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Dear Sir/Madam

Submission to the Draft R&D Tax Credit

We provide the following comments in response to the Exposure Draft issued 18 December 2009 in relation to the draft R&D Legislation and associated Explanatory Memorandum.

We have reviewed the draft R&D law and assessed its impact on our existing clients and also discussed issues with other interested parties. We believe the changes proposed will significantly reduce eligible expenditure levels to a degree which will not be offset by the increased R&D tax credit rate as a percentage. **Companies will get less support for their R&D efforts.** This is a very clear message to the SME sector that R&D activities will attract lower levels of support through the tax system.

This is directly contrary to the stated aims of the proposed changes, which are to support a greater uptake of R&D by a larger number of small companies, to create a larger number of successful innovations within Australia, thereby increasing our competiveness and strengthening our industries in the global market place.

The current R&D legislation is well established and has been tried and tested before the Courts, with a raft of rulings supporting the law. There exists a high degree of certainty and understanding around the law within the relevant Government Agencies and business, and an acceptable risk profile is understood and established, allowing business to comfortably seek access to the concessions now available.

All this has been put at risk by the extensive changes outlined in the draft legislation and EM. It is clear that the proposed changes will put all existing claimants in a position of higher costs to manage and comply with the new laws (at least in the short term).

Most will face a high likelihood of much lower levels of qualifying eligible expenditure under the new legislation, and many will find the "increased rate" of tax benefit not sufficient to make up for the restricted expenditure rules.

The addition of new tests, exclusions and tighter definitions can only increase uncertainty for companies, who may now find the whole concession less attractive and may take this as a sign from Government to reduce their investment in R&D.

Many of the changes proposed appear aimed at the few very large claims by big business. If the intention is to redirect a high proportion of R&D support to SMEs, other changes could be made that would not involve putting more hurdles in front of nearly all existing claimants, for many of whom the R&D concession is a very important part of their budgeted cash flow.

This would allow additional support to the SME R&D sector with out requiring excessive administration and compliance costs through extra monitoring and tracking of further dissected costs, for the benefit of Australia. Many SMEs do not have the luxury of extensive resources both in accounting resources and manpower to take on the extra compliance demands proposed under the draft laws.

As to specific issues, we note only the following.

- Or becomes And – To require both novelty and technical risk will severely tighten eligibility. Many existing claimants may find it hard to have previously accepted R&D projects continue to qualify for exemption. It is clear this change will reduce the number of qualifying R&D projects, or require more effort to meet the dual requirements, again increasing compliance costs. Many existing claimants will face substantial costs in reviewing existing projects to this new standard.
- Supporting activities – exclusion of supporting activities will cut eligible R&D expenditure quite savagely.
- PKI test – This new test will require an analysis and tracking of costs "in addition to or in the place of normal operations …" again adding to compliance costs and risk.
- Acquittal rules to Associates – This change will see a need to additionally monitor payments rather than merely liabilities, with honest errors made risking the total loss of any tax benefits.
- Software – It seems software has been especially picked out for much reduced support by the R&D tax concession. While the future of many innovations is technically driven, software development is a key component to projects across many industries. The specific exclusion of software from supporting activities will have much greater implication on support for innovations than may have been anticipated.
- Feedstock – The feedstock rules around valuation will greatly increase compliance costs and risk. The market value is a difficult concept for prototypes and uncertainty will increase.
- Dominant Purpose – To seek a dominant purpose will severely restrict the width of the concession and again marginalise the benefits to existing claimants.

The measures proposed (whilst reducing some of the exorbitant R&D claims) will have the effect of increasing compliance costs and complexity, diverting focus from projects that will have a quick commercial return or result, and reducing the value of eligible R&D expenditure for all claimants.

We are of the view the proposals introducing the need for adjustment of prior claims in later financial years (for instance, payments to associates and feedstock valuations), will only reduce the level of certainty of the benefit of the R&D tax credit.

We are aware of submissions being made by other parties and have endeavored not to duplicate comments being made by them. However, it is evident the changes proposed are seen by the wider R&D community (including claimants, prospective claimants, consultants, tax specialists and officials in the relevant Government agencies) as overly cumbersome and restrictive, and there is strong support for a fresh take on how to legislate to meet the intentions of the Government.

We are also aware of the tight legislative timeframe hanging over all proposed legislation this year, and trust that the review of the R&D tax credit is not compromised by the realities of the parliamentary process.

As stated earlier this is not an exhaustive list of the specific issues raised by the proposed laws that provide significant problems for the concession. We are willing to provide further information or assistance in reviewing alternative approaches. Please contact either Michael Webb or Jackie Trimby on 08 9429 7020.

Yours sincerely

Michael Webb

Director, Indirect Tax Consulting

5 February 2010