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AusBiotech
AUSTRALIA'S BIOTECHNOLOGY ORGANISATION

AusBiotech

The new research and development tax incentive

Submission to:

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Contents

Executive summary

AusBiotech has reviewed the Federal Government's consultation paper released in September 2009 against key issues facing the Australian biotech Industry and has compared the proposals against other global R&D tax concession regimes. Our key recommendations to Treasury are summarised below:

- Expenditure on overseas R&D should be eligible for the R&D tax credit where the IP is retained (owned and controlled) within Australia
- Tax exempt ownership interest should be increased to 75% for private companies with university equity before loss of the entitlement to the R&D tax credit and the cap for publicly funded research should be removed
- An option should be available for eligible claimants to be paid the refundable R&D tax credit on a quarterly basis
- The wording about "additionality and spillovers" should not remain in the legislation as a rationale that underpins its intent
- The definition of eligible R&D activities must not include the requirement that innovation "and" high levels of technical risk be present at the activity level
- Core R&D should not be differentiated from supporting R&D
- We do not support amending the list of excluded activities or extending its application to supporting activities
- No special legislation is required for software R&D as this R&D should be treated consistently with all other R&D activities
- The current provisions dealing with undeducted core technology expenditure should be amended to allow any undeducted expenditure to be eligible under the uniform capital allowance provisions
- To assist with clarity, certainty and simplicity, it would be of great benefit to claimants and improve the administration of the concession if industry-specific guidelines and examples were released and updated on a regular basis.

Background

AusBiotech, the voice of Australia's biotechnology industry, represents more than 3,000 members, encompassing medicines, medical diagnostics and devices, agriculture, alternative fuels and climate change. Of those listed on the ASX, 90% are AusBiotech members. Member companies export more than $5 billion annually.

There are at least 1,100 companies in the Australian biotechnology sector (460 covering human therapeutics and diagnostics, plus 636 [1]- 1,000 [2]medical device companies, plus 'cleantech', industrial companies and those in the agriculture sector).

Australia has an established competitive advantage in innovative biotechnologies, where we "punch way above

[1] Innovation Dynamics, 2008, BioIndustry Review – Australian and New Zealand.
[2] IBIS World, 2005, IBIS World Industry Report: Medical and surgical equipment manufacture in Australia (the 2008 updated report says 1725 companies).

our weight", ranking sixth[3] in the world.

Our medical discoveries have improved the quality of health for millions of people across the world. These include penicillin, the Cochlear hearing implant, the cervical cancer vaccine (Gardasil) and sleep apnoea devices (ResMed).

Value to Australian economy

In the case for reform it is stated that:

'8. *The new R&D tax incentive will be more effective in delivering support for business R&D and in targeting that support to where it is most likely to produce net-benefits for the Australian community'.*

The biotech industry is a key component of the Australian community, improving not only the quality of health around the world, but also generating a large number of jobs, significant exports and a considerable impact on Australia's GDP.

Jobs

Jobs of the future will be found in innovative industries - like biotechnology. The industry currently provides an estimated 40,000[4] direct Australian jobs in the biotech and pharmaceuticals sector, plus at least 10,320[5] in the medical technology sector. There are also many thousands of direct jobs in the agricultural and industrial biotechnology sectors and indirect jobs in dependent areas such as clinical trial teams, medical research and supplies to the medical technology sector and in services such as patent attorneys. These are highly-skilled jobs with long-term prospects.

Export

Around half of Australia's biotechnology and pharmaceutical companies export more than 50% of their total sales, totalling more than $5billion[6].

The medical technology export market alone is worth in excess of $1.4bn, while the global market is valued at over AUD$214 billion a year and is one of the fastest growing markets in the world, with projected growth of over 10% a year.[7]

Australia ranks number one in the world for clinical trials.[8]

Pharmaceuticals "exhibits R & D intensity" four times the size of manufacturing, and is Australia's second largest exporter of manufactured goods.[9]

Turnover and market capitalisation

Biotechnology and pharmaceuticals combined turnover equates to $12bn[10] annually in Australia.

The top 10 medical device companies aggregated market cap was $11.4bn at the end of 2008[11].

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[3] AusBiotech, 2009, www.ausbiotech.org
[4] Commonwealth of Australia, 2008, Report: Pharmaceutical Industry Strategy Group.
[5] IBIS World, 2008, IBIS World Industry Report: Medical and surgical equipment manufacture in Australia
[6] AusBiotech estimate (based on PISG Report 2008 of 40,000 plus 10,000 in the med tech sector in IBIS World Report, 2008)
[7] Department of Industry Tourism and Resources, 2006, *Medical devices for a healthy life*
[8] Invest Australia (now AusTrade), 2006, *Australian biotechnology, Capability Report 2006*.
[9] Commonwealth of Australia, 2008, Report: *Pharmaceutical Industry Strategy Group*.
[10] Ken Smith, 2008, *Who's on drugs around here*, Australasian Biotechnology, December 2008.

The Victorian State Government estimates that the market capitalisation of the top ten biotech companies has grown from $7.5 billion in 2001 to over $21 billion in 2008.[12]

Will biotechnology be a significant industry of the future?

Within Australia's emerging biotechnology sector there are numerous success stories, but the majority of the sector is in development, vulnerable, but so very promising. The sector is characterised by the need for significant funding and start-up funds to bring innovations to commercialisation. Biotech companies need ongoing access to venture capital and international markets.

If the biotechnology sector is not adequately supported, Australia risks becoming an exporter of well educated people (like Ireland) rather than an exporter of high value technologies or manufacturers.

It has been commonly accepted for many years now that future highly-skilled jobs will be in innovative industries, with many of the jobs not even conceptualised yet.

It is estimated that the car and biotechnology industries are roughly the same size in terms of contribution to GDP and jobs, with the automotive sector said to be worth $8 billion a year to GDP, with exports of $5.6 billion a year[13]. This compares to biopharmaceuticals and medical devices that account for $12 billion in turnover and at least $5 billion in exports.[14]

AusBiotech supports the recommendations made by Terry Cutler in his *venturousaustralia* report commissioned by the Federal Minister for Innovation, Industry, Science and Research in 2008, but feels that there are several significant improvements to be made to the proposed changes in the Federal Government's consultation paper released in September 2009 – so that the announcements from the May 2009 Budget are implemented as intended.

Principle 1: Access to the new incentive

"The new R&D tax incentive will be available to companies incorporated in Australia for R&D conducted in Australia. Location of ownership of the resulting IP will not be relevant".

Response

The Australian biotech industry comprises a full range of companies, from small start up companies (often university spin-offs) seeking the advantages of increased initial investment and improved cash flow, to large companies within multinational groups competing with other countries for strategic investment at the group level.

We endorse the proposed relaxation of the beneficial ownership rules covering the location of intellectual property. This is a positive step towards encouraging greater investment in R&D activity within Australia, leading to greater social and economic benefits.

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[11] Innovation Dynamics, 2008, *BioIndustry Review – Australian and New Zealand*
[12] Victorian Government, 2008, *Life science a priority for Victoria*, Australasian Biotechnology, December 2008
[13] Biotech Daily, 18 Dec 2008
[14] Ken Smith, 2008, *Who's on drugs around here*, Australasian Biotechnology, December 2008.

Where it is not possible to conduct R&D activities in Australia, we submit that if the resultant IP is owned and controlled by an Australian claimant company, overseas R&D should be eligible for inclusion in the Australian claimant's R&D claim.

Clinical research and trials

The importance of the tax concession is highlighted by GSK in its Submission to National Inquiry into Innovation System: "From *GSK's perspective investing in R&D is dependent on a number of factors of which skills availability is crucial as is Gov support".*

Over the past two decades, pharmaceutical industry-supported trials have seen significant growth, with Australia seen to conduct innovative and high quality clinical research at a reasonable speed and cost. With changes including the increased cost of drug development, however, clinical trials have increasingly been undertaken in emerging markets such as the Asia Pacific region, South America and Central & Eastern Europe where costs are lower and potential patient populations are far larger. At GSK, this has increased from approx 10-15% in the early 2000s to almost 50% of new patients being randomised in trials from emerging markets in 2007.[15]

Tax-exempt entities

AusBiotech supports the proposal to increase the tax exempt ownership interests for eligibility to claim the R&D Tax credit. The 50% cap is still too low, however, and we further recommend that tax exempt ownership interest be increased to 75% for private companies with university equity before loss of the entitlement to the R&D tax credit, and that the cap be removed for publicly funded research.

The proposal that the new R&D tax credit will be open to companies with up to 50% ownership by tax-exempt entities (such as universities) is still likely to significantly stifle the innovation process as most university based start-ups will be ineligible.

The new R&D tax incentive is designed to provide additional support to small and medium-sized businesses, which are more responsive to fiscal incentives. This is clearly the case with biotech start-up companies that are created to commercialise public sector IP. The need for capital and cash flow in this phase of an entity's lifecycle is critical. In the absence of a fully functioning venture capital market, the refundable 45% R&D tax credit will play an important role in funding R&D. The nature of the biotechnology business model is such that it is usual for start ups to commence in high cash burn and tax loss. As they progress through the R&D and commercialisation cycles, there is often the need for several funding rounds that lead to changes in ownership and may even have significant changes to its R&D portfolio. These changes in ownership can affect the companies' ability to utilise any of the tax losses generated and carried forward as, after following these necessary funding and development activities, the company may not meet the continuity of ownership test (COT) or the same business test (SBT).

> *"The need for capital and cash flow in this phase of an entity's lifecycle is critical. In the absence of a fully functioning venture capital market the refundable 45% R&D tax credit will play an important role in funding R&D".*

We propose the Government consider an amendment to both the tax exempt ownership threshold and ownership threshold for continuity of ownership to 75% for companies with turnover less than $20m p.a. for private companies with university equity and that the cap be removed for publicly funded research. In addition, the turnover of the tax exempt ownership should be excluded from the group turnover threshold. This definition could exclude small companies who have partnerships with big pharmaceutical companies for the co-development of technology and may impact in an unintended way on small innovative companies and reduce investment and attractiveness.

[15] GSK innovation review submission.

Question 1

"Should there be any exceptions to the general rule that eligible R&D activity must be conducted in Australia?"

Yes. Many large biotech companies undertake clinical trials overseas as a result of greater patient access and lower costs, for which the work is coordinated, analysed, and controlled from Australia with consequent benefits from the knowledge obtained benefitting the Australian community as a whole, not just through increased economic benefits, but also through, for example, early access to improved healthcare.

With the current structure of the tax concession, only 10% of the costs can be included within the R&D tax concession and only with advance approval from Innovation Australia. With other jurisdictions such as Japan, Korea and the UK offering R&D tax incentives on expenditure incurred overseas, Australia's competitive advantage is diluted.

We recommend the Government considers the proposal that in circumstances in which R&D activities cannot be undertaken in Australia for valid reasons, and where the resultant IP is owned and exploited by a company resident in Australia, that the R&D activity undertaken overseas be eligible for the R&D tax incentive.

We contend that appropriate spillover benefits will accrue from the broader project conducted in Australia and the exploitation of resultant IP.

Principle 2: Standard R&D tax credit

"The Standard R&D Tax Credit will be available at a rate of 40 per cent for eligible R&D expenditure and can be carried forward where a company's income tax liability is zero".

Response

We support this proposal.

Principle 3: Refundable R&D tax credit

"The Refundable R&D Tax Credit will be available to companies with a turnover of less than $20 million at a rate of 45 per cent for eligible R&D expenditure".'

Response

We support this proposal, but argue for a higher threshold of $50 million, as recommended in the Cutler Review.

Timing of the tax credit receipt

"38. Companies can only access refunds after their tax assessment is completed. The Australian Taxation Office (ATO) in conjunction with AusIndustry will apply appropriate risk management procedures before issuing refunds".

A key factor in the success of R&D projects is access to adequate capital and project funding. A survey, conducted by AusBiotech and Deloitte as part of a series of tax credit briefings in July, showed that almost every respondent entitled to the refund believed the timing of the receipt of tax credit payments, (i.e. quarterly or annually) will be a critical factor in their value as an incentive for additional R&D activities.

We propose that claimant companies with group turnover of less than $20 million a year receive the R&D tax credit on a quarterly basis aligned with the Business Activity Statement. Transitional measures will be required for first-time claimants.

Question 2

"How should the new R&D tax incentive treat R&D expenditure that is currently deductible at 100%?"

Expenditure currently treated as 100% deductible that is incurred on eligible R&D expenditure should be eligible for the R&D tax credit. This includes the refundable 45% R&D tax credit.

We propose the current core technology provisions dealing with non-deductible core technology expenditure be amended to allow for any non-deducted core technology expenditure to be eligible under the uniform capital allowance provisions.

Question 3

"Should expenditure incurred to associate entities only be eligible for the new R&D tax incentive where paid in cash?"

We express no opinion on this question.

Principle 4: Efficient and effective administration

"Legislation for the new R&D tax incentive will provide support for the scheme's efficient and effective administration".

Response

The joint administration model with the Innovation Australia Board and the ATO has proved successful in implementing and monitoring the current R&D tax concession, and so we support the proposal to continue in this manner, but with greater power to adopt a more active approach in their roles.

If the timing of payments is reconsidered for loss-making SMEs as detailed above, a framework under which AusIndustry reviews the R&D plans on a look forward basis would enable the minimisation of risk in payout above the final benefit and would provide a level of comfort about the eligibility of the activities undertaken.

To provide clarification and thus reduce the complexity of R&D claims, it would be highly beneficial for Government to prepare industry-specific guides, similar to those relating to the Canadian tax concession, which can be found online at:

http://www.cra-arc.gc.ca/txcrdt/sred-rsde/pblctns/sctr-eng.html

Providing further guidance about the nature of the activities that will be eligible for the tax concession will enable companies to understand the extent to which they can claim and will help make self-assessment more consistent.

Principle 5: Spillover and additionality

'The new R&D tax incentive should target R&D that:

a) in addition to what otherwise would have occurred; and

b)provides spillovers – benefits that are shared by other firms and the community - that are large relative to the associated subsidy.'

Response

We support the concept of Principle 5; however we do not support the proposition that this principle be included in the legislation. Its inclusion is open to abuse and misinterpretation.

It is unnecessary to include, either as an intended purpose of the proposed legislation, or within the legislation itself, the objective that the R&D tax incentive should be aimed at R&D that is in addition to what would otherwise have occurred. Additionality is not a principle that should form a part of the intended policy for the new tax incentive. It is a highly subjective concept, and will cause difficulties in assessing whether R&D factually arose as a result of the new tax incentive, or was simply supported by the new tax incentive. It is possible that numerous resources will be required to assess the principle of additionality for all future claims under the new incentive. This would detract from the ease of application of the tax incentive, increase compliance and regulatory costs and would stifle support of R&D in Australia.

We recommend that the proposed legislation does not include an 'additionality and spillovers' test as this would add significant complexity and subjectivity to any claim at a time when business is looking for simplification and certainty with any tax claim. It should be acknowledged that the biotech industry already provides significant community spillover as a result of their R&D; this does not, however, need to be enshrined as an objective or in legislation.

We recommend that the legislation does not refer to concepts of additionality or spillover benefits, but rather gives a clear definition of eligible R&D activities and expenditure.

Principle 6: Definition of core R&D activity

"Eligible R&D activity will be defined as systematic, investigative and experimental activity that:

(a) involves both innovation and high levels of technical risk; and

(b) is for the purpose of producing new knowledge or improvements".

Response

We do not support the proposal of requiring core R&D activities to involve innovation and high levels of technical risk. While we understand that a policy objective of the new R&D tax incentive is to remain revenue neutral, it is also understood that another objective is to intentionally redistribute support in favour of small and medium-sized businesses, which are more responsive to fiscal incentives.

The proposed amendment to definition of core R&D goes too far and it is debatable whether or not this objective will be achieved. The proposed definitional changes would adversely affect claimants of all size – not just large companies.

The requirement at the activity level for both innovation and high levels of technical risk will result in a significant reduction in activities eligible for the concession, even if when viewed at the project level, the project may have both innovation and high levels of technical risk.

Within the biotech industry, the proposed changes to the definition of core R&D will affect the ability of companies to claim the R&D tax credit. For example, many of the activities or processes undertaken as part of a biotech project may be not be innovative as they follow established and known protocols, although the hypothesis they seek to validate may be unknown and contain high levels of technical risk.

Definition of core R&D in other jurisdictions

"55. A definition which requires that core R&D activities involve both innovation and high levels of technical risk means that the new scheme will better align with the Frascati Manual and international practice. Currently Australia has one of the broadest definitions of R&D (when compared to the Frascati Manual).Many countries, including the United Kingdom and the United States, take a narrower approach".

Response

We do not agree with this proposition.

We have conducted a review of the definition of core R&D activities used in a number of foreign jurisdictions, which support that there is no requirement for both innovation "and" high levels of technical risk to be present to align the definition with the Frascati manual.

US definition of R&D

The US test for the eligibility of activities to qualify as R&D does not focus on 'innovation' or on 'technical risk' but requires that the activities must be devoted toward the development of a new or improved business component, be technological in nature, address a technical uncertainty encountered at the outset of an endeavour and involves a process of experimentation.

UK definition of R&D

Similar to the US definition, the UK test does not focus on 'innovation' or on 'technical risk' as such, but requires there to be a 'project' that seeks to 'achieve an advance in science or technology' ... 'through the resolution of scientific or technological uncertainty'.

The US and UK definitions of R&D link much more closely with the Frascati manual, and are easier to understand than the Australian definition.

Asia-Pacific definitions of R&D

Japan, Singapore and South Korea are all countries within the Asia-Pacific region with R&D as a % of GDP exceeding that of Australia.[16] Japan is currently undergoing a review of its R&D tax concession, and South Korea has no specific regulation that provides definition or scope of R&D activities that qualify for R&D incentives.

In Singapore, R&D is defined to mean "any systematic, investigative and experimental study that involves novelty ***or*** technical risk carried out in the field of science or technology with the object of acquiring new knowledge or using the results of the study for the production or improvement of materials, devices, products, produce, or processes..."

[16] www.nationmaster.com/graph/eco_res_and_dev_exp_of_gdp-economy-research-development-expenditure-dgp

In Malaysia, *The Promotion of Investments Act 1986* defines research and development as "any systematic or intensive study carried out in the field of science or technology with the objective of using the results of the study for the production or improvement of materials, devices, products, produce or processes but does not include:

- quality control of products or routine testing of materials, devices, products or produce;
- research in the social sciences or humanities;
- routine data collection;
- efficiency surveys or management studies ;and
- market research or sales promotion."[17]

In the Thai R&D tax incentive regime, qualifying activities must have the following characteristics:

- Basic industry research, which means a research or study to discover new knowledge to benefit the development of the new products, processes or services or to make progress to existing products, processes or services

- Applied research, which means the change of outcomes of basic industry research into work plan in order to change, modify or create the products, processes or services either for sale or own use. It also includes model inventions that cannot be used for commercial purpose, conceptual formulation and design of products, processes or various forms of services, and the preliminary demonstration or pilot project in condition that such project cannot be modified or used for industrial or commercial purpose. However, applied research shall not include the ordinary change or change over period of time of the products, production system, production process, provision of services or other ongoing activities even if such changes may cause a process.

Under the New Zealand R&D tax incentive regime, R&D activities must be systematic, investigative and experimental. They must either seek to resolve scientific or technological uncertainty ***or*** involve an appreciable element of novelty and be directed at acquiring new knowledge or creating new or improved products or processes.

It is evident from this review that the existing Australian definition is no broader than that of other countries.

We recommend that, if it is the Australian Government's intention to align the definition of R&D more closely with that in the Frascati manual, it follows the example of the UK and US concessions in order to build on the experience of those jurisdictions and avoid unnecessary restriction and confusion.

Principle 7: Supporting R&D

"Supporting R&D will continue to be recognised under the new R&D tax incentive but claims will be subject to new limitations".

Response

It is welcomed that supporting R&D activities and expenditure will continue to be recognised under the new R&D tax incentive. Research and development activities that are undertaken in a commercial or industrial context are necessarily underpinned by a range of supporting activities that enable the core R&D activity to occur. The key is to ensure sufficient and commensurate connection with the core R&D activity, so that subsidy by the R&D tax incentive is warranted and appropriate. We have significant concerns, however, about the current proposal to split core and supporting R&D, and with the options provided in the consultation document for a framework of identifying and then limiting the eligibility of supporting activities.

[17] http://www.mida.gov.my/en_v2/index.php?page=research-and-development

We are appreciative of the objective to limit the expenditure incurred on supporting activities where the degree of proximity to supporting the core R&D activity appears too broad or removed. The five (5) options proposed in the consultation document would, however, inappropriately and adversely affect claimants of all sizes and from all industries. It may well be that the quantum of eligible expenditure by smaller entities will make it uneconomical to claim – particularly as the costs of compliance will be higher because of the need to differentiate between core and supporting R&D, and the possibility of claiming these activities at different rates. Few accounting or project management systems identify and allocate expenditure at the proposed level of detail required.

With policy objectives including replacing the existing scheme "with less complex and more predictable tax credits" and "the intentional redistribution of support in favour of small and medium-sized businesses", the requirement of identifying the core and supporting activities and attributing expenditure to these activities contravenes these objectives.

Question 4

"Should supporting activities:

(a) be capped as a proportion of expenditure on core R&D?
i. If so, what would be the appropriate proportion (for example, 1:1)?

(b) only be eligible where they are for the sole purpose of supporting core R&D activity?

(c) exclude production activities or dual role activities?

(d) only be eligible on a net expenditure basis?

(e) attract a lower rate of assistance than core R&D?

Response

The role of supporting R&D is fundamental to the validation of any theoretical or conceptual ideas, and their natural progression from the laboratory towards field trials and ultimately commercial production. Most biotech companies exist purely to conduct R&D. Supporting activities are therefore essential – without them the core R&D could not be undertaken. There should be no distinction in eligibility between core and supporting activities. It's a different situation for operating companies who conduct R&D, where a distinction might be appropriate.

Below is our response to each of the five options presented within the Paper. It should be read in the context of the comments noted in Comment 1 above:

(a) Capped as a proportion of expenditure on core R&D

The view expressed by Treasury that *"…the amount of supporting activity being subsidised is also a significant part of the cost of a related commercial activity…*[18]*"* is relevant, however it is also a reflection of the necessary activities that comprise R&D projects undertaken by corporate Australia. Supporting R&D activities make up a valuable portion of the R&D evolution and a blanket cap would therefore be detrimental to the delivery and expedition of many projects within the industry.

We do not support limiting the extent of directly-related supporting activities on a capped basis. Any cap referenced to a fixed dollar quantum, percentage of core R&D expenditure or direct R&D salary and wage expenditure, for example, is poor policy. It is likely to introduce a range of unintended consequences such as industry bias, R&D life cycle bias and "safe harbour" behaviour.

(b) Only eligible where they are for the sole purpose of supporting core R&D activity

The introduction of a sole purpose test is unduly restrictive where core R&D activity is necessarily undertaken by companies in a commercial, industrial or production context.

There is often also a commercial purpose to undertaking various activities that are also directly supporting a core R&D activity.

The current R&D tax concession has operated in the context of a fully functioning business and has not been limited to the situation where R&D is undertaken in isolation. The program has been realistic in recognising the context of R&D in Australian business, and as a result has furthered R&D activities within Australia.

Limiting supporting activities to those that are *only eligible where they are for the sole purpose of supporting core R&D activity*, will limit the effectiveness and applicability of the new R&D tax incentive.

(c) *Exclude production activities or dual purpose activities*

We do not support the proposed methodology, which would *exclude production activities or dual purpose activities* from being eligible supporting R&D activities.

To pursue such a limiting methodology would be detrimental to the majority of claims undertaken in a commercial context in Australia. Where core R&D is necessarily undertaken in a commercial or production context, we recommend that consideration be given to including those supporting activities that are still experimental in nature. Guidance can be taken from the Canadian policy, which looks for and supports "experimental production" and "experimental development" that can occur in conjunction with or simultaneously with commercial production.

We draw to your attention to the Canadian Application Policy SR&ED 2002-02R2, which sets out practical and workable guidance in this situation.

(d) Only be eligible on a net expenditure basis

A net expenditure basis introduces an additional level of compliance, which detracts from the concession. Although the Paper states that "*…consideration could also be given to applying a recoupment approach to both core and supporting R&D …"* this approach is predicated on the ideal of being easily able to separate both core and supporting R&D activities. This unfortunately will lead to increased administration complexity.

Many biotech companies do not operate suitable systems that could effectively isolate R&D supporting expenditure, which could then be set off against any benefit resulting from the related R&D. The inclusion of this option would make the concession unworkable. It also detracts from the policy objective of the new tax incentive, which is to be *more effective in delivering support for business R&D.*

The current feedstock provisions operate effectively to ensure that only the net cost of the transformational activity is included on an R&D claim. To expand this concept to include a broader supporting R&D activities and expenditures will add to complexity and administration.

(e) *Attract a lower rate of assistance than core R&D*

We are not in favour of this proposed methodology for the reasons that it again relies on the separation of core and supporting activities and, if successful, would devalue the importance and effort expended on supporting activities.

A two-tiered program will not be *"more effective in delivering support for business R&D and in targeting that support to where it is most likely to produce net-benefits for the Australian community"*. A lower rate of assistance for supporting activities will introduce further compliance costs in the additional calculations for R&D support, and different record keeping systems to isolate core and supporting expenditure.

Question 5

"Should the current list of activities excluded from being considered core R&D be:

(a) amended in any way?

(b) extended to exclude certain activities from being considered supporting activities?"

Response

We do not support the proposal to amend or extend the current list of activities considered core R&D activities. In particular we draw your attention to item K of section 73B(2C), which covers commercial, legal and administrative aspects of patenting, licensing and other activities. While we acknowledge that this activity would not meet the definition of "core" R&D, this activity is a critical element of many R&D projects undertaken in the biotech industry. Where this activity is required during the conduct of an R&D project, these costs are a necessary and integral element of achieving a projects technical objective. It should not be excluded for consideration as an eligible supporting activity.

In referring to the Frascati manual, it is clearly identified that those activities that are to be excluded as core R&D activities may be eligible to be included as supporting activities. For example:

131. …In R&D statistics, the practice is that … expenditure data should cover the full cost of R&D, including the indirect supporting activities which are treated as overheads…[19]

A large number of the global R&D tax incentive regimes are drafted based on the Frascati manual, and consequently allow activities as supporting activities that would not be consideredeligible as core activities.

AusBiotech is unable to recognise the benefit in restricting the nature of the supporting activities, and believes that it would be detrimental to the Australian competitive position if an extension of the excluded activities was applied to supporting activities.

Question 6

"How should the new R&D tax incentive treat software R&D?"

Response

China, Japan, UK and Canada have no special treatment for assessing the eligibility of R&D forsoftware development. AusBiotech proposes that, in order to bring the tax incentive into alignment with these other jurisdictions, the multiple sale requirement is abolished within the new R&D tax incentive scheme and eligibility should be assessed against the normal R&D rules.

[19] Frascati Manual, Proposed Standard Practice for Surveys on Research and Experimental Development, OECD. 2002