

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

Varian Australia Pty Ltd  
A.B.N. 67 004 559 540  
P.O. Box 222 Clayton South 3169  
679 Springvale Rd Mulgrave 3170  
Victoria Australia

Phone: +61 3 9560 7133  
Fax: +61 3 9560 7950

<http://www.varianinc.com>



**VARIAN**

By email: [rdtaxcredit@treasury.gov.au](mailto:rdtaxcredit@treasury.gov.au)

26 October 2009

Dear Sir/ Madam

**Submission in relation to the Treasury Consultation Paper – “The new research and development tax incentive” – September 2009**

Varian Australia welcomes the opportunity to make this submission in relation to the above Consultation Paper released by Treasury on 18 September 2009.

Our company has been a claimant of the R&D tax concession for more than 20 years and our intention is to continue to claim. We are also a past recipient of an AusIndustry R&D START grant and have been able to demonstrate the significant and ongoing benefits of the R&D funded by this grant to Australia.

The current R&D tax concession is an important part of the company's decision making process both in the projects that it will support and the way projects are funded. R&D is integral to the commercial success of the company and we encourage the Government to continue its support of the program.

In this letter, we will be focussing on those principles and questions that are relevant to our circumstances. Our company in Australia can be characterised by:

- Significant % of investment to sales devoted to R&D
- Significant % of employees devoted to R&D and commercialisation of new products
- Substantial employer of science and engineering graduates.
- Substantial payer of tax in Australia as a result of our activities
- Extremely high percentage of manufactured products exported
- Global marketing, R&D and manufacturing on one site
- Substantial subsidiary of multinational company

We stress the importance of simplicity, clarity and ease of administration, for both claimants and Government. Any changes made from this Consultation Process should result in additional funds for R&D and with a minimalist approach to administration including costs of administration to the recipient Companies. We will begin by bringing some context into our response by way of our company's background.

**Varian, the company**

Varian Australia, a subsidiary of Varian, Inc. – a global technology leader, specialises in the manufacture and export of hi-tech scientific instruments from its Mulgrave, Victoria plant. It has a staff of more than 400 skilled people and is involved in research and development, manufacturing, marketing and sales of seven different world leading analytical instrument technologies that are for use in the world biotechnology, industrial and environmental sectors. The Melbourne head office of Varian Australia generates annual sales in excess of \$190 million and exports over 92% of its total output. In 2008, Varian Australia passed \$2 Billion in cumulative exports.

In 2008, for the first time, Varian Australia started exporting two new generation analytical instruments designed in Melbourne; Fourier Transform Infra-Red (FT-IR) Spectroscopy and High Performance Liquid Chromatography (HPLC). FT-IR Spectroscopy is a \$400 million per year market and HPLC is a \$1 billion per year market globally. Varian realised considerable growth in emerging markets such as Pacific Rim and Latin America. As a result, in 2008/2009 Varian Australia increased its export sales by more than 14% and expects to realise further export growth in the next five years as a result of its investment in research and development.

Varian's Australian operations are considered by its parent company as an R&D 'centre of excellence' for design of optical measurement technologies.

Our products can be used in a broad range of industrial and life science applications, such as by environmental laboratories in performing chemical analyses of water, soil, air and food products; by agricultural, chemical, mining and metallurgy companies in conducting research and quality control; by pharmaceutical companies in drug development, manufacturing and quality control; and by research hospitals and universities in basic chemistry, biological, biochemistry and health care research.

**Varian's R&D and our R&D process**

At Varian, we carry out commercially driven research and development by drawing on our knowledge of fundamental scientific (academic style) research.

It is work which has not been done by us before, and in many cases not done by anybody before. We have several core patents which cover new scientific invention. The R&D we perform requires innovation, inventiveness and scientific characterization of the design capabilities we are seeking. This is what gives us our principal competitive advantage.

The Intellectual Property owned and generated is what enables Varian Australia to remain successful in business, by way of manufacturing our products for sale to customers. The investment that Varian Australia makes in R&D is significant, with 25 % of Varian Australia's total workforce in Australia employed in R&D – significant by general Australian standards.

Most departments within the company are integral to and at some stage tied in with our R&D activity.

A major contributor to Varian's competitive advantage is that the company's R&D design team works closely with the marketing team so the company is able to not only produce scientific instruments that the customer wants, but strive to enhance the instruments in the design process to achieve/exceed customer expectations. New product models are therefore either more productive in output, have additional

functionality or are more competitive in performance, or indeed publically introduce equipment based on our entirely new scientific inventions.

## **Submission**

### **Principle 1**

The new R&D tax incentive will be available to companies incorporated in Australia for R&D conducted in Australia. Location of ownership of the resulting IP will not be relevant.

### **Submission – Principle 1**

We agree with the proposed Principle of removing the relevance of the location of ownership of the resulting IP.

### **Question 1**

Should there be any exceptions to the general rule that eligible R&D activity must be conducted in Australia?

### **Submission – Question 1**

The unavailability of local expertise on certain projects and the cost prohibitive nature of making the expertise available locally means R&D conducted overseas is an essential element of the R&D undertaken by the company. The present provisional certificate application process is cumbersome, time consuming and costly beyond necessity.

For the reasons outlined above, we believe that the program should support R&D carried out overseas.

We accept the 10 per cent limitation on claimed overseas expenditure. For ease and efficiency of administration, we submit that the 10 per cent limitation be applied on the total R&D Company claim amount year on year and not on a project-by-project basis.

### **Principle 2**

The Standard R&D Tax Credit will be available at a rate of 40 per cent for eligible R&D expenditure and can be carried forward where a company's income tax liability is zero.

### **Submission – Principle 2**

In general, we support this proposed Principle and in particular, the Government's proposal to increase the base rate of claim benefit; however,

- the provision of a two-tiered tax credit rate introduces a level of unnecessary complexity from a compliance and administration perspective for all parties. We submit that one rate be applied to all eligible companies
- we also submit that the Standard R&D Tax Credit be defined in such a way that its accounting treatment gives rise to an 'above the line' benefit.

**Principle 3**

The Refundable R&D Tax Credit will be available to companies with a turnover of less than \$20 million at a rate of 45 per cent for eligible R&D expenditure.

**Submission – Principle 3**

Reiterating our submission at Principle 2, we highlight that the provision of a two-tiered tax credit rate introduces a level of unnecessary complexity and submit that one rate be applied to all eligible companies.

**Question 2**

How should the new R&D tax incentive treat R&D expenditure that is currently deductible at 100 per cent?

**Submission – Question 2**

We submit that no change be made to the provisions relating to the treatment of and deductions available for core technology.

The current provisions act as an important conduit for significant spillover benefits in Australia. From our perspective, the provisions can be a critically important decision-making incentive in the acquisition of IP assets. We have acquired overseas IP assets in the past and we continue to further develop them here in Australia using local expertise, which has resulted in significant export revenue.

**Question 3**

Should expenditure incurred to associate entities only be eligible for the new R&D tax incentive where paid in cash?

**Submission – Question 3**

We have no comments in relation to Question 3.

**Principle 4**

Legislation for the new R&D tax incentive will provide support for the scheme's efficient and effective administration.

**Submission – Principle 4**

We support the Government in its proposal for the scheme's more efficient and effective administration. We also support the requirement for R&D Plans and appreciate the benefits that they bring to the management of our projects. However, we make the following observations:

- The scheme must be efficient and effective to administer for claimant companies. The Government in structuring its new program should take into account the burden of excessive and/or unnecessary administration on the claim process. The overhead administrative cost of making a claim should be kept to a minimum. Varian Australia's submission in the preceding Principles and following Principles support this.
- Of particular concern to us is the mooted requirement for claimant companies to split and cost registered activities into core and support. We will address this in our response to Principle 7.

**Principle 5**

The new R&D tax incentive should target R&D that:

- (a) is in addition to what otherwise would have occurred; and
- (b) provides spillovers – benefits that are shared by other firms and the community – that are large relative to the associated subsidy.

**Submission – Principle 5**

We do not consider additionality and spillover benefit to be measurable quantities, consistent with our interpretation of the Consultative Panel's verbal comments. We cannot envisage any particular benefit for companies assessed by these factors. As such, we submit that they not be added to the principles of the program.

**Principle 6**

Eligible R&D activity will be defined as systematic, investigative and experimental activity that:

- (a) involves both innovation and high levels of technical risk; and
- (b) is for the purpose of producing new knowledge or improvements.

**Submission – Principle 6**

We accept the Government's intention to move to a definition of eligible R&D that requires both innovation and high levels of technical risk to be met; however, in our view, this test needs to be applied in a practical and workable manner.

- Innovation must be defined clearly and in the context of the commercial reality, which is that the vast majority of technological advancements in Australia are achieved incrementally, and not through fundamental overhauls of existing knowledge.
- We're conscious of our requirement to self assess what is sufficient for innovation under the legislation. Given that the Government Administrators are required to assess the same requirement of innovation, it is essential that the guidelines are clear and unambiguous to both parties.
- If the criteria for eligibility of a typical R&D project are made more complex, the consequential increased complexity of the assessment should not be underestimated. We draw reference to the patent legislation and requirement to use quite skilled professionals to make the patent assessment. We should not make the assessment of innovation more complex with the arguable need for a higher calibre of assessor for the Government review. Administrators of greater knowledge and experience are likely to be required. *{The concept of "a person skilled in the art" and whether it would be obvious to combine knowledge from different sources of known technology. The greater the number of different sources of known technology to be combined, the more likely it is that the concept is inventive. New Zealand, in developing its definition, made reference to the concept of "a competent professional". We submit that it would be impractical and commercially unrealistic that the test for R&D eligibility be more rigorous and restrictive than that for the granting of a patent.}*

- The change in the purpose requirement from “creating new or improved materials, products, devices, processes, or services” to “producing new knowledge or improvements” creates uncertainty. The original intent of support for R&D, being to provide an incentive for greater levels of R&D in Australia across a range of industries, should not be forgotten. We note that this proposed change is already more restrictive than that required for patents. Commercial reality should never be removed from the framework of the proposed Principles. To obtain clarity and for ease of administration, we submit that the original purpose requirement be retained, being “for the purpose of creating create new or improved materials, products, devices, processes, or services”.

#### **Principle 7**

Supporting R&D will continue to be recognised under the new R&D tax incentive but claims will be subject to new limitations.

#### **Submission – Principle 7**

We submit that the split between core and support R&D is a fiction created by the tax law and not reflected in commercial reality. We do not manage our projects according to core and supporting activities, so asking us to do so is a significant and unnecessary administrative and compliance burden. Such requirements divert effort away from, and reduce the benefit of, R&D.

We manage our projects according to objectives, tasks and milestones – objectives set the framework of the project, tasks are the effort required to achieve on objectives, and milestones are the deliverables. All tasks within the R&D phase of a project are necessary to bring that project to completion.

We submit that:

- the fiction created by the classification of supporting and core R&D be reassessed
- the new R&D incentive use the opportunity to update the assessment such that it is based on the commercial realities of how a project is conducted
- all five forms of limitation proposed for supporting activities, as provided by Question 4, create inequality and are likely to result in skewed claims without the purpose of reflecting the true involvement of R&D in the project.

#### **Question 4**

Should supporting activities:

- (a) be capped as 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?

**Submission – Question 4**

If limitations are to be imposed on supporting activities, we submit that proposal (b) be adopted, with the word "sole" replaced by the word "primary".

The other options proposed add complexity and increased administration, which would be against the intent of Principle 4.

**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 certain activities from being considered supporting activities?

**Submission – Question 5**

For ease of administration, certainty and clarity, we submit that:

- the current list of activities excluded from being considered core R&D be retained and unmodified from the current form
- the list should not be extended to exclude certain activities from being considered supporting activities.

**Question 6**

How should the new R&D tax incentive treat software R&D?

**Submission – Question 6**

We submit that:

- no separate definition is created to assess eligible software R&D. In addition to ease of administration, this will ensure that an inequality does not arise between developments in different industries. We also make reference to the fact that the lower level software development of questionable R&D content will already be made ineligible through the proposed changes to the definition of core R&D, thus making a separate definition to further restrict software R&D an unnecessary complexity
- whilst the current requirement multiple sale test does not create an issue for us in terms of eligibility of a software development effort, it does not appear to achieve the Government's intention of limiting software and could therefore be removed
- a greater quantity of relevant and commercially realistic guidance material is needed in relation to what the Government considers to be eligible software R&D. The example provided in the consultation paper does not provide guidance as it does not reflect an appreciation of the technical difficulties and the nature of R&D in the context of software development.

**Conclusion**

In summary, we wish to highlight the need to consider the commercial realities of the research and development effort in industry in Australia in developing the Principles and specifics of the new R&D tax incentive. We would be happy to discuss any of our comments further. Please do not hesitate to contact:

Colin Stow, Finance Manager on 03 9566 1165 or John Pulsford, R&D Director on 03 9560 7133 to discuss.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Colin Stow', with a stylized flourish extending to the right.

Colin D Stow  
Finance Manager  
Varian Australia Pty Ltd