Insight
Beyond
the obvious

Federal Budget Brief 2015

A review of the Budget's major business implications:

Research & Development

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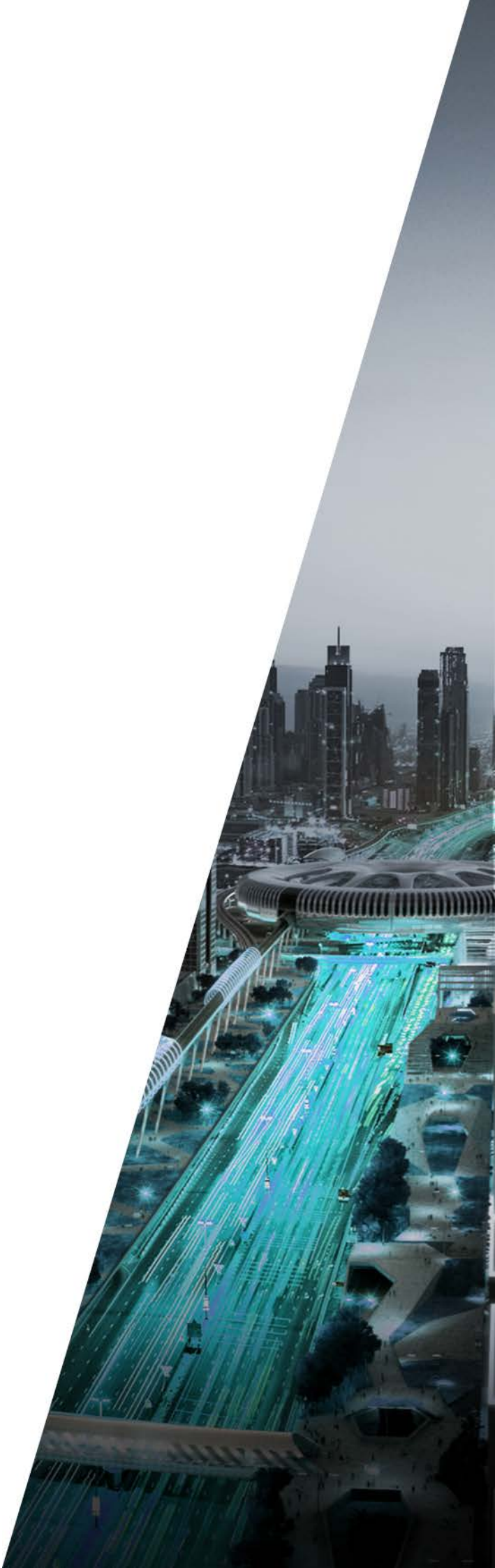

Introduction

The 2015 Federal Budget aims to refocus innovation and investment in Australia by providing greater assistance to small businesses, which is consistent with recent government policy to shift innovation funding away from large corporates. From a tax perspective, the measures in the Budget are fairly limited, however the Federal Government's *Re:Think* Tax discussion paper, will drive the tax reform agenda over the coming months and years.

Earlier this year, the Tax Laws Amendment (Research and Development) Bill 2013 (commonly known as the Targeting Access Bill) was passed into law. As a result and for income years commencing on or after 1 July 2014, claimants will only receive a tax offset over and above the corporate tax rate for the first $100 million of R&D expenditure incurred. An earlier proposal to reduce the R&D tax offset rates was voted down in the Senate, leaving the rates unchanged at 40 and 45 percent depending on the aggregated turnover of the claimant.

The Budget has not proposed any changes to the R&D Tax Incentive programme, but some of the proposed measures will have an impact on certain entities accessing the programme. We summarise these changes, and consider some of the possible implications. However, note that the proposed changes are subject to the passing of legislation and the impact, intended or not, of the specific wording of any provisions.

David Gelb
Partner,
National Leader,
R&D Incentives

Grant funding

From a grant funding perspective, the Budget did not deliver any major changes as no new direct business focused grant programmes were introduced. Instead, the government continues to maintain its focus on the five key 'Growth Sectors' (Food and Agribusiness, Mining equipment, Technology and Services, Medical technologies and Pharmaceuticals, Advanced manufacturing and Oil, Gas and Energy Resources) identified in the Industry Innovation and Competitiveness Agenda announced in October 2014. The focus on supporting manufacturing transition and commercialisation remains unchanged although existing programmes saw a modest reduction in funding. The snapshot table provides an overview of the changes to programmes in the Grants landscape:

Grant	Update
Automotive Transformation Scheme	Previously announced funding reductions will not be progressed. Net impact of this measure is $105 million retained in the program budget for this scheme.
Cooperative Research Centres	The Cooperative Research Centres Program's $738 million budget is currently under the microscope, irrespective of the review outcome, a reduction of $26.8 million in funding has been confirmed in the budget estimates
Entrepreneurs' Infrastructure Programme	The Government has cut $27.3 million out of the program budget with $526.4 million still remaining to support the implementation of the program's objectives
Telecommunications Data Retention Implementation	$131.3 million for a new grant program for telecommunications service providers to assist in the development of capability, to meet the data retention obligations under the mandatory telecommunications data retention regime
Tropical Health and Medicine Research	$15.3 million over for years has been allocated to medical research into exotic disease threats.

Closer look into R&D measures

Small (<$2 million turnover) business tax rate cut and small business immediate write-off

The government has followed through with its proposed cut in the company tax rate for small businesses, reducing it to an almost 50-year low of 28.5 percent, effective 1 July 2015. While the budget papers simply define small business as those with a turnover less than $2 million, it is likely that any legislation will rely on the small business provisions in the *Income Tax Assessment Act 1997 ('ITAA')* which uses 'aggregated turnover' rather than the turnover of just the one entity.

In brief, aggregated turnover for the purposes of the reduced tax rate includes the tax entity's annual turnover for the income year, combined with the annual turnover of any other entity that is *connected with* or that is an *affiliate* of the tax entity during the relevant income year. This includes the turnover of any foreign connected or affiliated entities.

The Budget proposal to reduce the corporate tax rate for small business by 1.5 percentage points has not been mirrored by a corresponding reduction to the R&D tax offset rate. This means small businesses will receive an additional R&D benefit for financial years commencing on or after 1 July 2015. Specifically, where sufficient tax losses exist, small businesses will still be able to 'cash out' the 45 percent refundable tax offset, increasing the permanent tax benefit from 15 to 16.5 percent. There is no impact for larger companies beyond the $100 million expenditure cap enacted earlier this year. This demonstrates an important increase in government support for innovation by Australia's smaller companies.

Aggregated Turnover	Corporate Tax Rate	R&D Tax Offset	Net Benefit
$20 million and above	30%	40%	10%
$2 million to <$20 million	30%	45%	15%
<$2 million	30%	45%	16.5%

Depreciation

As part of the government's small business package announced in the Budget a series of accelerated depreciation incentives were also introduced for businesses with an aggregated turnover of less than $2 million. Similar to the application of the reduced tax rate, whether these changes have an impact on companies is subject to the details, including turnover definitions and the wording of any new legislative provisions. The current interpretation is that this accelerated depreciation claim will be applicable to R&D assets thereby allowing small businesses to obtain a timing benefit on eligible assets. Typically, claiming depreciation on small assets such as computers, office equipment and tools or machinery is a cumbersome process for R&D, with many companies opting to not claim depreciation. Two issues in particular have historically contributed to this;

1. a requirement to separately track assets that have had depreciation claimed under the R&D Incentive; and
2. restrictions around claiming pooled assets.

The Budget, *prima facie*, addresses these concerns for small claimants by:

- An immediate write off on assets purchased (i.e. acquired not already owned) costing less than $20,000 for small businesses (relevant to assets acquired and installed from 12 May 2015 to 30 June 2017). This means that companies can now claim this as an expense up front at the 45 percent refundable rate, rather than over time. This small change could potentially free up thousands of dollars that would have otherwise been delayed by the requirement to depreciate over the asset's effective life, or excluded due to the compliance burden. As the changes only apply to purchased assets, recent tax rulings around design expenditure for the creation of R&D assets are unlikely to be relevant, in that design expenditure is only incurred on built, not purchased, assets. As such, the restrictions around design expenditure should not operate or interact with this new measure.
- The option to pool assets costing $20,000 or more with accelerated depreciation – 15 percent in the first year and 30 percent thereafter (with an immediate deduction when the balance falls below $20,000). While this doesn't correct the exclusion for pooled assets under s355-310(4)(c) *ITAA 1997* more generally, if a new mechanism is put in place for small businesses it could offer an opportunity for those claims to include pooled assets outside of s40-425 *ITAA 1997*. The devil will certainly be in the detail with this provision – so watch this space.

Conclusion

While the Budget did not introduce any major changes to the Grants or R&D landscapes, the reduction to the tax rate for small businesses is welcome news and a positive step to support innovation in the private sector. Current research by the Organisation for Economic Co-operation and Development (OECD) shows a positive correlation between government support for innovation and an increase in a country's GDP. KPMG believes a broad range of incentives are required to reward innovation, foster commercialisation and keep those same innovators (and their profits) in Australia, and the R&D Tax Incentive supports these aims. The *Re:Think* Tax discussion paper released in March 2015 will provide an opportunity to examine Australia's innovation policy and determine how the tax system can best support and benefit from the performance of R&D activities in Australia and abroad. KPMG is contributing a submission in response to the Treasurer's invitation to discuss tax reform and looks forward to engaging in dialogue with the government. We encourage others to do the same.

Contact us

David Gelb
Partner
+61 3 9288 6160
dgelb@kpmg.com.au

James Edwards
Partner
+61 8 9263 7216
jedwards1@kpmg.com.au

Kristina Kipper
Partner
+61 2 9335 7847
kkipper1@kpmg.com.au

Mark Prentice
Partner
+61 3 9288 5508
mprentice@kpmg.com.au

Mathew Herring
Partner
+61 8 8236 3163
mherring@kpmg.com.au

Paul van Bergen
Partner
+61 2 9455 9373
pvanbergen@kpmg.com.au

Scott Olding
Partner
+61 2 9335 8745
scottolding@kpmg.com.au

Jonathan Turner
Executive Director
+61 7 3225 6888
jturner5@kpmg.com.au

Alex Demetriou
Director
+61 3 9288 5989
ademetriou1@kpmg.com.au

Anthony Petrilli
Director
+61 8 8236 3167
apetrilli@kpmg.com.au

Gareth Newport
Director
+61 3 9288 5011
gnewport@kpmg.com.au

Gary Veale
Director
+61 3 9288 6125
gveale@kpmg.com.au

Helen Gilfedder
Director
+61 3 9288 6179
hgilfedder@kpmg.com.au

Helen Sant
Director
+61 3 9288 6094
hsant1@kpmg.com.au

Marina Maryanovksy
Director
+61 3 9288 6702
mmaryanovsky@kpmg.com.au

Merrill Lee
Director
+61 2 9335 8137
merrilllee@kpmg.com.au

Ramanie Naidoo
Director
+61 7 3225 6988
rnaidoo2@kpmg.com.au

kpmg.com/au/budget