

Consultation on the draft Treasury Laws Amendment (Research and Development Incentive) Bill 2018 and Explanatory Materials

June 2018



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Consultation Process

Request for feedback and comments

The purpose of this paper is to highlight key questions on the implementation of the Government's 2018-19 Budget measure – *'Better targeting the research and development tax incentive'*. The Government is seeking stakeholder feedback on the implementation of this measure, specifically:

- The calculation of R&D intensity under the R&D premium; and
- The process for implementing a 'clinical trials' exemption under the \$4 million cap on annual cash refunds.

Comments on other matters in the draft Bill and Explanatory Materials are also welcome.

The outcomes of this consultation will feed into the finalisation of legislation required to implement this measure. Interested parties are invited to submit their responses to the discussion questions in the document, which have also been reproduced at Appendix A.

Electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted.

If you would like part of your submission to remain in confidence, you should provide this information marked as such in a separate attachment. A request made under the Freedom of Information Act 1982 (Cth) for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Please note all submissions, including those that are confidential, will be shared with the Department of Industry, Innovation and Science, the Department of Health, the Australian Taxation Office (ATO) and other Government agencies as required for the purposes of this consultation.

Closing date for submissions: 26 July 2018

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The principles outlined in this paper have not received Government approval and are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.

Research and Development Tax Incentive

Reforming the Research and Development Tax Incentive

The 2016 *Review of the R&D Tax Incentive* and the 2018 *Innovation and Science Australia 2030 Strategic Plan* found the R&DTI did not fully meet its policy objectives, particularly in inducing business research and development expenditure beyond business as usual activities. The Government's response acknowledges these reports' findings with a package of reforms to enhance the additionality, integrity and fiscal affordability of the R&DTI.

2018-19 Budget Announcement

As announced on 8 May 2018, the Government will amend the R&DTI to better target the program and improve its integrity and fiscal affordability in response to the recommendations of the 2016 *Review of the R&D Tax Incentive*. The changes will apply for income years starting on or after 1 July 2018.

For companies with aggregated annual turnover of \$20 million or more, the Government will introduce an R&D premium that ties the rates of the non-refundable R&D tax offset to the incremental intensity of R&D expenditure as a proportion of total expenditure for the year. The marginal R&D premium will be the claimant's company tax rate plus:

- 4 percentage points for R&D expenditure between 0 per cent to 2 per cent R&D intensity;
- 6.5 percentage points for R&D expenditure above 2 per cent to 5 per cent R&D intensity;
- 9 percentage points for R&D expenditure above 5 per cent to 10 per cent R&D intensity; and
- 12.5 percentage points for R&D expenditure above 10 per cent R&D intensity.

The R&D expenditure threshold — the maximum amount of R&D expenditure eligible for concessional R&D tax offsets — will be increased from \$100 million to \$150 million per annum.

For companies with aggregated annual turnover below \$20 million, the refundable R&D offset will be a premium of 13.5 percentage points above a claimant's company tax rate. Cash refunds from the refundable R&D tax offset will be capped at \$4 million per annum. Refundable R&D tax offsets from R&D expenditure on clinical trials will not count towards the cap. R&D tax offsets that cannot be refunded will be carried forward as non-refundable tax offsets to future income years.

The Government will further improve the integrity of the R&DTI by implementing stronger compliance and administrative improvements. These improvements include increased resourcing for the Australian Taxation Office (ATO) and Department of Industry, Innovation and Science, which will be used to provide improved program guidance to claimants, supported by greater enforcement activity. Other changes include improving the transparency of the program by enabling the ATO to publicly disclose claimant details, including the R&D expenditure they have claimed; limits on time extensions to complete R&D registrations; and amendments to technical provisions (such as the feedstock and clawback rules and the general anti-avoidance rules).

The package is estimated to have a net gain to the budget of \$2.4 billion in fiscal balance terms over the forward estimates period. In underlying cash terms, the net gain to the budget is \$2.0 billion over the forward estimates period.

TREASURY LAWS AMENDMENT (RESEARCH AND DEVELOPMENT INCENTIVE) BILL 2018 AND EXPLANATORY MATERIALS

Calculation of R&D Intensity – total expenditure

Proposed implementation

As outlined in the draft Bill and Explanatory Materials, incremental R&D intensity will be calculated as eligible R&D expenditure as a percentage of total expenditure, such that:

$$R\&D\ intensity = \frac{\text{eligible R\&D expenditure (R\&D notional deductions)}}{\text{total expenditure (expenditure)}}$$

Eligible R&D expenditure (up to \$150 million) will be determined from the R&D notional deductions of the claimant. The total expenditure will be based on that of the claimant, which would be retrieved from the claimant's own tax return.

This approach, while administratively simple, requires careful consideration as to whether it would give rise to integrity concerns. An R&D intensity calculation on a claimant level may not appropriately reflect the R&D intensity of the claimant as part of its broader economic group. Examples of where this might occur include where companies have diverse and non-consolidated business structures. Feedback on appropriate means of addressing integrity concerns is welcome.

Questions

1. Do you foresee any implementation and ongoing compliance challenges arising from the proposed calculation of R&D intensity?
2. Does the proposed method of calculation of R&D intensity pose any integrity risks?
3. Could total expenditure be aggregated across a broader economic group? Would this create any implementation and ongoing compliance challenges?

Clinical Trials exemption under the \$4 million refund cap

Proposed implementation

As outlined in the draft Bill and Explanatory Materials, R&D entities with an aggregated annual turnover less than \$20 million may receive an exemption from the \$4 million refund cap for clinical trials expenditure provided Innovation and Science Australia (ISA) determines the eligible R&D expenditure also satisfies the definition of a clinical trial.

For the purposes of the R&DTI program, the proposed definition of a clinical trial is based on that of the Therapeutic Goods Administration (TGA). As noted in the Explanatory Materials:

“A clinical trial is a planned study of the safety or efficacy in humans of an intervention (including a medicine, treatment or diagnostic procedure) with the aim of achieving at least one of the following:

- *the discovery, or verification, of clinical, pharmacological or other pharmacodynamic effects;*
- *the identification of adverse reactions or adverse effects;*
- *the study of absorption, distribution, metabolism or excretion.”*

TREASURY LAWS AMENDMENT (RESEARCH AND DEVELOPMENT INCENTIVE) BILL 2018 AND EXPLANATORY MATERIALS

To facilitate the exemption of clinical trial expenditure, ISA will have expanded authority to make findings binding on the Commissioner of Taxation about the eligible R&D activities that qualify as 'clinical trials'. This authority is consistent with ISA's current powers to make findings on whether an entity's activities are R&D activities.

This carve-out is available only on R&D expenditure incurred directly on the identified clinical trial activity. Clinical trial expenditure reported by R&D entities as part of their ongoing registration must match the expenditure amounts subsequently reported to the ATO. Current definitions around core and supporting R&D activities, as well as the requirements around overseas expenditure, will continue to operate unchanged.

To reduce undue administrative burden for the majority of R&D entities, the clinical trial carve out will operate on an opt in basis, and form part of existing registration and finding processes.

Questions

4. Does the definition of clinical trials for the purpose of the R&DTI appropriately cover activities that may be conducted now and into the future?
5. Does the proposed finding process represent an appropriate means of identifying clinical trials expenditure for the purposes of the \$4 million refund cap?

Additional questions

Questions

6. Do the draft feedstock and clawback provisions give rise to any unintended consequences that need to be addressed?