



**CORPORATE TAX
ASSOCIATION**
of Australia Incorporated

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General Manager
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By email: randdtargetingaccess@treasury.gov.au

Research and Development (R&D) Tax Incentive: Targeting Access

The Corporate Tax Association welcomes the opportunity to comment on the draft legislation dealing with the Research and Development (R&D) Tax Incentive: Targeting Access (Exposure Draft legislation *Tax Laws Amendment (2013 Measures No.2) Bill 2013*).

We would like to encourage a review of the policy with a view to not proceeding with the proposed changes. We do not believe that the proposed changes will achieve an outcome that is in Australia's best interests. However, if these proposed changes are proceeded with, we have made some suggestions relating to determining which companies will be determined to be in the new tier three.

It is extremely unusual to have a piece of tax legislation that discriminates against a very small group of taxpayers. As stated by the Treasurer, "*(t)he change will affect less than 20 corporate groups*" (Media Release No 27 of 2013). In the same Media Release, the Treasurer also stated that "*(t)he R&D Tax Incentive is one of the most important elements of the Government's support for our innovation system*". In spite of this, the proposed R&D amendments will deny a small number of large corporates access to the R&D incentive.

One of the drivers for the policy change, as stated by the Treasurer in the Media Release, was that "*small firms are more responsive to R&D tax incentives than large firms*". However, the removal of the incentive for large corporates as proposed can only reduce R&D expenditure in Australia. As a company's management has a duty to minimise the cost of R&D, a decision to not undertake certain R&D activities may be made on the basis that is simply no longer viable due to the increased after tax costs. Alternatively, the option of conducting the R&D offshore may become more attractive.

Under the current R&D incentive, when a large corporate engages an external party to undertake R&D activities on its behalf, the terms of engagement often include an express requirement that the R&D activities (or at least the majority of the activities) be conducted in Australia. Given the proposed changes, there will no longer be any incentive for large corporates to include such a requirement.

The end result does not benefit Australian research facilities, associated businesses etc., many of which are small and medium enterprises. These are the very businesses the government is trying to support in order to provide Australians with employment opportunities (as announced in February this year in “A Plan for Australian Jobs”).

For these reasons we believe that the R&D incentive needs to remain for the large corporates currently affected by the proposed legislation.

Despite this, if the proposed changes proceed and the R&D incentive is not available for larger corporates, we believe that the determination of the third tier based on a turnover notion is more appropriate than using assessable income. It more accurately reflects the activities of a business and therefore the size of a business. For example, turnover does not include one off transactions that are not part of a normal business activity. The inclusion of one off transactions may result in a corporate that should be below the \$20 billion threshold being classified as a third tier company and wrongly denied access to the R&D tax incentive.

Also, when considering connected entities, a control test (control being holding a 50 per cent or higher interest) should be used to avoid a number of compliance problems such as obtaining information from entities that may be connected but are not controlled.

In summary, our preferred position is the retention of the existing provisions for the reasons outlined above. However, if the policy is to exclude large corporates from the R&D incentive, the third tier companies should be determined by the use of a turnover concept (rather than assessable income). Also, when determining a controlled entity, a control test of 50 per cent interest should be used as outlined above.

Please contact me if you wish to discuss.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Frank Drenth". The signature is stylized with large, flowing loops and a prominent initial "F".

(Frank Drenth)
Executive Director
Corporate Tax Association