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

12 November 2009

Dear Sir

Submission on The New Research and Development Tax Incentive Consultation Paper

I am making this submision on behalf of the Winemakers' Federation of Australia in response to the *New Research and Development Tax Incentive Consultation Paper* released in September 2009.

The Winemakers' Federation of Australia (WFA) is the peak national body representing wine enterprises of all sizes across Australia. Voluntary membership represents in excess of 95% of wine production in Australia. It develops policies and programs for the whole industry on a range of political, social, environmental, trade and technical issues with both a national and international dimension.

Wine is an important industry in Australia, contributing significantly to a number of regional economies and directly employing some 28,000 people in both winemaking and grape growing (2006 Census), with further downstream employment in retail, wholesale, hospitality and tourism industries. The Australian wine industry is comprised of approximately 8,000 wine grape growers supplying over 2,000 wineries. In 2007, the total vineyard area reached almost 164,000 hectares. Wine grapes are grown in all states of Australia, with South Australia, New South Wales and Victoria accounting for the majority of production.

The rapid expansion of wine production in Australia over the last decade combined with a small domestic market has seen the Australian industry become increasingly export oriented. Australia exports wine to 104 countries, and has an eight per cent volume share of global wine exports. In 2007 wine exports totalled a record 787 million litres with an estimated value of $2.9 billion which accounted for around 10 per cent of Australia's agricultural exports. These wine export volumes currently represent almost 60 per cent of Australian wine sales and make Australia the world's fourth largest wine exporter. This is despite Australia's wine production accounting for only four per cent of total world production. Approximately half of Australia's wineries currently export to overseas markets.

The wine industry has been a success story for Australia but times and conditions are changing. Volatile currency markets, aggressive competition from new market entrants, limited loyalty to Brand Australia, water restriction and quality issues, and a harsher climate have all resulted in challenges that were not expected twenty years ago. Robust and practical research is needed to assist the industry maintain and grow its importance to the Australian economy.

We welcome 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.

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".

Standard rules for carrying forward unused 40% credits is regarded as appropriate. Furthermore, 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 key proposed changes outlined in the Consultation Paper that concern us are:

- Principle 6 - the adoption of an 'and' rather than an 'or' test, with the need for R&D activities to involve both innovation and high levels of technical risk rather than either, and
- Principle 7 - potential limitations to supporting R&D activities.

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 our industry and assisted the funding of our R&D activities. However, we are concerned that the definitional changes proposed will adversely impact our ability to utilise the benefits of the incentives in furthering R&D and its commercialisation. 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.

Therefore, we do not believe 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.

These key principle changes will have potentially negative consequences for certain industries in comparison to others, there are practicalities of implementation, and difficulties in distinguishing "core" from "supporting" activities. Further, there has been a lot of time spent on the consideration of changing the actual definition of R&D from an activity level to a project level.

There are also potential benefits in the Consultation Paper, with the adoption of the Refundable R&D Tax Credit (Principle 3) likely to increase the opportunity for smaller, mid tier wineries to receive a cash refund for R&D activities, provided the above definitional issues are resolved favourably.

Overriding the above issues is the requirement for the new R&D tax incentive be revenue neutral over its first four years, rather than providing an increase in funding for the new R&D tax incentive given the current economic climate.

In conclusion, the R&D Tax Concession is a major plank in making the wine industry internationally competitive. 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. Any fundamental overhaul of the definition will create uncertainty and may defeat the purpose of the incentive program.

We are happy to talk through the Consultation Paper with you or at a later date discuss the proposed legislation.

Yours sincerely

Tony Battaglene
General Manager
Strategy & International Affairs