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General Manager  
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The Treasury  
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PARKES ACT 2600



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## **Response to the New Research and Development Tax Incentive - Exposure Draft Legislation and Explanatory Materials**

Dear Sir/Madam,

Thank you for the opportunity to comment on the exposure draft of the Tax Laws Amendment (Research and Development) Bill 2010 released 18 December 2009.

The Australian Private Equity & Venture Capital Association Limited (AVCAL) is a national association which represents the private equity (PE) and venture capital (VC) industries. AVCAL's members comprise most of the active private equity and venture capital firms in Australia. These firms provide capital for early stage companies, later stage expansion capital, and capital for management buyouts of established companies.

We welcome the Government's stated intent in delivering a "more generous, more predictable, and less complex tax incentive". AVCAL views the introduction of the 45% tax credit as a very positive development for businesses which are engaged in significant innovation and R&D in Australia.

However, we are concerned that a number of the proposed changes will limit the ability of businesses to claim the R&D tax incentive and drastically reduce the scope, accessibility and attractiveness of the R&D Tax Incentive programme.

In particular, the narrowing of the eligibility criteria for the R&D tax incentive will materially affect the future of many innovative businesses in Australia. These businesses, which would have been at the forefront of the Government's efforts to foster home-grown innovation, will now be ineligible for the very incentives which are intended to propel innovation forward in Australia.

### **Main concerns**

Some of the specific areas of concern we have in relation to the proposed R&D tax credit changes are:

1. The introduction of the eligibility test of "considerable novelty and high levels of technical risk" to qualify as core R&D, replacing the current test for the activity to be innovative or involving high levels of technical risk. This change to the definition may unintentionally lead to the exclusion of many genuine value-adding R&D activities that should be supported and are currently eligible for support under the existing R&D tax concession;
2. The narrowing of eligible supporting activity (to activities where the "dominant purpose" is supporting R&D activities) will greatly limit the extent of supporting activity that can be claimed despite being integral to the R&D process. It will also impose a severe evidentiary burden on claimants as many support activities will have commercial as well as R&D purposes, and providing evidence that one purpose is clearly dominant over the other will be almost impossible in many cases;

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3. The exclusion of a large number of activities from now being either core or supporting activities, via the continued use and extension of the former s73B(2C) of the Income Tax Assessment Act 1936 (ITAA 1936) in s355-35(2). This change, while having obvious negative consequences for the computer science and information technology industries in Australia, also has (possibly unintentional) consequences, including that:
  - s355-35 (2)(l) renders clinical trials ineligible as they are performed for (amongst other purposes) the preparation of a regulatory requirement of the Therapeutic Goods Administration;
  - the drafting of s355-35(2)(h) suggests that manufacturing industries will have eligible R&D processes, including trials, drastically reduced;
  - s355-35(2)(i) is broadly drafted and needs to be clarified; and
  - s355-35(2)(o,p,q and r) will result in the exclusion of the majority of IT-related R&D from obtaining support under the programme.
4. The introduction of the augmented feedstock provisions from R&D claims will greatly reduce support for companies needing to test and trial invention in a production or manufacturing setting, and discriminate against legitimate R&D phases of a project cycle (such as project feasibility and prototype development), specifically where ultimately an output of market value is achieved. Assessing this will be costly and complex.

## Recommendations

AVCAL submits that the Government should:

1. Leave in place the eligibility test of “innovative or involving high levels of technical risk” for core R&D activity, to avoid the unintentional exclusion of genuine value-adding R&D;
2. Delete the exclusions list and thereby not use it as a means to limit supporting activities, or, if absolutely necessary to achieve policy objectives, redraft s355-35(2) to clarify those activities which are intended to be excluded or limit application of the excluded activities list to core R&D activities only;
3. Ensure that first in man, and proof of concept clinical trials are not excluded in the definition of core or supporting R&D;
4. Remove the specific exclusions on computer software to ensure that genuine R&D undertaken that is information technology related is supported by the R&D tax credit program going forward; and
5. Retain the existing feedstock provisions of s73B of the ITAA 1936 which effectively limit incentives to the net cost of trials or, alternatively, quarantine some specific costs such a labour and plant depreciation from the feedstock rule to ensure that the R&D tax incentive is always available to key activities that are most likely to produce spillover benefits.

The new R&D tax credit legislation, if implemented in its current form, would adversely impact a large proportion of those fledgling Australian companies which are seeking to exploit innovative technologies by excluding the majority of R&D projects undertaken by ICT and biotech companies regardless of their potential strategic importance or benefits to the overall economy. This is counterproductive to Australia’s long-term innovation agenda.

We believe that the above recommended changes to the exposure draft will be more consistent with the Government’s policy objective of a more effective, predictable and less complex tax incentive that rewards successes and value-adding R&D whilst maintaining revenue neutrality.

AVCAL would be pleased to meet with you to discuss or clarify the above comments.

Yours faithfully,



Andrew Rothery  
Chairman