INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

BUILDING AUSTRALIA TOGETHER

RESPONSE TO THE EXPOSURE DRAFT LEGISLATION

The New Research and Development Tax Incentive

5 February 2010

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Infrastructure Partnerships Australia is a national forum, comprising public and private sector CEO Members, advocating the public policy interests of Australia's infrastructure industry.

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1. INTRODUCTION

1.1 ABOUT INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

Infrastructure Partnerships Australia is the nation's peak infrastructure body. Our mission is to advocate the best solutions to Australia's infrastructure challenges, equipping the nation with the assets and services we need to secure enduring and strong economic growth and importantly, to meet national social objectives.

Infrastructure is about more than balance sheets and building sites. Infrastructure is the key to how Australia does business, how we meet the needs of a prosperous economy and growing population and how we sustain a cohesive and inclusive society.

Infrastructure Partnerships Australia seeks to ensure governments have the maximum choice of options to procure key infrastructure. We believe that the use of public or private finance should be assessed on a case-by-case basis. IPA also recognises the enhanced innovation and cost discipline that private sector project management and finance can deliver, especially with large and complex projects.

Our Membership is comprised of the most senior industry leaders across the spectrum of the infrastructure sector, including financiers, constructors, operators and advisors. Importantly, a significant portion of our Membership is comprised of government agencies.

Infrastructure Partnerships Australia draws together the public and private sectors in a genuine partnership to debate the policies and priority projects that will build Australia for the challenges ahead.

1.2 SUMMARY

The current R&D Tax Concession has been an integral part of the many successes Australia has had with its challenging infrastructure development over the years. Australia's future competitiveness and economic growth as the world recovers from the financial crisis will rely more than ever on the nation's ability to produce innovation and better, more efficient ways of delivering critical infrastructure.

IPA members support any reform that simplifies the law, encourages focused development and encourages spillover effects to the Australian economy. IPA submits however that the proposed changes, as they stand, will exclude incentives for legitimate R&D Activities which help drive innovation and new development in the infrastructure space.

IPA appreciates that government policy is to maintain revenue neutrality in respect of government assistance on R&D. However IPA contends the proposed changes are at odds with this stated policy intent and will significantly decrease the access afforded to many companies. It would be self defeating were budgetary savings to be realised at the expense of future economic growth and the curtailing of innovation in our most productive sectors of the economy.

The requirements for core activities to be both *considerably* novel *and* involve high levels of technical risks, together with an extensive list of "excluded" activities will significantly reduce legitimate R&D activities from being eligible under the new tax credit scheme. In addition, the exclusions in relation to the proposed feedstock provisions will greatly reduce support for companies undertaking new infrastructure projects. We will discuss these further below.

The explanatory material to the proposed changes discusses the way the R&D Tax incentive is to target activities most likely to generate 'spillovers' beneficial to the economy as a whole and improve productivity. The activities of our members generate significant 'spillovers' into the community. However it is likely the majority of these innovative and technically risky projects, that generate these significant 'spillovers' to the economy, will not be supported by the proposed changes.

2. SPECIFIC IPA CONCERNS

2.1 THE "AND" TEST AND CHANGE FROM "INNOVATION" TO "CONSIDERABLE NOVELTY"

The change from the "or" test to "and" will significantly reduce the amount of core R&D that would be eligible for the R&D Tax Credit. The change of the meaning of 'innovation' to 'considerable novelty' creates significant uncertainty, as the proposed legislation does not define what 'considerable novelty' means. Based on the commentary in the explanatory material there appears to be a new, stricter definition and therefore a harder test to satisfy. If in fact 'considerable novelty' has the same common law meaning as 'innovation', then why not maintain the status quo? A change in core R&D terminology will reduce certainty amongst our members and may discourage many from accessing the tax credit due to the lack of comfort around what 'considerable novelty' means and how the new dual test will be interpreted by Innovation Australia/AusIndustry in future reviews of claims.

2.2 FEEDSTOCK

The proposed changes in relation to the feedstock provisions are extremely broad, are overly complex and will create much uncertainty in relation to how they will operate. This is particularly evident when trying to apply the proposed feedstock "clawback" provisions. The extension of reduced R&D feedstock expenditure from R&D claims will also greatly reduce support for companies needing to test and trial the innovative solutions in the development stages of complex infrastructure projects.

2.3 NARROWING OF SUPPORT ACTIVITIES AND EXTENSION OF EXCLUDED ACTIVITIES

IPA submits that the proposed changes narrowing eligible supporting activities to activities where the dominant purpose is supporting R&D activities, in conjunction with the list of excluded activities and the narrowing of the definition of "core R&D expenditure" discussed at 2.1 above, will significantly limit many valid R&D supporting activities from being claimed. These support R&D activities legitimately have to be undertaken in a commercial environment in order to complete the overall technical

objective of the project and hence, in IPA's view, should not be excluded from being eligible R&D activities.

2.4 "ON OWN BEHALF" AND "AT RISK"

IPA submits that the change from the 'on own behalf' requirement to the significant extent test creates significant uncertainty and many entities will not know where they stand in relation to eligibility. IPA recommends that the "on own behalf" requirement be redrafted to include the three criteria of financial ownership, control and effective ownership mentioned in the explanatory material. This would in IPA's view provide greater certainty to all claimants.

In addition, IPA considers that the proposed 'expenditure not at risk' provision should be removed as this seems to contradict ATOID 2009/107 which was recently issued by the ATO, and is not required as the redrafted "on own behalf" requirements will adequately address the issue.

2.5 IT CHANGES

IPA considers that the proposed changes in relation to software have created some unintended consequences. In many infrastructure projects, software development in relation to programmable logic controllers and new process development is an integral part of the project and such development will be significantly impacted without the support of the R&D Tax Credit. IPA recommends that software activities in relation to integration activities and computer software services be removed from the exclusion list in order to provide continued support for these valid R&D support activities.

2.6 ADMINISTRATION CHANGES

The proposed R&D Tax Credit is to operate on a self assessment basis, similar to the current R&D Tax Concession scheme. However with AusIndustry potentially having increased autonomy to reject R&D registrations upon lodgement (based on our understanding of the explanatory material), this has the real potential to reduce certainty around self assessment and ultimately increase compliance costs.

The Draft Bill provides that the Board may revoke an entity's R&D registration if the entity is not an "R&D entity" at any time when an activity covered by the registration was conducted during the income year. Determining that an entity is an "R&D entity" involves detailed analysis of the residence and source provisions in Australia's tax laws, and we question whether it is appropriate for the Board to have the ability to revoke registrations on this basis (particularly without direction from the Commissioner of Taxation).

Additionally, it appears from sections 27B and 27H in Division 2 of Schedule 2 to the Draft Bill that the Board is not permitted to make a finding on whether an entity is an "R&D entity" when the entity applies for registration for the tax offset, or when the Board examines an entity's registration for an income year. Additionally the Board does not appear to have any power, independent of sections 27B and 27H to make such a finding. On this basis, we question when the Board would examine an entity's registration for the purposes of determining whether it is an R&D entity, and how it would have the power to make a finding on this matter.

Importantly, if the Board is to be given this power we suggest it be included in the wording of sections 27B and 27H, or an independent power to make such findings be included in the final Bill. However for the reasons noted above we question whether the Board is the appropriate body to be undertaking such determinations, in the absence of a clear direction from the Commissioner of Taxation.

IPA would welcome the opportunity to discuss this submission to the proposed changes at any future time.

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