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# The New R&D Tax Incentive
# Submission to Consultation Process

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**Inventure R&D Tax Pty Ltd is a specialised consultancy business, which focuses on delivering R&D Taxation Concession advice and services to enterprises throughout Australia, although with a strong focus on the South Australian SME community**

**The value proposition of Inventure is to assist enterprises that have either no knowledge of the R&D Tax Concession system, or lack the skills and/or time to properly configure their R&D plans and activities.**

**Inventure R&D Tax is aligned with Inventure Partners Pty Ltd, Australia's most prolific and successful facilitator of innovation grant outcomes (R&D Start, Commercial Ready, Climate Ready), who have managed over 200 supported applications valued at over $275 million.**

**Inventure R&D Tax advises in excess of 100 R&D tax registrants annually, ranging from small manufacturing companies, to large corporations with substantial R&D in house resources. In addition, Inventure works with many accounting firms, as a specialist provider of expertise relating to R&D Tax, adding value to their client base.**

**Inventure considers itself a relevant and interested party in the analysis of the proposed R&D Tax Credit system.**

## Preamble

Given the importance of R&D to the overall productivity and growth of the Australian economy as a supplier of technology, IP and knowhow to the world, rather than as simply a supplier of manufactured goods, any methodology that sustainably seeks to increase this activity amongst small and medium sized enterprises is valuable to the economy.

Inventure absolutely supports the spirit of the proposed R&D Tax Incentive and what it seeks to achieve.

The newly proposed R&D Tax Credit system will better target small and medium enterprises, who are the most responsive to fiscal incentives and who are arguably, a solid source of good quality innovation that is free of the inertia that tends to be a hallmark of larger organisations.

The proposed increase in benefit to these organisations will result in a greater overall level of activity and the requirement for innovation and technical risk together will provide a practical bar to test the efficacy of the proposed R&D for which an incentive is sought.

At its core, Inventure considers that the R&D Taxation Concession in its present form, but more so from its analysis of the proposed new R&D Tax Credit is, ostensibly, a leverage program where the objective is to enable a registrant to mitigate some of the financial risk associated with an investment in R&D.



Based on this observation, the notion of leverage necessitates that the incentive must exist in order to trigger an R&D investment in an amount, scale or speed that would not ordinarily have occurred in the absence of the incentive.

In addition, many R&D Tax registrants access the program after the commencement of the R&D project and often without any initial intent to make use of the R&D Tax Concession. This is mainly due to a lack of awareness of the program from the outset, or from poor advice as to its applicability.[1]

In this instance, the R&D Tax Concession is not stimulating investment in R&D that would not have occurred if the R&D Tax Concession did not exist.

It is present form, the R&D Taxation Concession, in the main, is NOT a leverage program because of several factors that could be addressed and resolved through the proposed R&D Tax Credit program.

The following is a series of comments specifically relating to some of the practical aspects of the proposed scheme and how it may be applied in the market. The suggestions are based on a combination of the extensive experience that Inventure possesses in relation to the preparation and submission of the R&D Tax Concession scheme and the extensive experience of Inventure staff in the administration of Companies that undertake R&D and technology commercialisation activities.

In order to ensure that the R&D Tax Credit becomes a leverage program with a higher level of strategic intent and budgetary control, the following could be considered:

## Registration Timing & Format Recommendations

That the format for registration for the tax concession vary from the current approach and be made mandatory, prior to the eligibility of R&D expenditure sought to be claimed under the tax concession.

In this situation, expenditure can be self assessed as eligible by the claimant from the date that a registration is made, however this expenditure will be at the risk of the claimant until such time as a registration number is granted to the claimant.[2]

Such a process would translate to evidence of a greater linkage between the R&D activities and the Tax incentive

## Innovation and Technical Risk

Inventure considers that the proposed changes to the definition of R&D that necessitates the existence of both innovation and high levels of technical risk within the activities for which a tax concession is sought, is a positive development subject to several conditions.

On the basis of Inventure's experience, it is clear that a lack of understanding of the principles of innovation and/or technical risk has caused difficulty for organisations

[1] It is noted that in these cases the business often does not have a dedicated R&D Plan as per the requirements of the Act, however these organizations possess business plans that detail the R&D activities prior to commencement.
[2] It is noted that the act of registration being granted does not translate necessarily to either AusIndustry or the ATO considering the expenditure or the project to be eligible



seeking assistance through the current R&D Tax Concession Program. Furthermore, from Inventure's experience, this lack of understanding also exists in the accounting community, the core advisers to prospective R&D Tax registrants.

The requirement for both innovation and technical risk to be effectively demonstrated in the R&D Plan will potentially cause both prospective registrants and their advisers' substantial difficulty, if the test for these parameters is not effectively described.

For example, page 10 of the Consultation document provides an illustration of innovation as:

*"The device was innovative because it was novel."*

Those who have been involved in patent applications appreciate that the test of novelty is one that has occupied capable minds for long periods without satisfactory resolution of what novelty really means. The additional inference is that unless the innovation could result in a patent application, it is not in fact innovative. There are many innovations that are not in fact novel and the submission of a patent application is not all related to subsequent grant, which can take many years to prosecute. Accordingly, a Company could argue that there is innovation because a patent application has been lodged, when in fact; the application could have no prospect of ever being granted.

Technical risk is more simply defined as per the same example on page 10 of the document:

> *"The activities involved technical risk as a solution was not predictable from current knowledge."*

The notion of technical risk is more easily defined and understood, by comparison with innovation, provided that the issue of "current knowledge" is clearly defined.

Technical risk and novelty go hand in hand to the extent that to R&D a novel outcome, there is inherent technical risk. To this extent, a qualifying test of whether an R&D project is eligible for the concession could be the existence of a novel outcome through the deployment of a SIE method as demonstrated through the R&D Plan and registration documentation.

The same does not follow with technical risk in isolation of innovation, which should still be considered R&D, provided that the focus is on the creation of new or improved products, systems, processes, etc through the deployment of SIE activities and where there is a practical advance on the technological state of the art.

While a project itself may have an innovative outcome, achieved through SIE activities with technical risk, the activities themselves, in isolation, may not present innovation, other than the realisation or achievement of milestones, which in themselves, are the building blocks of the ultimate innovative outcome.

That under the new Tax Credit system there will be a resistance by the accounting profession from the 2nd tier firms down to provide advice or make a determination on the qualitative aspects of innovation and technical risk due to the prospect of



AusIndustry reviews reducing or disallowing claims, which would result in clients being faced with a potential reversal of benefits received.

## R&D Existence Test Recommendations

Improved use of worked examples demonstrating the boundaries of innovation and technical risk that are acceptable (or unacceptable) under the proposed scheme would deal with this issue effectively and provide a level of clarity to Companies who are contemplating R&D activities and whether they would comply with the requirements.

The presence of a patent application, or independent IP advice, should be seen as compelling supporting evidence, but not in itself pivotal to the demonstration of the presence or absence of innovation.

Inventure suggest that many potential issues can be resolved through changes to the R&D Tax registration forms. A requirement for greater planning detail, particularly a detailed major activities table that requires detail on the technical challenges and innovation within each activity of each milestone should be included.

It is possible that this could mirror the format of the Major Activities Table contained within the Commercial Ready Grant and Climate Ready Grant Application form.

The R&D registration form itself could be further modified to include a series of questions (with a choice of pre-determined responses) to test the presence of innovation and technical risk.

The responses could be used to generate an automated response on the veracity of any application that was to be subsequently submitted by an entity.

Indeed, the responses could be expanded to ensure that questions relating to grouping, turnover and company structure were included as part of the initial self assessment process that could occur prior to any submission being made for support under the proposed scheme.

Inventure has developed and actively deploys a tool specifically designed for the suggested pre-qualification process described above. Inventure routinely utilise this tool (termed i-Point) which has the following basic functions:

- Companies can self assess their capacity to meet the requirements for the R&D Tax Concession (or other Grant facilities that exist), without obligation, or providing their details to Inventure unless and until they choose to do so.
- Companies can ‘hone’ their proposed project, based on the responses from i-Point, to ensure that they are optimally positioned in terms of the Grant facility requirements.
- Once in a position where they are ready to apply, Companies can provide the base information that will be necessary for an application to be made, without wasting time in meetings or travelling.



## Supporting R&D

Under the current R&D Tax Concession many registrants do not realise that supporting activities can form part of their overall cost of performing R&D. It is clear that some applicants from specific sectors have a very good grasp of this issue and this appears to have driven the proposed scheme to attempt to limit the scope and extent of the cost of supporting activities.

It could be argued that attempting to limit the extent of supporting activities as a percentage of the overall spend or capped as a proportion to core R&D will not provide the desired effect. Immediately, the concept of 'core R&D' is introduced, increasing the complexity of assessing compliance and potentially, giving rise to extraneous effort in relation to proving the extent of 'core' (and therefore 'non core') R&D.

## Recommendation

If a Company is able to demonstrate that it is undertaking compliant R&D with the required levels of innovation and technical risk as per the suggestions detailed previously in this submission, should they not be able to claim those activities that support the performance of this R&D?

If it is 'good' R&D, why not make the benefit available to Companies, taking care to provide definitions of what are acceptable supporting activities, as part of the worked example process suggested?

Perhaps specific market sectors (known to be the source of concern in the past) could have their supporting activity scope limited to a percentage of core R&D, provided that there are industry specific examples to illustrate the intent.

The introduction of notions such as 'core R&D' and 'sole purpose' will look and feel like Tax Office driven measures and we need to face the fact that the Tax Office spends an outrageous amount of time in the definition and policing of these definitions. The yearly tax guide book should provide all the evidence necessary as to why the proposed R&D Tax Incentive scheme should not go down the road of introducing petty definitions for the sole purpose of 'grabbing back' money from the very groups the scheme aims to assist.

The current list of excluded activities, are generally, in the opinion of Inventure, consistent with the spirit of the proposed incentive scheme. Market research, QC, prospecting, pre-production etc are not in the main directly related to R&D. In many respects they can be inputs to the decision to undertake R&D or, are the result of R&D being undertaken.

Depending upon how the issue of innovation is dealt with, it may be worthwhile to consider admitting some of the costs associated with patent lodgment. This will require some controls to be set in place, as suggested below.



Providing assistance to Companies that have undertaken effective R&D that does result in the firm prospect of patent lodgment, could conceivably take the form of admitting some of the functions of patent as supporting activities.

Rather than attempt to support the patent lodgment process in general, the support could be provided in the form of allowing the costs to assess patentability (patent attorney fees associated with assessing the patentability of the innovation, extent of novelty and searches for prior art).

The effect would be:

- To contain the cost, make the patent process more accessible to Companies and possibly create some competition around the assessment process, which arguably does not exist currently.
- Increase overall awareness amongst SMEs in relation to patentability, costs and the patent process. This is especially important in terms of prior art and the notion of disclosure prior to lodgment of patent applications.

Otherwise, the exclusions as they current stand are thought to be relevant.

Inventure suggests that contract arrangements between applicants and Era's to be treated as core activities to stimulate connectivity between business and the research community.

## The R&D Registration Process

Assuming that the legislation is successful and the R&D Tax Incentive Scheme includes the requirement for both innovation and technical risk, there is a very real outcome of a percentage of R&D registrations failing. The major reason for this is that the 'test' for innovation and risk is not applied at time of registration and hence, there is scope for a lack of definition and understanding, especially if the notions of innovation and risk have not been clearly specified using examples and other methods as discussed previously.

There are practical limitations to applying a test at the time of registration, since AusIndustry does not have the human resources to assess each application in sufficient detail to effectively establish compliance. However there needs to be a level of certainty in the registration process for obvious reasons and this has been a problem observed with the application process associated with Grants such as Commercial Ready and in particular, Climate Ready. There have been a number of examples observed where Companies have undertaken significant work to prepare an application (often 150 hours +) only to be informed after some months, that " the application was not thought to contain a significant level of technical risk."

It is true to say that this is not the only reason for the failure of the application, but it is clear that the failure to effectively assess this measure up front was an area where the process could be improved and in any case, certainly appeared to be somewhat subjectively assessed in each case.

## Recommendation

As per Section 1 of this report, Inventure has a number of computer based evaluation processes in place. Termed i-Point and i-Mods, these processes have been specifically designed to assess these and other measures, before the point where significant works have been undertaken.

It is suggested that tools such as these could be applied to the registration process as discussed below:

- Potential applicants could self assess before making an application to 'hone' their project and increase the necessary levels of understanding regarding innovation, technical risk and systematic experimentation, contemporaneous record keeping etc.
- Applicants would be required to outline the major tasks within the R&D plan and through pre-set questions, with pre-set responses, detail the level of innovation and risk resident within the project.
- At time of application, responses could be grouped in terms of perceived risk from an ATO/AusIndustry perspective, for further questions or random audit; in much the same manner as is undertaken for offset applicants currently.
- The level of understanding in relation to innovation, R&D methodology, record keeping standards etc would improve, as applicants would be required to make statements in relation to their readiness, the existence of the R&D plan and records in a manner more effective than the current system requires.



## Summary & Conclusions

It can be seen from the discussions above, that Inventure supports the spirit of the proposed R&D Tax Incentive and what it seeks to achieve. In general terms, the suggestions proffered are of a procedural nature only, designed to facilitate access to the program by eligible companies.

There is an excellent opportunity to ensure that the proposed legislation builds upon the progress made from the current scheme, not only in terms of efficacy, but also in terms of accessibility and ease of use from the perspective of the ultimate Customer of the scheme.

Inventure are more than prepared to discuss any aspect of this submission in detail, should the need arise, including a demonstration of the utility of tools such as i-Point and i-Mods. Please refer to the contact details shown below:

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