Tax Laws Amendment (Research and Development) Bill 2013

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Contents

Purpose of the Bill .......................................................... 2
Background ........................................................................ 2
The origin of the proposed reform ....................................... 2
The current proposal ........................................................ 3
Statement of Compatibility with Human Rights .................. 3
Financial impact .............................................................. 3
Key provisions .................................................................. 3
Aggregated assessable income of an R&D entity ................. 3
Detailed explanation of new law ....................................... 4
Application of amendments .............................................. 4

Date introduced: 14 November 2013
House: House of Representatives
Portfolio: Treasury
Commencement: On the day the Act receives the Royal Assent and applies to income years commencing on or after 1 July 2013.

Links: The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bill’s home page, or through http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation

When Bills have been passed and have received Royal Assent, they become Acts, which can be found at the ComLaw website at http://www.comlaw.gov.au/.
Purpose of the Bill

The purpose of this Bill is to limit the research and development (R&D) tax incentive to companies with aggregated assessable income of less than $20 billion.

Background

Currently, companies can receive a tax offset calculated as a percentage of their spending on research and development (R&D).

A tax offset is an amount that can be used by a taxpayer under tax law to reduce the gross tax payable on their taxable income for an income year. If a tax offset exceeds the gross tax payable, the excess may or may not be refundable to the taxpayer by the Australian Tax Office.

Division 355 in Part 3-45 of the Income Tax Assessment Act 1997 (ITAA 1997) provides the conditions under which an R&D entity may be entitled to a tax offset for R&D activities. Section 355-100 of Division 355 provides for offsets at two rates depending on the size of the R&D business:

- a 45 per cent refundable tax offset for eligible entities with an aggregated turnover for the income year of less than $20 million and
- a non-refundable tax offset of 40 per cent for all other eligible entities.

This is referred to as the two tiered basis of granting the R&D tax offset for eligible R&D entities.\(^2\)

The origin of the proposed reform

On 17 February 2013 the Gillard Labor Government released A Plan for Australian Jobs (APAJ).\(^3\) This was a response to the report, Smarter Manufacturing for a Smarter Australia, by the non-Government members of the Prime Minister’s Taskforce on Manufacturing.\(^4\) The Bills Digest on the Australian Jobs Bill 2013 gives further information about the implementation of some of the recommendations in APAJ.\(^5\)

Chapter 6 of APAJ set out the Government’s proposals to help small and medium enterprises (SMEs) to grow and create new jobs. It included the proposal to target SMEs for additional R&D support. It cited the experience in other jurisdictions to support the case that more responsive R&D spending of small firms is more responsive to R&D tax incentives than larger firms. Consequently, it stated that very large companies with annual Australian turnover of $20 billion or more would no longer be entitled to the non-refundable 40 per cent R&D tax offset.\(^6\)

This Bill reintroduces a measure that was introduced in Schedule 1 of the Tax Laws Amendment (2013 Measures No. 4) Bill 2013 (the No. 4 Bill). That Bill lapsed when Parliament was prorogued before the 2013 federal election.\(^7\)

Schedule 2 to the No. 4 Bill proposed to amend the Taxation Administration Act 1953 to enable taxpayers to claim specified refundable tax offsets in quarterly instalments in anticipation of their end of year refund from those offsets. Similar to the current Pay-As-You-Go instalment system, a taxpayer’s quarterly instalments are reconciled against its actual refund entitlements when its annual income tax assessment is made. The system was initially only to apply to the R&D refundable tax offset. This measure was due to apply to instalment quarters starting on or after 1 January 2014.

The impact on the Commonwealth cash flow of the Quarterly credits measure was stated as follows in the Explanatory Memorandum to the No. 4 Bill (paragraph titled Financial impact, page 4):

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2. The Australian Taxation Office (ATO) website for ‘Research and development tax incentive’, gives details of the eligibility conditions and other aspects of the R&D tax incentive program which came into effect from 1 July 2011 and replaced the R&D tax concession which applied prior to that date, accessed 14 November 2013.
7. The homepage of the Tax Laws Amendment (2013 Measures No. 4) Bill 2013 (No. 4 Bill) gives the details of the No. 4 Bill and the Explanatory Memorandum, accessed 18 November 2013.
Financial impact: The estimated impact on the underlying cash balance is:

<table>
<thead>
<tr>
<th>Year</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013–14</td>
<td>$-75m</td>
</tr>
<tr>
<td>2014–15</td>
<td>$-165m</td>
</tr>
<tr>
<td>2015–16</td>
<td>$-15m</td>
</tr>
<tr>
<td>2016–17</td>
<td>$-15m</td>
</tr>
</tbody>
</table>

This impact is a change in timing of the payments, not an extra cost.

The current proposal

The Coalition’s 2013 election platform included a Policy to Boost the Competitiveness of Australian Manufacturing. It stated:

The Coalition recognises that tax incentives for innovation and industry funded research (including research and development) are important to promoting private sector investment in building the competitive advantages of tomorrow.

We will therefore use the opportunity of the scheduled 2014 changes to the R&D Tax Incentive programme to review access to R&D tax support for many businesses that have been barred from possible access under a series of retrograde cost savings made by Labor.

The Explanatory Memorandum to the R&D Bill states that:

The Government has committed to using the scheduled 2014 review of the R&D tax incentive to review access to R&D support, and the taxation White Paper to consider the effectiveness of existing tax incentives for innovation.

The quarterly tax credits proposal of the previous government has been deferred for further consultation according to a media release by the Treasurer on 6 November 2013.

Statement of Compatibility with Human Rights

As required under Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011 (Cth), the Government has assessed the Bill’s compatibility with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of that Act. The Government considers that the Bill is compatible with human rights as it does not raise any human rights issues.

The Bill has not yet been considered by the Parliamentary Joint Committee on Human Rights.

Financial impact

The Explanatory Memorandum states that this measure is estimated to have a gain to revenue of $1.1 billion over the forward estimates period. This is identical to the amount stated in the Explanatory Memorandum to the No. 4 Bill.

Key provisions

Item 1 of Schedule 1 inserts proposed section 355-103 titled ‘Exception for large businesses’ into the ITAA 1997. Proposed subsection 355-103(1) provides that an R&D entity is not entitled to a tax offset for an income year if the amount worked out under proposed subsection 355-103(2) for that entity for the income year is $20 billion or more. This amount is called the R&D’s ‘aggregated assessable income’ and is described below.

Aggregated assessable income of an R&D entity

Proposed subsection 355-103(2) states that an R&D entity’s aggregated assessable income is the sum of its assessable income for the income year and the assessable income of:

12. The Statement of Compatibility with Human Rights can be found in paragraphs 1.26 to 1.29 at pages 11 and 12 of the Explanatory Memorandum to the Bill.
14. Ibid., p. 3.
any entity that is connected with the R&D entity at any time during that income year
any entity that is an affiliate of the R&D entity at any time during the income year and
any entity of which the R&D entity is an affiliate at any time during the income year.

The expression ‘connected with’ is defined in section 328-125 of the ITAA 1997. It provides that an entity is connected with another entity if:

(a) either entity controls the other entity in a way described in section 328-125; or
(b) both entities are controlled in a way described in section 328-125 by the same third party.

The word ‘affiliate’ is defined in section 328-130 of the ITAA 1997. It broadly means that one entity could reasonably be expected to act in accordance with the wishes of the other.

Proposed subsection 355-103(3) states that the assessable income of an entity that is only connected with an R&D entity because both entities are controlled by the same Australian government agency is disregarded for the purpose of proposed section 355-103.

**Detailed explanation of new law**

The Explanatory Memorandum in paragraphs 1.10 to 1.18 gives a detailed explanation of the new law with examples of its application.\(^{15}\)

**Application of amendments**

Item 3 of Schedule 1 provides that the amendments made by this Schedule apply in relation to an R&D entity’s assessments for income years commencing on or after 1 July 2013.

\(^{15}\) Explanatory Memorandum, op. cit., pp. 6–9.
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