



26<sup>th</sup> October 2009

General Manager  
Business Tax Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600  
[drtaxcredit@treasury.gov.au](mailto:drtaxcredit@treasury.gov.au)

Dear Sir/Madam,

## **THE NEW RESEARCH & DEVELOPMENT TAX INCENTIVE CONSULTATION PAPER SEPTEMBER 2009**

Centennial Coal Company Limited would like thank Treasury for the opportunity to comment on the consultation paper issued September 2009, dealing with the New Research & Development Tax incentive.

### **1.0 Executive Summary**

We believe it is in the interest of both industry and government to simplify and clarify the rules surrounding the Research & Development ("R&D") tax incentive.

Accordingly, we support Treasury's proposal to:-

- Apply a standard 40% R&D tax credit to all eligible R&D expenditure;
- Allow carry forward of this tax credit for companies with no income tax liability for the year in which the R&D is incurred; and
- Change the definition of "Eligible R&D activity" as systematic, investigative and experimental activity that:-
  - (a) involves both innovation and high levels of technical risk; and
  - (b) is for the purpose of producing new knowledge or improvements.

We do not, however, support proposals which:-

- Seek to apply an "additionality" rule to the availability of the R&D tax credit – we believe such a rule will have the practical affect of excluding corporate R&D projects access to the R&D tax concession;

- Require taxpayers to separately identify core & non-core R&D costs – we believe this would create much uncertainty, for both taxpayers and the Australian Taxation Office (“ATO”) leading to an increase in disputes, moving away from the simplicity of the existing system and ultimately decreasing R&D in Australia.

## **2.0 New incentive – 40% tax rebate**

We agree with the Government’s proposed 40% tax credit for companies with a turnover of greater than \$20 Million. This approach is simpler than the existing 25% additional deduction, plus the additional 175% deduction – the latter being complex to understand and calculate.

In order to allow all companies to access the 40% R&D tax rebate, it is imperative that companies that do not have assessable income in the year in which the R&D occurs, are able to carry forward the tax rebate. This will ensure that companies that continue their R&D activities during unprofitable years are not penalised.

## **3.0 Eligible R&D Activity**

### **Principle 5**

**The new R&D tax incentive should target R&D that:**

- (a) is in addition to what otherwise would have occurred; and**
- (b) provide spillovers – benefits that are shared by other firms and the community – that are large relative to the associated subsidy.**

Our views on Principle 5 are outlined below.

### **3.1 The “Additionality” requirement**

We believe the “additionality” requirement proposed is unclear, and may unintentional exclude many companies from accessing the R&D tax concession.

When is an R&D Project undertaken “in addition to what otherwise would have occurred”?

Many Australian companies undertake R&D projects within their existing operations to improve existing processes & products. Such R&D has the effect of improving worker & equipment productivity, employee safety, compliance with government regulations, reduced environmental impact of processes & operations, and improvements in technology leading to better products & services for the Australian community.

Would R&D projects undertaken by such companies be in addition to what otherwise would have occurred? Many of these companies carry out these R&D activities as they view these activities as beneficial for both shareholders and customers. Would such companies pass the “additionality” requirement? If not, this would lead to a large number of Australian companies not being able to access the R&D tax concession.

Based on the consultation paper, is it intended that the R&D concession only be made available to entities set up and operated for the sole purpose of undertaking R&D activities? If so, this will greatly restrict access of

the R&D concession for companies – a step we believe is not in the interest of corporate Australia, or the Australian community.

For example, a company that undertakes R&D activities in order to improve safety and operating conditions within the mining industry provides just as much value to the Australian community as the R&D activities of a company seeking to develop cures for diseases.

We expect that the R&D required for the creation of the technologies needed to reduce carbon emissions will be undertaken by companies currently operating in the energy industry. Such companies have both the knowledge and resources necessary to do the R&D. However, regardless of the vital nature of this type of research, the additionality rule could still preclude energy companies from accessing the R&D tax concession.

It must be recognised that Australian companies are, in many cases, best placed to undertake the R&D projects required to promote major technological change. In many cases, it is the profitable operations of these companies that fund the R&D activities. However, many companies still rely on the Government's R&D tax concession to reduce costs. Any uncertainty regarding access to the R&D tax concession will greatly reduce its effectiveness, and greatly reduce the number of R&D projects undertaken by Australian companies.

### **3.2 Creation of spillover benefits**

We agree that spillover benefits should be apparent in any R&D project. However, if such a requirement is to be imposed, the definition of "benefit" should be widely defined to include all possible benefits. Such benefit should include:-

- Financial benefits associated with the commercialization of the R&D, including increased production for the Australian operations, increased Australian & export markets, which leads to more Australian jobs, and additional tax revenue for the Australian authorities;
- Environment benefits associated with the R&D, including activities which seek to (a) assist entities to accurately monitor carbon and/or other fugitive emissions, and /or (b) create processes or products that assist in reducing carbon and/or fugitive emissions.
- Other benefits – for example (a) improvement in the safety and productivity of Australian workers, or (b) improvement of safety standards for products, which in turn provide improved safety for the Australian consumer.

### **4.0 Principle 6**

**Eligible R&D activity will be defined as systematic, investigative and experimental activity that:**

- (a) involves both innovation and high levels of technical risk; and**
- (b) is for the purpose of producing new knowledge or improvements.**

We support this amendment.

The majority of the R&D activities undertaken by our companies involve both innovation and high levels of technical risk, and are for the purpose of producing new knowledge or improvements.

We believe most R&D projects should be able to meet this requirement.

## **5.0 Principle 7**

**Supporting R&D will continue to be recognized under the new R&D tax incentive but claims will be subject to new limitations**

**Should supporting activities:**

- (a) be capped as a proportion of expenditure on core R&D? If so, what would be the appropriate proportion (for example 1:1)**
- (b) only be eligible where they are the sole purpose of supporting core R&D activity”**
- (c) exclude production activities or dual role activities?**
- (d) Only be eligible on a net expenditure basis?**
- (e) Attract a lower rate of assistance than core R&D? If so, what would be the appropriate rate?**

We oppose any proposal that seeks to separately identify & treat differently core & non-core costs associated with an R&D project.

Our reasons are detailed below.

### **5.1 Distinction between core & non-core unclear**

In many cases, we believe the distinction between core & non-core R&D Project costs is subjective. The distinction may depend on the project, and the activities undertaken by the taxpayer. Any rule that cannot be easily and objectively applied, leads to uncertainty. This will ultimately lead to an increase in disputes between taxpayers and the ATO - not a desirable outcome. Uncertainty of application of the R&D concession will ultimately prove to be a disincentive for taxpayers, resulting in reduced R&D activity.

### **5.2 Importance of non-core costs**

We do not believe there are reasons for treating core & non-core costs differently for R&D purposes.

Companies that seek to introduce new processes and procedures into their existing operations will have large non-core costs. When testing a new process within an existing business environment, the non-core costs will usually represent the costs of failure – because if the new process/product fails, the company will be required to rework or redo the process, which can prove very costly.

Hence, from an R&D perspective, such costs are no different to core R&D costs and should be treated the same.

### **5.3 Increase in compliance**

Requiring taxpayers to distinguish between core & non-core R&D costs will greatly increase compliance costs. Depending on the taxpayer's IT systems, recording core & non-core costs separately may or may not be possible.

Where the identification of such costs is subjective in nature – it will be even less likely that existing management information system will be able to split these costs.

### **5.4 R&D within existing production environment**

We do not believe R&D activities within a company's existing production environment should be excluded from the R&D tax concession.

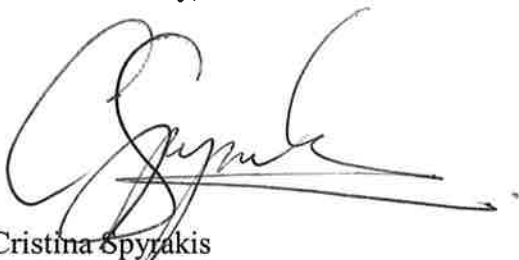
These R&D activities have enabled Australian industry to greatly improve its productivity, and bring better products and services to the Australian & international markets. In addition, many of the improvements in worker safety / protection in Australia are due to R&D activities of Australian companies undertaken in the production environment.

We believe the Government needs to continue to support such activities.

In summary, we see no reason why core & non-core activities should be treated separately from an R&D perspective. Such costs identify the total costs associated with the R&D activity, and as such should attract the same treatment from a tax perspective.

If you have any queries regarding the views expressed above, we would be happy to discuss these with Treasury staff. Please feel free to contact myself on 02 9266 2700.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Cristina Spyralis', with a horizontal line drawn through the middle of the signature.

Cristina Spyralis  
Group Taxation Manager  
Centennial Coal Company Limited