Savings from additional measures

- Efficiency dividend – 84.9 227.6 290.4 299.8 902.7
- HECS discount abolished – 30.2 67.5 81.3 97.7 276.7
- $2,000 cap on work related expenses – (0.3) (0.7) 247.8 267.8 514.3
- Student Start-up Scholarships will become income equivalent loans 1.0 42.2 232.8 424.8 482.8 1,186.3
Executive Summary

After just 3 years of operation, the Government has proposed a reduction in the R&D tax incentive offset rate by 1.5 percentage points.

We are disappointed with the cut to the permanent tax benefit of up to 15 percent of tax savings from R&D claims for the 2015 income year. Whilst such a reduction is unfortunate, its impact should be limited to 1 year only, if the Government achieves its commitment to reduce the company income tax rate by 1.5 percentage points from 1 July 2015.

We are pleased with measures in the Budget reflecting the focus of the Government to support private enterprise to innovate, commercialise and build nation building infrastructure.

It is important to remember most Budget measures need to pass through Parliament. Thus the final version of the measures may differ to those announced in the Budget. To manage this uncertainty, KPMG can advise you so that you can position your company to access the R&D Tax Incentive, infrastructure support and/or grants opportunities announced in the Budget.

David Gelb
National Leader R&D and incentives practice

R&D Tax Incentive

Analysis of R&D Tax Incentive cuts

The Australian Government has provided some form of R&D Tax Incentive since the mid eighties. Whilst the mechanics and generosity of the R&D benefit have changed over that time, Government commitment to some form of R&D Tax Incentive has not.

The current R&D Tax Incentive was only introduced for the 2012 income year. At the time, there was bipartisan support for a more generous program and it is disappointing that so soon after its introduction, the Government has sought to reduce its support; first through the introduction of a Bill to exclude Australia’s largest companies and now through cutting the R&D tax offset that applies ahead of a matching reduction in the company tax rate.

Specifically, the R&D tax offset will be cut by 1.5 percentage points, effective 1 July 2014.

For companies with an aggregated turnover of $20 million or more, this means the non-refundable tax offset will be reduced from 40 percent to 38.5 percent.

For companies with an aggregated turnover of less than $20 million, this means the refundable tax offset will be reduced from 45 percent to 43.5 percent.

In theory, the reduction to the R&D tax offset is balanced out by a 1.5 percentage point reduction in the company tax rate (from 30 percent to 28.5 percent). However the proposed company tax rate reduction will only take place from 1 July 2015, 12 months after the reduction in the tax offset. Whilst not impacting the tax saving from the
R&D offset, the proposed levy for the Paid Parental Leave Scheme negates the company tax rate reduction for companies with taxable income over $5 million.

It is likely all proposed measures will take effect for financial years commencing on or after announced dates (i.e. R&D tax offset reduction effective 1 July 2014 will apply to financial years commencing on or after 1 July 2014).

To illustrate the financial impact of R&D Tax Incentive reduction, we have prepared examples highlighting the impact of these changes over the next 3 years.

Very large companies

Companies with extremely high Australian assessable income ($20 billion or more) are currently able to access the non-refundable 40 percent R&D tax offset. Proposed legislation (currently before the Senate) seeks to exclude those companies from claiming.

The Bill, if enacted as is, may have retrospective effect and prevent those companies from claiming the R&D Tax Incentive for years commencing on or after 1 July 2013. Note this will not affect foreign companies that, despite being of the same or even larger size, have Australian assessable income less than $20 billion.

Large companies

At present, companies with an aggregated turnover of $20 million or more are able to access the non-refundable 40 percent R&D tax offset. For these companies, the permanent tax benefit (calculated as the R&D tax offset rate less company tax rate) will receive a reduced tax offset from 1 July 2014 (FY15) onwards.

However due to the reduction in the company tax rate from 1 July 2015 (FY16), the permanent tax benefit will be restored to 10 percent after FY15, although other company levies may apply.

Smaller companies

Companies with an aggregated turnover of less than $20 million are able to access the refundable 45 percent R&D tax offset. From 1 July 2014, the R&D tax offset will drop to a refundable 43.5 percent R&D tax offset, providing a 13.5 percent permanent tax benefit. The permanent tax benefit will be restored to 15 percent after 1 July 2015, although other company levies may apply.

If the company has sufficient tax losses, it will still be able to cash out the entire tax offset. In such cases, the refundable amount will be at the lower rate of 43.5 percent.

The refundable offset is particularly attractive to start-up companies in pre-revenue phase. The potential refund of up to 45 percent of R&D spend, as it currently stands, will only drop to 43.5 percent. Effectively they continue to be able to cash out R&D spend instead of building up their tax losses.
Grants

Refocused funding

Every budget has winners and losers. With the announced cuts of $845 million worth of industry support, it’s easy to conclude that industry has missed out. This will almost certainly be true for some industries, for example the automotive sector will experience direct funding cuts such as the Automotive Transformation Scheme.

In this budget, we see a closer alignment of the Government’s policy intent to encourage private sector participation. New funding initiatives are focused on strengthening the overall business environment, building capability, driving innovation, transitioning to new industries and boosting productivity.

Key industry-focused announcements

<table>
<thead>
<tr>
<th>$ million</th>
<th>Program</th>
<th>Description</th>
<th>Industries likely to benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2,550</td>
<td>Emissions Reduction Fund</td>
<td>Incentive based approach to support abatement activities across the economy</td>
<td>Businesses of all sizes, across all sectors with projects to reduce emissions</td>
</tr>
<tr>
<td>484</td>
<td>Entrepreneur’s Infrastructure Program</td>
<td>Supporting commercialisation, job creation and capability of small business</td>
<td>Innovative small to medium businesses across all sectors</td>
</tr>
<tr>
<td>476</td>
<td>Industry Skills Fund</td>
<td>Supporting the training needs of small to medium enterprises</td>
<td>Innovative small to medium businesses across all sectors</td>
</tr>
<tr>
<td>100</td>
<td>Growth Fund</td>
<td>Supporting new jobs, investment and economic growth in South Australia and Victoria following announcements by vehicle manufacturers</td>
<td>Businesses of all sizes, across all sectors with plans to expand and employ</td>
</tr>
<tr>
<td>100</td>
<td>Exploration Development Incentive</td>
<td>Exploration credits, paid as a refundable tax offset, for greenfields mineral exploration</td>
<td>Mineral exploration</td>
</tr>
<tr>
<td>50</td>
<td>Manufacturing Transition Grants Program</td>
<td>Assist transition to higher value manufacturing activities</td>
<td>Manufacturers</td>
</tr>
</tbody>
</table>

Re-focused support may assist a broader range of industries

One example of re-focused support is the Emissions Reduction Fund (ERF). Whilst the ERF’s key focus is to reduce carbon emissions, there are a wide range of activities that can achieve this across a variety of sectors. Therefore projects which drive business productivity, efficiency and reduced energy usage are more likely to fit within the ERF funding mandate.

Transition, growth and competitiveness emerge as the focus for new funding programs in the manufacturing sector which is likely to result in a broader range of businesses having access to funding opportunities. Newly announced programs include the Manufacturing Transition Program and the Growth Fund which will encourage expansion and employment in strongly performing manufacturing businesses.

Fewer programs with a consolidated function

In line with the Government’s ambition to reduce red tape, there are a number of new and much larger programs which appear to consolidate the functions of multiple smaller programs into an overarching program. An example is the creation of the Entrepreneur’s Infrastructure Fund which appears to cover the functions of a number of abolished programs such as Commercialisation Australia and Enterprise Connect as well as deliver outcomes similar to those sought by a range of abolished innovation related programs.

Whilst not targeted specifically at industry, other areas of significant new investment with broad funding mandate include the $20 billion Medical Research Future Fund, $1 billion to establish the National Landcare Initiative and $1 billion for a National Stronger Regions Fund.
What has been cut?

The Government has found net savings across a range of industry programs including cessation of the Australian Renewable Energy Agency ($1.3 billion) and the Ethanol Production Grants Program ($120 million over 6 years), modification of biodiesel tax treatment ($156 million) and reduced funding for the Automotive Transformation Scheme ($618 million).

It has also cut the following programs:

- Australian Industry Participation
- Enterprise Solutions
- Industry Innovation Councils
- Industry Innovation Precinct
- Clean Technology (Investment and Innovation)
- Textile, Clothing and Footwear Small Business and Building Innovative Capability
- Commercialisation Australia
- Innovation Investment Fund
- Enterprise Connect
- Cooperative Research Centres

Key messages

The Government has refocused industry support programs to reflect transitional challenges facing the Australian economy and Federal policy agendas.

In an environment where grant funding is being aligned towards building capability and boosting innovation and productivity, it is critical that companies consider the opportunities for grant funding applications as part of their investment strategies.

Crafting the story of your investment project in ways that emphasise these themes, and having conversations with government early will result in applications that more closely align to policy, and are therefore positioned for stronger outcomes.

The Budget initiatives announced could be a driver for innovation. The Government will want better value and return for its investment in infrastructure and medical research, pushing the private sector to develop innovative solutions for increased productivity. Cuts to the health care and education budgets may drive the need for more innovation in management and delivery systems.

Future changes to the R&D funding landscape

The Government has foreshadowed in its response to the 2014 National Commission of Audit recommendations that there may be further reforms to tax incentives for R&D and grant programs following the Budget, including through the Taxation White Paper.

The White Paper was announced as part of the Coalition’s Election Policy in September 2013 and is scheduled to be released toward the end of 2015. We expect the White Paper to take a broader and more holistic approach to the funding of R&D. This approach would also consider the effectiveness of existing taxation incentives for R&D and industry funded research and their ability to promote innovation, economic growth and global competitiveness.

If the proposed reforms are accepted, it is likely that the Government would seek to implement them during its second term.
How can we help?

We are already speaking with government and industry about how the new measures will be implemented and what it will mean for those receiving funding and those likely to be eligible for funding under proposed new programs.

KPMG has the largest and highly experienced Grants and Incentives team in the country with a proven track record of winning grants for our clients, having helped raise over $350 million for our clients in the last 3 years.

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