

## Comparison of the existing R&D Tax Concession with proposed Tax Credits

The current R&D Tax Concession is a tax deduction which reduces the firm's taxable income by increasing (by 25 percent) the amount it can claim as a deduction for its R&D expenditure.<sup>1</sup> The proposed 40 percent and 50 percent Tax Credits will operate differently by providing firms with Credit to meet their tax liabilities. However they will not be able to claim their R&D expenses as a business deduction.

For a firm in tax profit, the benefit of the 40 percent Tax Credit can be considered as the sum of a 100 percent business deduction (based on a 30 percent corporate tax rate) plus an additional 10 per cent incentive. Similarly, the 50 percent Tax Credit is the equivalent of a 100 percent business deduction plus an additional 20 per cent incentive.

The examples in the accompanying table show the differing assistance effects of the existing tax incentives and the proposed Tax Credits for firms in tax profit and loss.

Where a firm is in tax loss, the 40 percent tax credit is not refundable. Accordingly, as in the case with the existing 125 percent tax concession, the concession is of no value unless and until the firm becomes profitable at which time the credit can reduce tax otherwise payable. For that reason the longer the firm takes to move into tax profit, the less value both the 40 percent tax credit and the 125 percent tax deduction concessions have. And where firms never move into profit, they gain nothing from these concessions. This is reflected in the accompanying table as a value of assistance varying between zero and 10 percent of R&D investment for the 40 percent tax credit, where the value of assistance to tax profit firms is 10 percent of R&D investment in tax saved.

Where this works to the *disadvantage* of tax loss firms for non-refundable concessions, the existing Tax Offset – which is refundable – turns this mechanism to the *advantage* of tax loss firms. Where firms receive the Tax Offset, they receive cash equivalent to the sum of two factors:

- The tax benefit in the credit/additional deduction – currently equal to 7.5 percent of eligible R&D investment which would become 20 percent under the proposed refundable tax credit – plus;
- The deduction they would have received on that R&D investment if they had been in tax profit. At current rates of tax that is 30 percent of R&D investment.<sup>2</sup>

This latter cashing out of the benefit of the deduction is effectively an interest free loan which is clawed back when the firm comes into tax profit. Accordingly the longer it takes for the firm to move into tax profit, the greater the benefit of this loan, and where the firm never moves into profit, the 'loan' is in perpetuity and is equivalent to a grant. Accordingly in the table below, the after tax value of assistance to tax loss firms varies from a minimum of 20 percent to a maximum of 50 percent which applies where they never move into profit.

<sup>1</sup> In some cases some or all of the R&D may be depreciable, or treated as a capital item, and so would not normally be deductible. Where this is the case the concession will generally increase deductibility by more than 25 percent.

<sup>2</sup> Subject to the previous footnote - some or all of the R&D may be depreciable, or treated as a capital item, and so would not normally be deductible. In this case the scheme offers additional assistance over non-concessional tax arrangements.

## ANNEX 8

Current R&D Tax Concession Support	Tax profit	Tax Loss
<b>125% Deduction</b>		
<i>R&amp;D Expenditure</i>	\$1,000,000	
Deduction @ 125%	\$1,250,000	
Impact on Taxable Income	(\$1,250,000)	
Impact on Tax Liability	(\$375,000)	(*1)
<b>Total Tax Deduction</b>	\$375,000	0 - \$375,000
less: Normal business deduction	(\$300,000)	(\$0 - \$300,000)
equals: Additional benefit	\$75,000	\$0 - \$75,000
<b>Value of assistance (*2)</b>	<b>7.5% of R&amp;D</b>	<b>0 - 7.5% of R&amp;D (*3)</b>
	(*3)	
<b>Tax Offset</b>		
<i>R&amp;D Expenditure</i>	\$1,000,000	
Deduction @ 125%	\$1,250,000	
Impact on Taxable Income	(\$1,250,000)	
Impact on Tax Liability	(\$375,000)	(*1)
<b>Total Tax Deduction</b>		\$375,000
less: Normal business deduction		(\$0 - \$300,000)
equals: Additional concession deduction	<b>Profitable firms not eligible for tax offset, normal 125% concession applies</b>	\$75,000
<b>Value of assistance (*2)</b>		<b>7.5% - 37.5% (*3)</b>
		<b>Refund at 37.5% of R&amp;D</b>
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Proposed Tax Credits	Tax profit	Tax Loss
<b>40% Tax Credit (Firm Turnover in excess of \$50m)</b>		
<i>R&amp;D Expenditure</i>	\$1,000,000	
Deduction	\$0	
Impact on Taxable Income	\$0	
Impact on Tax Liability	(\$400,000)	(*1)
<b>Tax Credit @ 40%</b>	\$400,000	\$0 - \$400,000
less: tax deduction forgone (at current 30% tax rate)	(\$300,000)	(\$0 - \$300,000)
equals: net tax credit benefit	\$100,000	\$100,000
<b>Value of assistance</b>	<b>10% of R&amp;D</b>	<b>0% - 10.0% of R&amp;D</b>
<b>50% Refundable Tax Credit (Firm Turnover under \$50m)</b>		
<i>R&amp;D Expenditure</i>	\$1,000,000	
Deduction	\$0	
Impact on Taxable Income	\$0	
Impact on Tax Liability	(\$500,000)	(*2)
<b>Tax Credit @ 50%</b>	\$500,000	\$500,000
less: tax deduction forgone (at current 30% tax rate)	(\$300,000)	(\$0 - \$300,000)
equals: net tax credit benefit	\$200,000	\$200,000 - \$500,000
<b>Value of assistance</b>	<b>20% of R&amp;D</b>	<b>20% - 50.0% of R&amp;D</b>
		<b>Refund at 50% of R&amp;D</b>

<sup>1</sup> Where firms earn credits or deductions but are in tax loss these are of no value unless and until they can reduce tax when the company becomes profitable. For that reason tax benefits to a tax loss company decline in value over time. By the same token, where, as is the case with the Tax Offset, firms receive cash equivalent to the sum of the tax benefit in the credit/additional deduction *and* the original deduction they would receive on expensing the R&D this bringing forward of the benefit of the deduction is clawed back when the firm comes into tax profit. It has the status of an interest free loan. Accordingly the longer it takes for the firm to move into tax profit, the greater the benefit of this interest free loan, and in the case of the firm which does not move into profit, the 'loan' is in perpetuity and is equivalent to a grant. A firm that never reaches profit will get a zero value of assistance from a non-refundable credit/deduction as they are unable to utilise the credits/deductions carried forward. In contrast, firms that never reach tax profit receive the maximum level of assistance from the existing Tax Offset (37.5 percent) and from the proposed refundable tax credit. (50 percent)

<sup>2</sup> Value of Assistance based on entitlements under the current corporate tax rate of 30 percent.

<sup>3</sup> Firms can currently claim an additional 50% deduction for increased R&D expenditure over a 3 year average. With the Premium deduction the 'after tax value of assistance' can be as high as 22.5%. For firms eligible for the Tax Offset with the Premium deduction the 'after tax rate of assistance' can be as high as 52.5%. Note also that levels of assistance are greater than those quoted above, where some of the the R&D expenditure would, without the concession, be classified as depreciable or as of a capital nature.