

2 April 2013

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

Dear Sir/Madam

RE: R&D Tax Incentive: quarterly credits Consultation Paper August 2012
Submission of Michael Johnson Associates Pty Ltd

Michael Johnson Associates (MJA) welcomes the opportunity to provide this response to the Treasury Consultation Paper (the Paper), "R&D Tax Incentive: quarterly credits". MJA is a specialist service provider in the area of government support for innovation. We have provided services to Australian companies in respect of the former R&D Tax Concession (the Concession) since its inception in 1985. We now assist organisations ranging from start-ups to ASX Top 100 companies in claiming the new R&D Tax Incentive (the Incentive).

In responding to the Paper, we believe that the appropriate analytical framework is to assess the quarterly credit proposal in terms of its capacity to provide improved R&D support against the impact on business risk for taxpayers and program risk for the Government. On that basis, we believe that the design of the delivery system detailed in the Paper is a sound one. However, based on our practical experience with the Rebate available under the old Concession and our current understanding of the proposed administration of the new Incentive, we believe that the increased risks for taxpayers and the Government will outweigh any benefits that a more "real time" refund can practically deliver. As such, we would be advising our clients not to opt-in to the quarterly credits system until we had sufficient evidence that the claim risks were manageable.

In summary, we submit that the issue does not lie with the design of the system in theory. Our concern is with how it could work in practice.

Turning to the four questions posed in the paper, we have framed this response to cover the questions raised but have set out our response in the following manner:

- Review of Stated Purpose
- Analysis of Policy Design
- Concerns Raised by the Concession Experience
- Concerns Raised by the Incentive Compliance Model
- Conclusion

Review of Stated Purpose

The Paper states that the purpose of the changes to provide equitable tax treatment between current income year net refund companies and current income year tax payable companies eligible for the 45% Refundable Offset. MJA accepts this purpose and the fact that the offer is not available for 40% Non-Refundable Offset claimants.

Analysis of Policy Design

The Paper indicates that the credits are designed to support “small and medium companies” on page 10. We would note that the group annual turnover limit of \$20 million means that this is a small company support offering and that all medium-sized companies are definitely excluded.

We support the self-assessment opt-in nature of the program.

The claiming process set out in Figure 1 on Page 11 is a sensible proposal in terms of how the program could operate. The main concern relates to understanding what is involved in obtaining an accepted prospective notification from AusIndustry and what would constitute “appropriate compliance activity, including the issuing of findings during the year...” (page 10). Examples need to be provided of this feature of the system so they can be assessed against the Paper’s stated desire of minimising additional compliance obligations.

We are comfortable with the two choices of credit calculation - the ‘safe harbour’ and variation methods. We understand the ‘necessary history’ requirement in the context of the activities of “phoenix companies” mentioned on Page 12. However, we think that worked examples need to be provided in terms of the circumstances and nature of the variation penalty scenario described at page 15. The penalty criteria go to the heart of assessing the risks of electing to receiving quarterly payments under the variation method.

The end-of-year claim requirements are as we would expect.

Concerns Raised by the Concession Experience

Since the introduction of the Rebate in 2001, MJA has dealt with a number of start-up enterprises that have come to grief through failing to understand the exacting eligibility requirements of the program. Misunderstanding of issues such as grouping rules, the meaning of expenditure incurred and R&D aggregate amounts has led to companies doing legitimate R&D being presented with requests from the Australian Taxation Office (ATO) for repayment of rebate funds along with interest charges and punitive penalties. These claims have usually been made in concert with advisers who did not understand the intricacies of the Concession and in the absence of definitive “How To Claim” guidance from AusIndustry and the ATO.

An inherent problem of a self-assessment system is that the receipt of a benefit such as a cash rebate payment inevitably precedes any scrutiny by the regulators. Whilst the 45% Refundable Offset has some different features to the Rebate, the fact that payments can occur quarterly in the proposed system heightens the risks for both the taxpayer and the government. This needs to be addressed prior to the 2014 start date. Comprehensive guidance material needs to be published in draft well in advance for public comment. Guidelines regarding adjustments, interest, penalties and repayment terms will need to be crystal clear. The ways in which the Government intends to handle potential losses through misuse and companies going under need to be worked through and publicised. The pressure on AusIndustry and ATO resources will also be a consideration.

MJA submits that the problems outlined above have caused increasing delays in processing Rebate claims under the previous regime in recent years. We have noted a marked increase in registration review activity by AusIndustry under the Concession Compliance Model with registrants being routinely asked to supply information on projects in a manner fully consistent with a statutory assessment under the *Industry Research And Development Act, 1986 (Cth.)*. On 13 August 2012, the Australian Financial Review reported that the ATO had about 400 company returns on hand that were more than 50 days old. An ATO spokeswoman was quoted as saying that the regulator was reviewing “...excessive incremental claims, large amendment claims that could not be substantiated and failure to apply strict tests to curb dodgy claims.” Such concerns can only presumably heighten in a quarterly system in comparison to the Rebate’s annualised version.

Concerns Raised by the Incentive Compliance Model

Taxpayer and regulator risk appears to increase with the more real time access provided under the proposal as the self-assessed benefits flow increasingly in advance of the Government’s opportunity to test the veracity of the claims. MJA submits that these concerns are raised to even higher levels when you consider the more attractive nature of the Incentive in comparison to the Concession.

In basic terms, the Incentive offers twice the basic benefit (a permanent difference of 15 cents cf. 7.5 cents) to a larger cohort of companies (\$20 million group turnover cf. \$5 million) with no limit on aggregate R&D amount (\$2 million under the Concession).

As such, the current annualised system is under greater pressure because of the increased interest and number of eligible claimants. A consequence of this has been the introduction of a pre-registration review step in the Incentive Compliance Model where AusIndustry can make additional requests for eligibility information prior to conferring registration. Further, we understand that the ATO can now request that AusIndustry conduct registration reviews prior to the issue of credit cheques. This will inevitably result in even longer turnaround times than reported under the Concession.

The quarterly payments system would be a dramatic reversal of this trend and it is not at all clear that the concerns driving the current state-of-play are ameliorated at all under the proposal.

Conclusion

MJA will always support improved R&D support measures but not at the expense of program integrity. We are concerned that the proposed system will place too great a burden on program administrators seeking to deliver real time benefits in the face of those who honestly misunderstand the program requirements and those that would seek to exploit its self-assessment nature.

As such, we would need to see a great more program detail than the Paper currently provides to be an advocate of the changes. Having said that, we are fully available to provide whatever resources are deemed appropriate to address these issues over the coming months in order to help deliver a viable program.

Should you wish to discuss any aspect of this response, please contact Kris Gale, Managing Partner, MJA on (02) 9810 7211 or kris.gale@mjassociates.com.au

Yours Sincerely,

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