Budget 2018

FACT SHEET
Tax Integrity

Reforming the R&D Tax Incentive

The Government is reforming the Research and Development Tax Incentive (R&DTI) to reward additional investment in R&D while also ensuring the integrity and fiscal affordability of the R&DTI.

The 2016 Review and the Government's reforms

The 2016 Review of the R&DTI (the Review) found that the R&DTI does not fully meet its stated policy objectives and made recommendations to improve the effectiveness, integrity and additionality of the program. The cost of R&DTI was expected to be $1.8 billion per annum when it was introduced in 2011-12; in 2016-17 it cost around $3 billion.

The Government's reforms will:

- improve the integrity of the R&DTI, helping ensure ineligible R&D claims are denied;
- continue to provide support for smaller companies that undertake R&D activities; and
- refocus support for larger companies towards those undertaking additional, higher intensity R&D.

Improve the integrity of the Research and Development Tax Incentive

Although the majority of taxpayers do the right thing, some claimants, spread across all industry sectors, have engaged in behaviour such as incorrect self-assessment of eligible R&D activities, exaggerating their expenditure claims, 'pushing the boundaries' of the interpretation of the R&D definition and engaging in other forms of non-compliance.

The Government will implement a series of compliance, enforcement and administration changes to improve the integrity of the R&DTI.

This will help maximise the returns to the Australian community from the investment of public money in the R&DTI.

Integrity: strengthening anti-avoidance rules in the tax law so the ATO can ensure taxpayers do not avoid paying their fair share of tax by using tax schemes involving the program;

Enforcement: additional resourcing so the Government can help ensure that ineligible R&D claims are denied;

Transparency: publishing company names claiming the R&DTI and the amounts of R&D expenditure they have claimed, to improve public accountability for R&D claimants;

Guidance: enabling Innovation and Science Australia to produce public findings similar to the ATO, and provide more effective, binding guidance on the scope of what is eligible R&D. This will help ensure taxpayers do not unintentionally misinterpret the meaning of the law; and

Administration: imposing a three month limit on extensions of time available from when applications, registrations and reviews are due.

Smaller companies will continue to benefit from a refundable R&D tax offset

The R&DTI provides critical cash flow support for start-ups who are often unprofitable in early years. However, the Government must also make sure taxpayer dollars are spent responsibly and the program is fiscally affordable.

To this end, the Government will, from 1 July 2018:

- Introduce a $4 million annual cap on cash refunds for R&D claimants with aggregated annual turnover less than $20 million. Amounts that are in excess of the cap will become a non-refundable tax offset and can be carried forward into future income years;

- Exclude R&D tax offsets for clinical trials from the $4 million cap on cash refunds, recognising the critical role of R&D expenditure on clinical trials in developing life changing drugs and devices; and
- Amend the refundable R&D tax offset so it is a premium of 13.5 percentage points above the claimant's company tax rate for that year.

A $4 million cap on cash refunds continues to provide generous support for small innovative Australian companies and contributes to fiscal affordability. It is consistent with the recommendations of the ISA 2030 Strategic Plan and the Review to place a cap on cash refunds from the refundable offset.

Linking the rate of the R&D offset to the claimant's company tax rate reduces the need for ongoing legislative amendment of tax offset rates as company tax rates change. It will ensure that companies receive a fixed premium (above the value of a tax deduction) for R&D expenditure as the Government's tax cuts under the Enterprise Tax Plan take effect.

Refocus support for larger companies towards higher intensity R&D

A key finding of the Review is that the R&DTI is not achieving its objectives of encouraging greater additionality and that greater benefits accrue to the community from companies that are R&D intensive.

The Government's reforms will support and reward higher, more intensive, additional R&D investment.

The Government will, from 1 July 2018, introduce a new research and development premium for companies with aggregated annual turnover of $20 million or more, which provides higher rates of R&D support for higher R&D intensity (that is, the proportion of R&D expenditure over total annual expenditure). The research and development premium will provide multiple rates of non-refundable R&D tax offsets, increasing with the intensity of the claimant's incremental R&D expenditure.

The Review found that among larger companies, those with higher R&D intensity provide the greatest benefits to the Australian economy. Encouraging more companies to increase their R&D intensity and undertake additional R&D activities is a key objective of the R&DTI.

The research and development premium has been developed in recognition that many larger companies undertake research and development and that this should be afforded a baseline level of support, but stronger incentives are required for them to increase their overall R&D intensity.

Consistent with this objective, the Government will also, from 1 July 2018 increase the $100 million R&D expenditure threshold to $150 million, allowing larger companies to continue to be rewarded for additional R&D they undertake as they grow.

R&D premium example for a larger company

A company with a 30 per cent tax rate that has $120 million of R&D expenditure for the year and $300 million of total expenditure will have an overall R&D intensity of 40 per cent. It claims R&D tax offsets at a rate of 34 per cent for the first $6 million of R&D expenditure, 36.5 per cent for the next $9 million of R&D expenditure, 39 per cent for the next $15 million of R&D expenditure and 42.5 per cent for the final $90 million of its R&D expenditure. It also benefits from the increased $150 million R&D expenditure threshold as it can claim concessional R&D tax offsets for its R&D expenditure that exceeds $100 million, rather than claiming these offsets at the company tax rate.

The new R&D tax offsets

R&D Tax offset	Rate of offset
Refundable R&D Tax offset (companies with aggregated annual turnover less than $20 million)	The claimant's tax rate for the year plus 13.5 percentage points.
Non-refundable R&D Tax offset (companies with aggregated annual turnover of $20 million or more)	The claimant's tax rate for the year, plus: • 4 percentage points for R&D expenditure between 0 per cent and 2 per cent R&D intensity (inclusive); • 6.5 percentage points for R&D expenditure above 2 per cent to 5 per cent R&D intensity (i.e. not including R&D expenditure falling within the first 2 per cent of the claimant's total expenses for the year); • 9 percentage points for R&D expenditure above 5 per cent to 10 per cent R&D intensity (i.e. not including R&D expenditure falling within the first 5 per cent of the claimant's total expenses for the year); and • 12.5 percentage points for R&D expenditure above 10 per cent R&D intensity (i.e. not including R&D expenditure falling within the first 10 per cent of the claimant's total expenses for the year).

Financial impacts

The package provides a net gain to the budget of around $2 billion over the forward estimates period. By improving integrity, the package allows the Government to reward those larger companies undertaking incremental, high intensity R&D, improve the affordability of the program and fund other investments being made as part of the Budget.