

# Ford Motor Company of Australia Limited

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

By email: [rdtaxcredit@treasury.gov.au](mailto:rdtaxcredit@treasury.gov.au)

Dear Sir/Madam

## **EXPOSURE DRAFT: TAX LAWS AMENDMENT (RESEARCH & DEVELOPMENT) BILL 2010**

We write in response to an invitation for public comment on the abovementioned exposure draft legislation and associated explanatory material.

Ford Australia is one of Australia's largest private sector investors in research and development. It is a leading automotive company with approximately 4000 employees and extensive design, engineering and manufacturing facilities located in Broadmeadows and Geelong, Victoria. Its core products are take Ford Falcon and Ford Territory. In 2009, Ford Australia sold 96,506 locally manufactured and imported vehicles.

Ford Australia announced in July 2009 its intention to invest \$230 million in a suite of environmentally oriented new vehicle initiatives including the introduction of four cylinder EcoBoost and liquid injection LPG technology for the Ford Falcon and clean diesel technology for the Ford Territory. In addition, Ford Australia has been the lead design and engineering source for the recently launched Ford Figo small car in India and for a yet-to-be launched compact pick-up truck which is to be sold in more than 100 countries.

Ford Australia now competes on a global basis for its research and development projects. As outlined in a submission dated 26 October 2009, an increasingly globally integrated Australian automotive industry has significantly broadened the boundaries of design competition. This also means that at a time of substantial change and uncertainty in the global industry due in large part to the GFV – where a wide range of cancelled investment initiatives by many companies in many countries has created significant research and development over-capacity – Ford Australia must compete vigorously for new research and development projects. This demands an internationally competitive policy environment.

It was in the abovementioned context that Ford Australia urged that considerable care be taken in the design of proposed changes to the long-established R & D tax concession. Ford Australia believes this concession has played an important role in fostering an innovative culture across different sectors of the economy, and has assisted companies like Ford Australia to manage the risks associated with research and development activities. The

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company indicated it believed it would be a step too far to both tighten the definition of R & D and also significantly tightening eligible expenditures on support activities.

Ford Australia believes it regrettable the draft legislation proposes to make significant amendments beyond the cautious approach suggested by the company in its earlier submission. These proposed amendments are likely to have a wide-ranging impact on the competitiveness of innovation in Australia. The innovative culture encouraged by the existing policy arrangements, and targetted for a renewal impetus by the new policy arrangements, could indeed stall.

Ford Australia provides the following specific comments:

- Core R&D activities to be eligible must now involve *considerable novelty* and high levels of technical risk and are conducted for the purpose of acquiring new knowledge or information. By way of explanation, the EM states that "novelty" needs to be considered in the context of technology which is publicly available on a reasonably accessible worldwide basis.

The OECD "Frascati Manual" defines R&D to include an appreciable level of *novelty* and the resolution of scientific and/or technological uncertainty<sup>1</sup>. There is no requirement to consider "novelty" in the broader global context, and to satisfy high levels of technical risk. In fact the definition is satisfied by the resolution technological uncertainty without the additional requirement for novelty. Therefore, such an unduly restrictive definition appears to be out of step with OECD member countries including the USA<sup>2</sup> and Canada<sup>3</sup>. In addition, these countries consider the concept of "novelty" within the context of the "taxpayer" and not the world at large.

Further as over 90% of Business expenditure on R&D undertaken in Australia has been classified as either "Applied Research" or "Experimental Development"<sup>4</sup>, it will be extremely difficult for this expenditure to meet the onerous definition criteria for eligibility. In addition, as large business contributes the majority of total R&D spend in Australia<sup>5</sup> we do not believe that this very restrictive definition will achieve the express government policy objective which is to encourage business to invest in R&D.

- Supporting R&D activities must now be undertaken for the *dominant* purpose of supporting core activities. The separation of support activities and the requirement to substantiate a "dominant purpose" test will create uncertainty, complexity and potential for costly dispute in an audit context. Support activities have inherently filled a vital role in R&D. The success of any R&D project will not be possible unless support activities are present. Restricting "support activities" to those activities which are undertaken for the dominant purpose of supporting core R&D activities will make the new restricted definition of R&D one of the most stringent tests to satisfy. In

<sup>1</sup> OECD Frascati Manual paragraph 79

<sup>2</sup> Internal Revenue Code Section 41(d)

<sup>3</sup> Income Tax Act Subsection 248(1)

<sup>4</sup> Australian Bureau of Statistics Research and Experimental Development, Businesses Australia 2007-08 at page 7

<sup>5</sup> Australian Bureau of Statistics 8104.0 – research and Experimental Development, Business, Australia, 2008-08 Issue released 25 September 2009 Business Expenditure on R&D (BERD) at page 1 — Businesses with 200 or more employees made the largest contribution (\$10,040 million or 70%).



addition, the further exclusion of activities such as "initial market studies" which have been inserted in the "exclusion list" from being able to be claimed as support activities will further diminish R&D claims. Traditional activities such as initial market studies which are undertaken for the purpose of defining the scope of an R&D project are paramount to its success. Ford Australia accordingly believes that it would be detrimental to place these new limitations on the eligibility of supporting R&D.

- It is not clear from Section 355-25 of the Draft Bill whether each inter related activity in a project needs to be examined to determine if the definition of core R&D (i.e. "novelty & technical risk") test is satisfied or whether aggregated activities within a project need to be examined as a whole. Whilst paragraph 2.16 of the EM only uses the "experimental test" for individual activities, and then states that, "innovation & technical risk" test will be applied on a collective basis, this policy intention should be clearly stated in the legislation for the avoidance of doubt. The Acts Interpretation Act only permits the use of extrinsic materials (such as an EM) in certain circumstances in the interpretation of the law.

### **Non Refundable Tax Offsets – Ability To Carry Forward**

Ford Australia welcomes the decision that an R&D entity may carry forward a non-refundable tax offset to a later year, provided it satisfies the standard rules about the carry-forward of tax losses. Without this ability to carry forward indefinitely, a company in tax losses would be severely disadvantaged as it would lose for ever the tax deductibility of any R&D expenditure.

### **Consolidated Groups**

Ford Australia welcomes the decision to continue to treat the Head Company of a tax consolidation group as the R&D entity that is registered for certain R&D activities. This will reduce complexity in compliance and maintain the integrity of the single entity rule.

### **Amendment Period**

Ford Australia welcomes the 4 year amendment period which will bring the R&D tax concession in line with the income tax amendment period

### **Final Comments**

A report prepared in 2008 by the European Commission on the evaluation of R&D incentives concluded that the majority of R&D expenditure is conducted in-house by large firms and that R&D activity is becoming increasingly mobile.<sup>6</sup> In view of these findings, as mentioned in our earlier submission, it is important that Australia pursues broad international competitiveness with regard to R&D policy framework. This is particularly relevant recognising Australia's relative scale versus developed and rapidly developing economies in the region, and the increasing global mobility of R&D activities. Therefore, it is important that large global R&D investors look towards Australia as a location which offers competitive policy frameworks for investing in R&D. The proposed change to the definition will not achieve this policy intention as stated in the EM.

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<sup>6</sup> The Final Report of the Expert Group on R&D Tax Incentives Evaluation "Comparing Practices in R&D Tax Incentives Evaluation" prepared by the Directorate General – Research of the European Commission in Brussels in October 2008 - at page 120

We would be happy to provide further elaboration if requested. The writer can be contacted on (03) 9359 7142.

Yours sincerely

A handwritten signature in dark ink, appearing to be 'R Scoular', with a long horizontal line extending to the right.

**Russell Scoular**  
Government Affairs Manager

**Reference material used**

1. Ford Australia response to Consultation Paper October 2009
2. The OECD "Frascati Manual" para 79.
3. Australian Bureau of Statistics Research and Experimental Development, Businesses Australia 2007-08 (at page 7)
4. Revenue Canada - Income Tax Act definition of R&D – Sub Section 248(1)
5. Internal Revenue Code (USA) definition of R&D - Section 41
6. Final Report of the Expert Group on R&D Tax Incentives Evaluation "Comparing Practices in R&D Tax Incentives Evaluation" prepared by the Directorate General – Research of the European Commission in Brussels in October 2008 (page 120)
7. Australian Bureau of Statistics 8104.0 – research and Experimental Development, Business, Australia, 2008-08 Issue released 25 September 2009 Business Expenditure on R&D (BERD).