



# R&D activities conducted for an associated foreign entity

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Many overseas life science businesses often ask whether they can establish a presence in Australia to conduct research and development activities through a wholly owned company and whether they are eligible to claim the R&D Tax Incentive. The following sets out a general overview of Australia's R&D Tax Incentive benefits and some of the requirements and considerations for R&D activities conducted for an associated for an associated foreign entity.

## Australia's R&D Tax Incentive Benefits

The current tax benefits that can be accessed through the R&D Tax Incentive program are a 43.5% refundable R&D tax offset for companies with a grouped or "aggregated turnover" below A\$20 million, and a 38.5% non-refundable R&D tax offset for companies with a grouped or aggregated turnover above A\$20 million. While there is no claimable ceiling, the tax offset is reduced to the company tax rate for deductions in excess of A\$100 million. Companies in a tax loss position and an aggregated turnover of less than \$20 million benefit the greatest from this program as they may be eligible to receive the tax offset in the form of a cash refund, as is demonstrated in the following table:

Aggregated turnover	R&D Expenditure	Company Tax Rate	R&D Tax Offset	Net Benefit (Tax Loss Position)	Net Benefit (Tax Payable Position)
< A\$20m	A\$1m	27.5%	43.5%	A\$435,000	A\$160,000 tax offset
A\$20m - A\$50m	A\$1m	27.5%	38.5%	A\$110,000 tax offset*	A\$110,000 tax offset
> A\$50m	A\$1m	30%	38.5%	A\$85,000 tax offset*	A\$85,000 tax offset

\*The non-refundable benefit can be carried forward and used in future income years.

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. Annual turnover is the total ordinary income derived in the income year in the ordinary course of carrying on its business activities. This would include sales revenue, milestone payments (recognised as revenue in the accounts) or license fee revenue but does not include capital raised.

## Eligible R&D expenditure for R&D Tax Incentive

Eligible R&D expenditure is expended on eligible R&D activities and for R&D conducted in Australia through subsidiaries of foreign corporations, the typical areas of expenditure include: Australian contract research organisation costs, clinical trial materials, Australian representation/project management costs, clinical trial insurance and TGA fees.

Essentially any Australian activity and cost that has direct connection to the R&D activity can be claimed. There are some exceptions, such as accounting fees, legal fees, interest, and core technology purchases.

## R&D activities conducted for an associated foreign entity

Only eligible R&D entities can claim the R&D tax incentive. An R&D entity must be a corporation that is any of the following:

1. incorporated under Australian law
2. incorporated under a foreign law but is an Australian resident for income tax purposes
3. incorporated under a foreign law and is both:
  - i. a resident of a country with which Australia has a double tax agreement, with a definition of 'permanent establishment'
  - ii. carrying on business in Australia through a permanent establishment as defined in the double tax agreement.

R&D activities can be conducted for an associated foreign corporation (ForCo) by an R&D entity (AusCo) if certain conditions are met.

Where AusCo is an R&D entity conducting R&D activities for one or more foreign corporations, each being a resident of a foreign country that has a double tax agreement with Australia, AusCo must first consider whether it meets the following further conditions:

- The R&D activity must be conducted solely in Australia or an external Territory.
- If the R&D activity is a supporting activity (broadly activities relating to core R&D activities), each corresponding core activity must be conducted solely within Australia or an external Territory and be an activity for which you have registered or could register for the R&D tax incentive for the income year.
- When the R&D activity is conducted, each foreign resident (ForCo) must be either:
  - » connected with AusCo
  - » an affiliate of AusCo or AusCo must be an affiliate of each foreign resident (ForCo).
- The R&D activity must be conducted in accordance with a written agreement binding only on AusCo and each foreign resident (ForCo), specifying that the R&D activities are to be conducted either:
  - » directly by AusCo
  - » indirectly by another entity under an agreement binding on AusCo (for example conducting the R&D activity under a subcontract).

## Ownership of intellectual Property (IP) developed in Australia

The IP may be held exclusively overseas by ForCo and it is not a requirement that AusCo hold any IP developed in Australia. In this regard, the legislation has an exception to the 'on own behalf' rule, with the condition that ForCo and any related foreign associate corporation must be a resident of a country that has a comprehensive double tax agreement.

Regard should be had for both Australia's and the foreign jurisdiction's international transfer pricing rules to determine the extent to which any IP rights should be given to AusCo, having regard to the functions, assets, and risks of AusCo relevant to the group's commercial, technical and transfer pricing position (i.e. ForCo).

MELBOURNE | SYDNEY  
**Cameron Allen**  
Partner  
+61 3 9939 4488  
cameron.allen@aa.tax

MELBOURNE | SYDNEY  
**Dr Martin Schlegel**  
Principal  
+61 3 9939 4488  
martin.schlegel@aa.tax

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