R&D Tax Incentive: quarterly credits

Consultation Paper
August 2012

ISBN 978-0-642-74841-6

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Consultation Process

Request for feedback and comments

The Australian Government seeks your feedback and comments on the proposals outlined in this consultation paper.

All information (including name and address details) contained in submissions will be made available to the public on the Treasury website, unless you indicate that you would like all or part of your submission to remain confidential. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment. A request made under the *Freedom of Information Act 1982* for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please email responses in a Word or RTF format. An additional PDF version may also be submitted.

Closing date for submissions: 31 August 2012

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FOREWORD

We are very pleased to release this consultation paper on the Australian Government’s proposed arrangements for implementing quarterly credits under the R&D Tax Incentive.

The R&D Tax Incentive is the biggest reform to the way Government supports business investment in innovation for over a decade. It is designed to encourage companies to undertake R&D activities, which will deliver wider benefits to the economy and society.

R&D quarterly credits will be a new, important part of the R&D Tax Incentive for small and medium sized companies.

R&D quarterly credits will be an opt-in element of the R&D Tax Incentive available to eligible companies with an annual aggregated turnover of less than $20 million.

R&D quarterly credits will allow these companies to access their benefits sooner, improving their cash flow and incentives to invest in R&D, while minimising additional compliance obligations for companies. Encouraging small and medium sized companies to invest in R&D, which is an important part of business innovation, will help create further business opportunities and jobs for the future.

Businesses that invest in innovation are more productive, more profitable and more likely to increase staff. Innovation has a key role in driving Australia’s productivity and economic growth.

Boosting productivity and competitiveness is the common thread running through the Government’s policy reforms. Through measures such as the R&D Tax Incentive, the Government is helping businesses to invest in their own future success and in doing so we are investing in Australia’s long-term economic future.

We encourage interested parties to provide feedback on the proposed arrangements for R&D quarterly credits. Your feedback is an important part of the tax design process and will be valuable in ensuring the effective implementation of this measure.

The Hon David Bradbury MP
Assistant Treasurer
Minister Assisting for Deregulation

The Hon Greg Combet AM MP
Minister for Industry and Innovation
Minister for Climate Change and Energy Efficiency

1. SUMMARY

On 15 June 2011 the Australian Government announced its intention to introduce quarterly credits for companies entitled to the research and development (R&D) refundable tax offset, that is, companies with aggregate annual turnover of less than $20 million (small and medium sized companies).

The R&D refundable tax offset is normally provided annually as part of a company's income tax assessment. Providing a quarterly credit in advance of that process will improve company cash flow and enhance incentives to invest in R&D. Quarterly credits will be accessible for each quarter commencing on or after 1 January 2014.

Quarterly credits will be an opt-in element of the R&D Tax Incentive. The proposed design seeks to minimise additional compliance obligations and maintain tax system integrity.

To access quarterly credits, a company must, in respect of the relevant income year:

- be a complying taxpayer;
- have the necessary history with the R&D Tax Incentive; and
- expect to receive the R&D refundable tax offset.

An eligible company will be able to receive quarterly credits that are either:

- a 'safe harbour' amount calculated by the Australian Taxation Office (ATO) based on a company's refund of the R&D refundable tax offset for the latest year for which income tax has been assessed; or
- a variation of this amount based on the company's expected refund of the R&D refundable tax offset for the current income year.

An end-of-year process will then reconcile the company's expected income tax position with its actual income tax position.

The necessary rules for quarterly credits will be incorporated into legislation.

The Government seeks your comments on the proposed arrangements for quarterly credits.

2. Background

2.1 The R&D Tax Incentive

The Australian Government provides the R&D Tax Incentive to encourage industry to conduct R&D activities that might not otherwise occur because the benefits 'spill over' to the rest of the community and the return to the individual company is uncertain. Under the R&D Tax Incentive:

- eligible companies with an aggregated annual turnover less than $20 million are entitled to a 45 per cent refundable tax offset for expenditure on eligible R&D activities; and

- all other eligible companies are entitled to a 40 per cent non-refundable tax offset for expenditure on eligible R&D activities, which may be able to be carried forward to reduce future tax liabilities.

Companies that are exempt entities, that is, companies whose whole income is exempt from tax, are not eligible for the R&D Tax Incentive. In addition, a company controlled by an exempt entity is not eligible for the R&D refundable tax offset.

The R&D Tax Incentive replaces the former R&D Tax Concession for income years commencing on or after 1 July 2011. The new R&D Tax Incentive features a better targeted definition of eligible R&D activity and higher base rates of support. There is no limit on the amount of R&D expenditure that companies can claim.

The *Tax Laws Amendment (Research and Development) Act 2011* (TLA(R&D) Act 2011) established the R&D Tax Incentive, and received Royal Assent on 8 September 2011.

2.2 Introducing quarterly credits

Key elements of the R&D Tax Incentive are based on a model proposed by the 2008 Review of the National Innovation System. The Review said in recommendation 8.5 that:

> *Risk management models be developed to maximise the extent to which the refundable tax [offset] can be paid more regularly — at least quarterly in arrears. Regard should be had to the likely benefit relative to administrative and compliance costs and the need to manage risk.*

On 15 June 2011, the Deputy Prime Minister and the then Minister for Innovation, Industry, Science and Research, in a joint media release, announced that:

> *the Government will introduce quarterly payments for small and medium businesses from 1 January 2014. These firms will get their credit sooner, significantly improving their cash flow and incentives to invest in R&D.*

The 'small and medium businesses' referred to in the media release are those eligible for the R&D refundable tax offset, that is, companies with an aggregated annual turnover of less than $20 million.

The necessary rules for 'quarterly payments' or quarterly credits will be incorporated into legislation. The current regulation making powers in Schedule 3A of the TLA(R&D) Act 2011 will therefore not be needed and will be repealed.

2.3 What is the purpose of quarterly credits?

The purpose of quarterly credits is to allow eligible companies expecting to receive a refund of the R&D refundable tax offset for the current income year to anticipate that refund, on a quarterly basis. Companies that are eligible for the R&D refundable tax offset fall into two broad groups (i) tax payable companies and (ii) net refund companies. The pay as you go (PAYG) instalment system already allows tax payable companies to fully anticipate, on a quarterly basis, the impact of the R&D refundable tax offset. Quarterly credits will mean this opportunity is also available to eligible net refund companies.

Current income year tax payable companies can already anticipate the R&D refundable tax offset through the PAYG instalment system

In a company's income tax return, its R&D refundable tax offset is deducted from its gross tax. Where an amount of tax is still payable, the full benefit of the R&D refundable tax offset has been realised.

Tax payable companies are also generally required to pay quarterly instalments toward future income tax liabilities under the PAYG instalment system. The ATO informs companies of whether they are required to pay quarterly PAYG instalments, with instalments being calculated on the basis of the latest income year (the 'base year') for which the company's income tax has been assessed.[1]

The ATO will provide tax payable companies with either a quarterly PAYG instalment rate or amount, with the rate or amount incorporating the R&D refundable tax offset.[2] The PAYG instalment system therefore assumes that a company will receive the R&D refundable tax offset for the current income year if it was received for the base year. This means that the R&D refundable tax offset is already anticipated on a quarterly basis for these companies.

In addition, a tax payable company can vary the quarterly PAYG instalment rate or amount provided by the ATO, if it expects its end of year income tax position to be different to that implied by the rate or amount. This includes an ability to vary the rate or amount to zero where the company expects to have no income tax payable upon assessment. For example, a different amount of expenditure on R&D activities from the base year could be a factor affecting a company's end of year tax position and be a reason for it to vary its quarterly PAYG instalment rate or amount.

Current income year net refund companies cannot fully anticipate the R&D refundable tax offset through the PAYG instalment system

Where a company has a PAYG instalment rate or amount and expects for the current income year to receive a refund of the R&D refundable tax offset, it is able to anticipate on a quarterly basis the

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1 Companies are required to lodge an income tax return for each income year; however, returns are not required to be lodged for an extended period after the end of the income year. As a result, the ATO's advice to a company about a PAYG instalment rate or amount may be made on a base year assessment that is two or more income years old.

2 While the PAYG instalment calculation includes the R&D refundable tax offset it may exclude certain other items, for example, capital gains and tax losses.

amount of the R&D refundable tax offset used to offset any gross tax by varying its rate or amount to zero. However, it has no ability to anticipate on a quarterly basis the amount of the R&D refundable tax offset that may be refunded to it.

Where a company has no PAYG instalment obligation and expects for the current income year to receive a refund of the R&D refundable tax offset, it currently has no ability at all to anticipate that refund on a quarterly basis.

Therefore, the purpose of quarterly credits is to allow eligible companies expecting to receive a refund of the R&D refundable tax offset for the current income year to anticipate that refund, on a quarterly basis, in a broadly similar fashion to how the PAYG instalment system already allows tax payable companies to fully anticipate, on a quarterly basis, the R&D refundable tax offset.

An eligible net refund company will be able to receive quarterly credits that are either:

- a 'safe harbour' amount calculated by the ATO based on a company's refund of the R&D refundable tax offset for the latest year for which income tax has been assessed; or
- a variation of this amount based on the company's expected refund of the R&D refundable tax offset for the current income year.

Current income year net refund companies eligible for the R&D non-refundable tax offset

Arrangements for companies claiming the R&D non-refundable tax offset will not change.

A net refund company that is eligible for the R&D non-refundable tax offset does not receive at year-end, and after any gross tax has been reduced to zero, any immediate benefit from the remainder of its tax offset. Instead, the remainder of the R&D non-refundable tax offset is carried forward for use in future years, subject to the rules for carry forward losses. Consequently, quarterly credits are not intended to apply to companies entitled to the R&D non-refundable tax offset.

However, a company with PAYG instalment obligations that expects for the current income year to receive the R&D non-refundable tax offset and to have no tax payable will continue to be able to vary its instalment rate or amount down to zero to reflect the expected outcome.

3. POLICY DESIGN

Quarterly credits are designed to assist small and medium sized companies expecting to receive a refund of the R&D refundable tax offset for the current income year to anticipate that refund on a quarterly basis. Quarterly credits will be accessible for each quarter commencing on or after 1 January 2014.

Quarterly credits will improve cash flow, and enhance incentives to invest in R&D. The proposed design seeks to minimise additional compliance obligations and maintain tax system integrity.

3.1 ADMINISTERING QUARTERLY CREDITS

Innovation Australia and the Australian Taxation Office will administer quarterly credits

Quarterly credits will be administered by Innovation Australia (through AusIndustry) and the ATO. This is consistent with the administration of the R&D Tax Incentive.

The quarterly credit process

Companies will self-assess their eligibility for quarterly credits, consistent with the existing approach to the R&D Tax Incentive. (The flowchart in Figure 1 provides an overview of how quarterly credits will work.)

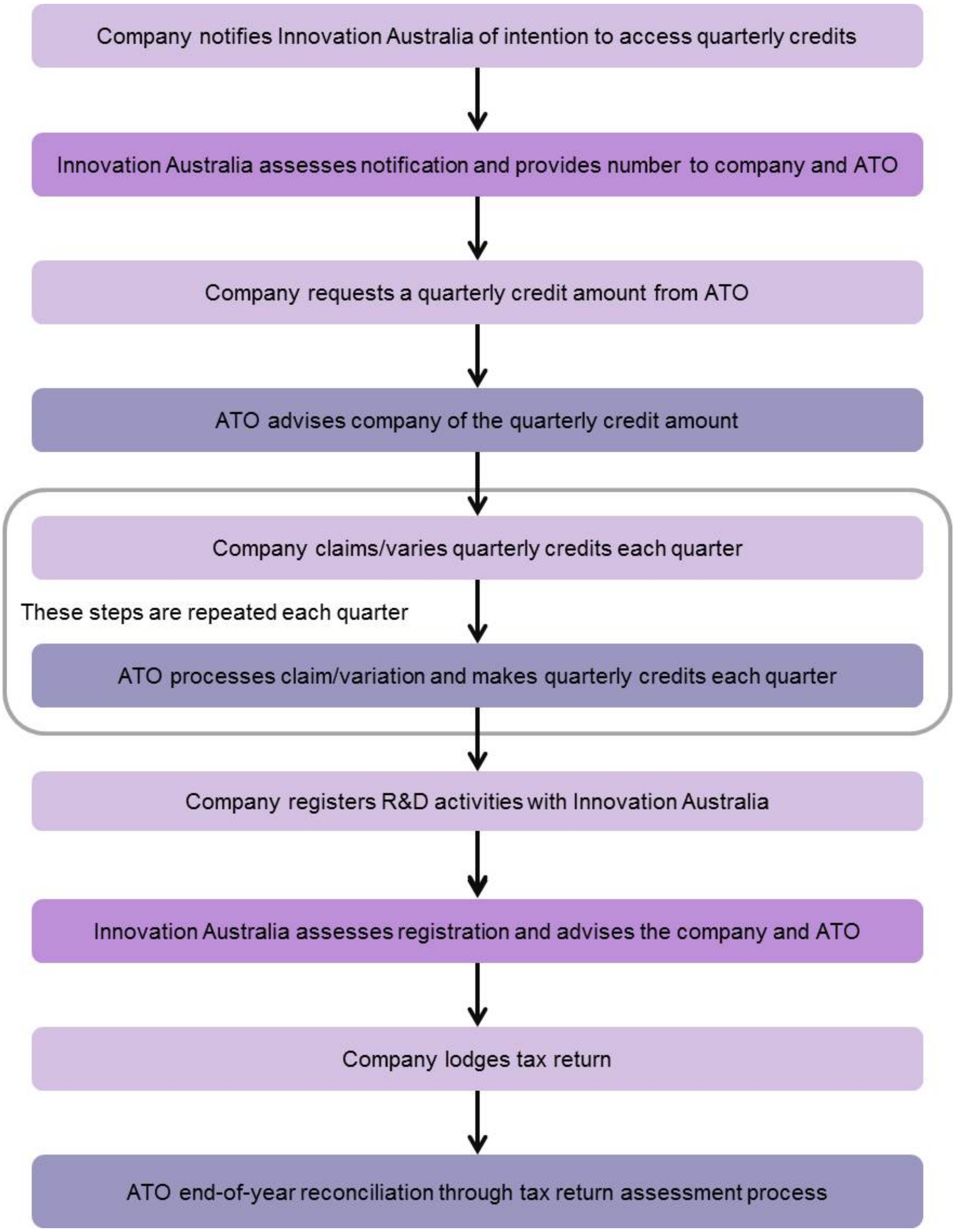
To access quarterly credits, a company will notify Innovation Australia once each income year of its intention to claim quarterly credits and provide an outline of the R&D activities that it expects to undertake. Innovation Australia will consider the notification and, if appropriate, will advise the company that its notification has been accepted and provide the company with a quarterly credits notification number. The ATO will also be advised of the notification number. Notification by a company will enable Innovation Australia to undertake appropriate compliance activity, including the issuing of findings during the year about the company's R&D activities.

Using the quarterly credits notification number, the company will then approach the ATO for advice on its quarterly credit amount. If the company meets the relevant criteria (detailed in Section 3.2), the ATO will calculate the company's quarterly credit amount for the income year, based on the latest year for which the company's income tax has been assessed. The ATO advised quarterly credit amount will be the same in respect of each quarter of the income year, and could be zero. The calculation of the quarterly credit amount is detailed in Section 3.3.

To claim the credits each quarter, the company will confirm to the ATO that it continues to be eligible and that it either accepts the ATO advised amount or that it wishes to vary that amount.

For each quarter of the income year, in making the quarterly credits, the ATO will offset the quarterly credit amount against any existing tax liabilities the company may have and transfer any surplus credit to the company's nominated income tax financial institution account.

Figure 1: Flow chart of R&D quarterly credits process



After the end of the income year, and consistent with current practice, companies will be required to register with Innovation Australia and, if registration is accepted, claim the R&D refundable tax offset as part of their company income tax return. However, the company income tax return will also incorporate a reconciliation process for quarterly credits. Quarterly credit amounts paid to the company in respect of the income year will be debited against the company's income tax assessment to determine whether it has an amount due or refundable. The reconciliation process is explained further in Section 3.4.

3.2 Accessing quarterly credits

For integrity reasons, not all companies that are eligible for the R&D refundable tax offset will be able to access quarterly credits.

To access quarterly credits, a company must, in respect of the relevant income year:

- be a complying taxpayer;
- have the necessary history with the R&D Tax Incentive; and
- expect to receive the R&D refundable tax offset, which means that it also expects to:
  - be an R&D entity;
  - have aggregated annual turnover of less than $20 million;
  - not be controlled by an exempt entity; and
  - undertake eligible R&D activities.

Although not a formal requirement for accessing quarterly credits, a company should expect to receive an appropriately sized refund of the R&D refundable tax offset otherwise it will be generating a debt that will need to be repaid on the date of the company's income tax assessment for the year.

A company that does not meet the requirements to access quarterly credits may still be entitled to register for and claim the R&D refundable tax offset through its end-of-year income tax return.

Be a complying taxpayer

A company must not have any outstanding tax liabilities and be up to date with respect to all lodgement requirements.

Have the necessary history with the R&D Tax Incentive

A company must have received either the R&D Tax Incentive refundable tax offset or non-refundable tax offset for at least one of the last five income years.

This requirement will not be met by having accessed the former R&D Tax Concession, either as an enhanced deduction or a refundable tax offset. In addition, registering with Innovation Australia for the R&D Tax Incentive will not be sufficient; a company must have received the offset in its income tax assessment.

This means that, in practice, when quarterly credits first begin from 1 January 2014, companies will need to have had a history with the R&D Tax Incentive in at least one of the previous two income years, with the effective history period increasing incrementally to five years over time.

Requiring a history with the R&D Tax Incentive will assist in maintaining the integrity of the tax system by, for example, reducing the risks that may arise through the activities of phoenix companies.

A history with the R&D Tax Incentive will also increase the likelihood that companies will have a clearer understanding of eligible R&D activities and have a better capacity to anticipate their end-of-year tax position, inclusive of any R&D refundable tax offset.

Expect to receive the R&D refundable tax offset

A company must expect to receive the R&D refundable tax offset for the income year. This, in turn, means that a company must expect a number of other events to occur. These events are that a company must: be an eligible company under the R&D Tax Incentive (that is, an R&D entity); have aggregated annual turnover of less than $20 million; not be controlled by an exempt entity; and undertake eligible R&D activities.

A company could demonstrate an expectation of receiving the R&D refundable tax offset for an income year by, for example, preparing an outline of its R&D activities and estimating its likely expenditure on those activities.

The R&D activities to be undertaken during the income year may be the subject of a finding by Innovation Australia. In order for the activities that are the subject of a finding to be eligible, the finding must be positive. A positive finding consists of Innovation Australia determining that particular activities are eligible core or supporting R&D activities.

A negative finding consists of Innovation Australia determining that particular activities are not core or supporting R&D activities. That is, they are not eligible R&D activities and a company's expenditure on those activities cannot be claimed under the R&D Tax Incentive. Such activities will therefore not give rise to an entitlement to quarterly credits.

Eligibility for quarterly credits may be affected by findings made by Innovation Australia at any time before or after a company accesses quarterly credits. Findings issued by Innovation Australia about R&D activities are binding on the ATO.

3.3 Quarterly credit amount

To ensure quarterly credits are available in a timely way four times a year, and to minimise additional compliance obligations, the ATO will advise a company of a quarterly credit amount calculated on the basis of the latest year for which the company's income tax has been assessed. For this amount to be greater than zero, the company will need to have received a refund of the R&D refundable tax offset for that income tax assessment.

However, a company may also seek a variation to the quarterly credit amount advised by the ATO so that it better anticipates the company's expected refund of the R&D refundable tax offset. It is therefore reasonable for a company to receive quarterly credits despite the ATO having advised a zero quarterly credit amount.

A summary of these options is provided in Table 1.

Table 1: How quarterly credits amounts are determined

Position in latest income tax assessment	Position for current income year		
	PAYG instalment obligation	**ATO-advised quarterly credit amount**	**Company-varied quarterly credit amount**
Net refund company	No PAYG instalment obligation	Take the lesser of the R&D refundable tax offset or the remainder of any refundable tax offsets and then divide by four	Option to vary quarterly credit amount
Tax payable company	PAYG instalment obligation (option to vary to zero)	Zero	Option to vary quarterly credit amount

ATO's calculation of the quarterly credit amount

To calculate the quarterly credit amount, the ATO will take the lesser of:

- the R&D refundable tax offset;[3] or
- the remainder of any refundable tax offsets;[4]

provided to a company, for the latest income year for which an income tax assessment has been made, and divide it by four. (For a worked example see Example 1 in Section 5.)

Calculating the quarterly credit amount in this way provides the most advantageous outcome where the company may be entitled to two or more refundable tax offsets.

Calculation of the quarterly credit amount is designed to use the latest income tax assessment that is available, rather than making a company wait until the tax assessment from the immediately prior year has been made.

The quarterly credit amount advised by the ATO may be zero and will apply in respect of all four quarters for an income year, unless varied at the request of a company.

The quarterly credit amount advised by the ATO will be a 'safe harbour' amount. Thus, where a company has been eligible to claim quarterly credits throughout the year but ends up with tax payable or is paid a total amount of quarterly credits that exceeds the refund of the R&D refundable tax offsets, it will be required to pay any tax owed and repay any excess quarterly credits paid. These payments will be due on the same day as any amount payable as a result of the company's income tax assessment for that year. If paid on time, no General Interest Charge (GIC) will apply to the excess quarterly credits paid.

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[3] The R&D refundable tax offset is the amount calculated by multiplying a company's total notional R&D deductions by 45 per cent. This amount is shown at Label U in item 22 on page 9 of the company tax return 2012.

[4] The remaining amount of any refundable tax offsets is that amount left after any gross tax has been reduced to zero and before eligible credits and PAYG instalments raised are credited to the company. This amount is shown at Label I of the calculation statement on page 10 of the company tax return 2012.

There will be a cut-off date for quarterly claims. The cut-off date will be the 28th day after the end of the quarter. A company accessing quarterly credits for the first time in an income year after a cut-off date can still access credits in respect of any remaining quarters in that income year. The quarterly credit amount advised by the ATO for those remaining quarters will be calculated as if there were four quarterly payments being made for the income year, that is, without any element of 'catch up' for any missed quarters.

A company that takes up quarterly credits at the start of the income year can access up to four quarterly credit amounts in respect of that income year. If the company lodges its income tax return before all the quarterly credits for that income year have been claimed, no further quarterly credits will be able to be claimed for that income year.

Variation of the quarterly credit amount

A company may seek to vary the quarterly credit amount advised by the ATO, to better anticipate the company's expected refund of the R&D refundable tax offset. This will be done as part of the quarterly process by which companies confirm their eligibility for quarterly credits (and accept the quarterly credit amount advised by the ATO or request a varied amount). Such variations will be subject to acceptance and subsequent review by the ATO. A variation to increase the quarterly credit amount will not have 'safe harbour' protection. (For a worked example see Example 2 in Section 5.)

A variation of the quarterly credit amount can be sought for any quarter on a prospective basis, that is, a variation can be sought in respect of the current and any future quarter in the income year. A company will be required to support a variation by providing additional information. The ATO may, if necessary, delay payment of a varied quarterly credit amount until it is satisfied that there are reasonable grounds for the variation.

A variation may be for an increase or a decrease in the quarterly credit amount. Where a company has been eligible to claim quarterly credits throughout the year and has increased the quarterly credit amount but ends up with tax payable or is paid a total amount of quarterly credits that exceeds the refund of the R&D refundable tax offset, it will be required to pay any tax owed and repay any excess quarterly credits paid. These payments will be due on the same day as any amount payable as a result of the company's income tax assessment for that year. If paid on time, no GIC will apply to the excess quarterly credits paid. However, a variation penalty may apply if there is a sufficiently large margin between the total amount of quarterly credits and the refund of the R&D refundable tax offset.

Where a company has been eligible to claim quarterly credits throughout the year and has decreased the quarterly credit amount but ends up with tax payable or is paid a total amount of quarterly credits that exceeds the refund of the R&D refundable tax offset, it will be required to pay any tax owed and repay any excess quarterly credits paid. These payments will be due on the same day as any amount payable as a result of the company's income tax assessment for that year. If paid on time, no interest will be charged on the excess quarterly credits paid. In addition, no variation penalty will apply.

A tax payable company that has tax payable in the latest income year for which it has an income tax assessment is likely to be required to make PAYG instalments. If such a company were to access quarterly credits it would be advised by the ATO of a zero 'safe harbour' quarterly credit amount. However, the company would then have the option to vary that amount so that it anticipates an expected refund of the R&D refundable tax offset for the current income year. Such a company would normally also vary any PAYG instalment rate or amount down to zero, using the normal PAYG instalment system processes.

3.4 END-OF-YEAR RECONCILIATION

Quarterly credits provide payments in anticipation of a company's refund of the R&D refundable tax offset for the current income year. An end-of-year process is required to reconcile the company's expected income tax position with its actual income tax position.

Entitlement to quarterly credits does not replace the normal process for claiming the R&D refundable tax offset. A company must still register its R&D activities with Innovation Australia and claim its R&D refundable tax offset in its income tax return. Failure to register and claim the R&D refundable tax offset will result in a requirement to repay any quarterly credits claimed.

The receipt of any quarterly credit amounts paid to the company during the income year will be taken into account in the company's income tax return. This may result in the company owing tax.

The end-of-year reconciliation process, which will occur as part of the company's self-assessment, will operate as follows:

- A company's R&D refundable tax offset from expenditure on eligible registered R&D activities will be calculated as normal, without regard to whether or not quarterly credits amounts were provided to the company.

- A company's R&D refundable tax offset (if any) will be included as a credit in the company's income tax return. This amount will be first used to reduce any gross tax. If tax payable has been reduced to zero, any remaining amount will be potentially refundable.

- An amount equal to the sum of quarterly credits provided to the company in relation to that income year will be included as a debit in the company's income tax return.

Normal processes will then apply depending on whether the return results in the company having an amount due or refundable.

For worked examples of how the reconciliation process works see Examples 1 and 2 in Section 5.

3.5 START DATE OF 1 JANUARY 2014

Eligible companies will be able to access quarterly credits for each quarter commencing on or after 1 January 2014.

The quarterly credit amount advised by the ATO will be based on the 2011-12 income year, unless the company has lodged its 2012-13 income tax return sufficiently early in which case the 2012-13 income year will be used.

3.6 OTHER ISSUES

Companies with substituted accounting periods will be able to access quarterly credits, consistent with their treatment under the R&D Tax Incentive.

Consolidated groups with aggregated annual turnover of less than $20 million will be able to access quarterly credits with modifications to address particular risks, for example, the risks associated with entry and exit of subsidiaries.

Quarterly credits have been designed with a view to minimising additional compliance obligations for companies. It is not expected that there will be further significant record keeping obligations in addition to what is already required for the R&D Tax Incentive and the tax system more generally.

Quarterly credits incorrectly paid to companies because one or more eligibility requirements are not met will be required to be repaid to the ATO immediately. The GIC will apply to amounts owing from the date they are due. If warranted, additional penalties may also apply.

4. CONSULTATION QUESTIONS

1. Are the proposed arrangements for quarterly credits workable? What features are most useful? Are there any features that are problematic? How might the arrangements be improved while appropriately managing risks to companies and the Commonwealth?

2. What type of guidance material or services would be most useful to assist companies to access quarterly credits and meet any associated obligations?

3. Do the proposed arrangements for quarterly credits create any problematic interactions with other taxation or regulatory arrangements? If so, what are these interactions and how should they be addressed?

4. Are there any other comments on the proposed arrangements for quarterly credits outlined in this consultation paper?

5. Worked examples

A company tax rate of 30 per cent and a 45 per cent R&D refundable tax offset is assumed for these examples.

Example 1: ATO advised quarterly credit amount

New Knowledge Innovation Pty Ltd is a company incorporated in Australia that manufactures products for sale to a world market.

Example 1

	2014-15	2015-16	2016-17
Income	*6,000,000*	*5,000,000*	*5,000,000*
Deductions	*3,500,000*	*3,000,000*	*3,000,000*
Taxable income[5]	2,500,000	2,000,000	2,000,000
Gross tax[6]	750,000	600,000	600,000
Refundable tax offset — other[7]	100,000	100,000	100,000
Total notional R&D deductions[8]	*0*	*2,000,000*	*2,000,000*
Refundable tax offset — R&D[9]	0	900,000	900,000
Tax payable[10]	650,000	0	0
Remainder of refundable tax offsets[11]	0	400,000	400,000
Credit for PAYG instalments raised[12]	600,000	0	0
Debit for R&D quarterly credits claimed	0	0	400,000
Amount due (refundable)[13]	50,000	(400,000)	0

2014-15 income year

In 2014-15, New Knowledge Innovation's taxable income was $2,500,000. New Knowledge Innovation was eligible for $100,000 in (non-R&D related) refundable tax offsets. New Knowledge Innovation paid a PAYG instalment of $150,000 each quarter. Total PAYG instalments were $600,000. Upon finalisation of New Knowledge Innovation's income tax assessment, it owed $50,000 in tax in 2014-15.

2015-16 income year

In 2015-16, New Knowledge Innovation lost sales to a competitor. In response, New Knowledge Innovation invested $2,000,000 in eligible R&D activities to enhance its product range. New

[5] Amount at Label A in the Calculation statement (p10) in the company tax return 2012
[6] Amount at Label B in the Calculation statement (p10) in the company tax return 2012
[7] Amount equal to the amount at Label E in the calculation statement (p10) *less* the amount at Label U in Item 22 (p9) (both contained in the company tax return 2012)
[8] Amount at Label Z1 in Item 4 in Part E in the research and development tax incentive schedule 2012
[9] Amount at Label U in Item 22 (p9) in the company tax return 2012
[10] Amount at Label T5 in the Calculation statement (p10) in the company tax return 2012
[11] Amount at Label I in the Calculation statement (p10) in the company tax return 2012
[12] Amount at Label K in the Calculation statement (p10) in the company tax return 2012
[13] Amount at Label S in the Calculation statement (p10) in the company tax return 2012

Knowledge Innovation expected to be eligible for the R&D refundable tax offset and estimated that, as a result of the offset, it would not owe any tax for 2015-16. New Knowledge Innovation therefore varied its PAYG instalments for 2015-16 to zero. New Knowledge Innovation's taxable income for 2015-16 was $2,000,000. New Knowledge Innovation was eligible for $100,000 in (non-R&D related) refundable tax offsets. New Knowledge Innovation's R&D refundable tax offset was $900,000. New Knowledge Innovation received a refund of $400,000.

2016-17 income year

In 2016-17, New Knowledge Innovation planned to invest a further $2,000,000 in eligible R&D activities. After receiving its 2015-16 tax assessment, New Knowledge Innovation also notified Innovation Australia that it wanted to access quarterly credits, and was subsequently accepted. New Knowledge Innovation then approached the ATO for advice on its quarterly credit amount. The ATO advised a quarterly credit amount of $100,000 per quarter. This amount was calculated by taking the lesser of New Knowledge Innovation's 2015-16 R&D refundable tax offset ($900,000) or its remainder of any refundable tax offsets ($400,000) and dividing it by four (that is $400,000/4 = $100,000). Total quarterly credits made were $400,000 for 2016-17. New Knowledge Innovation paid no PAYG instalments for 2016-17 because it had no income tax payable in 2015-16. New Knowledge Innovation's taxable income for 2016-17 was $2,000,000. New Knowledge Innovation was eligible for $100,000 in (non-R&D related) refundable tax offsets. New Knowledge Innovation's R&D refundable tax offset was $900,000. New Knowledge Innovation received no refund and paid no tax because the quarterly credits made to it were debited against the refund it would otherwise have received.

Example 2: company varied quarterly credit amount

2016-17 income year

Example 2 is the same as example 1, with two exceptions. In 2016-17, New Knowledge Innovation invests more in eligible R&D activities ($3,000,000 in example 2 compared to $2,000,000 in example 1). As a result, New Knowledge Innovation varies its quarterly credit amount, increasing it from $100,000 per quarter to $200,000 per quarter. Total quarterly credits made were $800,000. New Knowledge Innovation is paid a refund of $50,000.

Example 2

	2014-15	**2015-16**	**2016-17**
Income	*6,000,000*	*5,000,000*	*5,000,000*
Deductions	*3,500,000*	*3,000,000*	*3,000,000*
Taxable income	2,500,000	2,000,000	2,000,000
Gross tax	750,000	600,000	600,000
Refundable tax offsets — other	100,000	100,000	100,000
Total notional R&D deductions	*0*	*2,000,000*	*3,000,000*
Refundable tax offset — R&D	0	900,000	1,350,000
Tax payable	650,000	0	0
Remainder of refundable tax offsets	0	400,000	850,000
Credit for PAYG instalments raised	600,000	0	0
Debit for R&D quarterly credits claimed	0	0	800,000
Amount due (refundable)	50,000	(400,000)	(50,000)

6. Glossary

Abbreviation	Definition
AusIndustry	AusIndustry is a program delivery division within the Department of Industry, Innovation, Science, Research and Tertiary Education.
ATO	Australian Taxation Office
Complying tax payer	A company must not have any outstanding tax liabilities and be up to date with respect to all lodgement requirements.
Exempt entity	An entity whose whole income is exempt from tax.
GIC	The General Interest Charge is a uniform interest charge imposed where there is a late payment of a tax debt. Taxpayers can ask the ATO for a remission of GIC.
Innovation Australia	Innovation Australia is an independent statutory board, established under the *Industry Research and Development Act 1986*, to assist with the administration of innovation programs designed to support industry. AusIndustry administers the R&D Tax Incentive on behalf of Innovation Australia.
Necessary history with the R&D Tax Incentive	A company must have received either the R&D Tax Incentive refundable tax offset or non-refundable tax offset in respect of at least one of the last five income years.
Net refund company	A company with a remaining amount of refundable tax offsets after any gross tax has been reduced to zero and before eligible credits and PAYG instalments raised are credited to it. The remainder of any refundable tax offsets are shown at Label I of the calculation statement on page 10 of the company tax return 2012.
PAYG	pay as you go
R&D	research and development
R&D entity	To be an R&D entity a company must: (i) be incorporated under Australian law; or (ii) be incorporated under a foreign law and be an Australian resident for tax purposes; or (iii) be incorporated under a foreign law and be a resident of a foreign country with a relevant double taxation agreement with Australia and have a permanent establishment in Australia through which it carries on business. In addition, it cannot be an exempt entity.
Refund of the R&D refundable tax offset	The remaining amount of R&D refundable tax offset after any gross tax has been reduced to zero and before eligible credits and PAYG instalments raised are credited to the company. The remaining amount of the R&D refundable tax offset is included at Label I of the calculation statement on page 10 of the company tax return 2012.

Abbreviation	Definition
'Safe harbour' quarterly credit amount	The quarterly credit amount advised by the ATO will be a 'safe harbour' amount. If the total amount of quarterly credits paid to a company exceeds the refund of the R&D refundable tax offset, the company will be required to repay any excess. However, if repaid on time, no GIC will apply to the excess quarterly credits paid.
Small and medium sized companies	For the purposes of the R&D Tax Incentive these are companies with aggregate annual turnover of less than $20 million.
Tax payable company	A company with income tax payable greater than zero before eligible credits and PAYG instalments raised are credited to it. Tax payable is shown at Label T5 of the calculation statement on page 10 of the company tax return 2012.
TLA(R&D) Act 2011	Tax Laws Amendment (Research and Development) Act 2011