



2018 COCHLEAR LIMITED

# Tax Contribution Report

*Hear now. And always*



Cochlear®

## Table of Contents

<b>1</b>	<b>Chief Financial Officer statement</b> .....	<b>2</b>
<b>2</b>	<b>Cochlear Limited</b> .....	<b>3</b>
<b>3</b>	<b>Cochlear Group tax strategy and governance</b> .....	<b>4</b>
3.1	Approach to risk management and governance .....	4
3.2	Attitude towards tax planning.....	4
3.3	Accepted level of risk in relation to taxation .....	4
3.4	Approach to engagement with global revenue authorities.....	5
<b>4</b>	<b>International related party dealings</b> .....	<b>6</b>
<b>5</b>	<b>Income taxes disclosed in 2018 Annual Report</b> .....	<b>8</b>
5.1	Reconciliation of accounting profit to income tax expense .....	8
5.2	Reconciliation of income tax expense to cash tax paid .....	9
5.3	Effective tax rates for Cochlear Limited Consolidated Worldwide Group .....	9
<b>6</b>	<b>Tax contribution summary</b> .....	<b>10</b>
<b>7</b>	<b>ATO tax transparency disclosures</b> .....	<b>11</b>

## 1 Chief Financial Officer statement

We are pleased to present this Tax Contribution Report for 2018 for Cochlear Limited detailing Cochlear's taxes paid in Australia and globally and Cochlear's global tax strategy.

A key driver of our global tax strategy is Cochlear's longstanding commitment to Australian based research and development (R&D) and to growing the business with benefits for Australia. Our tax strategy reflects that the majority of Cochlear's intellectual property is generated in Australia and the assets, risks and functions of implementing that strategy meant that 83% of Cochlear's corporate income tax was paid in Australia in 2018.

Our research, product development and manufacturing are all inextricably linked and also substantially based in Australia. Cochlear currently employs significant numbers of scientists and engineers who are engaged in R&D projects and a large number of employees who are engaged in manufacturing. The vast majority of whom are employed in Australia.

During the year, a number of new products were launched including the Nucleus® 7 Sound Processor, the world's first Made for iPhone cochlear implant sound processor, the Nucleus Smart App for Android™ smartphone users and the Baha® SoundArc, a non-surgical behind-the-head band that works together with all of Cochlear's Baha 5 sound processors.

Cochlear continues to demonstrate its commitment to being the technology leader in our industry with ongoing investment in R&D. During the year we invested over \$160 million, 12% of sales revenue, in R&D with a pipeline of new products expected to be launched over the coming years.

In the increasingly competitive global environment, the R&D tax incentive available in Australia is critical to Cochlear continuing this level of investment in R&D in Australia. In this respect, Cochlear supports the recently proposed changes to the R&D tax incentive of the increase in the cap to \$150 million and the premium offset rate for high intensity R&D investors such as Cochlear.

Cochlear has a strong commitment to transparency and compliance from a regulatory and financial perspective and values the principles of being transparent with respect to its tax strategy and compliance here in Australia and globally.

Signed



Brent Cubis  
Chief Financial Officer  
14 August 2018



Kimberley Simpson  
Group Tax Manager  
14 August 2018

## 2 Cochlear Limited

Cochlear is the global leader in implantable hearing solutions with products including cochlear implants, bone conduction implants and acoustic implants. Cochlear commenced operations in 1981 as part of the Nucleus group and in 1995, listed on the Australian Securities Exchange. Today, Cochlear is a Top 50 listed Australian company with a market capitalisation of over A\$10 billion.

Cochlear aims to support cochlear implantation becoming the standard of care for people with severe to profound hearing loss and provide bone conduction implants for patients with conductive hearing loss, mixed hearing loss and single sided deafness. The Company has provided more than 550,000 implant solutions to recipients who benefit from one – or two – of the Company's implantable devices. Whether these hearing solutions were implanted today or many years ago, Cochlear provides new technologies and innovations for all recipients. Cochlear invests more than \$160 million each year in R&D and currently participates in over 100 collaborative research programs worldwide.

Cochlear's global headquarters are on the campus of Macquarie University in Sydney, with regional headquarters in Asia Pacific, Europe and the Americas. Cochlear has a deep geographical reach, selling in over 100 countries, with a direct presence in over 30 countries and a global workforce of over 3,500 employees.

For the financial year ended 30 June 2018, 62% of Cochlear's sales revenue was from cochlear implant (Nucleus) products and 12% from Acoustics (bone conduction and acoustic implant) products. Services revenue, which includes sound processor upgrade and accessories sales revenue, accounted for 26% of total sales revenue. On a regional basis, Cochlear sales revenue was split:

- Americas (US, Canada & Latin America) – 48% of sales revenue
- EMEA (Europe, Middle East and Africa) – 35% of sales revenue
- Asia Pacific (Australasia & Asia) – 17% of sales revenue

Cochlear's third party sales are primarily overseas with approximately 95% of revenue in FY18 generated from countries outside Australia.

By contrast, all cochlear implant manufacture is conducted in Australia with bone conduction implant manufacture occurring in Sweden. Cochlear implant and services revenue account for 88% of our revenue. There is considerable know how associated with this specialised manufacture and the technology that underpins our products has been developed in Australia and is protected by patents. Our tax strategy is aligned with this holding of intellectual property in Australia.

### **3 Cochlear Group tax strategy and governance**

This section on tax strategy and governance is approved by the Audit Committee. Publication of this statement is regarded as satisfying the statutory obligation under Paragraph 16(2), Schedule 19, Finance Act 2016 (UK) which prescribes that the UK tax strategy must be published for UK entities of the Cochlear global group. The UK entities to which this strategy applies are Cochlear Europe Limited and Cochlear Research and Development Limited.

#### **3.1 Approach to risk management and governance**

Cochlear Limited operates in a highly regulated global industry in the area of implantable hearing solutions. Cochlear must ensure it enters into transactions in a way which does not inhibit its ability to design, develop, manufacture and distribute its products globally and which also maintains its reputation with Regulators and Governments in the countries in which it operates.

An overall low risk tax strategy is adopted by Cochlear in order to meet this objective and this strategy is adopted across Cochlear's global locations.

Cochlear's global tax and finance teams work together to identify, analyse and evaluate global tax risks. Key global tax risks are identified by the Tax Manager EMEA for UK and EMEA tax risks, the Associate Manager, Tax for US tax risks, the Tax Manager Corporate for Australian tax risks and also by the regional heads of finance for global locations and escalated to the Group Tax Manager who is a direct report of, and identifies tax risks to, the Chief Financial Officer.

Each Audit Committee has an agenda item on global tax and, where appropriate, matters are reported through to the full Board. The principal global external tax advisor attends periodic Audit Committee meetings. They are also available during the private session with Directors, which excludes management, for Directors to make enquires.

These processes are written and approved by the Audit Committee in Cochlear's Tax Risk Management and Governance Framework.

#### **3.2 Attitude towards tax planning**

Cochlear's attitude towards tax planning is to ensure that transactions and compliance activities undertaken by Cochlear in Australia and by its subsidiaries overseas results in maintaining the overall low risk tax strategy adopted by Cochlear. Where appropriate, Cochlear will engage external advisors on complex transactions and for review of compliance activities.

Cochlear together with its Australian subsidiaries has formed a tax consolidated group for Australian tax purposes with Cochlear Limited as the head company of the Australian tax consolidated group.

#### **3.3 Accepted level of risk in relation to taxation**

Cochlear's level of accepted risk in relation to taxation is to accept an overall low level of risk in relation to major transactions and when undertaking tax compliance activities globally. The Audit Committee reviews this approach annually.

### **3.4 Approach to engagement with global revenue authorities**

Cochlear's approach to engagement with global revenue authorities including but not limited to the ATO, Internal Revenue Service and Her Majesty's Revenue and Customs, is to be compliant with tax legislation and fulfil all tax obligations in accordance with local tax laws and practice.

Cochlear's approach is to engage early with global revenue authorities on major transactions and to ensure cooperative, collaborative and transparent communication.

In this respect, Cochlear has signed two Bilateral Advanced Pricing Agreements with the ATO; one with the National Tax Authority of Japan and one with the Internal Revenue Service of the United States. These are long standing arrangements which are both currently being renewed. Cochlear's dealings with its UK subsidiary based in London are concluded on similar principles but are not encapsulated in a formal Advanced Pricing Agreement.

## 4 International related party dealings

Cochlear Limited is the ultimate parent entity of the Cochlear group. Cochlear has its global headquarters on campus at Macquarie University in Sydney, Australia, with regional headquarters in Asia Pacific, Europe and the Americas.

As the global manufacturer and developer of implantable hearing devices, Cochlear undertakes the majority of manufacturing and R&D activities in Australia. Cochlear also conducts manufacturing and R&D activities in other locations via service arrangements with its group entities located in Sweden, Belgium and the United States. All new knowledge and intellectual property generated from R&D activities is owned by Cochlear Limited.

Product manufactured by Cochlear is sold either directly by Cochlear Limited or through Cochlear's headquarter distributors located in the UK, US and Panama and also through distributors located in Asia Pacific.

A summary of Cochlear Limited's international related party dealings is provided below. All dealings between related parties within the Cochlear group are priced on an arm's length basis in accordance with global transfer pricing laws and OECD guidelines:

- Cochlear manufactures the cochlear implant product at three sites in Australia - Macquarie University and Lane Cove in NSW and Brisbane in QLD. The manufacture of bone conduction and acoustic implants is carried out under contract manufacturing agreements in Sweden, Belgium and the US.
- All intellectual property is owned by Cochlear Limited in Australia with the majority of R&D activities undertaken in Australia. There are R&D capabilities in Sweden, Belgium and the United States and Cochlear Limited has contract R&D agreements with the subsidiaries in those regions.
- Cochlear has headquarter distributors located in the UK, US and Panama as well as other distributors located across Asia Pacific who purchase product directly from Cochlear Limited for ultimate sale in their regions.
- Cochlear operates a Global Repair Centre in Malaysia. This entity provides testing, diagnostic and repair of sound processors, logistic activities including packing and shipping, scrapping of devices and related administrative tasks for Cochlear group entities globally.
- Cochlear operates Shared Service Centres in Malaysia and Panama. These centres provide support to Cochlear group entities such as customer order entry, service request entry, registration, invoicing, user acceptance testing, customer account set up and maintenance. The centre in Malaysia also provides back office IT support services to the Cochlear group.
- Cochlear has a captive insurance company in Singapore. It provides captive insurance services to subsidiaries in Americas, EMEA and Asia Pacific. The captive insurance company is managed by an independent third party insurance broker.

The following table provides a summary of the nature of activities undertaken by subsidiaries incorporated, and branches located, in jurisdictions outside of Australia:

Country	International related party dealing
Singapore <sup>1</sup>	Captive insurance company
Sweden	Service provider (contract manufacturing, R&D and marketing)
United States	Service provider (contract manufacturing and R&D)
Belgium	Service provider (contract manufacturing and R&D)
Malaysia <sup>1</sup>	Shared services provider (global repair centre, IT, customer service admin)
Panama <sup>1</sup>	Shared services provider (customer service admin)
United Kingdom	Headquarter distributor for EMEA
United States	Headquarter distributor for North America
Panama <sup>1</sup>	Headquarter distributor for Latin America
China / Hong Kong <sup>1</sup>	Distributor of Cochlear products
Japan	Distributor of Cochlear products
India <sup>1</sup>	Distributor of Cochlear products
Korea <sup>1</sup>	Distributor of Cochlear products
New Zealand	Distributor of Cochlear products
Singapore <sup>1</sup>	Distributor of Cochlear products

Note 1 – The subsidiary companies in these countries are treated as Controlled Foreign Companies for Australian income tax purposes and are subject to tax at the Australian corporate tax rate of 30% on any profits generated from any activities between the subsidiaries and Cochlear Limited.



## 5 Income taxes disclosed in 2018 Annual Report

The income tax expense (ITE) disclosed in the Cochlear Annual Report is calculated based on International Financial Reporting Standards (IFRS). In any one income year there may be a difference between the ITE calculated in the Annual Report to the total cash taxes paid to a relevant taxation authority during that same income year. This is because of a number of factors such as the timing of corporate tax instalment payments made to the relevant tax authorities and other taxes being excluded from ITE such as FBT, payroll and employee taxes. The ITE for Cochlear is also reduced by the R&D tax offset available in Australia.

Cochlear calculates its Effective Tax Rate (ETR) as ITE divided by accounting profit before income tax. For 2018, the ETR for Cochlear Limited was 27.8%. Provided below is the calculation of the ITE for Cochlear and its Australian operations showing the impact of adjustments to the ITE on the calculation of the ETR, a reconciliation of income tax expense to cash tax paid and 5 year historical ETRs for Cochlear.

### 5.1 Reconciliation of accounting profit to income tax expense

Cochlear Limited Consolidated Worldwide Group	2018 A\$m	2018 ETR	2017 A\$m	2017 ETR
Net profit	245.8		223.6	
Income tax expense	94.7		85.2	
Profit before income tax	340.5		308.8	
<b>Tax at the Australia tax rate of 30% (2016: 30%)</b>	<b>102.1</b>	<b>30.0%</b>	<b>92.6</b>	<b>30.0%</b>
Increase in income tax expense due to:				
Non-deductible expenses	0.1	0.0%	0.8	0.3%
Restatement of US deferred tax asset <sup>1</sup>	6.3	1.8%	-	-
Effects of different tax rates in foreign jurisdictions	-	-	0.6	0.2%
Decrease in income tax due to:				
Research and development allowances	(9.8)	(2.8%)	(9.2)	(3.0%)
Effects of different tax rates in foreign jurisdictions	(2.4)	(0.7%)	-	-
	<b>96.3</b>	<b>28.3%</b>	<b>84.8</b>	<b>27.5%</b>
Adjustment for prior years	(1.6)	(0.5%)	0.4	0.1%
<b>Income tax expense on profit before income tax</b>	<b>94.7</b>	<b>27.8%</b>	<b>85.2</b>	<b>27.6%</b>

Note 1 – Restatement of US deferred tax balances as at 31 December 2017 resulting from the enactment of H.R 1 (US tax reform legislation) on 22 December 2017.

Cochlear Limited's Australian Tax Consolidated Group	2018 A\$m	2018 ETR	2017 A\$m	2017 ETR
Net profit	245.4		173.9	
Income tax expense	75.9		68.0	
Profit before income tax (reported)	321.3		241.9	
Dividends from wholly owned foreign subsidiaries	(47.1)		(1.5)	
Profit before income tax (excluding dividends from wholly owned foreign subsidiaries)	274.2		240.4	
<b>Profit before income tax (reported)</b>	<b>321.3</b>		<b>241.9</b>	
Income tax expense using the Company's domestic tax rate of 30%	96.4	30.0%	72.6	30.0%
Increase in income tax expense due to:				
Controlled foreign company income	1.0	0.3%	2.4	1.0%
Other non-deductible expenses	2.1	0.6%	1.7	0.7%
Decrease in income tax due to:				
Research and development allowances	(8.5)	(2.6%)	(8.1)	(3.3%)
Exempt foreign sourced dividends from wholly owned subsidiaries	(14.1)	(4.4%)	(0.5)	(0.2%)
	<b>76.9</b>	<b>23.9%</b>	<b>68.1</b>	<b>28.2%</b>
Adjustment for prior years	(1.0)	(0.3%)	(0.1)	(0.1%)
<b>Income tax expense on Australian profit before income tax</b>	<b>75.9</b>	<b>23.6%</b>	<b>68.0</b>	<b>28.1%</b>

## 5.2 Reconciliation of income tax expense to cash tax paid

Cochlear Limited Consolidated Worldwide Group	2018 A\$m	2017 A\$m
<b>Income tax expense on profit before income tax</b>	<b>94.7</b>	<b>85.2</b>
Timing differences recognised in deferred tax	0.4	5.3
Effects of different tax rates in foreign jurisdictions	0.1	0.1
Current year tax instalments payable next year	(15.0)	(21.1)
Prior year instalments paid this year	21.1	9.0
<b>Cash taxes paid as per cash flow statement</b>	<b>101.3</b>	<b>78.5</b>

## 5.3 Effective tax rates for Cochlear Limited Consolidated Worldwide Group

Cochlear Limited Annual Report	2014	2015	2016	2017	2018
Profit before tax (A\$m)	117.1	196.3	254.3	308.8	340.5
Tax expense (A\$m)	23.4	50.5	65.3	85.2	94.7
Effective tax rate (%)	20.0%	25.7%	25.7%	27.6%	27.8%

## 6 Tax contribution summary

Provided below is a summary of Cochlear's total cash taxes paid to Australian and overseas tax authorities by region for the financial years ended 30 June 2018 and 2017. The majority of Cochlear's taxes are paid in Australia to the ATO. This is in line with Cochlear's business model where the majority of manufacturing and R&D is performed in Australia and the majority of intellectual property is owned in Australia.

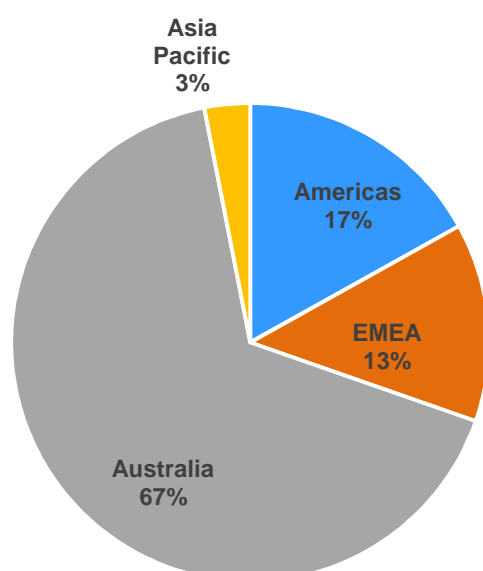
Cochlear has not separately disclosed the net VAT/GST position as Cochlear's products generally are exempt from VAT/GST.

Region	Corporate income tax		Employer / payroll taxes <sup>2</sup>		Employee taxes remitted		Total tax contribution	
	2018 A\$m	2017 A\$m	2018 A\$m	2017 A\$m	2018 A\$m	2017 A\$m	2018 A\$m	2017 A\$m
Australia	84.0	57.1	11.7	10.6	50.8	44.8	146.5	112.5
Americas <sup>1</sup>	8.8	12.7	5.7	4.8	22.8	19.5	37.3	37.0
EMEA	5.3	6.4	8.6	7.6	15.6	13.6	29.5	27.6
Asia Pacific	3.2	2.3	0.0	0.0	3.6	3.1	6.8	5.4
<b>Total</b>	<b>101.3</b>	<b>78.5</b>	<b>26.0</b>	<b>23.0</b>	<b>92.8</b>	<b>81.0</b>	<b>220.1</b>	<b>182.5</b>

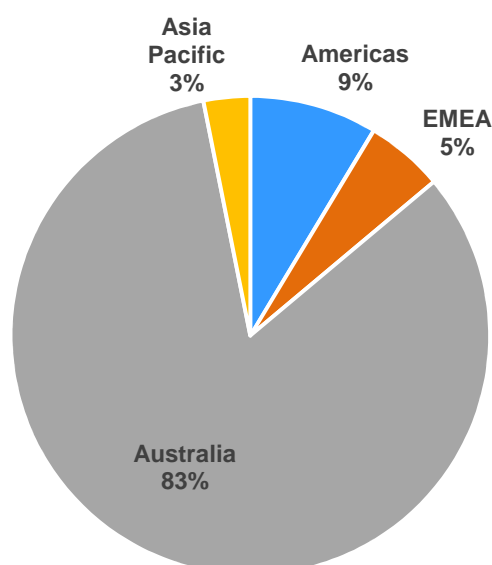
Note 1 – Includes taxes paid to US State tax authorities

Note 2 – Includes Australian FBT liability for year ended 31 March

**Total global tax contribution 2018**



**Total corporate income tax paid 2018**



## 7 ATO tax transparency disclosures

In December 2017, the Australian Taxation Office published the following taxation information from the Australian tax consolidated group income tax return for 2016:

2016	Cochlear Limited
Total income	\$827,096,271
Taxable / net income	\$325,029,178
Tax payable	\$57,413,426

Taxable income is calculated based on accounting profit adjusted for allowable tax timing and tax permanent differences as provided for in the Australian tax law. Tax payable is then calculated at the corporate income tax rate (30%) of taxable income, reduced by available tax offsets. For Cochlear, the primary tax offset which reduces the tax payable amount is the R&D tax offset.

Provided below is a summary of Cochlear's tax transparency information since 2014. Additional information has been provided in relation to the ATO tax transparency disclosures to demonstrate how the final tax payable amount is calculated after the R&D tax offset has been applied.

In summary, the R&D tax offset is calculated by adding back to taxable income 100% of the eligible expenditure incurred on R&D as non-deductible and taking a 38.5% tax offset (calculated as 38.5% of the eligible R&D expenditure added back to taxable income) against tax payable. This results in a net reduction to tax payable of 8.5% of the eligible R&D expenditure which is how the R&D tax offset is shown in the ITE in the Annual Report. For FY14-FY16, the tax offset was 40% (with a net reduction to tax payable of 10%).

Cochlear Australian Tax Consolidated Group – tax transparency disclosures	2014 (ATO tax transparency disclosures) A\$m	2015 (ATO tax transparency disclosures) A\$m	2016 (ATO tax transparency disclosures) A\$m	2017 (to be published) A\$m
Total income	649.3	692.6	827.1	854.8
Taxable income	171.4	247.8	325.0	348.4
Tax payable	10.7	35.6	57.4	65.0
<b>Application of R&amp;D tax incentive offset to tax transparency disclosures</b>				
Taxable income	71.0	153.9	226.8	248.4
R&D expense (100% add back)	100.4	93.9	98.2	100.0
<b>Taxable income published</b>	<b>171.4</b>	<b>247.8</b>	<b>325.0</b>	<b>348.4</b>
Tax payable (@30%)	51.4	74.3	97.5	104.5
R&D tax incentive offset	(40.1)	(37.5)	(39.3)	(38.5)
Other tax offsets	(0.6)	(1.2)	(0.8)	(1.0)
<b>Tax payable published</b>	<b>10.7</b>	<b>35.6</b>	<b>57.4</b>	<b>65.0</b>