[Insert DD Month YYYY]

|  |
| --- |
|  |

[Insert Client Name]

[Insert Client Position]

[Insert Company Name]

[Insert Company Address]

[Suburb State Post Code]

Dear [Insert Client Name]

**Re: The R&D Tax Incentive**

The R&D Tax Incentive provides Australian resident companies and corporate trustees of public trading trusts (and foreign companies operating a business via an Australian permanent establishment) with a tax offset in respect of qualifying expenditure incurred on R&D activities that have been registered with AusIndustry. These rules also apply to partnerships of eligible R&D entities where each partner is entitled to an R&D tax offset based on the partner’s proportional entitlement to qualifying expenditure in respect of eligible R&D activities.

This letter outlines the key features of the current R&D Tax Incentive, applicable for income years commencing on or after 1 July 2021.

**Companies with aggregated turnover of less than $20 million**

A company with an aggregated turnover of less than $20 million per annum is entitled to a refundable R&D tax offset at a rate of 18.5% above the claimant’s company tax rate for income years starting on or after 1 July 2021.

A company’s aggregated turnover will comprise the annual turnover of the company derived in the ordinary course of carrying on its business during the year (excluding GST) and the annual turnover of any affiliate or entity connected with that company for that year.

Companies in a tax loss position for an income year are entitled to receive a refundable tax offset (i.e. obtain a cash rebate in lieu of the tax loss for that year) if they are otherwise eligible for that offset.

**Companies with aggregated turnover of $20 million or more**

A company with an aggregated turnover of $20 million or more is entitled to a non-refundable tax offset equal to the claimant’s company tax rate plus a premium based on the level of their incremental R&D intensity for their R&D expenditure.

The intensity premiums apply to notional deductions within a range of R&D intensity for R&D expenditure where notional deductions are expressed as a proportion of the R&D entity’s total expenses:

1. Notional deductions representing up to and including 2% of total expenses will receive a non-refundable R&D tax offset equal to the corporate tax rate plus 8.5% premium.
2. Notional deductions representing greater than 2% of total expenses will receive a non-refundable R&D tax offset equal to the corporate tax rate plus 16.5% premium.

Any unutilised tax offset is non-refundable but is able to be carried forward to future income years.

**Rate of offset if notional deductions are less than $20,000**

Where an R&D entity’s total notional deductions are less than $20,000, it is only entitled to the applicable rate of R&D offset to the extent the expenditure is incurred in relation to a non-associated registered Research Service Provider or under the Co-operative Research Centres (CRC) program.

**Tax offset where notional deductions exceed $150 million**

Where an R&D entity’s notional deductions are in excess of $150 million for income years starting on or after 1 July 2021, the applicable R&D tax offset rate will only apply up to $150 million of qualifying expenditure on eligible R&D activities. To the extent that the company has notional deductions in excess of $150 million, that amount will only be eligible for the tax offset at the entity’s prevailing company tax rate.

**R&D activities**

Eligible R&D activities continue to be categorised as either core or supporting R&D activities. However, an activity will only be regarded as an eligible supporting activity if it relates to a core R&D activity.

Core R&D activities are experimental activities with outcomes that a competent professional can’t know or determine in advance. They must be carried out systematically by applying established scientific principles which proceed from hypothesis to experiment, observation and evaluation until logical conclusions are reached. It is also necessary that the activities be undertaken for the purpose of generating new knowledge (including new knowledge in the form of new or improved materials, products, devices, processes or services).

That is, in order for a taxpayer to qualify for the R&D offset, the R&D must be focussed on the pursuit of new knowledge and the taxpayer needs to systematically undertake experiments to discover that knowledge, with competent professionals being unable to determine the outcome of those experiments in advance.

In addition, activities that directly relate to the core R&D activities or are undertaken for the dominant purpose of supporting core R&D activities may be classified as supporting R&D activities and are also eligible for the offset. Activities which are conducted predominantly for other purposes (e.g., sales promotion, internal administration, goods and services production, etc.) rather than supporting the initiation and conduct of experimental activities will not be supporting R&D activities.

Activities must be registered with AusIndustry no later than 10 months after the end of the income year.

**Advance finding**

Under the R&D Tax Incentive, applicants can obtain an advance finding of whether their activities are eligible R&D activities by submitting a completed Advance Finding Application. The advance finding can be applied for prior to the commencement of R&D activities and will determine whether an activity is a core R&D activity, a supporting R&D activity or neither of the two. The finding will bind AusIndustry to register activities that the finding has determined as eligible and (if favourable) also binds the ATO to treat the activities as R&D activities when making a decision whether expenditure is eligible R&D expenditure.

Applications for advance findings are due before the end of the income year in which the R&D activity was first conducted or commenced and will apply to that income year and the next two income years.

**Overseas R&D**

Applicants can access the R&D Tax Incentive where parts of the R&D activities are conducted overseas, subject to the following conditions being met:

* the company received an advance finding that the activity is an eligible activity;
* the overseas activity must have a significant scientific link to one or more core R&D activities solely conducted in Australia, which are registered or reasonably likely to be conducted and registered in the future;
* the overseas activity cannot be conducted solely in Australia because conducting it requires access to a facility, expertise or equipment not available in Australia, would contravene a law relating to quarantine, requires access to a population (of living things) not available in Australia or requires access to a geographical or geological feature not available in Australia; and
* the total amount to be spent in all income years on the R&D overseas activities is less than the total amount to be spent on R&D in Australia.

**Excluded activities**

In-house software development is excluded from being a core R&D activity if it is being developed for the internal administration of business functions of the software developer or an affiliate of the developer or an entity connected with the developer.

Other excluded activities are:

* Market research, market testing or market development, or sales promotion. This includes consumer surveys.
* Prospecting, exploring or drilling for minerals or petroleum for the purposes of discovering deposits, determining more precisely the location of deposits or determining the size or quality of deposits.
* Management studies or efficiency surveys.
* Research in social sciences, arts or humanities.
* Commercial, legal and administrative aspects of patenting, licensing or other activities.
* Activities associated with complying with statutory requirements or standards, including maintaining national standards, calibrating secondary standards or routine testing and analysis of materials, components, products, processes, soils, atmospheres and other things.
* Any activity related to the reproduction of a commercial product or process by a physical examination of an existing system or from plans, blueprints, detailed specifications or publicly available information.

However, excluded activities may be regarded as a supporting R&D activity if it is undertaken for the dominant purpose of supporting an eligible core R&D activity.

**Clawback adjustment rules**

Starting from 1 July 2021, the uniform clawback rule applies in the following scenarios to include an amount in an R&D entity’s assessable income where:

* It has obtained the R&D tax offset in respect of goods, materials or energy which have been transformed or processed by the R&D activities into feedstock outputs, being tangible product(s) which are either sold or applied for the R&D entity’s own use (or that of an affiliate or connected entity).
* It has received or is entitled to receive government recoupment for eligible R&D activities.
* It disposes depreciating tangible assets of which their decline in value were included in calculating the R&D tax offset.
  + Note that in opposite of assessable balancing adjustment, if the disposal is for less than the written-down value of the asset depreciated in calculating the R&D tax offset, the net loss amount on the disposal can increase the deduction for a balancing adjustment event.

The purpose of these rules is to clawback the R&D Tax Incentive where expenditure has been effectively recouped as a result of the consumption or sale of feedstock outputs, receipt of government grant, or disposal of depreciating assets, regardless of whether these clawback events occur in the same year as the expenditure is incurred or in a subsequent year.

Under the uniform clawback rule and balancing adjustment changes, the R&D entity’s assessable income is increased by an amount equal to the grossed-up value of the incentive component of the associated amounts of R&D tax offset. An amount is included in the assessable income of the R&D entity that received or is entitled to the R&D tax offset in relation to a recoupment amount or feedstock revenue.

**R&D Tax Transparency Reports**

For income years commencing on or after 1 July 2021 the ATO is required to publish a company’s claimed R&D expenditure under an R&D tax transparency report. The first publication is to be made 2 years after the end of the financial year, and as soon as practicable after 1 July 2024. The purpose of publishing this information is to provide transparency on the benefits derived by companies from the R&D tax incentive and encourage voluntary compliance with the program. The information includes the name of the R&D entity claiming the R&D Tax Incentive, the entity’s Australian Business Number (ABN) or Australian Company Number (ACN), and the entity’s total expenditure on R&D less any feedstock adjustments.

**Guidance**

AusIndustry published a Guide to Interpretation in November 2020. The refreshed Guide uses clearer language, has less duplication and is designed to help R&D claimants plan, conduct and register eligible R&D.

AusIndustry has also released sector guides for R&D applicants in the following industries:

* Agrifood.
* Biotechnology.
* Built environments.
* Energy.
* Manufacturing.
* Software development.

The ATO released a number of Taxpayer alerts to provide a summary of concerns in relation to R&D Tax Incentive claims. The alerts confirm ATO compliance focus on the detail of R&D activities, expenditure and arrangements, and specific concerns related to the building and construction industry, software development, agricultural or general business activities.

The most recent Taxpayer alerts include:

* Taxpayer Alert TA 2023/4 - Research and development activities delivered by an associated entity (Service Provider). The ATO is specifically concerned with arrangements that:
  + incorrectly purport the R&D entity as having incurred or paid (or both) the relevant expenditure under an agreement with the Service Provider, or
  + have the effect of the R&D entity receiving a tax offset for expenditure on R&D activities, which are in substance being conducted for the Service Provider
* Taxpayer Alert TA 2023/5 - Research and development activities conducted overseas for foreign related entities outlines the ATO’s concerns about arrangements where Australian entities claim the R&D tax offset for expenditure incurred on R&D activities conducted overseas. Arrangements of concern include where an R&D entity has purported that R&D activities were conducted for its own benefit, but those activities were instead conducted for a foreign entity that is ‘connected with’, or is an ‘affiliate’, of the R&D entity. The ATO is concerned that R&D entities might be incorrectly claiming the R&D tax offset irrespective of whether:
  + the R&D entity has an overseas finding covering the R&D activities being conducted, or
  + under the contractual arrangements between the R&D entity and the foreign related entity, the R&D entity purportedly has an interest in any developed intellectual property (IP), know-how or other results from the R&D entity's expenditure on the R&D activities.

**In conclusion**

Whilst the eligibility criteria to claim the R&D Tax Incentive are reasonably complex, the incremental benefits for eligible R&D entities available via the R&D tax offset are considerable, especially for small to medium sized claimants whose aggregated turnover is less than $20 million per annum.

We recommend that all existing R&D claimants review their systems and processes to ensure that all eligible R&D activities are identified, tracked and documented properly.

If you are currently conducting R&D or are considering conducting R&D in the future and have not previously claimed the R&D Tax Incentive, we would be pleased to arrange a meeting to discuss any of the above changes or any other tax planning issues. Please do not hesitate to contact me on [insert telephone number of partner].

Yours faithfully

**[Insert name of Partner]**