

**General Manager
Business Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600**

26 October 2009

Dear Sir

Submission on Research and Development Tax Incentive Consultation Paper

Introduction

GBC Scientific Equipment Pty Ltd (GBC) is a designer and manufacturer of scientific equipment based in Dandenong, Victoria. The company has been producing quality equipment for over 30 years for domestic and international markets. GBC is a major manufacturer of analytical instruments and continues to employ Australia's leading specialists in elemental analysis. GBC continues to be highly innovative with many awards recognising their commitment to research and development excellence by creating products of a superior standard and world excellence.

The company is represented worldwide by one of the largest distribution networks ensuring that the Australian designer and manufactured products are available for sale in the 100 plus international countries. GBC continues to research and develop technology to create new equipment to maintain their eternal vision of enhancing the quality of life for all humankind.

GBC welcomes the Government's initiative to make significant changes to Australia's Research and Development tax incentive following the findings of its review of the National Innovation System detailed in its report of May 2009, *Powering Ideas*.

We support the reform objectives of making the new R&D tax incentive more effective in delivering support for business R&D, in targeting that support to where it is most likely to produce net-benefits for the Australian community and, just as importantly, making the rules less complex to understand and more predictable in their application.

Tax credits in lieu of deductions

In this regard, we firstly acknowledge the justification for replacing the current scheme of enhanced deductions with a simplified system of tax credits at rates designed to compensate for the loss of the 175% premium for increased R&D expenditure.

We also support the Government's recommendation to enable companies to report the R&D credit "above the line".

The ability of smaller enterprises to access a 45% credit, with their unused credits being cash refundable, will better ensure the ultimate effectiveness of the incentive for those enterprises. The higher turnover threshold of \$20 million rather than the current turnover threshold is also welcomed. We suggest that this threshold be indexed so that the level of incentive is maintained and that it does not become outdated as occurred with the current tax offset threshold.



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Change of R&D definition

On the other hand, we question the rationale for the proposed changes to the current R&D definition and, without a very strong and compelling rationale, there is a greater risk, in tampering with the definition, that it will only generate unwarranted confusion, uncertainty and unpredictability.

R&D tax incentives have been effective for us and assisted the funding of our R&D activities which has underpinned our company's growth and development. However, we are concerned that the radical changes proposed will adversely impact our ability to utilise the benefits of the incentives in furthering our R&D and its commercialisation.

We strongly believe that a cornerstone objective of Australia's R&D incentive should be to encourage R&D activities within Australia in order to, amongst other things, make eligible enterprises internationally competitive. Modifying and narrowing the definition is likely to have an adverse impact on encouraging investment in R&D in Australia and in today's global community, companies can choose to undertake R&D under more advantageous regimes elsewhere.

We do not agree that any sufficiently compelling case has been made out for either the replacement of "or" with "and" in the "core" R&D definition nor for any of proposed changes to the "support activities" definition, most of which are extremely arbitrary and potentially discriminatory as between industry segments. Nor do we agree with the statement that "the absence of either of these factors reduces the likelihood that the activity will produce spill over benefits in the addition to what would otherwise occur". The current principle of innovation or technical risk should continue to apply. The definition of R&D should apply to the project as a whole rather than to an activity or element of the project.

We believe that the Government's desire for revenue neutrality will be achieved through the abolition of 175% premium deductions, and therefore the changes to the definition are not necessary or warranted.

In response to the changes to more stringent rules to the definition of supporting R&D, again these changes should not be overly complicated and time consuming with administration. This equates to more administrative time and cost for SME's.

Regarding supporting activities, the activities should be capped as a percentage of expenditure on R&D for example, 1:1 ratio. For SME's it may be appropriate to fix the ratio without supporting documentation such as applied under the R&D Start Grants Scheme. This would reduce the administrative burden significantly.

A final change and significant issue for GBC is the changes to software development. GBC regards software development as a branch of engineering, not as an IT activity. In our industry software performs an essential instrument control and necessary algorithm function and therefore petition for the rules in respect of software development be the same as those for other R&D activity.

Overseas Activity

GBC has found in the past that the required expertise does not necessarily reside in Australia for some aspects of advanced technology and we have had to contract some of the R&D activity to an overseas party. An example of this was aspects of the development of our Time of Flight Mass Spectrometer. This knowledge and expertise was ultimately transferred to the benefit of Australia.

The ability to access tax incentives for R&D activity undertaken overseas should therefore continue to be available. We also recommend that this be part of a normal self assessment process, as for R&D activities undertaken in Australia, rather than the current separate pre-approval process.

Our view is that the resultant production (i.e. the outcome of the R&D activity) should be carried out in Australia or that some return, say licence fee income, be accrued to Australia should the production be moved offshore.

Administration

In the case of a company like GBC, we believe the administration and compliance of the R&D tax scheme should not be overly complicated. This should be the same for other ATO regulations. For a Small to Medium Enterprise (SME's) with limited personnel and financial resources, complexity can be a significant issue. Educational material should be made available on a timely basis and a publication such as the 150% R&D Tax Incentive Guide to Benefits published in 1994 would be of enormous benefit.

Incentives for exports

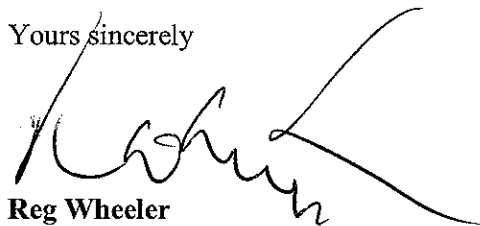
Each year GBC continues to export over 90% of all equipment manufactured in Victoria. Not only does GBC contribute to the Australian economy by providing employment opportunities and advancement of knowledge within the community, it also contributes to the export earnings. Accordingly, a higher rate of R&D tax credit would be desirable where export revenue is in excess of a specified percentage of sales, for example 75%. After all, Mr Rudd did state before the last election that he did not wish to be a Prime Minister of a country that did not have a manufacturing industry.

Conclusion

The R&D Tax Concession has worked extremely effectively for 24 years. Whilst we understand the need to address some occasional unintended consequences of large expenditure claims, the changes proposed have the potential to undermine the entire regime. Certainty is very important, particularly within a self-assessment system. Any fundamental overhaul of the definition will create uncertainty and defeat the purpose of the incentive program.

Should you have any queries, please do not hesitate to contact me.

Yours sincerely



Reg Wheeler
Financial Controller
GBC Scientific Equipment Pty Ltd