Submission to «The new research and development tax incentive»

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Preamble

Since 2005 the R&D Tax Concession has funded one third of Edentiti R&D. Without it, it is unlikely that the company would have survived. The company is now almost guaranteed of success. More importantly, the benefits from our innovative way of handling identification and providing business functionality will bring a return to the community many times the amount of the Tax Concession. Our company is one of the success stories of the R&D Tax Concession and provides solid justification for its continuance.

Question 1 – Should there me any exceptions to the general rule eligible R&D activity must be conducted in Australia

If the IP ownership remains in Australia and if it was difficult or impossible to get part of the research done in Australia then an exception could be made. Perhaps a limit should be set on the proportion that of overseas expenditure eligible. This would cater for those situations where an Australian might work overseas for some of the time and pay tax in the overseas country. If the person is taxed as an Australian then where they do the work should not matter.

Principle 4 – Legislation for the new R&D tax incentive will provide support for the scheme's efficient and effective administration.

The department currently supplies online forms where data can be entered and presumably goes directly into the departments computer systems. If the department published webservices where companies could directly send data then organisations could relatively easily provide interfaces to common accounting packages and so automate reporting.

Principle 5 – The new R&D tax incentive should target R&D that: is in addition to what otherwise would have occurred

This principle is a reasonable one provided it remains a principle and there is no attempt to define whether the investment would or would not have occured without the tax incentive. Any attempt to define this in explicit terms should not be attempted but it can be used to stop blatant attempts to rort the system.

Principle 6 – Eligible R&D activity will be defined as systematic, investigative and experimental actitity that: involves both innovation and high levels of technical risk

It his recommended that the «and» be changed to «or».

The reason is that some of the most successful innovation involves little or no technical risk. The best innovation often comes from using tried and true processes is new ways. This will almost always have a lower commercial risk and is more likely to succeed. If anything there could be a bias against technical risk and more of an emphasis on using a tried and true technology in new and innovative ways. This particularly applies to the IT industry which is making great strides through using the same technologies for different purposes.

Question 4 – what should be included as supporting activities

For a startup company where everything is focused on innovation and there are few sales, all expenses should be classified as R&D. This can be achieved by allocating a proportion of the supporting activities in accordance with the same proportion of sales to total expenditure.

Question 5 – Current list of excluded activities.

An important part of all Research is examining what others have done in the same area to prevent «reinventing the wheel». To that end items

(f), (i), (k), (l)

should be included as core R&D activity.

Question 6 – How should the new R&D tax incentive treat software R&D

The UK rules are inappropriate for the Web 2.0 and even more so for Web 3.0 where much software innovation is occuring. This is because most recent innovation in software has been in the way people interact. Under the UK restrictions FaceBook development, or Twitter, or LinkedIn would not be eligible. Neither would almost any iphone application.

The current method where software is sold many times either as a product, or as a service or as functionality should automatically qualify.

Other

It is important that some level of certainty with respect to qualifying for the R&D tax incentives be provided to companies when they embark on R&D activities. At the moment a company cannot include R&D tax incentives amounts as «income» when approaching investors because the company cannot give any level of certainty if the R&D tax incentive will be allowed. Perhaps a certificate as in the film industry could be used or perhaps the tax incentive could be supplied at the time of expenditure by more regular reporting. With the R&D rebate being a fixed 45% this would seem relatively inexpensive to implement.

Another approach is to allow companies to submit the R&D tax rebate figures monthly. We now have monthly submissions for employee tax and monthly submissions for GST so why not have monthly submission of figures? Allow it to be optional and require the tax office to publish web service specifications for data entry. Industry will soon come up with tools to help businesses do the reporting and if automated it will not involve the ATO in any increase in costs – other than giving the rebate earlier than the current yearly method.

The underlying reason that the R&D tax incentive is required is that equity, from new equity or retained profits, is the ONLY way of funding R&D because banks and other financial institutions cannot provide loan finance where outcomes are long term and highly uncertain. Another way of funding R&D activities is make it possible for banks and other financial institutions to provide loan funds. A separate submission will be made to indicate how this might be done.

Another way for small unlisted companies to fund R&D is through forgone wages. Unfortunately because it is tax related it means people within startups cannot work for low or zero salaries, build up equity in the business and still make R&D claims. The tax laws require employees to pay tax on equity as though it was a salary payment even though the equity is "worthless". It would be much easier if unlisted companies were able to pay staff in equity without causing a taxation event. The taxation event can happen if and when the equity becomes of value or is realised. Taxation events on equity do not occur if capital is put directly into the company until the capital "makes a profit". This means there is a different set of rules for labour than for capital which in turn distorts and restricts finance. A separate submission has been made to the enquiry into the treatment of employee share schemes.