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## AXA AUSTRALIA SUBMISSION IN RESPONSE TO THE TREASURY CONSULTATION PAPER:

## *THE NEW RESEARCH AND DEVELOPMENT TAX INCENTIVE*

### *Introduction*

We welcome the Government's initiative to make significant changes to Australia's Research and Development tax incentive following the findings of its review of the National Innovation System detailed in its report of May 2009, *Powering Ideas*.

We support the reform objectives of making the new R&D tax incentive more effective in delivering support for business R&D, in targeting that support to where it is most likely to produce net-benefits for the Australian community and, just as importantly, making the rules less complex to understand and more predictable in their application.

### *Tax credits in lieu of deductions*

In this regard, we firstly acknowledge the justification for replacing the current scheme of enhanced deductions with a simplified system of tax credits at rates designed to compensate for the loss of the 175% premium for increased R&D expenditure.

We also support the Government's recommendation to enable companies to report the R&D credit "above the line".

Standard rules for carrying forward unused 40% credits are regarded as appropriate. Furthermore, the ability of smaller enterprises to access a 45% credit, with their unused credits being cash refundable, will better ensure the ultimate effectiveness of the incentive for those enterprises.

***Change of R&D definition***

On the other hand, we question the rationale for the proposed changes to the current R&D definition and, without a very strong and compelling rationale, there is a greater risk, in tampering with the definition, that it will only generate unwarranted confusion, uncertainty and unpredictability.

R&D tax incentives have been effective for us and assisted the funding of our R&D activities which has underpinned our company's growth and development. AXA's annual Research & Development spend exceeds $80m. Only a small percentage of this qualifies for additional tax deductions, but its nevertheless is an important factor in the overall expenditure of the group.

However, we are concerned that the radical changes proposed will adversely impact our ability to utilise the benefits of the incentives in furthering our R&D and its commercialisation.

We strongly believe that a cornerstone objective of Australia's R&D incentive should be to encourage R&D activities within Australia in order to, amongst other things, make eligible enterprises internationally competitive. Modifying and narrowing the definition is likely to have an adverse impact on encouraging investment in R&D in Australia and in today's global community, companies can choose to undertake R&D under more advantageous regimes elsewhere.

Therefore, we do not believe that any sufficiently compelling case has been made out for either the replacement of "*or*" with "*and*" in the "core" R&D definition.

We believe that the Government's desire for revenue neutrality will be achieved through the abolition of 175% premium deductions, and therefore the changes to the definition are not necessary or warranted.

***Software definition***

While we acknowledge that the current "multiple sales test" is outdated, we do not believe that a separate definition for software is warranted.

We note the consultation paper refers to an alternative method in line with the current UK model. We do not believe this is an appropriate approach that should be adopted in Australia. If the undertaking of software development involves both high levels of technical risk and innovation, then that in itself should be sufficient to meet the eligibility test.

We recommend that while guidance could be sought from overseas models (eg NZ and Canada), ultimately, software should be treated the same as all other eligible expenditure. In particular, it should be noted that Australia has a world leading position in the provision of financial services and that ongoing investment is necessary to maintain that position.

## *Conclusion*

The R&D Tax Concession has worked extremely effectively for 24 years. Whilst we understand the need to address some occasional unintended consequences of large expenditure claims, the changes proposed have the potential to undermine the entire regime. Certainty is very important, particularly within a self-assessment system. Any fundamental overhaul of the definition will create uncertainty and defeat the purpose of the incentive program.

While the proposals outlined in the consultation paper will provide increased incentives to small business taxpayers (increase from 7.5% to 15% after tax benefit). However, large business taxpayers will only receive a 10% after tax benefit. It is evident the benefits arising from the new R&D regime appear to be skewed towards small business. This raises a question of whether the 10% benefit available to large business is sufficient to maintain/increase levels of research and development in Australia.

Should you have any queries, please do not hesitate to contact me.

Yours faithfully

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