GSM CONSULTING PTY LTD
13 The Greenway
ELANORA HEIGHTS NSW 2101
Phone (02) 9913 9321 Fax (02) 9970 6464
ABN : 86 137 744 702

October 19th 2009

Dear Sir,

I am afraid I can find little that is positive in the consultation paper regarding the R&D tax concession.

The consultation paper (CP) seems more akin to a dictate rather than a consultative document seeking constructive comments and it has lost its way. It's main purpose seems to be a cost cutting exercise . It ignores the main purpose to support and encourage business or industrial R&D and encourage increased levels of such activity in Australia.

To comment on the effectiveness of cutting costs is inappropriate when the need is to encourage further R&D in Australia . I will therefore limit my comments on any detail of the CP to an attachment.

The visionary R&D tax concession introduced circa 1985 sought to provide support for business R&D and address the low levels of Australian business R&D investment and activity when viewed as a proportion of Australian GDP. The tax concession was a leader in providing such support and recognising the benefits of supporting a current cost of R&D for a long term benefit . It also recognised that the base tax structures failed to provide effective support and encouragement for R&D in the Australian environment. It sought to assist overcome balance of trade deficits .

The tax concession has been successful in stimulating business R&D in Australia but it's competitive advantage has been reduced by the actions of other countries who also recognised the need to introduce support for business R&D appropriate to their own situation .

The Australian Financial Review of 9 October 2009(AFR 9/10) reports that Australian R&D of $14.4 billion in 2007-08 was 1.27% of GDP and below that of the average for the OECD of 1.59%.. It also reports a manufacturing trade deficit of $102.6 billion of which $72 million was in “Manufacturing and Equipment ‘ and “ Transport Equipment”.

The recent NIS recommendation to retain the thrust of the R&D tax concession although with some structural change included the recommendations to increase the level of support to the equivalent of 150% for small companies (while cutting out the 175% premium support), and to increase the size of company able to take advantage of the cash back facility within the tax concession. Such support could assist increase levels of R&D and in the long term assist reduce the trade deficit .

The CP attempts to reduce the base to which the R&D support applies and minimise the access to the cash back facility. The CP proposals will do nothing to encourage or support increased levels of R&D in Australia. They will do nothing to address Australia's comparatively low level of R&D compared to the OECD average .

For example the CP imposes a constraint on the level of ongoing support for R&D which does not appear to be part of the NIS report . This constraint appears in para 14 of the CP " The R&D tax Incentive is to be Revenue neutral for the first four years of operation. "

This constraint combined with a growing economy means a reduction in R&D as a percentage of GDP. Hardly compatible with any aim to increase that level in Australia, and the constraint will be effective in nullifying the thrust of the NIS to encourage additional levels of R&D in Australia.

There seem to be greatest emphasis placed on reducing the current costs to Government but ignoring the adverse long term consequences of such action. The attempts to cut out perceived excessive large claims seems to dominate the thinking behind this paper when in contrast there is a critical need to look for ways to encourage and support greater levels of R&D in Australia . It seems likely that if implemented these proposals will ' throw the baby out with the bath water' and reduce the levels of R&D in Australia. . Quite the contrary to the action required.

There would be a major benefit in going back to the original scheme to use the same rules and guidelines of the original 150% tax concession with a small change to a tax credit and cash back facility for companies with turnover less than $50 million

Yours sincerely,

Geoff Stearn
Managing Director
GSM C0ONSULTING PTY LTD

ATTACHMENT

COMMENTS ON CONSULTATION PAPER SEPTEMBER 2009

Principle 3 – The NIS seemed to recommend refundable tax credits for group turnover less than $50 million , not the reduced $20 million level in the CP.
Why the reduction?

REFUNDABLE R&D TAX CREDITS – Payments to Assosciates Question 3.

COMMENT Trying to add a mix of cash and accrual accounting is too complex. Attempts to address every anomaly can only lead to excessive complexity and should be avoided.

ADMINISTRATION

Para 46 & 47which seems to suggest more rather than less complexity and uncertainty for companies seeking to obtain support from the tax concession.
COMMENT – Keep the old definition.

ELEIGIBLE R&D ACTIVITY

Target and paras 48 & 49 – COMMENT The targets of "additionality and spillover" are NOT practical . They may be in the parlance of theoretical economics but are not part of the parlance of commerce. Their use will not provide any basis for companies to determine their eligibility for R&D, nor provide any encouragement or incentive for companies to undertake R&D.

Para 50 – COMMENT . It sets out the true purpose of the paper to cut costs – "the Government cannot afford to proceed with the incentive at the current rates and turnover threshold".-
This appears to be the real purpose of the CP

The next several paragraphs include various attempts to effect a reduction in the level of support for R&D The instances of inappropriate concepts are numerous. Some comments of just a few are set out below.

Para 50 notes correctly that "previous attempts to tighten the definition of R&D have been contentious". The attempts in CP to tighten are not only contentious but also potentially destructive to much R&D being undertaken in Australia.
The existing definition (Para 51) has and continues to provide a good definition of R&D in the Australian context.

Para 54 ignores the benefits to employees of undertaking such work in Australia rather than overseas. It ignores the benefit to Government of Income tax , payroll tax etc plus the long term benefit of IP in Australia.

Principle 6 seeks to define R&D as" Innovation <u>AND</u> Technical risk " rather than "Innovation <u>OR</u> Technical Risk".

COMMENT This change has been proposed by Government in the past when the problems with it have been pointed out by business and it has been rejected. The same problems remain and it should again be rejected.
.
55 – COMMENT - why look to the definitions of the USA and UK?. The situation prior to 1985 showed that without support or in a “level playing field “ much R&D would be undertaken overseas rather than in Australia.

56 - COMMENT _ the suggestion that the approach to supporting activities will be more stringent can only dis-encourage R&D Activity in Australia .

57 The writer of the CP seems unaware of the major costs of taking a novel concept into one of practical reality. There can be major benefits if successful for company and country . But these will only be obtained in Australia if the costs are supported here .

58 In many cases Supporting activities are critically important to the outcome of the R&D . The core activities need those support activities if a conclusion is to be reached. The main rewards for both company and country will only be forthcoming if those supporting activities are undertaken in addition to the core activities. Attempts to cut support for “supporting activities” risk cutting the potential rewards by a multiple of the costs which may have been saved. Thus the effects are negative .

The attempts to justify cutting out supporting activities in the next paras up to 70 are misguided and seem based on the aim to reduce costs rather than support R&D in Australia. Undertaking Core activities without supporting activities can be cheaper but will in many cases not produce most of the rewards

If the Australian R&D definition and support are similar to those in USA, Europe and UK much of the R&D will be undertaken in those countries further increasing the level of imports into this country

Software – paras 73- 77 . COMMENT Yes there is a need to review the multiple sale criteria for software and to expand the eligibility criteria to make the support more broadly accessible . There are huge sunk costs of development of Software which require major investment . Those funds have to be used to pay the R&D costs in which there is a high labour component . Those salaries are taxed through income tax and swell Government coffers . There would thus seem to be good reason to continue to support the R&D associated with software

However the thoughts to restrict the access to the criteria used in the UK would be counter productive. There are many reasons for companies to undertake their software development overseas including lower salaries . I am aware that there are many UK resident computer specialists who cannot obtain work in the UK who say that the industry has moved out of the UK . So I do not think it is sensible to look at how it has supported it’s computer and software industry.

SUMMARY – COMMENTS

I can find little in the CP to support the words in the summary . The proposals in CP appear to seek to reduce the support for R&D , and propose a number of complexities for the application of any support which might be available

In contrast a summery which said this document sets out a plan to slash levels of R&D support using complex rules would seem a better conclusion.