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Balancing adjustments for R&D assets

Read about the adjustments that can occur to your income tax position when assets are used for R&D activities.

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When and why a balancing adjustment can occur

Notional research and development (R&D) deductions can include the decline in value of tangible depreciating assets you use for R&D activities. When the asset stops being held there is a balancing adjustment event. Common examples are the sale or scraping of the asset. The balancing adjustment compares the economic value of the asset at that time (called its termination value) with its written-down tax value (called adjustable value). This can result in either an amount of assessable income or an additional deduction against assessable income.

This adjustment ensures your final income tax position reflects the actual decline in value of the assets over time, rather than the estimates on which your decline in value deductions were based. The adjustment is reduced for the non-taxable use of the asset and other reductions that apply to the decline in value deductions for the asset.

For assets that were only used for R&D activities, the balancing adjustment is worked out under section 355-315 of the *Income Tax*

Assessment Act 1997 (ITAA 1997). For assets that were also used for other taxable purposes, the balancing adjustment is worked out under subdivision 40-D of the ITAA 1997 on the assumption that a taxable purpose includes using the asset for the purpose of conducting R&D activities.

A further clawback adjustment or catch-up deduction arises for the additional benefit of the R&D tax offset for these assets. The clawback adjustment or catch-up deduction for a balancing adjustment arises where:

- an R&D entity has used a depreciating asset for R&D activities
- it is or has been entitled to an R&D notional deduction for decline in value for the asset in any year
- a balancing adjustment event happens in the current year
- a balancing adjustment is included in assessable income or as deduction in the current year.

This further amount either claws back the incentive component of the R&D tax offset claimed for the asset in relation to the balancing adjustment, or it allows a further deduction to catch-up an equivalent amount to that incentive component that had not previously been claimed.

Basic balancing adjustment for R&D asset

When an asset is disposed of, or stops being held in another way, its value at the time of disposal may vary from its adjustable value (which is the original cost of the asset less its decline in value). Where this occurs for a depreciating asset used to conduct R&D activities, the tax treatment for the gain or loss (balancing adjustment) on disposal must also be considered.

A balancing adjustment gain is made when the value of the asset at the time of disposal (termination value) exceeds its adjustable value. This gain is included in assessable income to the extent that the asset was used in deriving assessable income or conducting R&D activities over its life.

A balancing adjustment loss is made when the adjustable value exceeds its termination value. This loss is allowable as an additional

deduction to the extent that the asset was used in deriving assessable income or conducting R&D activities over its life.

Example: Basic balancing adjustment

A new item of equipment costing $1,000,000 is used during the year for a taxable purpose described in subsection 40-25(7) of the ITAA 1997. Assuming that the effective life is 10 years, the decline in value allowable as a deduction for the year is calculated, if choosing the prime cost method, as follows:

$$\$1,000,000 \times (365 \div 365) \times (100\% \div 10) = \$100,000$$

If the equipment is disposed of for the sum of $850,000 at the end of the year, a balancing loss on disposal of $50,000 is incurred, calculated as follows:

- Cost is $1,000,000
- Minus decline in value of $100,000
- Equals adjustable value which is $900,000
- Minus termination value of $850,000
- Equals balancing adjustment (loss) of $50,000.

If the equipment had been instead disposed of for $925,000 rather than $850,000, a balancing adjustment gain of $25,000 would have been made.

Note: The termination value can exceed the cost of the asset resulting in a balancing adjustment gain that includes a gain over its original cost.

Assets used partly for R&D purposes

If the asset was used for a taxable purpose as well as for R&D purposes, the balancing adjustment is worked out under section 40-285 of the ITAA 1997 on the assumption that a taxable purpose includes using the asset for the purpose of conducting R&D activities. This assumption is made under section 40-292 of the ITAA 1997 (or section 40-293 of the ITAA 1997 in the case of an R&D partnership).

Assets used only for R&D purposes

If the asset was used only for R&D purposes, the balancing adjustment is worked out under 355-315 of the ITAA 1997 (or section 355-525 of the ITAA 1997 in the case of an R&D partnership). In this situation, a balancing adjustment only applies if the company is registered for R&D with AusIndustry for the year in which the balancing adjustment event happens.

Additional clawback adjustment or catch-up deduction for R&D assets

Where a basic balancing adjustment arises for an asset that has been used for R&D activities, a further adjustment may be required. The further adjustment claws back or provides a catch-up deduction for the incentive component of the R&D tax offset. This is in addition to the basic balancing adjustment to which the company's corporate tax rate is applied. These rules apply on an equivalent basis to R&D partnerships with a proportionate approach applying to each partner.

Clawback amount and catch-up amount

A clawback adjustment is included in assessable income if a gain arises on the balancing adjustment event. Unlike the basic balancing adjustment, the calculation of the amount of the gain to be clawed back (called the clawback amount) is limited to a termination value up to the cost of the asset. Any part of the gain in excess of the cost of the asset is not included.

A catch-up deduction is included as a deduction from assessable income if the balancing adjustment event gives rise to a loss (the catch-up amount).

For an asset partly used for R&D activities the clawback amount or catch-up amount is reduced to that portion of the total decline in value for the asset that represents the total R&D decline in value deductions for the asset.

Calculating the clawback adjustment or catch-up deduction

A clawback adjustment included in assessable income is worked out as:

(Starting offset – Adjusted offset – Deduction amount) ÷ R&D entity's corporate tax rate for the present year

A catch-up deduction on a catch-up amount is worked out as:

(Adjusted offset – Starting offset – Deduction amount) ÷ R&D entity's corporate tax rate for the present year

The formula calculates an amount on a year by year basis and the total of the amounts worked out for each offset year is included in assessable income or deductions for the year in which the balancing adjustment event happens.

The *starting offset* is the actual amount of R&D tax offset the entity receives that includes an amount being clawed back. The formula is used separately for each offset year that includes an R&D decline in value claim for the asset.

The *adjusted offset* is the offset amount that the entity would have received for the offset year if its notional R&D deductions were either reduced by the amount being clawed back or increased for the catch-up amount.

The difference between these two amounts is the offset differential. This is the amount of tax offset on the balancing adjustment attributed to the offset year being clawed back or deducted. If the overall rate of tax offset is the same for the starting offset and adjusted offset, the calculation can for practical purposes be made directly by applying the tax offset rate to the balancing adjustment attributed to the offset year. This may not be possible for a tiered non-refundable offset or if expenditure exceeds the incentive cap.

The *deduction amount* is the amount being clawed back or the catch-up amount multiplied by the R&D entity's company tax rate for the offset year. By subtracting this, the clawback only includes the incentive component of the tax offset. The additional amount reflects the enhanced benefit that you have obtained or could have obtained through the R&D tax offset for the decline in value.

The amount worked out above is then grossed-up for the entity's company tax rate for the current year to work out the equivalent amount included in assessable income or deducted.

Additional adjustment for depreciating assets used only for R&D activities

For assets used solely for R&D activities, the additional balancing adjustment only applies if the company is registered with AusIndustry for any R&D activity for the year in which the balancing adjustment event happens. This additional balancing adjustment results in either a further (catch-up) deduction, or an additional amount being included in assessable income (to recover earlier notional R&D deductions).

Example: balancing adjustment for asset used only for R&D activities

B Pty Ltd was incorporated in Australia and carries on a business in Australia that includes R&D activities that it conducts wholly in Australia. Its aggregated turnover for each income year is under $20 million. B Pty Ltd has a standard income year ending on 30 June.

On 1 July 2020, B Pty Ltd purchases a mass spectrometer for use in its R&D activities. The unit costs $30,000. B Pty Ltd assesses the effective life of the unit as 5 years and chooses the prime cost method for calculating its decline in value. B Pty Ltd is entitled to depreciate $6,000 ($30,000 ÷ 5) in each of the 5 income years.

During 2020–21 and 2021–22 income years, B Pty Ltd uses the unit only in carrying on its R&D activities. It sells the unit on 31 December 2021 for $15,000.

Basic balancing adjustment loss

As B Pty Ltd only used the unit for R&D activities, it will work out a balancing adjustment under the R&D rules. This is worked out on the difference between its adjustable value and its termination value. The termination value is $15,000. The adjustable value as at 31 December 2021 is equal to the opening adjustable value at 1 July 2021 less the part year decline in value during 2021–22 income year. The opening adjustable value is $24,000. The part year decline in value is $3,000. Accordingly, the adjustable value is $21,000.

B Pty Ltd has made a balancing adjustment loss (the adjustable value exceeds the termination value) and the loss is allowable as an additional deduction. B Pty Ltd is entitled to a balancing adjustment deduction of $6,000 ($21,000−$15,000) in the 2021–22 income year.

Catch-up deduction

B Pty Ltd was registered for its ongoing R&D activities for the 2021–22 year. It is entitled to a further deduction for the catch-up amounts that relate to the two income years (each being an offset year) in which B Pty Ltd has claimed the R&D tax offset in relation to the asset's decline in value.

The catch-up amount is the $6,000 amount worked out above as the balancing adjustment loss.

B Pty Ltd works out the portion of the $6,000 catch-up amount that is attributable to each offset year. In this case, it follows the proportion of the decline in value claimed in each year. For 2020–21 this amount is $4,000 and for 2021–22 it is $2,000.

B Pty Ltd has total notional deductions of $500,000 in 2020-21 and $550,000 in 2021–22 income years and its company tax rate is 26% for 2020–21 and 25% for 2021–22.

Calculating the catch-up deduction for the 2020–21 income year

For the 2020–21 income year, B Pty Ltd calculates the offset differential by multiplying the catch-up amount for that year by the R&D tax offset rate for that year. It is calculated as the difference between the tax offset received for the year and the tax offset that would have been received had it included the catch-up amount for the year. This represents the additional R&D tax offset that would have applied to the balancing adjustment loss. In practice here it can be worked out directly on the catch-up amount for the year.

($504,000 × 43.5%)−($500,000 × 43.5%)

$4,000 × 43.5% = $1,740

B Pty Ltd determines the deduction amount by multiplying the catch-up amount by the company tax rate for the offset year.

$4,000 × 26% = $1,040

The difference between these amounts ($700) represents the premium or incentive component of the R&D tax offset for that year. A catch-up deduction is calculated on this amount by grossing up for the company's tax rate for the year in which the deduction is claimed.

($1,740−$1,040)/25% = $2,800

Calculating the catch-up deduction for the 2021–22 income year

For the 2021–22 income year, the calculation is as follows:

The offset differential is $870. This is the part of the catch-up amount for the offset year ($2,000) multiplied by the R&D tax offset rate for that year (43.5%).

The deduction amount is $500, calculated on the catch-up amount ($2,000) at the company tax rate for the offset year (25%).

The catch-up deduction is $1,480, calculated as the difference between these amounts ($370) and grossed up for the company's tax rate for the present year (25%).

Total catch-up deduction

The total catch-up deduction claimed in the 2021–22 income year is the sum of the amounts worked out for each year:

$2,800 + $1,480 = $4,280

Alternative assessable clawback adjustment

If the termination value in the example above was $27,000 rather than $15,000, B Pty Ltd would make a balancing profit (the termination value exceeds the adjustable value of $21,000), and so B Pty Ltd would be required to include the balancing adjustment gain of $6,000 in its assessable income, plus a further assessable clawback adjustment of $4,280.

Example: balancing adjustment for non-refundable tax offset

Ozzie Electric Pty Ltd has an aggregated turnover of over $20 million and below $50 million for each of the 2019–20 to 2021–22 income years. Its total expenses in the 2021–22 income year are $15 million. Its notional deductions for these years are:

2019–20	**2020–21**	**2021–22**

$355,000	$327,000	$298,000

On 18 April 2020, Ozzie Electric acquired a tangible depreciating asset for $80,000 and used the asset entirely for R&D purposes. The asset has an effective life of 5 years and Ozzie Electric uses the prime cost (straight line) method to work out the asset's decline in value as follows:

Income year	Days asset used	Decline in value	Adjustable value
2019–20	73	$3,200	$76,800
2020–21	365	$16,000	$60,800
2021–22	365	$16,000	$44,800
Total decline in value	N/A	$35,200	N/A

Ozzie Electric sells the asset on 1 July 2022 for $34,900. It continues to be registered for R&D for the 2022–23 income year. When the asset is sold, there is a balancing adjustment event. As the asset's adjustable value of $44,800 exceeds its termination value of $34,900, Ozzie Electric is entitled to a deductible balancing adjustment amount of $9,900. This amount is allowed as a deduction against its assessable income in the 2022–23 income year.

Ozzie Electric is also entitled to a further deduction against assessable income on the balancing adjustment of $9,900. The catch-up deduction is worked out on the incentive component of the R&D tax offset if it were increased for that balancing adjustment.

The balancing adjustment and the catch-up deduction are considered in calculating taxable income in the year the balancing adjustment event happened. They are not notional

deductions and are not considered in calculating the R&D tax offset.

Calculating the catch-up deduction

The catch-up deduction is worked out on the total of the additional tax offset on the portion of the balancing adjustment attributable to each offset year, using the following formula on a year by year basis:

> (Adjusted offset − Starting offset − Deduction amount) ÷ R&D entity's company tax rate for the balancing adjustment year

A portion of the balancing adjustment (called the catch-up amount) is attributed to each offset year based on what the additional decline in value would have been for that year. The total catch-up amount of $9,900 is attributed to each year as follows:

Income year	Original decline in value	Revised decline in value	Catch-up amount
2019–20	$3,200	$4,100	$900
2020–21	$16,000	$20,500	$4,500
2021–22	$16,000	$20,500	$4,500
Total amount	$35,200	$45,100	$9,900

The starting offset is the amount of the offset that was claimed each year. The adjusted offset and deduction amount are calculated considering the catch-up amount.

Income year	2019–20	2020–21	2021–22

Offset rate	38.5%	38.5%	Tiered rates
Company tax rate	27.5%	26%	25%
Notional deductions	$355,000	$327,000	$298,000
Starting offset	$355,000 × 38.5% = $136,675	$327,000 × 38.5% = $125,895	All claimed at Tier 1 rate (company tax rate + 8.5%) $298,000 × (25% + 8.5%) = $99,830
Catch-up amount	$900	$4,500	$4,500
Increased notional deductions	$355,900	$331,500	$302,500
Tier 1 offset (company's tax rate + 8.5%)	N/A	N/A	Applies to first $300,000 of notional expenditure: $300,000 × (25% + 8.5%) = $100,500
Tier 2 offset (company tax rate +16.5%)	N/A	N/A	Applies to the remaining amount: $2,500 × (25% + 16.5%) = $1,037.50
Adjusted offset	$355,900 × 38.5% = $137,021.50	$331,500 × 38.5% = $127,627.50	$100,500 + $1,037.50 = $101,537.50
Deduction amount	$900 × 27.5% = $247.50	$4,500 × 26% = $1,170	$4,500 × 25% = $1,125

(catch-up amount x company tax rate)			
Catch-up deduction	($137,021.50−$136,675−$247.50) ÷ 25% = $396	($127,627.50−$125,895−$1,170) ÷ 25% = $2,250	($101,537.50−$99,830−$1,125) ÷ 25% = $2,330

The total catch-up deduction for the 2022–23 income year for the balancing adjustment event for the asset is:

$396 + $2,250 + $2,330 = $4,976

Additional adjustment for depreciating assets used for R&D activities and a taxable purpose

For assets that were used for a taxable purpose and also used for R&D activities, the additional balancing adjustment applies whether or not the company is registered with AusIndustry for the year during which the adjustment event happens. However, it only applies only on that portion of the gain or loss attributable to their R&D use.

The clawback amount or catch-up amount on which the additional balancing adjustment is calculated is using the formula:

(Total R&D deductions/Total decline in value) ÷ Section 40-285 amount

In this formula:

Total R&D deductions is the total decline in value amounts for the asset for all income years included in notional R&D deductions.

Total decline in value is the cost of the asset less its adjustable value.

Adjusted section 40-285 amount is the balancing adjustment gain or loss on the balancing adjustment event. However, the gain is adjusted to exclude that part in excess of the cost of the asset. This means any assessable clawback amount is capped by the original cost of the asset using an adjusted section 40-285 amount.

Example: Balancing adjustment for assets used

partly for R&D activities

C Pty Ltd was incorporated in Australia and carries on a business in Australia that includes R&D activities. Its aggregated turnover for each income year is under $20 million. Its total R&D expenditure was $150,000 in the 2020–21 income year and $160,000 in the 2021–22 income year.

On 1 July 2020, C Pty Ltd purchases injection mould for use in its business at a cost of $30,000. C Pty Ltd assesses the effective life of the unit as 5 years and chooses the prime cost method for calculating its decline in value. C Pty Ltd uses the unit 50% of the time for carrying on ordinary business activities and 50% of the time for carrying on R&D activities.

On 31 December 2021, C Pty Ltd sells the unit for $28,800 (its termination value). C Pty Ltd includes in assessable income an amount equal to the termination value less the adjustable value. The adjustable value is equal to the opening adjustable value less the decline in value during 2021–22 income year. The opening adjustable value is $24,000. The decline in value during the year is $3,000. Accordingly, the adjustable value is $21,000. C Pty Ltd includes assessable income of $7,800 ($28,800−$21,000).

C Pty Ltd includes a further amount in assessable income as a result of the use of the asset in R&D activities for 50% of the time it has been held by C Pty Ltd. C Pty Ltd is entitled to total notional R&D decline in value deductions of $4,500 (50% × ($6,000 + $3,000)).

It will need to calculate the additional clawback amount for each offset year relevant to the R&D decline in value claimed. The total clawback amount is attributed based on each year's proportion of the total decline in value. The clawback amount that relates to each year is calculated as:

- 2020–21 income year: ($3,000/$4,500) × $7,800 = $5,200
- 2021–22 income year: ($1,500/$4,500) × $7,800 = $2,600

Calculating the offset deferential and deduction amount for the 2020–21 income year

For the 2020–21 income year, in this case C Pty Ltd can calculate the offset differential by multiplying the clawback portion for that year by the R&D tax offset rate for that year as:

$5,200 × 43.5% = $2,262

C Pty Ltd determines the deduction amount by multiplying the clawback amount by the company tax rate for the year it claimed the notional deduction.

$5,200 × 26% = $1,352

The clawback adjustment for that year to be included in assessable income is calculated on the difference between these amounts and grossed up for the company's tax rate for the year in which the balancing adjustment event happens:

($2,262−$1,352)/25% = $3,640

Calculating the offset deferential and deduction amount for the 2021–22 income year

For the 2021–22 income year, the amount is calculated as:

Offset differential: $2,600 × 43.5% = $1,131

Deduction amount: $2,600 × 25% = $650

Clawback amount: ($1,131−$650)/25% = $1,924

Total catch-up deduction

The total clawback adjustment included as assessable income in the 2021–22 income year is the sum of the amounts worked out for each year:

$3,640 + $1,924 = $5,564

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Clawback of feedstock adjustments

Find out when feedstock adjustments are required under the research and development (R&D) tax incentive.

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Find out when feedstock adjustments are required under the research and development (R&D) tax incentive.

What is a feedstock adjustment

A feedstock adjustment applies when your R&D tax offset includes amounts for feedstock expenditure incurred on R&D activities. You will need to include an amount in your assessable income when those activities produce tangible products that are either:

- supplied to others
- applied to your own use.

The feedstock adjustment applies to the following amounts claimed in any year as a notional R&D deduction:

- expenditure on goods or materials (feedstock inputs) that are transformed or processed during R&D activities in producing one or more tangible products (feedstock outputs)
- expenditure on energy that is input directly into that transformation or processing the feedstock input
- decline in value of assets used in acquiring or producing the feedstock inputs.

The feedstock provisions:

- apply to both core and supporting R&D activities that transform or process feedstock inputs
- are not confined to mass production or industrial activities, and can have application to agricultural production processes.

If a feedstock adjustment is triggered, you must include an amount in your assessable income. This may be in the current or future income

year, depending on when the output is sold or applied.

How the feedstock rules work

The feedstock rules work by increasing your assessable income, rather than by reducing the deductions or offset you can claim.

The feedstock rules effectively adjust the R&D tax incentive benefit you receive for your expenditure on certain 'inputs', reflecting the value of the related 'outputs'.

Why we have feedstock adjustments

The feedstock adjustment is intended to recover the 'incentive' component of the R&D tax offset you receive for your feedstock expenditure. That is, the amount you receive above the general tax deduction that would otherwise be available.

When a feedstock adjustment is triggered

A feedstock adjustment will not be triggered, unless you have claimed the R&D tax incentive for expenditure on one or more of the following:

- acquiring or producing feedstock inputs (including the decline in value of depreciating assets)
- energy inputs directly into the processing or transformation of the feedstock inputs.

The feedstock adjustment is triggered in the year in which you either:

- sell, or otherwise supply to someone else, the feedstock output, or a marketable product derived from it
- apply that output or product to your own use (unless it is for the purpose of transforming that product for supply to someone else).

The feedstock adjustment also applies where an affiliate or an entity connected with you supplies or uses the marketable product as if you had done so.

The feedstock adjustment can be triggered during the income year in which you claimed the R&D incentive, or a future income year.

You can find more information at **Grouping for aggregated turnover purposes**.

What feedstock revenue is

Where the feedstock output is immediately sold or applied, the feedstock revenue will be its market value at that point. Where further expenditures are incurred on the feedstock output between the R&D activity and the point of sale or application to own use, then the feedstock revenue will be a proportion of the value of the marketable product that is sold or applied.

Feedstock revenue is calculated as follows:

 Market value of the marketable product multiplied by the cost of producing feedstock output divided by cost of producing marketable product.

How to calculate your feedstock adjustment

Your feedstock adjustment amount is calculated on the lesser of:

- expenditure in acquiring or producing feedstock inputs and energy inputs for which you have claimed the incentive, to the extent that it is reasonably attributable to the production of the relevant feedstock output for the year (feedstock expenditure)
- feedstock revenue.

To calculate the amount to include in your assessable income for your feedstock adjustment in the trigger year, work out:

- the clawback amount, which is the lesser of the following 2 amounts
  - feedstock expenditure relevant to the feedstock output
  - feedstock revenue
- the grossed-up value of incentive component of the clawback amount obtained in the step above, using the formula below:

 Starting offset minus adjusted offset minus deduction amount divided by corporate tax rate for the present year.

This formula calculates an amount on a year-by-year basis and the total of the amounts worked out for each offset year is included in assessable income for the trigger year.

The 'starting offset' is the actual amount of R&D tax offset that includes the feedstock expenditure being clawed back. The formula is used separately for each offset year that includes the feedstock expenditure being clawed back.

The 'adjusted offset' is the offset amount that the entity would have received for the offset year if its notional R&D deductions were reduced by the clawback amount.

The 'deduction amount' is the clawback amount multiplied by the R&D entity's company tax rate in the offset year. By subtracting this, the clawback only includes the incentive component of the tax offset.

The amount worked out above is then grossed-up for the entity's company tax rate for the current year to work out the equivalent amount to include in assessable income.

This formula is also used to calculate the assessable income included in relation to other clawback amounts for balancing adjustments, for depreciating assets and some government grants. The formula will be used repeatedly where there is more than one clawback amount.

For more tools to calculate the amount for your feedstock adjustment, refer to the:

- R&D tax incentive schedule Instructions 2022
- R&D tax incentive calculator.

If you sell a feedstock output you applied to your own use

Where you have triggered a feedstock adjustment for an output you applied to your own use (other than use for the purpose of further transformation of the product for supply) and you later sell it (with or without further transformation), the sale will not trigger another feedstock adjustment.

If you use a feedstock output yourself on a recurring basis, only the first use can trigger the feedstock adjustment.

How feedstock adjustments apply to outputs used as inputs

Where a feedstock output from one R&D activity is used as a feedstock input for a later R&D activity, no feedstock adjustment will apply to it at that stage. The feedstock adjustment will only apply to the feedstock output from the final R&D activity in the chain.

However, there may be a feedstock adjustment for any by-products that are produced as feedstock outputs before the final R&D activity. The relevant feedstock expenditure would be the amount of any feedstock expenditure that is reasonably attributable to the by-product.

If the by-product is used as a feedstock input for a later R&D activity, it will not attract a feedstock adjustment at this time.

How feedstock adjustments apply to R&D with multiple outputs

Several feedstock inputs can be processed to create a single feedstock output and vice versa.

Where you produce multiple feedstock outputs from an R&D activity, a feedstock adjustment will apply to each of them. The relevant feedstock expenditure for each of those outputs is the amount of feedstock expenditure reasonably attributable to the production of each of them.

This means where your R&D activity produces multiple feedstock outputs that are:

- substantially identical, those outputs can be treated as a single feedstock output for practical purposes
- similar items of variable quality, you can treat the faulty items separately from the successful ones.

Example: feedstock adjustment clawback amount

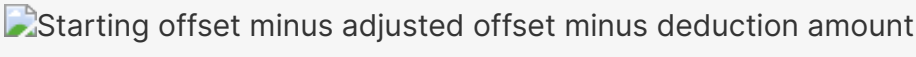
Landscape Supplies Pty Ltd (Landscape Supplies) trials an experimental granite crushing process to produce marketable

granite sand, with the sand produced being sold for $9,000 in the 2021–22 income year. Landscape Supplies has aggregated turnover in that year of $15 million. The company's tax rate is 25%.

The notional R&D deductions the company can claim for the related R&D activities are $22,000 in the 2021–22 income year, which includes $10,000 in feedstock expenditure. The company has no other clawback amounts.

All the granite sand produced is sold during the same year, the feedstock revenue is $9,000. This means the Landscape Supplies will calculate the amount to be included in assessable income for their feedstock adjustment as follows:

1. Landscape Supplies determines the lesser of feedstock revenue ($9,000) and feedstock expenditure ($10,000) to clawback which is $9,000.
2. The company then determines part of the clawback amount determined at Step 1 above to be included in assessable income by applying the following formula:



The starting offset amount is calculated by multiplying the notional deductions by the refundable tax offset rate of 43.5% which is calculated as:

- $22,000 × 43.5% = $9,570.

The adjusted offset is calculated by reducing the notional R&D deduction by the clawback amount and multiplying the result by the refundable tax offset rate of 43.5% which is calculated as:

- $22,000 − $9,000 = $13,000
- $13,000 × 43.5% = $5,655.

The deduction amount is calculated as the clawback amount multiplied by the company's tax rate for the 2021–22 income year which is calculated as:

- $9,000 × 25% = $2,250.

The calculation

The difference between the starting offset and adjusted offset reduced by the deduction amount, is calculated as:

- $9,570 – $5,655 – $2,250 = $1,665.

This is the incentive component of the R&D tax offset on the feedstock amount that is clawed back. This amount is divided by the company's tax rate to calculate the equivalent amount to include in assessable income:

- $1,665 ÷ 25% = $6,660.

Landscape Supplies includes $6,660 in its assessable income for the 2021–22 income year.

Contact us

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Contact AusIndustry

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- submitting an email enquiry

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70889

Clawback of recoupment amounts

How receiving a reimbursement or grant may impact you if you've claimed the research and development (R&D) tax offset.

22 November 2022

How receiving a reimbursement or grant may impact you if you've claimed the research and development (R&D) tax offset.

Application of clawback adjustment

A clawback adjustment applies for a recoupment if:

- you receive (or are entitled to receive), a government recoupment (such as a grant or reimbursement) for eligible research and development (R&D) expenditure
- you have claimed the R&D tax incentive tax offset for this eligible R&D expenditure (or decline in value of notional deductions where the expenditure was for a depreciating asset used in R&D activities).

Clawback does not decrease the grant or tax offset you receive. Rather, it increases your assessable income by an amount for the notional deduction that an R&D entity received or is entitled to receive in relation to the recoupment amount. This is called a 'clawback adjustment'.

This clawback adjustment also applies to you if the recoupment belongs to an entity that is connected or affiliated with you, or you are affiliated with.

A clawback adjustment does not apply to:

- cash flow boosts you receive as it is not a recoupment of expenditure incurred on or in relation to certain activities
- a JobKeeper payment you received for your paid employees as the payment already triggered the at-risk rule – the total expenditure you can claim as a notional deduction for your wage expenditure

has already been reduced by its receipt on application of the at-risk rule

- a JobKeeper payment you received based on business participation as the payment is not a recoupment of expenditure incurred on or in relation to certain activities.

Recoupments you receive under the Cooperative Research Centre (CRC) Program are exempt from the clawback adjustment.

For more information see:

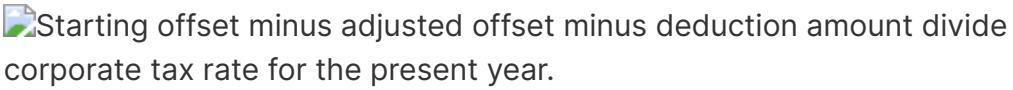
- **section 355-440 and section 355-450 of the ITAA 1997**
- **Subdivision 355-K of the ITAA 1997**
- **connected entities** and **affiliates**
- Taxation Determination **TD 2021/9** *Income tax: JobKeeper payments received or expected as a result of research and development expenditure*

The amount to include in your income for your R&D recoupment

The clawback adjustment is calculated on the R&D expenditure and decline in value for which you claimed a notional deduction in relation to the recoupment. The expenditure amount is reduced for any repayments of the recoupment.

A cap applies to ensure the clawback adjustment cannot exceed the amount of a grant you received that, on a pro-rata basis, relates to the total expenditure on R&D activities and related decline in value. This means the benefit of the R&D tax incentive cannot be clawed back beyond the amount of the grant.

The adjustment for each clawback amount is worked out as:



This formula calculates an amount on a year-by-year basis. The total of the amounts worked out for each offset year is included in assessable income for the trigger year.

The 'starting offset' is the actual amount of R&D tax offset the entity receives that includes an amount being clawed back. The formula is

used separately for each offset year that includes an amount being clawed back.

The 'adjusted offset' is the offset amount that the entity would have received for the offset year if its notional R&D deductions were reduced by the amount being clawed back.

The 'deduction amount' is the clawback amount multiplied by the R&D entity's company tax rate for the offset year. By subtracting this, the clawback only includes the incentive component of the tax offset.

The amount worked out above is then grossed-up for the entity's company tax rate for the current year to work out the equivalent amount to include in assessable income.

This formula is also used to calculate the assessable income included in relation to other clawback amounts for feedstock and balancing adjustments. The formula will be used repeatedly where there is more than one clawback amount.

For more tools to assist you to calculate the amount to include in your assessable income for your recoupment, you can also refer to the **R&D tax incentive schedule instructions 2022** and the **R&D tax incentive calculator**.

Example: clawback of recoupment

Burgundy Bagasse Ltd (Burgundy) conducts R&D activities in relation to a new machine that removes, shreds, crushes and bales grape vines. The activities for which they receive the R&D tax incentive include trials on a vineyard they use to produce table wine.

Burgundy Bagasse Ltd also receives a reimbursement under a government vine-pull scheme for certain costs they incurred to remove those vines. They received $400,000 for expenditure which they notionally deducted under the R&D tax incentive.

Burgundy's aggregated turnover for the 2021–22 income year is below $20 million and its total notional R&D deduction for that year is $2 million. The company's tax rate is 25%. Burgundy is eligible for a 43.5% refundable tax offset for the 2021–22 income year.

The company has no other clawback amounts.

Burgundy's starting offset is $2,000,000 × 43.5% = $870,000.

Burgundy's adjusted offset is determined by excluding the reimbursement amount that was notionally deducted and multiplying the result by its tax offset rate, which is:

- $2,000,000 − $400,000 = $1,600,000
- $1,600,000 × 43.5% = $696,000.

The **deduction amount** is determined by multiplying the reimbursement amount that was notionally deducted by Burgundy's tax rate in the 2021–22 income year, which is $400,000 × 25% = $100,000.

For the expenditure that is reimbursed under the vine-pull scheme, Burgundy includes the clawback amount of $296,000 in its 2021–22 income year, which is calculated as follows:

- ($870,000 − $696,000 − $100,000) ÷ 25% = $296,000.

If you repay the recoupment

If you have repaid a recoupment (such as a grant) in full or in part, the amount you received is taken to be the recoupment less the amount you repaid. This will reduce the amount included in assessable income for the year in which you received the recoupment.

When you are liable to pay the clawback adjustment amount

You include the amount in assessable income for a recoupment you receive in the year in which you receive it or become entitled to receive it. This is called the 'trigger year'. This is the case regardless of whether you claimed the related R&D tax offsets in the same, an earlier or a later income year. If you receive a related R&D tax offset in a later income year, your past income tax assessment for the trigger year may need to be amended.

When grants for R&D are assessable

Grants you receive for R&D expenditure that attract the R&D tax incentive must be included in your total assessable income, unless they are specifically exempt under a provision of either the:

- *Income Tax Assessment Act 1936* (ITAA 1936)
- *Income Tax Assessment Act 1997* (ITAA 1997)

You can find more information at **Whether recoupments are assessable income**.

Contact us

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70891

Grouping for aggregated turnover purposes

How grouping rules work to determine which tax offset you may be entitled to under the R&D tax incentive.

30 March 2023

> **When and why a balancing adjustment can occur**

> Basic balancing adjustment for R&D asset
>
> Additional clawback adjustment or catch-up deduction for R&D assets
>
> Clawback amount and catch-up amount

How grouping rules work to determine which tax offset you may be entitled to under the R&D tax incentive.

How to use grouping rules

You use the following grouping rules to work out whether your entity is:

- a research and development (R&D) entity that meets the aggregated turnover threshold to qualify for the refundable tax offset, as this is calculated on a 'group' basis
- controlled by one or more exempt entities, again to see if it qualifies for the refundable tax offset.

Turnover threshold

The rate of tax offset and whether it is refundable depends primarily on an R&D entity's 'aggregated turnover'.

An R&D entity's aggregated turnover is the sum of the annual turnovers of the R&D entity and any entity with which it is either connected or affiliated, ignoring any dealings between those entities.

Connected entity

Your entity is connected with another entity if any of the following applies:

- you control the other entity
- the other entity controls you
- you and the other entity are controlled by the same third entity.

Direct control

Broadly, your entity controls another entity if either of the following applies to your entity, its affiliates or both:

- they own or have the right to acquire the ownership of interests in the other entity that carry between them the right to receive at least 40% of any distribution of
  - income
  - capital
  - net income of the partnership if the other entity is a partnership
- if the other entity is a company, they own or have the right to acquire the ownership of interests in the company with at least 40% of the voting power in the company.

We can decide that your entity does not control another entity, where your control percentage is at least 40%, but less than 50%. Refer to **subsection 328-125(6)** of the *Income Tax Assessment Act 1997* (ITAA 1997).

Different rules apply for a discretionary trust.

For detailed information about the meaning of 'connected with' and 'control', refer to **section 328-125** of the ITAA 1997.

Indirect control

If your entity directly controls a second entity, and the second entity controls (whether directly or indirectly) a third entity, then your entity is taken to control the third entity.

There are some exceptions to this rule – refer to **subsection 328-125(8)** of the ITAA 1997.

Affiliate

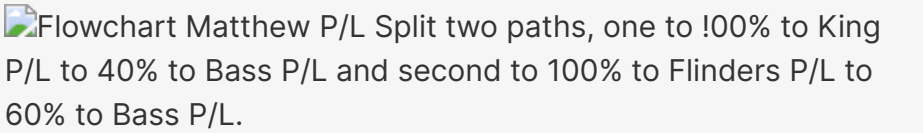
An individual or company is an affiliate of your entity if, in relation to the affairs of their business, they act, or could reasonably be expected to act, in either of the following ways:

- in accordance with your entity's directions or wishes
- in concert with your entity.

Two or more entities in partnership are not each other's affiliates just because one partner acts or could reasonably be expected to act in

concert with the other in relation to the affairs of the partnership business.

Example: aggregated turnover


Flowchart Matthew P/L Split two paths, one to !00% to King P/L to 40% to Bass P/L and second to 100% to Flinders P/L to 60% to Bass P/L.

To work out the aggregated turnover of each of the above entities, you would need to consider the following:

- Matthew Pty Ltd
  - directly controls (and is therefore connected with) Flinders Pty Ltd and King Pty Ltd
  - indirectly controls (and is therefore connected with) Bass Pty Ltd, through both Flinders Pty Ltd and King Pty Ltd.

- Flinders Pty Ltd and King Pty Ltd
  - are each controlled by (and are therefore connected with) Matthew Pty Ltd
  - are each controlled by the same entity (and are therefore connected with each other)
  - each directly control (and are therefore connected with) Bass Pty Ltd.

- Bass Pty Ltd
  - is directly controlled by (and is therefore connected with) Flinders Pty Ltd and King Pty Ltd
  - is indirectly controlled by (and is therefore connected with) Matthew Pty Ltd.

In summary, to work out the aggregated turnover of any of the four companies, the annual turnover of all four companies must be included in the calculation (excluding any dealings between them).

Exempt entity control

To work out whether one or more exempt entities control your R&D entity, you must apply the connected entity rules, but adopt 50% as the control percentage, instead of 40%.

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71968

Keeping records and calculating your notional deductions

Records you need to keep and how to apportion your expenditure between R&D activities and non-R&D activities.

23 March 2023

> When and why a balancing adjustment can occur
>
> Basic balancing adjustment for R&D asset

> Additional clawback adjustment or catch-up deduction for R&D assets
>
> Clawback amount and catch-up amount

A guide for what records you need to keep to show what R&D activities you are undertaking and to support your claims.

Records you need to keep

Your business and tax records must show what research and development (R&D) activities you are undertaking and support the amounts you claim.

You must keep records that:

- specify and explain all transactions - including any documents that are relevant for the purpose of working out your tax liabilities
- are made as soon as transactions occur or as soon as possible after they occur
- relate to all taxes for which you are liable - including income tax, goods and services tax, pay as you go taxes, capital gains tax, and fringe benefits tax
- relate to any election, choice, determination or calculation made under a tax law, including the basis on which any were made.

A valid record for the purposes of claiming the R&D tax incentive is any record that verifies or contributes to calculating your claim.

Your records must be in English (or easily translated into English) and you must keep them for 5 years after you make a claim as we may ask to see them. You can store records in either paper or electronic form. You do not need to send your records to us unless we ask you to.

If you are having difficulty maintaining your records you could talk to an experienced bookkeeper or accountant about setting up a good record-keeping system to keep track of your business records.

Records that are backdated or contain non-specific details of the work undertaken are not appropriate records.

The following products and guides will help you meet good record keeping practices:

- Manage your invoices, payments and records
- Valid tax invoices and GST credits
- Record keeping evaluation tool
- Accountability for business record keeping

Information about the types of records you need to keep is also available in the following taxation rulings:

- Taxation Ruling TR 96/7 *Income tax: record keeping - section 262A - general principles*
- Taxation Ruling TR 2018/2 *Income tax: record keeping and access - electronic records*

Specific records

Although your usual business and tax records may provide enough information to support your R&D claim, some aspects of the R&D tax incentive may require additional or more detailed records. You may need specific records to show all the following apply:

- The amounts you are claiming relate to your registered R&D activities.
- You receive the major benefit from your R&D activities.
- You have correctly apportioned between eligible R&D activities and non-eligible activities.

R&D record keeping

To work out your notional R&D deduction and support your claims, you need to keep records to show **all** of the following:

- how the expenditure you have incurred relates to the R&D activities you have registered
- how you have apportioned your expenditure between eligible R&D activities and ineligible activities
- that you received the major benefit from the R&D activities
- when amounts have been paid to associates

- how you have calculated adjustments required because of either
  - receiving a government recoupment (clawback)
  - producing a marketable product (feedstock adjustments).

These records must be relevant to the year you are claiming your R&D tax offset. However, if you need to make changes in a later year, these records may also be relevant in future years.

You must keep up-to-date records for each R&D activity, so you are ready to calculate and claim your R&D tax offset in your company tax return at the end of the year.

The records you currently keep for your business will generally be enough to support your R&D tax offset claim, if they show:

- you incurred the expenditure (and if incurred to an associate the amount(s) paid)
- the expenditure was eligible for the R&D tax incentive
- you received the major benefit from your expenditure on R&D activities
- the amount of your expenditure that relates to the R&D activities you have registered with AusIndustry.

You must also be able to support your methodology for apportioning your expenditure between eligible R&D activities and non-eligible activities.

- For examples of records you may need to keep in relation to your R&D activities refer to business.gov.au

Note: It is your responsibility to show us that the basis for calculating your notional R&D deduction produces, as far as practicable, accurate claims consistent with the law and its interpretation. You must be able to substantiate your claims for R&D expenditure with your records.

Linking your expenditure to your R&D activities

The expenses you can claim as R&D expenditure are limited to the extent they are incurred on R&D activities. Therefore, you must show that the amounts you are claiming on your tax return have been incurred on the activities you have registered with AusIndustry. The

type of expenditure that qualifies for a notional deduction under Division 355 of the *Income Tax Assessment Act 1997* depends on the facts of each particular case. Administrative costs and overheads may be incurred on R&D activities if there is a direct link between the R&D activities and the expenditure incurred.

Ineligible expenses are those without sufficient link to the R&D activities, particularly if they relate to general company operations or marketing expenditure that would be incurred regardless of the R&D activities.

In these circumstances, prior to claiming the amount, you should ensure that you have carefully considered the extent to which this expenditure has been incurred on R&D activities. If you are unsure if an amount is eligible for the R&D tax incentive, you should seek guidance from us or a registered tax professional

Claims under review

If we review your claim, we may request a full description of your R&D activities to ensure that they have the required relationship to the expenditure incurred.

We jointly administer the R&D incentive with AusIndustry (on behalf of Innovation Australia). AusIndustry determine if a particular activity is a 'core R&D activity' or a 'supporting R&D activity' – but this only covers the eligibility of the R&D activity itself. It is your responsibility to ensure that you have appropriate records to demonstrate the connection between your expenditure and the R&D activities you have undertaken. Your records must also be sufficient to demonstrate to AusIndustry that the claimed R&D activities took place and that they met all aspects of the legislative definition of 'core R&D activities' or 'supporting R&D activities'.

The records needed for specific expenditure types will vary and you may need to keep different records to show the connection between the amounts claimed and the registered R&D activities.

Salary expenditure for employees carrying out your R&D activities

You must substantiate the time spent on eligible R&D projects by your employees (that is, the researchers and technicians who carry out the R&D project). How you substantiate this depends on your specific circumstances.

Appropriate records for salary expenditure

The most accurate and effective method of allocating time is to maintain timesheets or job cards. If you don't use these methods, it may be more difficult to show that the allocation of time is accurate. It is your responsibility to make sure you keep sufficient records to support your claims.

However, we acknowledge that it may not always be practical for you to retain timesheets or job cards. If so, a summary sheet may be acceptable if the information is accurate and as reliable as a timesheet.

Situations where timesheets may not be practical include:

- having a large number of employees making it difficult to retain individual timesheets
- when an employee works exclusively on eligible R&D activities
- when an employee works on long term projects which are mostly eligible R&D activities and the ratio of time between eligible and non-eligible activities is fairly constant – in this case, the employee could maintain a diary of activities.

Note: If you use project hours as a basis of apportionment for other expenditure types, you may need to retain timesheets for this purpose, even if you do not need them to help support the salary component of your claim.

If your employees do not work a standard number of hours each day, you may need to establish how much time they spent on non-R&D activities. You need to calculate an employee's hourly rate of pay to work out the cost of employing that person on R&D activities.

Where a portion of a staff member's time is allocated to R&D as a component of 'other' expenditure, it would be useful for that staff member to keep a detailed timesheet. If it is unreasonable to keep detailed timesheets for these staff, you must still use a reasonable basis of apportionment for their time and be able to demonstrate how it relates to your R&D activities.

If salary amounts for R&D activities relate to your associate, you must calculate the amount on an arm's length basis and only amounts paid are eligible for a notional R&D deduction.

Note: If you choose to use any method of apportionment to calculate your claim, you must be able to explain why this is the most reasonable basis. You may need to keep additional records to do so.

Feedstock expenditure records

If a feedstock adjustment is triggered, you must include an amount in your assessable income. This may be in the current or in a future income year, depending on when the output is sold or applied.

It is important to keep detailed records of your feedstock expenditure to help work out your feedstock adjustment, especially if the feedstock adjustment may be triggered in a year after the R&D activities are conducted.

Specifically, records you may need to keep for this purpose are:

- invoices from the sale of the marketable products
- working papers documenting
  - the market value of products you apply to your own use
  - valuations of all goods and materials subject to processing or transformation and feedstock outputs
  - calculation of feedstock expenditure and resulting feedstock adjustment
- records showing energy usage input directly into the transformation or processing
- records of the R&D process, including the flow-through of materials or goods, subject to processing or transformation, to the marketable product
- records that describe the processing or transformation activities.

For more information refer to **Feedstock adjustments**.

Records to show you receive the major benefit from the R&D activities

Expenditure on R&D activities conducted to a significant extent for another entity will not be notionally deductible by you under the R&D tax incentive. These amounts may instead be deductible by the entity receiving the major benefit. Some special rules and exceptions apply if

the R&D activities are conducted for associated foreign corporations or by an R&D partnership.

Your eligible expenditure must be on R&D activities conducted for yourself and not (to a significant extent) for some other entity. This is intended to limit claims to cases where you receive the major benefit from your expenditure on those activities. It will also prevent duplication of claims by different entities where essentially the same R&D activities are involved.

Whether an R&D activity is conducted for you is a matter of fact. You need to work out if the activity is conducted, in substance, to provide the majority of knowledge benefits resulting from the activity to you.

If someone is conducting R&D activities (in whole or part) for you under contract, or you are under contract to produce a specific product for someone else (and R&D activities will be required to meet the contract), it is particularly important to ensure you maintain records to support this requirement.

For more information refer to **Who R&D activities are conducted for**.

Work performed for you under contract

If the R&D activity is undertaken for you by a contractor, documents relating to the contract and the R&D activities (for example, the project report and invoices) must contain:

- the dates the R&D activities are undertaken
- sufficient detail to ascertain the amount of expenditure incurred on the R&D activities as opposed to other goods or services being provided under the contract
- ownership of results – ownership of or rights to the resulting intellectual property as opposed to an end product.

If the contract is with your associate, the fee must be charged on an arm's length basis and only amounts paid are eligible for a notional R&D deduction.

To establish the relationship between your R&D activities and the expenditure you have incurred under the contract, we may need to look through the contract to establish the extent of the work done by the contractor on your behalf, particularly if you are not contracting at arm's length. You must keep sufficient records for this purpose. This may be required where the broad nature of the agreement makes it

difficult to determine the extent to which your expenditure has been incurred on R&D activities.

Supporting records

Records to support this requirement generally relate to the contracts and other agreements between yourself and any parties involved. On review of these documents we should be able to work out who:

- 'effectively owns' the know-how, intellectual property or other similar results arising from your company's expenditure on the R&D activities
- has appropriate control over both the day-to-day management and the overall direction of the R&D activities
- has the financial burden of carrying out the R&D activities.

If the commercial contracts you have entered into do not clearly show this, you will need to keep additional records or include additional clauses in your contracts to clearly show the arrangement between yourself and other parties.

When contracting with a related party, verbal contracts are made. Verbal contracts are recognised contracts under law in relation to commercial transactions. However, it may be difficult to remember the specific details of the agreement for the length of your two or four year review period under tax laws. For this reason, you could make a detailed written record, including (but not limited to) the parties involved, time, place and specific details of your agreement.

Apportionment

You can only claim a notional deduction under the R&D tax incentive to the extent that the expenditure has been incurred on R&D activities. In the case of expenditure to an associate it must be paid within the income year you want to claim the R&D tax offset in. The words 'to the extent that' mean that a method of apportionment may be required if you cannot specifically identify the value of expenditure incurred on R&D versus non-R&D activities.

There are many ways and methods you can use to apportion your expenditure. It is up to you to determine the most reasonable basis with the information you have at the time. You need to take into

account your circumstances, accounting methods and the type of expenditure.

For some types of expenditure incurred on R&D activities it may be difficult to examine each invoice received and calculate the amount of expenditure applicable to the R&D activity. You may need to apportion the expenses to achieve the best degree of accuracy. The method you chose to use will depend on the internal accounting procedure adopted by your company and the type of expense involved.

Under the R&D tax incentive, it is not accepted that one apportionment method or formula will be suitable for all expenditure types you may have. You need to consider each expenditure type separately to ensure that the method of apportionment you have used is reasonable and provides the most accurate measure of R&D expenditure.

To obtain certainty about the method of apportionment you have used, you can apply for a private binding ruling. **Getting help** provides information about different ways we can help.

Methods of apportionment

Preferably, your accounting and record keeping processes should enable the tracking of expenditure to your R&D activities on a 'real time' basis, so apportionment methodologies are only used in limited situations. However, we recognise that this is not always practical for companies, especially smaller companies where R&D activities only make up a small portion of the company's activities.

The appropriate basis of apportionment needs to be determined for each expenditure type based on all of the following:

- the type of R&D activities you are conducting
- how you are conducting your R&D activities
- the type of expenditure you have incurred.

If the expenditure is incurred over a period of use (for example, utilities such as electricity, decline in value of R&D assets), an apportionment based on the time spent by employees on R&D activities over total company employee hours may be more appropriate than a dollar value of R&D salary over total company salary. A dollar value can inflate or deflate an amount you can claim, because employees within a company are unlikely to be renumerated consistently. A dollar value is unlikely to be representative of time spent.

Expenses such as rates, land taxes, rent and lease costs which are mainly for the area used for R&D activities, may be best apportioned on a basis that reflects the area of use. How many staff and time spent is irrelevant for determining the extent to which this type of expenditure has been incurred on your R&D activities and would therefore not represent a reasonable basis of apportionment.

The apportionment basis of R&D salaries over total company salaries, for expenditure, will only be considered reasonable under the R&D tax incentive where the expenditure is based on how much an employee earns (for example, payments of super, worker's compensation and payroll taxes) and if these amounts can not be separately determined by reference to a company's accounts.

Using the decline in value costs for assets used in R&D activities as a proportion of total company decline in value, to apportion all expenditure (including expenses unrelated to the use of the R&D asset), is not an appropriate apportionment methodology.

Choosing the correct apportionment method

When working out your basis of apportionment for each expenditure type, you can ask yourself if the apportionment method best reflects the extent to which the expenditure has been incurred on my R&D activities.

If the answer is yes and you can explain why it is the best method of apportionment for this type of expenditure, then it is likely that you have chosen a reasonable basis of apportionment.

If you are unable to answer yes to this question, you should not use this basis of apportionment.

If you are still unsure and would like certainty from us, we can provide you with a private binding ruling. For more information about the individual advice we offer, refer to **Getting help**.

Examples of acceptable records

The types of records kept for tax or business purposes generally, may help you to substantiate your R&D claim. These can include:

- project plans and design specifications
- contracts between yourself and people conducting work for you

- contracts between yourself and a third party for which you have agreed to develop a product
- progress reports
- sales and purchase tax invoices
- receipts
- bank statements
- diaries
- expenditure journals and cash books
- R&D working papers
- financial statements
- apportionment based log books
- credit card statements
- bank deposit books and cheque butts
- bank account statements employee records such as copies of tax file number declarations, wage books, time sheets and super records
- motor vehicle expenses, including logbooks
- debtors and creditors lists
- records of depreciating assets
- stocktake records
- records of any private use in relation to assets or other purchases
- timesheets.

Compliance and monitoring

We work together with AusIndustry to undertake complementary risk assessment and compliance work. AusIndustry's compliance work focuses on the eligibility of R&D activities and our compliance work focuses on the R&D tax offsets allowable for those activities.

It is your responsibility to show us that the basis for calculating your notional R&D deduction produces, as far as practicable, accurate

claims consistent with the law and its interpretation. You must substantiate a claim for R&D expenditure by reference to reliable source documents.

If you make incorrect claims, you may incur penalties. For more information about our compliance and monitoring, refer to **Compliance model**.

Refer to business.gov.au for more information about AusIndustry's compliance work.

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R&D expenditure incurred to an associate

How the research and development tax incentive applies to expenditure you incur to an associate.

30 March 2023

> When and why a balancing adjustment can occur
>
> Basic balancing adjustment for R&D asset
>
> Additional clawback adjustment or catch-up deduction for R&D assets
>
> Clawback amount and catch-up amount

Expenditure to an associate paid in the same year

If you incur expenditure to an associate and you pay that amount in the same year, you can claim a notional deduction for that amount in that year. This is provided you meet all other eligibility requirements for the R&D tax incentive.

Paying an amount to an associate can include making a constructive payment, where you apply or deal with the amount on their behalf or as they direct.

If you do not pay the amount until a later year

If you do not pay the amount until a later income year, you can choose to either:

- claim a deduction under the normal income tax provisions (for example, the general deduction provision, **section 8-1** of the *Income Tax Assessment Act 1997*) for the income year in which the amount was incurred
- claim a notional R&D deduction in the year you make the payment.

If you claim the deduction (or obtain a non-R&D tax offset) for this expenditure under the first choice, you will no longer be entitled to claim a notional R&D deduction in the year you make the payment. This choice, (which can be made in your return or as an amendment) must be made by the time you lodge your return for the income year before the one in which the payment is made and cannot be reversed – for example, you cannot later request an amendment of the assessment to disallow the deduction you claimed.

Example: claiming notional deductions

Ingenious Plans Pty Ltd is a corporation incorporated in Australia that carries on a business in Australia. During the 2015 income year, Ingenious Plans incurs an expense of $20,000 to an associate to carry out R&D activities on their behalf. However, they do not pay the $20,000 until the 2016 income year.

Ingenious Plans is registered for the R&D activities for the income year in which they were conducted. The expenditure also satisfies the various eligibility requirements for the R&D tax incentive. However, Ingenious Plans cannot claim a notional deduction for the expenditure to the associate under the R&D tax incentive in the 2015 income year because they did not pay the amount in that income year.

When preparing their income tax return for the 2015 income year, Ingenious Plans did not take the expenditure incurred to their associate into account when they worked out the following:

- the amount they could claim as a deduction under any non-R&D provision
- their entitlement to a non-R&D tax offset.

Because of this, Ingenious Plans is entitled to a claim a notional R&D deduction for the expenditure of $20,000 in the 2016 income year.

Amounts incurred by a member of a consolidated group to another member of the same group are not required to be paid before being claimed under the R&D tax incentive (provided the amounts meet all other eligibility criteria). The amounts are taken to have been incurred by the head company of the group.

Who an associate is

In broad terms, associates are those entities that, by reason of family or business connections, might appropriately be regarded as being associates of a particular entity.

- This is set out in **section 318** of the *Income Tax Assessment Act 1936*.

Some examples of an associate of a company, other than a company in the capacity of trustee, include:

- a partner of the company or a partnership in which the company is a partner
- a trustee of a trust estate under which the company or associate benefits
- another entity (including a natural person) that, acting alone or with another entity or entities, sufficiently influences the company
- an entity (including a natural person) that, either alone or together with associates, holds a majority voting interest in the company
- a second company that is sufficiently influenced by the company or the company's associate
- a second company in which a majority voting interest is held by the company or the company's associate.

What 'sufficiently influence' means

Under the associate rules, a company is sufficiently influenced by an entity or entities if the company, or its directors, are accustomed or obligated to act (or might reasonably be expected to act) in accordance with the directions, instructions or wishes of that entity or entities.

The influence by another entity could be either formal or informal and the directions, instructions or wishes of the influencing entity can be communicated directly or through interposed companies, partnerships or trusts.

What 'majority voting interest' means

Under the associate rules, majority voting interest means the ability to cast, or to control the casting of, more than 50% of the maximum number of votes that may be exercised at a general meeting of the company.

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Refundable and non–refundable offsets

Work out which tax offset you may be entitled to under the research and development (R&D) tax incentive.

22 November 2022

> When and why a balancing adjustment can occur
>
> Basic balancing adjustment for R&D asset
>
> Additional clawback adjustment or catch-up deduction for R&D assets
>
> Clawback amount and catch-up amount

Work out which tax offset you may be entitled to under the research and development (R&D) tax incentive.

R&D tax offset rates

The rate of the research and development (R&D) tax offset and whether it is refundable or not depends primarily on the R&D entity's aggregated turnover:

- If your aggregated turnover is less than $20 million and you are not controlled by any exempt entities, then you can claim the refundable tax offset.
- If your aggregated turnover is $20 million or more, or you are controlled by exempt entities, then you can claim the non-refundable tax offset.

The R&D tax offset provides a premium component over the company tax rate for notional R&D deductions up to $150 million for an income year. The rate of the R&D tax offset is reduced to the company tax rate for that portion of an entity's notional R&D deductions that exceed $150 million for an income year.

For years commencing on or after 1 July 2014 and before 1 July 2021, the threshold was $100 million.

Aggregated turnover

Aggregated turnover is the sum of all of the following:

- the annual turnover of the R&D entity for the income year
- the annual turnover of any entity connected with the R&D entity, for that part of the income year that the entity is connected with the R&D entity
- the annual turnover of any entity affiliated with the R&D entity, for that part of the income year that the entity is affiliated with the R&D entity.

Any dealings between these entities while they are connected or affiliated with the R&D entity are excluded.

Australian entities and foreign entities can be connected or affiliated with you. This means your aggregated turnover includes both Australian and foreign entities for the period they are connected or affiliated with you.

To calculate your aggregated turnover, see **Steps to claiming the tax offset**.

Annual turnover

Your entity's annual turnover is the total ordinary income your entity derived in the income year in the ordinary course of carrying on its business activities. This includes income on a worldwide basis but does not include GST.

If an R&D entity is not carrying on a business at any time during the income year, its annual turnover is nil. If your entity carries on business for part of the income year, the annual turnover for that year must be worked out using a reasonable estimate of what your annual turnover would be if you carried on a business for the whole income year.

Example: calculating annual turnover

Company A does all of the following:

- carries on a business
- undertakes R&D activities
- incurs expenditure on its R&D activities and meets all eligibility requirements for the R&D tax incentive
- has an annual turnover of $15.5 million.

In the same income year, Company A is connected with Company B and no other entity for the full income year. Company A has no affiliates. Company B is not an exempt entity and has both of the following:

- an annual turnover of $6.7 million
- $2.7 million of ordinary income related to dealings with Company A.

To work out whether it is entitled to a refundable or non-refundable tax offset, Company A first adds the following:

Company A's annual turnover	$15.5 million
Company B's annual turnover	$6.7 million
Total	**$22.2 million**

Company A then subtracts the dealings between it and Company B:

- $22.2 million − $2.7 million = $19.5 million.

This means Company A's aggregated turnover is $19.5 million.

As Company A's aggregated turnover is less than $20 million and as it has met all the other eligibility criteria, it is entitled to a refundable R&D tax offset.

R&D refundable tax offset

If we retain your R&D tax offset refund

R&D tax offset refunds can be retained while they are checked. We may retain your income tax refund if we need to verify:

- information relating to your research and development tax incentive claim
- that your income tax refund has been correctly calculated and claimed.

We'll inform you within 30 days of lodgment of your tax return if we've retained your refund for verification purposes. If we don't inform you within 30 days, we'll issue your refund and may conduct verification later.

We may seek information that explains the basis for your claim or ask to see records used to prepare it. Responding promptly to requests for information or documents helps us process your claim quicker.

If we continue to retain your refund 60 days after the initial 30-day period, you may object to our decision to retain your refund. If we request information from you during this 60-day period, the period before which you may object is extended by the number of days it takes you to provide all information we request from you.

Normal income tax rules apply for refundable tax offsets

The normal income tax rules for refundable tax offsets apply, including the priority rules about how tax offsets must be applied against the

basic income tax your entity is liable to pay.

A refundable tax offset is applied after all other tax offsets, except tax offsets that arise from paying franking deficit tax.

If there is an excess of tax offsets, your entity may be entitled to a refund – subject to the rules on how we must apply credits, including refunds, to running balance accounts or against a particular tax debt.

R&D refundable tax offsets and franking debits

Generally, a franking debit arises in your entity's franking account when it receives a refund of income tax which includes a refunded amount from a tax offset.

However, special rules ensure that the amount of R&D tax offset refunded is not immediately reduced as a result of the entity becoming liable to franking deficit tax. The franking debit that usually arises when a refund of income tax is received is effectively deferred in relation to refundable tax offset amounts.

Where a debit has been deferred for this reason, a franking credit will not arise as a result of income tax or PAYG instalments your entity pays until it recovers these deferred franking debits.

For more information see:

- **Franking account tax return** about franking debits and instructions for lodging the return
- **Franking account** about when franking debits will arise.

R&D non-refundable tax offset

If the offset is a non-refundable tax offset, it is applied before refundable tax offsets and tax offsets that arise from paying franking deficit tax, but after all other tax offsets, such as a foreign income tax offset. An R&D entity can carry forward a non-refundable tax offset to a later year if it satisfies the tax offset carry-forward rules.

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Who R&D activities are conducted for

Read the details of who is entitled to the R&D tax offset resulting from incurring expenditure on R&D activities.

23 March 2023

Read the details of who is entitled to the R&D tax offset resulting from incurring expenditure on R&D activities.

Conducted for requirement

To claim this expenditure the R&D activity must also be conducted for you. In some cases, the activity can be conducted for a foreign entity that is connected or affiliated with you. You cannot claim the expenditure if the activity is conducted, to a significant extent, for

another entity that would not be eligible to claim expenditure on the activity. For example, if the R&D activity is conducted for you but is conducted to a significant extent also for a trust, you cannot claim expenditure incurred on those activities. This requirement also prevents duplication of claims by different entities for the same R&D activities.

An R&D activity is conducted for the entity that receives the major benefit of the activity. This is assessed by considering who:

- 'effectively owns' the know-how, intellectual property or other similar results arising from your company's expenditure on the R&D activities
- has appropriate control over the way the R&D activities are conducted
- bears the financial burden of carrying out the R&D activities.

Whether an R&D activity is conducted for your company is a matter of fact. It is determined by whether the activity is conducted, in substance, to provide the majority of knowledge benefits resulting from the activity, such as, access to intellectual property to your company.

Effective ownership of results

To decide whether a company has effective ownership you must look at:

- the circumstances in which R&D activities are conducted
- what practical, as well as formal, rights the company has to the results from those activities, such as, know-how and intellectual property.

Having effective ownership does not necessarily mean that your company is the proprietor of a piece of intellectual property in any formal sense. Such rights may not be available, or the formal owner of the resulting intellectual property may hold it on such terms that the company has all of the advantages of formal ownership. For example, it might have the right to use a patent over the R&D results, without further fee or payment, for the expected useful life of the patent.

You may give some theoretical rights of ownership, in relation to intellectual property or results, to others without denying your

effective ownership of them. For example, you might completely control the commercial results of R&D activities, yet permit the contract researcher some exclusive scientific publication rights.

Control of R&D activities

R&D activities may often be carried out under contract by experts in a particular field. A company may still have an appropriate degree of control over the conduct of the R&D activities in these circumstances if it can:

- choose the project of R&D
- decide on major changes of direction in those activities
- stop an unproductive line of research
- decide whether to follow up an unexpected result
- decide to end the project.

Who bears the financial risk

If R&D activities are carried out for a company, we would generally expect that the company would bear the financial risk of the R&D activities. If a company does not bear the financial risk, but effectively owns the results of R&D activities and controls the way the activities are carried out, we may still regard the activities as being carried out for the company. However, a company's notional deduction may be reduced under either of the following provisions of the *Income Tax Assessment Act 1997* (ITAA 1997):

- **section 355-405** (Expenditure not at risk)
- **section 355-440** (Clawback of R&D recoupments).

An example of an R&D entity bearing the financial risk in relation to R&D activities is where both of the following apply:

- The activities are merely incidental to the supply of a saleable product for a fixed price.
- That price bears no relationship to the extent of R&D activities the entity may need to conduct to produce the product.

An R&D entity is not entitled to a notional deduction under Division 355 of the ITAA 1997 for R&D expenses it incurs, if all of the following

apply:

- It conducts the R&D activities under contract for another entity.
- It does not own the results of the R&D activities.
- It does not bear the financial risk of the R&D activities it conducts because it can recoup its expenditure on those activities irrespective of whether they produce successful results.

Example: contract to conduct R&D activity

Company A Pty Ltd and Company B Pty Ltd are both R&D entities. They both enter into a contract under which Company B Pty Ltd is to carry out specified services that qualify as R&D activities under Subdivision 355-A of the ITAA 1997. Company A Pty Ltd has no expertise in the particular R&D field, but has given broad direction in the contract to Company B Pty Ltd about the specifications it wants achieved by the services. Company A Pty Ltd is obliged to pay Company B Pty Ltd for the cost of those services, irrespective of the results obtained.

Company A Pty Ltd receives the major benefit from the R&D expenditure it has incurred because only it can access intellectual property arising from the R&D activities to use for its own commercial purposes. Company B Pty Ltd does not benefit at all in relation to this intellectual property or any other knowledge benefits gained. Company B Pty Ltd conducts the R&D activities for Company A Pty Ltd and not to any extent, for its own purposes.

Foreign corporations and permanent establishments

If certain conditions are met, your company may be eligible for the R&D tax incentive for R&D activities conducted for one or more associated foreign corporations.

For more information about R&D activities being conducted for a foreign corporation, and foreign corporations carrying on business through a permanent establishment, refer to section 'Eligibility' in **Research and development tax incentive**.

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If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

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