

**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.

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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.

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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?

I envisage my company to reach over \$20m in coming years. In this aspect, I comment my view to this revised approach proposed above.

With over \$20m revenue (in the near future), I think this tax incentives to encourage R&D activities within my company is an improvement. Measuring the intensity of R&D expenditure over company expenditure, rewards expenditure, towards R&D in a more aggressive way i.e. I am spending most of my money on R&D because the non-R&D expenditure would have incurred and stabilised. The latter is not claimable under previous scheme but would be offset through this new scheme (if I understood this correctly).

When my company has \$20m revenue, I would anticipate R&D expenditure should reduce while revenues increase. The support for tax incentives should rightly reduce because my company had effective gain a foothold and should be satisfied. I wouldn't want to ask for more, in fact it should be time for me to give back to society.

My main business is in Marron, Olives and Sweet Potato thus do I anticipate more innovation when I reached \$20m? My answer will be yes, I have been in High-Tech environment and there is never lack of better ideas. At \$20m revenue, I would have engaged many professional, include scientist, engineers etc. It will these group of people that will provide the next level of R&D.

2. Does the proposed method of calculation of R&D intensity pose any integrity risks?

In my opinion, these amendments do not change the integrity of the client. If my intent is bad I will do everything to abuse the system.

With regards to client integrity I have the following comments and is not in order of preference and is purely my one-sided opinion:

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- a. Firstly, I have read many warnings to clients about cheating and some do end themselves in jail and also for their accountant. Not that is wrong to punish client who abuse the system in fact it could be the right thing to do. The scheme can be seen as too good a temptation for quick gain especially when client is in a group that think like wise. However, the karmatic effect works both ways. The one who puts the cash has the same blamed to the one who stole it. The same goes to the one who stole it receive the rightful karma but if the receiver took it positively and learned from its mistake then all should gain good karma however if resentment builds up while serving is due terms the one who dish out the punishment share the same down side of the karmatic effect. Therefore, neither the client nor the enforcer should put on the table where the money will clearly be abuse.
- b. How then can you ensure integrity process? There is of course no full-proof method but I would suggest the following:
 - i. Make it mandatory for the client to make claims to their R&D effort i.e., what sort of benefits cash returns, how long is going to take.
 - ii. True effort does not need lots of money and it takes time. These measures are clear to see the client's intention at first application. True efforts need help, no one can be a lone ranger except would be thefts because they need to keep to themselves or their intent will be exposed. True effort has likeminded people i.e. accountant who wants to see success of their business and not to think only the benefits of tax incentives.
 - iii. The client will have to repeat their stories during their R&D process because there are many regulators that has to approve their activities i.e. this is especially my case. These stories if genuine will not change but the details will and should improve over time i.e. the client's projection improves.
 - iv. More people to get involve the better. In the client's effort, external help or partnership would be needed i.e. this is especially so in my case. I will need help with power, housing, structural assessment, etc and partnership with relevant clients. It is good, for the department to provide extra service and match-make likeminded industry. When there are meetings, the client as well as others will benefit i.e. ideas, projection sharpen, share to resources etc. It will be easy for would be client that only has plan to abuse the system, to walk away and also easy for others to know that the client is not going to head in a way to self-sustain. Feedback to the right department should result i.e. no ones like myself would support wrong doing or I will share the downside of the karmatic effect.
- c. A dollar in the hands of genuine client would generate many times over the value. But the intangible benefits outweigh the monetary gains i.e. it brings messages, it transmits new learning, new ideas, new hope and it is this benefits that make people stop and think, hey, I feel better at this idea, there is hope etc. Then I notice people becomes sensible, it brings about a better individual that able to bring about a better family and then if everybody does that a better society. Regulators will drop their whips and words of advice will result instead because everyone is in

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their place, I meant literally. So, these are also good tell-tales signs that the R&D projects are worth supporting.

- d. Then what makes a human a person? I have my own practice and it had benefited me but it would not be appropriate to present here.

3. Could total expenditure be aggregated across a broader economic group?

No, I do not think should apply to a broader economic group. This is because this group has in excess of \$20M and with this revenue, for my company, I wouldn't be too mindful about getting more tax incentives. Unless, the effort could result in generation of patentable ideas, probably a few of the ideas could be Nobel Prize contended.

4. Would this create any implementation and ongoing compliance challenges?

The same difficulty the department is currently facing, in my opinion, will be the same. It is not in the system, the system is faultless, is the temptation that is difficult to control. How then can you manage temptation of your client? I offer one solution, often we think more than we speak and we speak more often than our action. This is wrong, we should allow our action to speak, speak than regulate our thinking that when thinking, speech and action are one, the result will be divine. I am sure you would know how to integrate this into your compliance.

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."*

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.

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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

5. 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?

My company currently do not have clinical trials but this should come in when I have scientist and professional on board.

Thus, I am not able to comments on this. My apology.

6. Does the proposed finding process represent an appropriate means of identifying clinical trials expenditure for the purposes of the \$4 million refund cap?

My company is not in clinical trails thus I cannot comments in this area. My apology.

Additional questions

Questions

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

In my opinion, I have gone through R&D even that of HongKong Gov, I think R&D tax incentives scheme provided by ISA is the most generous of all. I am using this as a stepping stone and would anticipate earning about \$1b within 7 years, touch wood. I can't speak for anyone else but there will not be any unintended consequences that need to be addressed. But I welcome auditors from ISA at any time, my set-up for Marron has begun, no marron yet (probably another 1 to 2 months I will be placing my first breeding stock) but the contraptions are emerging.

I do need help to secure Advance Finding so that my accountant will know what to claim for me.

I would like to take this opportunity to thank once again Science and Innovation AU for your funding and trust in my projects. As I claim before, I will pay every tax due.