



Knowledge Influence Support

CHAMBER OF COMMERCE AND INDUSTRY  
WESTERN AUSTRALIA

23 October 2009

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

Dear Sir/Madam

**SUBMISSION – THE NEW RESEARCH AND DEVELOPMENT TAX INCENTIVE:  
CONSULTATION PAPER SEPTEMBER 2009**

The Chamber of Commerce and Industry of WA (CCI) makes this submission to the Treasury about the *New Research and Development (R&D) Tax Incentive Consultation Paper September 2009*. As the leading business association in Western Australia with membership of over 5,000 organisations in all sectors, CCI recognises the importance of the R&D tax incentive to encourage businesses to be innovative.

Western Australia has a positive long term economic outlook. However, this does not come without challenges which include the return of acute labour shortages, tighter capital markets, high compliance costs and unnecessary regulatory barriers, among others. To address these future challenges the State requires an innovation agenda that can help to build the productive capacity of the economy, encourage economic expansion and diversify the State's economic base. Businesses' access to private and public sector funding for R&D, and commercialisation activities is integral in supporting innovative activity.

**R&D Tax Incentive**

A broad based tax incentive is a positive way to encourage all businesses to undertake R&D activity that meets market demand, rather than providing grants and subsidies for selective purposes. The broad tax base creates an overall environment for business success, rather than selecting individual businesses for preferential treatment through grants and subsidies. The tax incentive provides a moderate financial motivation for businesses that want to engage in R&D activities that are riskier than tested business operations.

The proposed changes will significantly impact the way the R&D incentive is administered, therefore the Treasury must ensure the changes do not have unwarranted consequences. The Treasury's consultation process is a positive step towards creating a more effective tax incentive.

**Re-Alignment to Small Businesses**

The proposal to provide a better incentive for businesses with group turnover less than \$20 million is one way to introduce greater focus and support for small businesses. This recognises that small businesses are disproportionately impacted by a lack of financial resources to support R&D. A refundable tax incentive for small businesses will provide a

positive and immediate benefit for start-up companies that do not receive a net income from their venture in the year they claim the incentive.

### **Compliance Costs**

Compliance costs should be kept to a minimum to ensure tax administration does not become a disincentive to claiming the tax offset. CCI articulated its position on tax compliance in the *Submission to the Australian Government's Review of the Tax and Transfer System, November 2008*, attached. The submission identified that complex tax laws and the threat of audits, if a taxpayer incorrectly interprets their tax affairs, creates an uncertain and costly tax environment focused on compliance. It also suggested that reforms to the tax system should focus on its current high level of complexity.

The proposition that the new incentive will be less complex and more predictable is flawed. Although it is positive that the incentive's structure is simplified into two main rates, introducing tighter definitions and criteria for eligible R&D activity will increase the burden of proof for businesses claiming the incentive, including the following issues detailed below.

#### *Additionality and Spillovers*

The ability for a business to prove additionality and spillover of research activities is impractical and redundant. The fact that a project is R&D and is measured by its innovativeness or technical risk suggests that additionality and spillover will occur. The application of this test should be removed as it is unnecessary and its subjectivity adds to the regulatory burden.

#### *Innovativeness and Technical Risk*

The ability to prove both innovativeness *and* technical risk for specific R&D activities does not reflect operational realities for R&D. Although an R&D project may be innovative and have technical risk, R&D activities do not always have both. For example, design activities may be innovative but not technically risky, or testing a prototype may be technically risky but not an innovative process. This criterion may unnecessarily reduce the volume of R&D claims despite being a legitimate R&D activity. R&D activities should continue to be defined to require innovativeness *or* technical risk, not both.

#### *Varying Treatment of Core and Supporting R&D Activity*

Distinguishing between core, supporting and non R&D activities is difficult and can depend on the type of R&D activity. For example, writing a manual for a new algorithm for software is currently not considered a supporting activity yet it is a development activity that helps make the research useable. The suggestion to exclude production and dual purpose activities as being an eligible supporting activity fails to recognise that R&D actually occurs during a production run, and that the same resources used for R&D may have spare capacity that could be used for other productive purposes.

AusIndustry currently plays an important role in validating what is or is not a R&D activity. The recommendation to empower AusIndustry to adopt a more active approach to the R&D tax incentive is welcomed, but should focus on assisting businesses validate R&D activities and costs, not auditing or compliance.

### *Compliance Cost on Small Business*

Complex tax legislation increases compliance costs. Small businesses are disproportionately impacted by compliance, as they have fewer resources to commit to complying with the incentive when compared to larger businesses. This contradicts the Treasury's intention to better align the incentive to small businesses.

Businesses have suggested that the net compliance cost associated with the new incentive may deter them from claiming the incentive and increase disputes. In addition, the intention to ensure the changes are revenue neutral will result in increased funding allocated to administration and less allocated to actual R&D activities. It is essential that compliance is kept to a minimum.

### **Location of Intellectual Property Ownership**

The removal of ownership restrictions on intellectual property is a positive step towards recognising the global nature of innovation commercialisation and diffusion. The proposal's requirement for R&D activity to occur in Australia will ensure some of the benefits remain in the country.

However, Australia does not have all the expertise and facilities to undertake every type of R&D activity. Australian companies should not be disadvantaged in seeking world class R&D. Therefore, the tax incentive should continue to allow claims for overseas R&D activities but remove the current prequalification process to streamline the process and allow flexibility for unexpected requirements during the R&D process. This could be modified to allow a portion of their R&D to be spent overseas as long as the company can demonstrate during an audit that overseas expenditure could not be carried out in Australia.

### **Tax Exempt Entities**

Innovative companies are often spun off and partly owned by universities. The proposed increase in ownership by exempt entities, such as universities, from 25 per cent to 50 per cent will ensure new businesses are not disadvantaged by collaborating with exempt entities.

### **Recommendation**

The new tax incentive represents a significant realignment of the Federal Government's support for R&D activities in Australia. It is important to ensure compliance costs are minimised to prevent the changes negating the potential benefits anticipated in changing the system. This is important because R&D is integral to the continued productivity and economic growth of Australia.

If you have any questions in relation to these matters, please contact Ms Sharon Dignard, Senior Adviser Business Policy, on (08) 9365 7531 or via email at [Sharon.Dignard@cciwa.com](mailto:Sharon.Dignard@cciwa.com).

Yours sincerely



John Nicolaou

Chief Officer, Membership and Advocacy