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General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

22 October 2009

Dear Sir

Submission on Research and Development Tax Incentive Consultation Paper

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 is 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. 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 nor for any of proposed changes to the "*support activities*" definition, most of which are extremely arbitrary and potentially discriminatory as between industry segments.

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.

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.

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

Yours faithfully,

DELTA HYDRAULICS PTY LTD

A handwritten signature in black ink, appearing to read 'J F White', with a large, sweeping flourish extending from the bottom left.

JOHN F. WHITE

MANAGING DIRECTOR