FEDERAL CHAMBER
OF AUTOMOTIVE
INDUSTRIES
ABN 53 008 550 347

GPO BOX 313, CANBERRA ACT 2601
10 RUDD STREET, CANBERRA CITY
ACT 2600 AUSTRALIA
TELEPHONE 02 6247 3811
FACSIMILE 02 6248 7673

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

Dear Sir/Madam

Submission on Revised Tax Laws Amendment (Research and Development) Bill 2010 - Exposure Draft

The Federal Chamber of Automotive Industries (FCAI) welcomes the opportunity to provide comments on the revised Exposure Draft which was released for public comment on 31 March 2010. Our comments should be read in conjunction with our submission of 16 February 2010 (copy enclosed) in response to the first draft *Tax Laws Amendment (Research and Development) Bill 2010*.

The Australian automotive industry is one of the largest investors in R&D in Australia and believes that an effective innovation system is vitally important to maintaining a competitive manufacturing industry in Australia.

Within this context FCAI appreciates the level of consultation that the Government has engaged in through this policy development process.

In previous representations FCAI has raised a number of concerns which have been considered by the Government and amendments made in the revised Exposure Draft. These include the proposed definition of eligible R&D expenditure, the augmented feedstock provisions and the dominant purpose test for all supporting expenditure.

In making these changes however, a number of new complexities have arisen and FCAI remains concerned that key aspects of the Bill will impair the competitiveness of Australia as an R&D centre.

Definition

As a key point, the FCAI firmly opposed the initial proposal that the definition of R&D include "considerable novelty and high levels of technical risk". FCAI expressed concern that this definition created uncertainty and would be highly restrictive.

The proposed definition of R&D in the revised Exposure Draft requires eligible activities to be both experimental activities (those that cannot be known in advance) and conducted for the purpose of generating new knowledge. In addition, the Explanatory Memorandum at para. 2.18 refers to "new knowledge" that is being sought. This will reflect a degree of novelty which is significant enough to require the application of the "scientific method".

This means that the definition of R&D still incorporates the need for both novelty and technical risk.

The FCAI therefore maintains that in the absence of a compelling rationale there is a real risk that the proposed change in definition will generate unwarranted confusion and uncertainty as well as limiting experimental research activities.

The new definition would be one of the most restrictive definitions in the world and is far more restrictive than the OECD Frascati Manual, which is satisfied by the resolution of technological uncertainty without the additional requirement for novelty (paragraphs 84 and 143).

Furthermore, the draft Explanatory Memorandum (paragraphs 2.22 and 2.23) refers to R&D activities that are part of an eligible experiment which indicate that companies will be required to identify each and every activity within a complex project and apply the eligibility criteria. This creates additional complexity and confusion to the management of a project, as well as arduous documentation requirements inherent in the "scientific method" which may be the norm in a science laboratory, but not so in an industrial or commercial environment.

The FCAI is concerned that this new definition of R&D will significantly reduce eligibility of R&D projects and will have a negative impact in justifying new R&D investment initiatives in Australia.

The proposed new definition of R&D has not been subjected to rigorous analysis in any recent review of innovation or R&D and given the importance of this issue to

maintaining competitive industries in Australia, the proposed changes should be subject to a more thorough public examination.

Support R&D Activities

The revised Exposure Draft includes a requirement that support activities will be eligible if they are directly related to core R&D activities. This by itself mirrors the current law. However, the revised Bill extends this test to exclude from support activities, amongst others, activities that are, or related to, "the production of goods and services". Such an activity is now only eligible if the dominant purpose is to support core R&D activities. As such, the "dominant purpose test" from the first Bill, to which we strongly objected, is resurrected in the revised Exposure Draft.

The FCAI is concerned about the restrictions on eligibility of costs incurred in supporting activities and by the additional compliance burden that will be placed on R&D claimants, as mentioned in our earlier submission. This is particularly so in the context of the undertaking of R&D activities in a commercial or industrial environment.

We consider that support activities are intrinsic to any core R&D activity and are required in order to bring about a successful conclusion to any R&D project. The FCAI is firmly of the view that the existing rules relating to support activities be maintained.

While the FCAI endorses the policy objectives underpinning the new R&D incentive, we are concerned that the adverse impact of measures to restrict eligible activities will substantially outweigh the benefits of other reforms.

Accordingly, we urge the Government not to introduce the legislation in its current form but instead seek to resolve a better way forward with industry and other stakeholders.

Yours sincerely

TIM REARDON
Director - Government Policy