Nexia Australia

Taxation Update

Research & Development Deadline Looms

April 2018

Lodge your 2017 R&D claims by 30 April 2018

Certain companies can claim a tax offset for expenditure incurred on R&D activities. The aim of this offset is to encourage companies to invest in R&D work to create new or improved materials, products, devices, processes and services.

To be entitled to claim the applicable R&D incentive in a company tax return for the year ended 30 June 2017, the company must register its R&D activities with AusIndustry (a division of the Department of Industry, Innovation and Science) by 30 April 2018 and if this deadline is missed the company will not be eligible for a R&D claim. We can assist you with lodging your claim.

Lodging your registration on time may give rise to the following benefits for you:

- a cash injection (e.g. a cash rebate equal to 43.5% of the amount spent on R&D activities) for companies that have aggregated turnover of less than $20 million a year; or
- a non-refundable tax offset of 38.5% for companies with aggregated turnover of $20 million or more a year (i.e. the offset reduces tax payable and therefore can only be used in years the company has taxable income).

This is the first year that the R & D offset is claimed at this lower rate. In 2016 the offset was 1.5% higher (i.e. 45% and 40% respectively).

What follows is a concise overview of how the R&D offset operates – our hope is that through this alert, Nexia Australia will provide you with more practical information so that we can continue our conversation with you about the potential R&D opportunities that may be available for you or your business.

Overview

- Tax offset
- Only companies
- Minimum $20,000 spend

R&D relief is provided in Australia through a tax based incentive program whereby the Australian Government provides **companies** with a cash rebate or tax offset (as opposed to a tax deduction) if they conduct eligible R&D activities and spend at least $20,000 on such R&D activities.

However, the size and nature of the offset and concessions differ depending on the turnover of the company as well as the amount of R&D expenditure incurred.

Clients conducting R&D activities through non-corporate / non-company structures may therefore want to consider incorporating their business structures or re-arrange the entity structure in which they conduct their R&D activities, because the incentive is NOT available to businesses conducting R&D activities through trusts, partnerships or as individuals.

The incentive is generally only available for R&D activities conducted in Australia, but in certain circumstances, R&D activities conducted outside Australia may qualify if the overseas activities have a significant scientific link to core R&D activities conducted in Australia and are not able to be conducted in Australia.

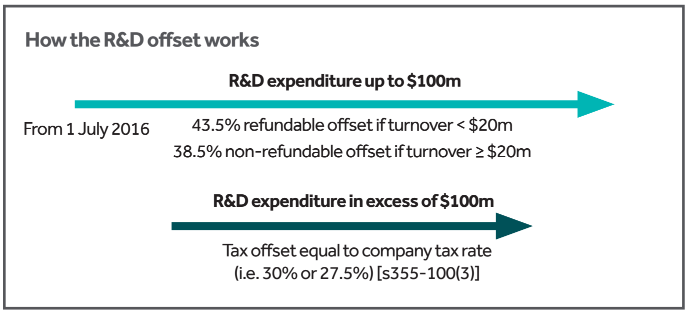
How does the R&D offset work?

- Do you spend more than $100 million on R&D?
- 43.5% refundable offset if group turnover < $20 million
- 38.5% non-refundable offset if group turnover ≥ $20 million

Subject to the conditions mentioned below, a company can claim in its tax return for the year ended 30 June 2017 a tax offset for deductions such as expenditure incurred on eligible R&D activities and for the decline in value of depreciating assets used in R&D activities provided the $20,000 expenditure requirement is met.

The size and the nature of the offset depend upon the company's turnover and the amount of R&D expenditure incurred by the company:

- For R&D expenditure up to $100 million:
  1. A company with a group turnover of less than $20 million can qualify for a 43.5% refundable offset (i.e. such smaller companies can receive a cash refund equal to 43.5% of the amount spent on eligible R&D activities, regardless of whether they are in a loss position or not); and
  2. A company with a group turnover of $20 million or more can qualify for a 38.5% non-refundable offset against tax payable (i.e. such companies which are in a loss position can carry forward their 38.5% offset to be deducted against tax payable in later years when they have taxable income).
- For R&D expenditure in excess of $100 million regardless of turnover, the tax offset will be limited to the company tax rate (i.e. 30% or 27.5%).



The 43.5% refundable offset available to smaller companies can therefore provide a cash injection to help start-ups that are often cash-strapped - for example, a startup company that is in a loss position for tax purposes which spends $1 million on R&D will receive a $435,000 cash refund under this incentive.

What are eligible R&D activities?

- Core & supporting R&D activities

Broadly, eligible R&D activities will create new or improved materials, products, devices, processes or services and can consist of either:

- **Core R&D activities** (broadly systematic experimental activities conducted for the purpose[1] of generating new knowledge); or
- **Supporting R&D activities** (broadly activities that relate to the core R&D activities).

Companies should meticulously document[2] how they are conducting their R&D activities as well as keep records of their observations, evaluations and conclusions resulting from these activities.

Some examples of activities that are **NOT** core R&D activities (but may be supporting R&D activities) include:

- Reverse engineering or developing computer software for internal administration;
- Market research, management studies or research in humanities, social sciences or arts; or
- Mineral exploration or activities to comply with statutory requirements or standards.

Warning: R&D Scheme involving grape growers and wine producers

The ATO has warned that grape growers and wine producers should not claim money paid towards the compulsory Wine Grapes Levy as eligible R&D expenditure in order to attempt to qualify for a 43.5% or 38.5% R&D offset.

Such a R&D claim will most likely not succeed because money spent on the levy does not necessarily have any connection with the R&D activities carried on – instead the expense on the levy may be deductible as a normal business expense.

Please speak to our Wine Industry specialists if you may be affected by this issue.

What are the formalities to claim the R&D offset?

- Lodge registration by 30 April 2018

The process involves two lodgments with two different government departments, the Department of Industry, Innovation and Science and the ATO. A company wanting to claim the R&D offset for an income tax year must lodge its registration with AusIndustry (a division of the Department of Industry, Innovation and Science within 10 months after year end.

This means that if a company conducted eligible R&D activities during the year ended 30 June 2017 the company must lodge its registration with the Department of Industry, Innovation and Science by 30 April 2018. Likewise, a company with an income year that ended 31 December 2017 will have to register by 31 October 2018.

To register, the company must provide details of all its R&D projects detailing the core and supporting activities undertaken in the income tax year. The company must keep detailed records describing each activity, planned objectives and the actual outcome in order to prove its eligibility in the event of a review or audit.

Once the company is registered it is provided with a Registration number which is required to be entered into the R&D schedule of the Company's tax return. That schedule will contain details of all expenditure related to each R&D activity (e.g. even the wages of laboratory assistants, overheads relating to the R&D activity and consumables used in the process). The R&D tax offset is claimed when the annual income tax return is lodged Importantly, the company must maintain detailed records (e.g. time sheets for staff costs) of all its R&D expenditure.

How can Nexia Australia help you?

Nexia Australia has the necessary skills and experience to assist you with all of your R&D claims and record-keeping requirements to ensure your company has the best chance of qualifying for this valuable incentive.

We can assess the eligibility of a company's business and projects (e.g. determine whether their activities are core or supporting R&D activities) and register the R&D activities with the Department of Industry, Innovation and Science by 30 April 2018 so that when the company lodges its company tax return and R&D schedule, the correct tax offset/refund may be claimed from the ATO.

Checking with us whether any of your activities may qualify for the R&D offset could be financially rewarding.

Please contact your Nexia Adviser if you would like to discuss how any of the issues mentioned above may affect your company so that we can identify R&D risks and opportunities for you.

1 - In JLSP and Innovation Australia ([2016] AATA 23), the Administrative Appeals Tribunal held that such a purpose does not need to be the dominant or prevailing purpose – however, it must be substantial enough for the activity to be characterised as conducted for that purpose (i.e. to generate new knowledge).

2 - In Docklands Science ([2016] AATA 973), certain projects were held to be non-R&D activities because the taxpayer did not have adequate contemporaneous documentation to prove that experiments had been undertaken.

Australia

Adelaide Office
Level 3, 153 Flinders Street Adelaide SA 5000
GPO Box 2163, Adelaide SA 5001
p +61 8 8139 1111, f +61 8 8139 1100
receptionSA@nexiaem.com.au

Brisbane Office
Level 28, 10 Eagle Street Brisbane QLD 4000
GPO Box 1189 Brisbane QLD 4001
p +61 7 3229 2022, f +61 7 3229 3277
email@nexiabrisbane.com.au

Brisbane South Office
Level 28, 10 Eagle Street Brisbane QLD 4000
GPO Box 1189 Brisbane QLD 4001
p +61 7 3229 2022, f +61 7 3229 3277
email@nexiabrisbane.com.au

Canberra Office
Level 7, St George Centre, 60 Marcus Clarke Street
GPO Box 500, Canberra ACT 2601
p +61 2 6279 5400, f +61 2 6279 5444
mail@nexiacanberra.com.au

Darwin Office
Level 2, 62 Cavenagh Street Darwin NT 0800
GPO Box 3770, Darwn NT 0801
p +61 8 8981 5585, f +61 8 8981 5586
receptionNT@nexiaem.com.au

Melbourne
Level 12, 31 Queen Street Melbourne VIC 3000
p +61 3 8613 8888, f +61 3 8613 8800
info@nexiamelbourne.com.au

Perth
Level 3, 88 William Street, Perth WA 6000
GPO Box 2570, Perth WA 6001
p +61 8 9463 2463, f +61 8 9463 2499
info@nexiaperth.com.au

Sydney
Level 16, 1 Market Street, Sydney NSW 2000
PO Box H195, Australia Square, NSW 1215
p +61 2 9251 4600, f +61 2 9251 7138
info@nexiasydney.com.au

New Zealand

Christchurch
Level 4, 123 Victoria Street, Christchurch
PO Box 4160, Christchurch
p +64 3 379 0829, f +64 3 366 7144
office@nexiachch.co.nz

www.nexia.com.au