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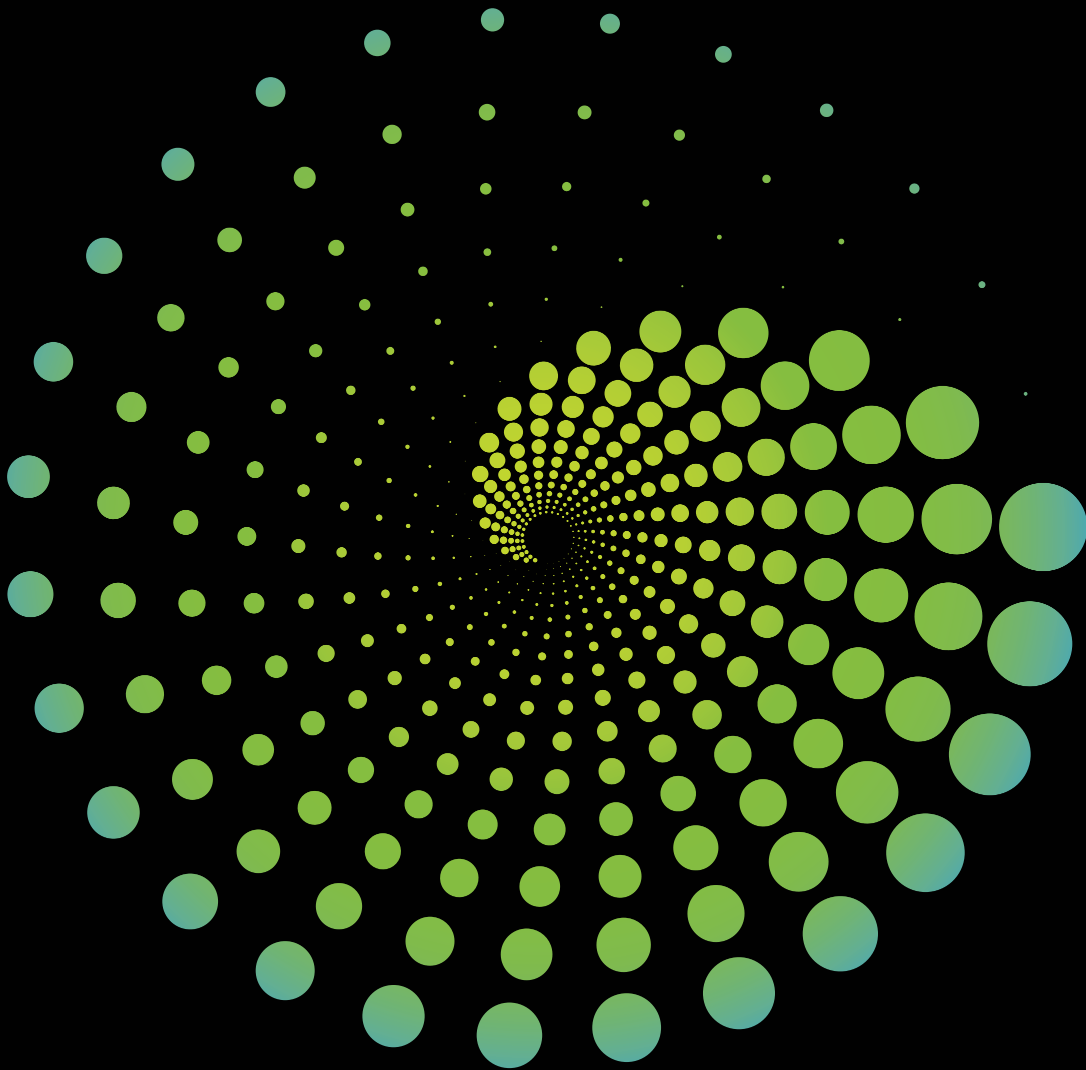


Tax Essentials
Understanding the R&D Tax Incentive regime

November 2022 | Australia

Snapshot

The Australian Research and Development Tax Incentive (RDTI) regime has been the Australian Government's primary mechanism to support innovation in Australia since 1 July 2011. The RDTI provides significant benefits to both Australian and foreign companies undertaking R&D activities in Australia.

Instead of a tax deduction at the prevailing corporate tax rate, one of two R&D tax offsets is available for eligible R&D expenditures over $20,000 incurred on eligible R&D activities that have been carried on during an income year.

The two R&D tax offsets available are either a refundable tax offset or a non-refundable tax offset, depending on whether the aggregated turnover of the claimant is less than $20 million (refundable) or $20 million and over (non-refundable).

The R&D tax offset rates and expenditure caps have changed over time, and the rates have been coupled to the prevailing corporate tax rates since 1 July 2021.

The R&D tax offset is calculated by applying the relevant premium rates to the total amount of eligible R&D expenditure for the income year and is then deducted from the claimant's income tax liability. With effect from 1 July 2021, the non-refundable offset is 8.5% plus a 16.5% premium on any expenditure that exceeds a 2% R&D intensity threshold. If the offset exceeds the tax liability, it is either refunded or carried forward to be used in future income years subject to satisfying continuity of ownership or business tests.

The net tax benefit of making an R&D claim for an income year will therefore depend on the difference between the premium rates of the R&D tax offset available on the expenditure claimed, and the prevailing rate of the company tax deduction forgone.

Although the net tax benefit remains the same regardless of the prevailing corporate tax rate, non-base rate entities that are eligible for the refundable R&D Tax offset can take advantage of a maximum cash refund of 48.5% of eligible R&D expenditure, rather than 43.5%. This will benefit the cash flow of pre-revenue or loss companies.

See our Deloitte Tax Essentials publication on "Understanding which corporate tax rate to use" for a detailed explanation of the corporate tax rates applying to base rate entities and other corporate taxpayers for different income years.

Income years	Refundable rates	Non-refundable rates	Annual expenditure cap $	Corporate tax rates (CTR)
FY12 – FY13	45%	40%	N/A	30%
FY14 – FY16	45%	40%	$100m	30% / 28.5%
FY17 – FY21	43.5%	38.5%	$100m	30% / 27.5% / 26%
FY22 onwards	CTR + 18.5%	CTR + 8.5% / 16.5%	$150m	30% / 25%

What qualifies as an eligible R&D entity?

Generally, companies are the only entities that can be an eligible R&D entity. However, companies acting in the capacity of a trustee of any entity (other than a public trading trust) and corporate limited partnerships cannot be an eligible R&D entity.

A company that is resident in Australia either due to incorporation or by way of a significant economic connection can be an eligible R&D entity. A company that is treaty resident in another country can also be an eligible R&D entity to the extent that it carries on business in Australia via a permanent establishment (PE) under a bilateral Australian double tax agreement treaty.

Where a company carrying on R&D activities is a subsidiary member of a tax consolidated group (TCG), it is the Head Company that must both lodge the application registrations with AusIndustry and claim the R&D expenditure in the TCG company income tax return.

Aggregated turnover threshold

To qualify for the refundable R&D tax offset rather than the non-refundable R&D tax offset, an eligible R&D entity must have an aggregated turnover below a $20 million threshold. A company's aggregated turnover is the sum of:

- The claimant company's own annual turnover; and
- The annual turnover of entities worldwide "connected with" the company; and
- The annual turnover of any worldwide "affiliate" of the company.

Broadly, annual turnover is the total ordinary income derived in the ordinary course of carrying on the business in that income year. Certain amounts are excluded and there are rules to exclude intra-group transactions and to ensure no double counting of income.

Broadly, an entity is "connected with" the claimant company if either entity controls the other entity, or both entities are controlled by the same third entity (for example, by owning at least 40% of the interests or having the right to receive at least 40% of its distributions).

An "affiliate" is any person or entity other than a trust that broadly acts or could reasonably be expected to act in accordance with the company's directions or wishes, or in concert with the company.

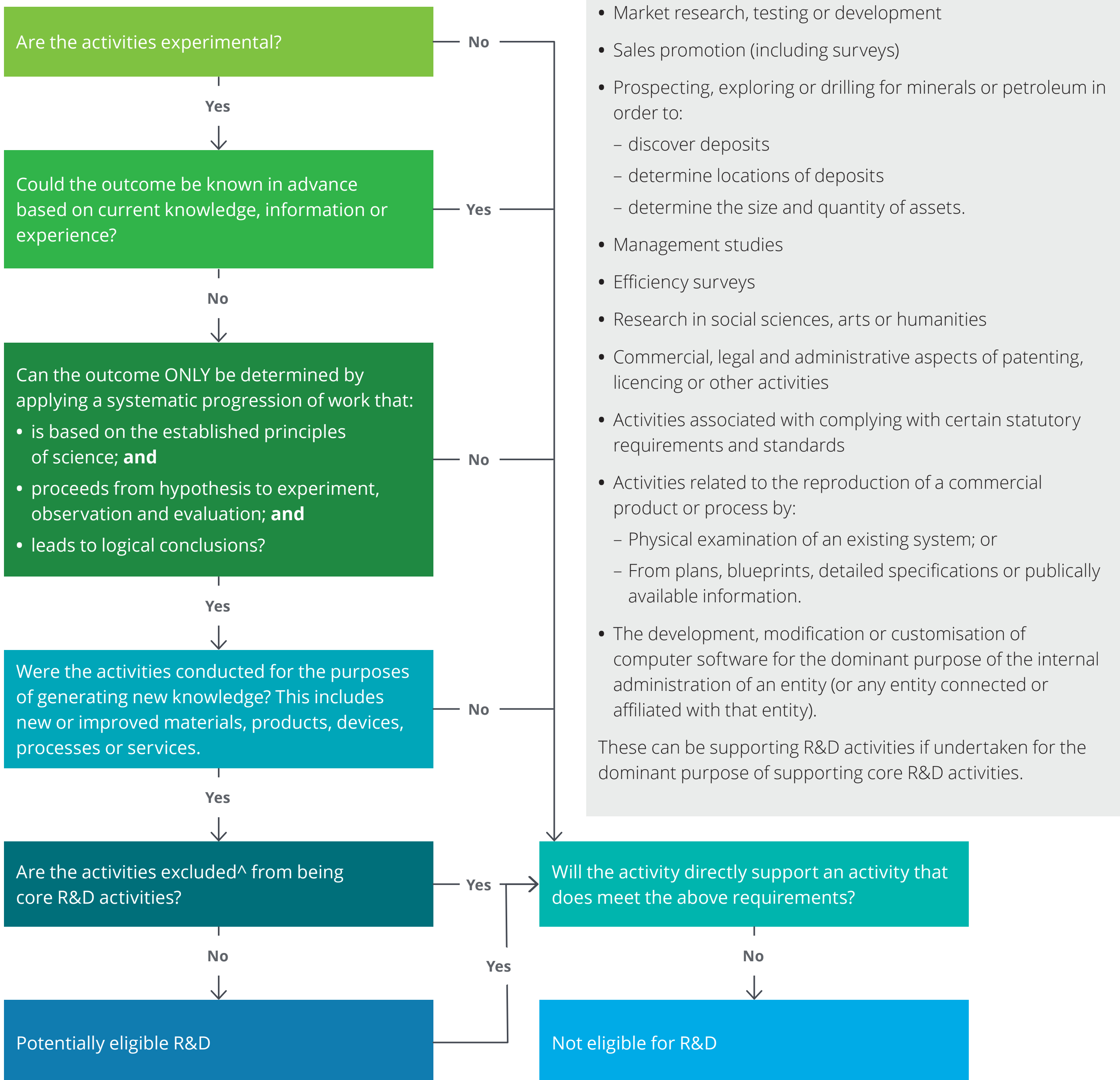
What can be eligible R&D activities?

The R&D activity decision tree on the following page sets out the key legislative requirements for activities to be either eligible core or supporting R&D activities.

Core R&D activities are experimental activities while supporting R&D activities are those which are 'directly related' to one or more eligible core R&D activities.

Certain activities are specifically excluded from being core R&D activities. These activities can still be supporting R&D activities if they are undertaken for the 'dominant purpose' of supporting core R&D activities. This dominant purpose test also needs to be satisfied where a supporting activity produces goods or services or is directly related to such production.

R&D activity decision tree



What expenditures can be claimed?

Expenditure incurred on eligible registered R&D activities can be notionally deducted and claimed provided that they are not precluded from being deductions under the wider tax laws (e.g. fines and penalties). The most common types of expenditures claimed are wages and salaries, contractor costs, consumables, software costs, and rents.

Certain expenditures are specifically excluded such as interest, expenditure on buildings and core technology, and expenditure included as part of the cost of tangible depreciating assets.

Expenditure incurred to associates (as defined) must also be paid in the income year to be eligible. If it has not been paid, it can either be deducted as standard in the income year incurred or included in eligible R&D expenditure in the income year it is paid.

Under certain circumstances, an R&D entity can claim the costs incurred on overseas activities provided that they are linked to Australian core R&D activities and cannot be carried on in Australia. The eligible overseas costs are capped at 50% of the anticipated total R&D expenditure. This involves applying for an advance overseas finding.

Depreciating assets used to carry on R&D activities

Amounts included in the cost of tangible depreciating assets can not be claimed outright. Instead, the tax decline in value of these assets can be claimed to the extent the assets are used to carry on, or are the subject of, R&D activities.

This can include most instant asset write offs, temporary full expensing and accelerated depreciation amounts. These amounts cannot also be claimed as a standard decline in value.

Other capital expenditures may also be included in eligible R&D expenditure to the extent it is incurred on or directly related to R&D activities; for example, project pool and primary producer costs.

Activities conducted for foreign entities

The RDTI was specifically designed to attract inbound investment to Australia. An Australian R&D claimant can carry out R&D activities in Australia on behalf of a connected foreign entity in certain circumstances, and be fully funded from overseas. Activities done on behalf of an overseas entity must be conducted solely in Australia.

Integrity measures

There are several integrity measures which ensure that:

- Activities must be carried on by or for the claimant entity – known as the on own behalf rule;
- Only expenditures that are at risk can be notionally deducted – known as the expenditure at-risk rule;
- Clawbacks will apply where government grants have funded any part of claimed R&D activities;
- Feedstock adjustments will claw back some of the net tax benefit where the R&D activities produce tangible goods of value that are sold or used in the business;
- Any group mark-up amounts can be excluded from eligible R&D expenditure; and
- Expenditures in excess of market value are reduced if transactions are not at arm's length.

Franking effects

The reduction in company income tax payable resulting from claiming R&D tax offsets in an income year will naturally reduce the franking credits available. In addition, the receipt of a R&D tax offset refund is defined to be a refund of income tax and will give rise to deferred franking debits which will reduce future franking credits that would otherwise arise on the payment of income tax.

Administrative aspects

There are two separate regulatory bodies responsible for administering the Australian RDTI regime.

Eligible R&D activities must be registered with Industry Innovation and Science Australia (IISA) within 10 months of the end of the income year in which the activities are carried on. The IISA registration number and the eligible expenditures on registered activities are then lodged with the Australian Taxation Office (ATO) as part of the company income tax return for the income year in which the expenditures are incurred.

Documentation and substantiation critical

Case law shows that many R&D claims can fail on audit or review due to insufficient documentation attesting to the satisfaction of the key legislative requirements. It is critical to maintain robust governance procedures and documentation that can substantiate the activities claimed were carried on, that each aspect of the legislative requirements is satisfied, and the nexus of the expenditures claimed to the activities.

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