2016 Tax Contribution Report Cochlear Limited





Table of Contents

1	Chief Financial Officer statement	3
2	Cochlear Limited	4
3	Tax strategy and governance	5
3.1	Approach to risk management and governance	5
3.2	Attitude towards tax planning	5
3.3	Accepted level of risk in relation to taxation	5
3.4	Approach to engagement with the ATO	5
4	International related party dealings	6
5	Income taxes disclosed in 2016 Annual Report	7
5.1	Reconciliation of accounting profit to income tax expense	7
5.2	Reconciliation of income tax expense to cash tax paid	8
5.3	Effective tax rates for Cochlear Limited Consolidated Worldwide Group	8
6	Tax contribution summary	9
7	ATO tax transparency disclosures	10



1 Chief Financial Officer statement

I am pleased to present this Tax Contribution Report for 2016 for Cochlear Limited. Cochlear welcomes the opportunity to present a report on its taxes paid in Australia and globally and provide detail on Cochlear's global tax strategy.

In this respect, we have followed the recommendations outlined in the Board of Tax's Tax Transparency Code. We support the adoption of this voluntary code and believe it provides users with a comprehensive picture of Cochlear's tax activities.

A key driver of our global tax strategy is Cochlear's longstanding commitment to Australian based research and development 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 mean that more than 75% of Cochlear's corporate income tax is paid in Australia.

Our research, product development and manufacturing are all inextricably linked and also substantially based in Australia. Cochlear currently employs more than 330 scientists and engineers who are engaged in research and development projects and around 800 employees who are engaged in manufacturing. The vast majority of whom are employed in Australia.

In 2016 Cochlear invested over A\$140 million or 12% of sales revenue in research and development ("R&D"). This investment is vitally important for Cochlear to retain its global market leadership position.

In the increasingly competitive global environment, the R&D tax offset available in Australia is critical to Cochlear continuing this level of investment in research and development in Australia. Cochlear continues to strongly advocate for the retention of the tax offset at current levels and the lifting of the \$100 million cap on eligible R&D expenditure.

Cochlear has been at the forefront of transparency reporting in Australia. In FY15 we early adopted an enhanced audit report and provided additional tax note disclosures in the Annual Report. We further improved the readability of our Annual Report by simplifying or reducing redundant disclosures. These enhanced disclosures have continued in the Annual Report for 2016 and together with this Tax Contribution Report provide comprehensive detail in relation to the tax matters for 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

Neville Mitchell Chief Financial Officer 9 August 2016



nuitcull



2 Cochlear Limited

Cochlear Limited is the global leader in implantable hearing solutions.

Our mission:

We help people hear and be heard. We empower people to connect with others and live a full life.

We transform the way people understand and treat hearing loss.

We innovate and bring to market a range of implantable hearing solutions that deliver a lifetime of hearing outcomes.

Cochlear commenced operations in 1983 as part of the Nucleus group. In 1995, the company listed on the Australian Securities Exchange.

Today, Cochlear is a global company using ground breaking technology first developed by Professor Graeme Clark AC at the University of Melbourne. The genesis of the company is a unique partnership of Government, academia and private sector expertise. Cochlear's global headquarters are on campus at Macquarie University in Sydney, Australia, with regional sales and marketing headquarters in Asia Pacific, Europe and the Americas. Cochlear has direct operations in over 20 countries and employs nearly 3000 people.

Cochlear develops a range of products including cochlear implants, bone conduction implants and acoustic implants, which address different types of hearing loss. The company invests more than A\$140 million each year in research and development and currently participates in over 100 collaborative research programs worldwide. The vast majority of this research and development is conducted in Australia and intellectual property is held by the Australian entity.

Over 450,000 people of all ages, across more than 100 countries, can now hear because of Cochlear.

Cochlear's promise is 'Hear now. And always' - to provide recipients with the best possible hearing and support for the rest of their lives.

For the financial year ended 30 June 2016, 63% of Cochlear's sales revenue was from cochlear implant (Nucleus) products and 12% from bone anchored and acoustic implant (Baha) products. Services revenue, which includes sound processor upgrade and accessories sales revenue, accounted for 25% of total sales revenue. On a regional basis, Cochlear sales revenue was split:

- Americas (US, Canada & Latin America) 45% of sales revenue
- EMEA (Europe, Middle East and Africa) 37% of sales revenue
- Asia Pacific (Australasia & Asia) 18% of sales revenue

Cochlear's third party sales are primarily overseas with over 95% of revenue in 2016 being from countries outside Australia.

By contrast, all cochlear implant manufacture is conducted in Australia with Baha 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 Tax strategy and governance

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.

A low risk tax strategy is adopted by Cochlear in order to meet this objective.

Cochlear's global tax and finance teams work together to identify, analyse and evaluate global tax risks. Key tax risks are escalated to the Head of Group Finance and Chief Financial Officer.

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

These processes are written and approved by the Audit Committee.

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 overseas result in maintaining the low risk tax strategy adopted by Cochlear.

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 a low level of risk in relation to major transactions and when undertaking tax compliance activities.

Cochlear's approach to risk is documented and has been shared with the Australian Taxation Office (ATO). The Audit Committee reviews this approach annually.

3.4 Approach to engagement with the ATO

Cochlear's approach to engagement with the ATO is to be compliant with tax legislation and to engage early with the ATO on major transactions to ensure cooperative 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. Cochlear's dealings with our European 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's operations overseas are conducted through a combination of subsidiary legal entities and independent third parties, all of whom are subject to local tax regimes. These subsidiary legal entities and their foreign jurisdictions are disclosed in the 2016 Annual Report. Cochlear has a number of international related party dealings with these subsidiary operations overseas and these dealings are summarised below:

- Contract manufacturing, contract marketing and contract research and development with Cochlear subsidiaries located in Sweden, UK, Belgium and the United States;
- Sales of product to Cochlear subsidiaries located in North and Central Americas, EMEA and Asia Pacific regions. The product distribution occurs through some 20 direct operations which are headquartered in Denver, London, Sydney and Panama City;
- Shared service activities with Cochlear subsidiaries located in Malaysia, United Kingdom and Switzerland including a global repair centre, information technology support and global customer service support that is provided to Cochlear entities globally;
- Shared service activities with a separate Cochlear subsidiary in Panama. This subsidiary in Panama provides dedicated customer service support to Cochlear subsidiaries located around the globe and in conjunction with Cochlear's distribution subsidiary in Panama is a dedicated presence for Cochlear to service our customers and support the Latin America region; and
- Captive insurance provided by a Cochlear subsidiary in Singapore to subsidiaries located in the 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 total value of these international related party dealings for Cochlear Limited for FY16.

	dealing	expenditure A\$'m	intercompany revenue A\$'m
Singapore	Captive insurance premiums	0.3	
Sweden	Contract Manufacturing	42.0	
United States	Contract R&D	6.6	
Sweden	Contract R&D	24.4	
Belgium	Contract R&D	24.9	
Malaysia	Shared service fees	2.1	
Singapore	Intercompany sales		1.0
New Zealand	Intercompany sales		3.8
Korea	Intercompany sales		7.6
India	Intercompany sales		15.4
Japan	Intercompany sales		18.5
Panama	Intercompany sales		34.3
China/Hong Kong	Intercompany sales		64.1
United Kingdom	Intercompany sales		269.5
United States	Intercompany sales		344.1
Sweden	Contract marketing fees	5.9	
Panama	Shared service fees	0.1	



5 Income taxes disclosed in 2016 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 2016, the ETR for Cochlear Limited was 25.7%. 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	2016	2016	2015	2015
	A\$'m	ETR	A\$'m	ETR
Net profit	189.0		145.8	
Income tax expense	65.3		50.5	
Profit before income tax	254.3		196.3	
Tax at the Australian tax rate of 30% (2015: 30%)	76.3	30.0%	58.9	30.0%
Increase in income tax expense due to:				
Non-deductible expenses	1.6	0.6%	1.3	0.7%
Decrease in income tax expense due to:				
Research and development allowances	(11.3)	-4.4%	(9.0)	-4.6%
Effects of different tax rates in foreign jurisdictions	- 1	-	(1.7)	-0.9%
	66.6	26.2%	49.5	25.2%
Adjustment for prior years	(1.3)	-0.5%	1.0	0.5%
Income tax expense on profit before income tax	65.3	25.7%	50.5	25.7%

Cochlear Limited's Australian Tax Consolidated Group	2016	2016	2015	2015
	A\$'m	ETR	A\$'m	ETR
Net profit	157.2		131.2	
Income tax expense	53.4		37.4	
Profit before income tax (reported)	210.6		168.6	
Dividends from wholly owned foreign subsidiaries	(9.6)		(14.1)	
Profit before income tax (excluding dividends from wholly owned foreign subsidiaries)	201.0		154.5	
Profit before income tax (reported)	210.6		168.6	
Income tax expense using the Company's domestic tax rate of 30%	63.2	30.0%	50.6	30.0%
Increase in income tax expense due to:				
Controlled foreign company income	2.3	1.1%	0.8	0.5%
Other non deductible expenses	0.8	0.4%	-	-
Decrease in income tax expense due to:				
Research and development allowances	(10.2)	-4.8%	(8.5)	-5.0%
Exempt foreign sourced dividends from wholly owned subsidiaries	(2.9)	-1.4%	(4.2)	-2.5%
Other non-assessable income	-	-	(1.0)	-0.6%
	53.2	25.3%	37.7	22.4%
Adjustment for prior years	0.2	0.1%	(0.3)	-0.2%
Income tax expense on Australian profit before income tax	53.4	25.4%	37.4	22.2%



5.2 Reconciliation of income tax expense to cash tax paid

Cochlear Limited Consolidated Worldwide Group	2016	2015	
	A\$'m	A\$'m	
Income tax expense on profit before income tax	65.3	50.5	
Timing differences recognised in deferred tax	6.3	(1.2)	
Effects of different tax rates in foreign jurisdictions	-	0.6	
Current year tax instalments payable next year	(9.0)	(18.1)	
Prior year tax instalments paid this year	18.1	0.4	
Cash taxes paid per cash flow statement	80.7	32.2	

5.3 Effective tax rates for Cochlear Limited Consolidated Worldwide Group

Cochlear Limited Annual Report	2012	2013	2014	2015	2016
	A\$'m	A\$'m	A\$'m	A\$'m	A\$'m
Profit before tax	72.2	172.6	117.1	196.3	254.3
Tax expense	15.4	40.1	23.4	50.5	65.3
Effective tax rate	21.3%	23.2%	20.0%	25.7%	25.7%



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 2016 and 2015. 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.

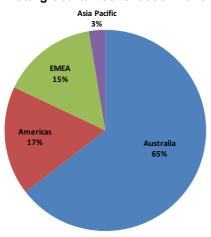
Region	Corpora	e income tax	Employer/ Payroll taxes ²		Employee taxes remitted	
	2016	2015	2016	2015	2016	2015
	A\$'m	A\$'m	A\$'m	A\$'m	A\$'m	A\$'m
Australia	62.7	19.0	9.9	8.3	41.9	36.1
Americas 1	10.3	9.0	4.4	3.5	16.3	12.4
EMEA	5.4	2.2	7.8	6.6	14.0	11.0
Asia Pacific	2.3	2.0	-	-	2.3	1.6
Total	80.7	32.2	22.1	18.4	74.5	61.1

Total tax contribution					
2016	2015				
A\$'m	A\$'m				
114.5	63.4				
31.0	24.9				
27.2	19.8				
4.6	3.6				
177.3	111.7				

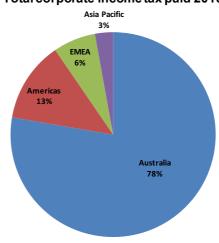
Note 1 - Includes taxes paid to US State tax authorities

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

Total global tax contribution 2016



Total corporate income tax paid 2016





7 ATO tax transparency disclosures

In December 2015, the Australian Taxation Office published the following taxation information from the Australian tax consolidated group income tax return for 2014:

2014	Cod	chlear Limited
Total income	\$	649,330,851
Taxable/net income	\$	171,357,997
Tax payable	\$	10,679,365

Taxable income is calculated based on accounting concepts and 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 2012. 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 40% tax offset (calculated as 40% of the eligible R&D expenditure added back to taxable income) against tax payable. This results in a net reduction to tax payable of 10% of the eligible R&D expenditure.

Cochlear Australian Tax Consolidated Group - tax transparency disclosures	2012 ¹ (comparable)	2013 ¹ (comparable)	2014 (ATO tax transparency disclosures)	2015 (To be published)
	A\$'m	A\$'m	A\$'m	A\$'m
Total income	570.7	604.0	649.3	692.6
Taxable income	207.2	194.8	171.4	247.8
Tax payable	17.3	23.4	10.7	35.6

Application of R&D tax incentive offset to tax transparency disclosures

Taxable income	98.0	109.3	71.0	153.9
R&D expense (100% add back)	109.2	85.5	100.4	93.9
Taxable income published	207.2	194.8	171.4	247.8
Tax payable (@30%)	62.2	58.4	51.4	74.3
R&D tax incentive offset ²	(43.7)	(34.2)	(40.1)	(37.5)
Other tax offsets	(1.2)	(0.8)	(0.6)	(1.2)
Tax payable published	17.3	23.4	10.7	35.6

Note 1: Figures provided for 2012 and 2013 have been provided for informational purposes only. These figures were not released by the ATO. The first year of ATO tax transparency disclosures was 2014

Note 2: These amounts are 40% of R&D expense compared to the ITE in the Annual Report which shows the net R&D tax offset at 10%. There will also be minor variances between the Annual Report and tax transparency disclosures due to the timing of completion of the review of the eligible expenditure for the R&D tax incentive in the tax return and the finalisation of the Annual Report

As the global leader in implantable hearing solutions, Cochlear is dedicated to bringing the gift of sound to people with moderate to profound hearing loss. We have helped over 450,000 people of all ages live full and active lives by reconnecting them with family, friends and community.

We aim to give our recipients the best lifelong hearing experience and access to innovative future technologies. For our professional partners, we offer the industry's largest clinical, research and support networks.

That's why more people choose Cochlear than any other hearing implant company.

Cochlear Ltd (ABN 96 002 618 073) 1 University Avenue, Macquarie University, NSW 2109, Australia Tel: +61 2 9428 6555 Fax: +61 2 9428 6352

www.cochlear.com

ACE, Advance Off-Stylet, AOS, AutoNRT, Autosensitivity, Beam, Button, Carina, Cochlear, コクレア, Codacs, Contour, Contour Advance, Custom Sound, ESPrit, Freedom, Hear now. And always, Hugfit, Hybrid, inHear, Invisible Hearing, MET, MP3000, myCochlear, NRT, Nucleus, 科利耳, Off-Stylet, SmartSound, Softip, SPrint, True Wireless, the elliptical logo and Whisper are either trademarks or registered trademarks of Cochlear Limited. Ardium, Baha, Baha SoftWear, BCDrive, DermaLock, EveryWear, Vistafix and WindShield are either trademarks or registered trademarks of Cochlear Bone Anchored Solutions AB.



