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Response to the exposure draft legislation and explanatory materials for the proposed R&D tax credit

We thank Treasury for welcoming submissions in respect of the Tax Laws Amendment (Research and Development) Bill 2010 and associated Explanatory Materials pertaining to the proposed R&D tax credit. In making this submission, Toll wishes to articulate our concerns in respect of the proposed legislative changes introducing the R&D tax credit, which contain a range of outcomes that were not anticipated to flow from the changes foreshadowed in the release of the Venturous Australia Report.

Toll develops, and continues to develop, technology and systems that effectively manage not only the physical flow of goods, but increasingly the flow of information and the complex technology that facilitates this. A key competitive advantage that has underpinned Toll's success has been a strong commitment to continuing development and innovation of its information and communications technology (ICT) platform.

We anticipate the R&D tax credit draft legislation and explanatory materials, as proposed, will significantly undermine Toll's investment in R&D in Australia, and in particular the new software development provisions appear to unreasonably exclude businesses innovating and developing in the ICT area.

In Toll's opinion, the draft R&D Tax Credit provisions effect an outcome contrary to the directions proposed by the Venturous Australia Report by directing support away from commercial innovation and development towards narrow theoretical research and unfairly impact industries focussed upon ICT innovation and development.

Background

Over 24 years, Toll has grown into a global consolidated logistics group with a turnover in excess of \$6.5 billion, providing an array of logistics services with the capability to manage a customer's whole supply chain, end-to-end, across multiple suppliers and partners in multiple countries and multiple time zones.

Toll Group operates from over 1,000 sites in over 55 countries and continues to develop an increasingly broad-based geographic distribution network. In addition, Toll maintains a focus on the Asian region, the fastest growing and most dynamic logistics marketplace in the world.



Toll's integrated logistics offering is a result of an array of complex service offerings, utilising all modes of transport, a specialised range of integrated logistics services and an extensive range of freight profiles across all major territories, and linked together by the flow of information.

Toll is an Australian company competing against the world's largest international logistics services providers in an industry where the development and application of new technology is a key service differentiator.

Toll Group investment in innovation and R&D

Toll is committed to maintaining and supporting its Australian-based technology teams, and currently employs in Australia more than 120 people in specialised technology divisions with large design and development budgets. In addition, Toll employs many more technical personnel across the Australian and global operations.

Toll's investment in R&D and innovation in Australia helps support and maintain the people and knowledge that make innovation and development in the Australian logistics technology area possible. The commitment to technology and the ICT area by Toll, and other large corporations, builds a strong base of expertise and experience that all businesses, from large corporations to small boutique consulting operations, rely on and utilise in taking Australian knowledge and expertise to the world.

It is of critical importance to have a sustainable and significant base of knowledge and talent in Australia. There is a threshold level where the lack of availability of local knowledge and expertise hinders further local investment in R&D and innovation and ultimately becomes a cyclical failure of the technology area.

Direct Government support through an R&D incentive has been one of many essential and complex factors that impact the sustainability of the technology industry.

Importance of innovation in the logistics industry

Innovation and new technology development is of critical importance to the Australian logistics industry to maintain international competitiveness, and has genuine flow-on benefits to the Australian economy. The productivity increases from technology based innovation reduce loads on national infrastructure, supports export industries and generates cheaper, safer and more environmentally sustainable logistics and transport outcomes.

To achieve this, Australia must remain an 'intellectual hub' in the ICT area and must be seen to develop ideas and solutions able to be pushed out offshore.

The value of information and ICT in a supply chain is critical. Notwithstanding that there is now access to unprecedented volumes of information, the usefulness of this information depends on the technologies and tools that connect the right information with the right person at the right time. Supply chains are becoming ever more complex with multiple suppliers, each with disparate systems and proprietary processes, and innovative ICT solutions are an essential part of achieving integrated logistics services and the productivity and efficiency gains that flow from these.

Impact of draft legislative changes on support for innovation

The support for R&D and innovation from regimes such as the R&D tax concession form an important part of the complex mix of decision making factors that guide both the location and the direction of R&D and innovation spend in any established corporation.



Unfortunately, in Australia the tendency of successive administrations to change the underlying rules, in parallel with the low rate of effective benefit, have resulted in real challenges for using the concession as a mechanism to directly incentivise specific R&D projects. In addition, regular changes to legislative and administrative requirements have increased the internal procedural costs (and the cost of consulting support) and further eroded the value of the incentive to business.

Importantly, none of the above comments should understate the significance of the concession in supporting Toll's overall commitment to R&D and the value that a predictable benefit has in feeding back into the Toll R&D budget. A predictable return from an R&D incentive creates the potential for funding very high risk and 'leading edge' development that is often difficult, if not impossible, to support from a business unit budget perspective.

Given the deviation of the proposed R&D tax credit legislation from the outcomes of the review process as reflected in the Venturous Australia report, it would seem appropriate for further discussions and consultation to occur to allow business to understand the policy reasons for the change and the extent to which the draft provisions appropriately reflect the policy intention. Specifically, Toll wishes to highlight the following concerns in respect of the proposed R&D tax credit provisions:

1. *Regular changes create an increased cost of compliance*

As noted above, changes to the rules and procedures for claiming the R&D tax support increase the cost of accessing the benefit and further erode the value to business. Changes have the effect of increasing the leakage of the benefit to the tax incentive consulting sector and tend to result in a view that the cost of complying outstrips the benefit.

2. *Narrow view of 'spill-over' benefit*

The tightened definition of 'support' costs reflects a narrow and uncommercial view of a 'spill-over' benefit. In the commercial sector, innovation and R&D is now tightly intertwined with operations and operational developments. Innovative changes and developments come at cost to business both through IP leakage and the inherent risk of failure through changes to established functional systems and technologies, and ultimately intermingles with the business operations in a complex way. The drafting of the proposed provisions appears to embrace a particularly narrow view that support costs can only be those costs that stand alone distinct from operational costs and in our view reflects a genuine misunderstanding of current trends in commercial R&D and innovation.

3. *Significant reduction in support for ICT focused R&D and innovation*

The proposed 'multi-sale' and associated software provisions have the effect of significantly reducing access to the concession for organisations involved in developing and innovating in information and communication technology for the purpose of supporting the core business operations. In our opinion, these provisions are unnecessary and also fail to recognise the significance of innovation and R&D in ICT as a critical aspect of business operations.

4. *Unintended and arbitrary preference for consulting over in-house ICT*

The new 'multi-sale' provisions appear to have the arbitrary outcome that, for exactly the same work, a specialist ICT consulting firm may be able to access the tax credit in circumstances when an in-house development team may not. In-house ICT teams are an important part of the ICT R&D and innovation area, and the provisions, as drafted, do not give effect to a fair application of the R&D tax credit.



Conclusion

In substance, the draft R&D tax credit legislation and explanatory materials tend to create an outcome that shifts R&D support from profitable established businesses to small 'start-up' enterprises focused on pure research orientated activities.

Further the concession also shifts support towards businesses that are not yet profitable and in many cases are unlikely to be profitable.

This is not an outcome that was supported by the extensive consultative process that led to the release of the Venturous Australia Report and, in Toll's opinion, results in an outcome that invariably understates the value of R&D support for established businesses and significantly reduces the R&D and innovation support for both large and small businesses generally.

In Toll's opinion, the proposed changes are unlikely to do enough to discourage the cascading pressure for shifting ICT innovation and development offshore. For Toll, as a global company to continue to commit to developing an Australian-based technology hub, it is critical for there to also be broad industry commitment, not just from the logistics area, to ICT innovation and development in Australia. Genuine government support for innovation in the ICT industry is an important factor in maintaining core levels of ICT expertise and knowledge in Australia.

Again, we thank Treasury for the opportunity to comment on the proposed legislative provisions and explanatory materials and would be supportive of further industry consultation in regard to the R&D tax credit.

Yours faithfully

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