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Feedback on the new research and development tax incentive

I have read through the September Consultation Paper and offer my input.

The benefits of the R&D tax changes are positive when compared with the current R&D tax incentive. However the fact is that for start ups the refundable tax incentive is actually also replacing the AusIndustry R&D grant schemes which were removed last year as a related outcome of the same NIS Review.

I should say up front that my views here are totally biased in favour of the small local start up, and are flavoured by my experience over the past twenty five years investing in local ICT product/technology development ventures with the object of (and occasional success in) local wealth creation. Over this period I have seen the variously named federal R&D grants successfully form the funding cornerstones for entrepreneurs starting new ventures or for existing businesses looking to venture down risky R&D side-roads. Now I know there a question as to whether such grant schemes actually had significant industry development impact, and I accept that times have changed with angels the start of a VC community here, and I do see great value in funding paths that are more predictable ... but I believe it is important that the tax department look at your questions and principles from the perspective that this new R&D tax scheme also really is displacing grants (whereas last year they complimented the grants). So it is essential you focus also on maximizing the benefit to smaller start up ventures who were getting grants before.

One simple way to ensure maximum benefit is realized is to **keep the new scheme as simple as possible**, with as low transactions costs as possible.

The current R&D tax scheme does not do this effectively as it is both high cost and low benefit. Most small ICT start up firms that I am aware of (and I have a stake in a swag of small companies and mentor a bunch of others) currently retain a consultant to register with AusIndustry and lodge for them the R&D tax refund etc ... and often a very large percentage of incremental benefit they receive goes straight to the consultants. Now these start ups are invariably in the cash burn investment phase (generally revenues under \$1M) so it the cash benefit of the R&D tax refund that is the key success contributor. My input here is that the Government should have a goal that the scheme be simple enough that 90% of the small firms can register/ lodge returns and get refunds using their normal tax advisement services (eg their accountant) with the need of extra consultants.

Also to be effective it would be worthwhile having performance goals on processing times for lodged applications (for refunds) so the cash is in hand ASAP

So to this end I would be most pleased to see Principle 4 (*efficient and effective administration*) become Principle #1 ☺



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I have embedded my response your Questions in the attached table.

Hope you find some value in my input

Regards

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Design questions		
Question 1	Should there be any exceptions to the general rule that eligible R&D activity must be conducted in Australia?	No. For smaller start ups this will have little benefit. Also I do not believe other countries (eg USA) see any need to subsidize/stimulate offshore R&D so cant understand why Australia would.
Question 2	How should the new R&D tax incentive treat R&D expenditure that is currently deductible at 100 per cent?	
Question 3	Should payments made to associate entities only be eligible for the new R&D tax incentive where they are paid in cash?	No this would not be a positive decision. Commonly start-ups engage associated firms (eg contractors who have invested in them etc) in their R&D activities and it would be a burden to make such small firms have to identify if the expenditure is to a related party and then to have to separate out cash expenditure from accrued expenditure and then track this from year to year. You would really want to be certain there is a real issue of magnitude here if you are seriously looking at adding this sort of complexity.
Question 4	Should supporting activities: (a) be capped as a proportion of expenditure on core R&D?(i) If so, what would be the appropriate proportion (for example, 1:1)?(b) only be eligible where they are for 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? (i) If so, what would be the appropriate rate be?	<p>This is one of the areas where if the legislation and rules are complex then you will by default be will necessitating engaging specialist consultants and as a result reducing the effectiveness of the scheme (i.e. failing Principle 4(1)).</p> <p>So chose whichever combination of 'a-d' that works best. A cap for supporting activities makes sense now you are opening this incentive to foreign firms. And please don't choose 'e' which seems to be just unnecessarily complicating the task.</p> <p>But most importantly for your smaller applicants (the under \$20M band) have a simple option where applicants can allocate a default proportion of the core R&D spend (and make this a modest allocation - say 25-30%) as supporting activities which are claimed at the R&D tax incentive rate</p>
Question 5	Should the current list of activities excluded from being considered core R&D be:(a)amended in any way?(b) extended to exclude such activities from being considered supporting activities?	No input
Question 6	How should the new R&D tax incentive treat software R&D?	<p>I agree the current definition of software R&D is dated and needs review and the various stakeholders (industry, govt Ausindustry and Tax folk etc) need to actively engage in creating an updated appropriate definition.</p> <p>But it would be unwise to try to rush anything through here. So I would recommend this issue should not be connected to the R&D tax incentive changes (which have a very short time to closure) and the new R&D tax incentive should continue to treat software R&D as it does now.</p> <p>I also recommend we look to USA definitions of software R&D as that is a country with a successful track record in spawning software R&D and deriving immense national wealth (and taxes) from there software R&D endeavours (c.f. UK which has not been significant at all in this space).</p>