit will be 'tightened up' to ensure that only genuine R&D receives support and that the Government's support for innovation is better targeted. The Budget Papers indicate that the Government will release a consultation paper in mid 2009 to progress this issue further.

BDO Kendalls' comment

One of the Government's motivations for introducing an R&D tax credit system was to bring clarity and transparency to what is currently a very complex program of R&D concessions. By omitting some basic details as to the manner in which the Government intends to administer the program, many companies will be confused as to whether they are eligible to make a claim under the new program.

Of particular concern is the issue of how non-refundable tax credits are to be treated in the hands of loss making businesses. If, for example, there is no facility to carry unused non-refundable tax credits forward (to be credited against future tax liabilities), a significant number of Australian businesses will have no ability to access the Government's key innovation incentive.

The current difficult economic conditions are likely to put some successful Australian businesses into temporary loss positions and, unless non-refundable R&D tax credits are able to be carried forward, many Australian businesses will be denied the benefits of this initiative when they most need it. As such, it is BDO Kendalls' view that the most pressing issue arising from the announced changes is the need for the Government to provide further clarification on the ability for companies in tax loss situations to carry forward the R&D tax credits.



What next?

Given that the changes to the current R&D incentive program will not take effect until 1 July 2010, this provides companies with an excellent opportunity to start thinking strategically about maximising the benefits associated with their R&D spend. For example, companies with increasing levels of R&D expenditure may wish to bring R&D spending forward, in order to take advantage of the 175% premium concession while it is still available. Companies that would benefit from the increased incentives offered under the new changes may investigate their ability to hold off incurring R&D expenditure until the new scheme takes effect. Also, companies would be prudent to consider whether there may be scope to legitimately maximise their R&D claims prior to the tightening of the definition of R&D activities.

As a final note, BDO Kendalls is pleased that the government is seeking industry consultation with respect to the redefinition of R&D from a taxation perspective. We look forward to being an integral part of this process and ensuring that the R&D tax credit scheme remains focused on incentivising Australian businesses to achieve commercially focused outcomes.

About the BDO Kendalls R&D tax 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.

More information

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