

# ALERT

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## Research and Development Tax Incentive

The new Research and Development Tax Incentive (**Incentive**) has a potentially broad application to a range of activities engaged in by local corporations (or foreign corporations residing in Australia). The Incentive is potentially available to businesses of all sizes.

To assist clients in ensuring they claim all available tax offsets, Cornwall Stodart offers an assessment service in relation to companies' current and proposed activities to determine eligibility for making claims under the Incentive, including advice on transitional arrangements to the new program.

### Overview

The Incentive provides research and development (**R & D**) tax offsets intended to encourage companies, including small firms, to engage in research and development, in order to boost competitiveness and improve productivity in Australia.

The Incentive features two core offsets. Companies engaged in R & D may be eligible for:

- a 45 per cent refundable tax offset (equivalent to a 150 per cent deduction) if their turnover is less than \$20 million per annum (provided they are not controlled by income tax exempt entities); or

- a 40 per cent non-refundable tax offset (equivalent to a 133 per cent deduction) for all other eligible entities (entities may be able to carry forward unused offset amounts to future income years).

The Incentive is jointly administered by AusIndustry and the Australian Taxation Office (**ATO**) under the *Income Tax Assessment Act 1997* and the *Industry Research and Development Act 1986*.

### Eligibility and registration

Where activities are eligible, businesses must register their R & D activities within 10 months of the end of the income year in which the activities were conducted with AusIndustry before being able to make Incentive offset claims. Registration for the Incentive will commence from 1 July 2012 and registration takes effect where a company lodges an application with AusIndustry.

Determining whether a company's activities constitute eligible R & D activities is complex, particularly in the transitional period from the former R & D Concession program to the Incentive, commencing 1 July 2011. Activities registered under the R & D Tax Concession are



# ALERT

not equivalent to R & D activities registered under the Incentive due to changes to the definition of these activities (however, where the Incentive legislation requires a company to identify a link to a core R & D activity, this may be a link to an activity conducted in an income year prior to 1 July 2011 if the activity (i) was registered under the R & D Tax Concession program and (ii) meets the Incentive definition of a core R & D activity).

Companies are required, under the Incentive, to self-assess their eligibility to register activities and claim R & D tax offsets in any given year. As a general rule, eligibility depends on whether a business is:

- an R & D entity;
- engaged in eligible activities; and
- able to identify eligible deductions.

## Eligible R & D entities

Only 'R & D entities' can register and claim R & D tax offsets. These must be corporations for whom R & D activities are conducted.

### A corporation

A company is an R & D entity if it is a corporation that is:

- incorporated under an Australian law; or
- incorporated under foreign law but an Australian resident for income purposes; or
- incorporated under foreign law and (i) a resident of a country with which Australia has a double tax agreement, including a definition of 'permanent establishment'; and (ii) carrying on business in Australia through a permanent establishment as defined in the double tax agreement.

A company is not eligible if: (i) it is a corporate limited partnership; or (ii) a tax exempt entity. Trusts are not generally eligible, unless they are a body corporate in the capacity of trustee for a public trading trust. If a company is part of a consolidated group, only the head company should apply for registration.

### For whom the R & D activities are conducted

Generally, an R & D entity is only entitled to an R & D tax offset if the R & D activities were conducted for one of either: (i) the R & D entity itself; or (ii) a foreign corporation that is a resident of a country with which Australia has a comprehensive double tax agreement and the activities are conducted under a written agreement between the entities.

## Eligible activities

Activities must satisfy the definition of core R & D activities or supporting R & D activities to be eligible under the regime. Companies, following self-assessment, may seek to register activities that they determine are likely to be eligible, but must maintain adequate records of their core and supporting activities after registration in case of any future compliance reviews by AusIndustry. At review stage, companies must provide copies of records and additional information that supports their self assessments.

### The definition of core R & D activities

Core activities involve a company conducting experiments to seek out new information/knowledge. Specifically, these are defined as experimental activities, the outcome of which cannot be known or determined in advance on the basis of current knowledge, information or experience, but can only be determined by applying a systematic progression of work that: (i) is based on principles of established science; (ii) proceeds from hypothesis to experiment, observation and evaluation; and (iii) leads to logical conclusions. 'Experimental activities' must also be conducted for the purpose of generating new knowledge. Activities need to satisfy all aspects of the definition to constitute core R & D activities.

Notably, specific activities are excluded from being considered core R & D activities. These excluded activities may, however, be eligible as supporting R&D activities (provided they satisfy the dominant purpose test). The exclusions list includes: market research, market testing or market development, or sales promotion (including consumer surveys); prospecting, exploring



or drilling for minerals or petroleum for specific purposes detailed on the list; management studies or efficiency surveys; research in social sciences, arts or humanities; and commercial, legal and administrative aspects of patenting, licensing or other activities.

### The definition of supporting R & D activities

Activities that are not 'core' may nevertheless be eligible as supporting R & D activities. These are defined as an activity undertaken for the dominant purpose of supporting core R & D activities that is: (i) referred to in the core R & D activities exclusions list; (ii) an activity that produces goods or services; or (iii) an activity that is directly related to producing goods or services.

It should be noted that there are specific tests for 'directly related' and 'dominant purpose' and that, generally, only R & D activities conducted in Australia qualify for the Incentive. Also, eligibility is determined on an activity basis rather than on a project basis so that a project, which typically comprises a set of activities, may not be eligible in its entirety. Rather, specific activities may be eligible.

### Review of applications

AusIndustry reviews all applications for registration to ensure: receipt within the statutory deadlines; adequacy of form completion and description of activities; submission by an appropriate person and consistency with previous findings made by Innovation Australia. Following initial review, AusIndustry sends a letter advising the applicant of the registration acceptance or refusal. If approved, the date of this letter is the date of registration. Registration does not, of itself, render the activities eligible R & D activities. After registration, AusIndustry may examine a registration in detail and make a formal finding about the eligibility of all or some of the registered activities. As such, record keeping is critical.

### Claiming

In order to lodge a claim under the Incentive for a tax offset, eligible companies must have established that they are an eligible R & D entity; their R & D activities and expenditure meet the requirements of the Incentive; and they have registered their R & D activities with AusIndustry and received their unique registration number.

If you think that your business may have engaged in activities falling within the Incentive program, we may be able to assist with a formal assessment of your eligibility for the R & D tax incentives.

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### Disclaimer

This Alert is intended to provide general information on legal issues and should not be relied upon as a substitute for specific legal or other professional advice.



**If you have any queries about the Incentive or would like to discuss our assessment service, please contact:**

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