

**Compliance Group Pty Limited (CG)**  
**Submission: The New Research and Development Tax Incentive**  
**October 2009**

CG comments are set out below.

*Question 1:*

*Should there be any exceptions to the general rule that eligible R&D activity must be conducted in Australia?*

Answer 1:

Yes, an exception to the general rule should include anytime where essential elements of an R&D project cannot be undertaken in Australia.

In order to remain competitive in a global market place Australian companies must not only be aware of what the competition is up to but must surpass it. If the successful development of a thing cannot be achieved in Australia, it either must be abandoned or achieved elsewhere.

If the Australian company were willing to back its ability to successfully undertake R&D overseas with its own funds, the provision of tax incentive support would appear to be a useful use of Government funds, so long as the claimant returns the benefits of the successful completion and exploitation of R&D to the Australian economy.

Conversely, to support only that R&D which is capable of being undertaken in Australia limits the breadth of the new incentive.

**Principle 5**

*The new R&D tax incentive should target R&D that:*

- (a) is in addition to what otherwise would have occurred; and*
- (b) provides spillovers — benefits that are shared by other firms and the community — that are large relative to the associated subsidy*

Such a principle appears to ignore the fact that support through tax concessions has been available for all eligible R&D since 1986. To move to support only that which is in addition to what would otherwise have occurred limits the usefulness of the new tax incentive to a very small pool of companies.

A company able only to undertake R&D because of a tax incentive raises serious questions about that company's chances of survival, given the risky nature of R&D. The Commercial Ready and STRAT grants programs were ideally suited to companies that lacked the necessary funding to carry out their R&D. A tax credit after the fact is unlikely to be what the majority of such companies need, or what will give the Government the sort of bang it's looking for from its buck.

Surely, the biggest bang will come from an incentive targeted at companies that have the best chance of successfully completing and exploiting their R&D activities. Since the cream will always rise to the top there is no need to guess

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where the funding is best directed: a broad based incentive available to all eligible companies provides a balance between funding companies that will achieve nothing at all, and funding companies that will achieve technical and business excellence.

Tax incentives encourage R&D by reducing the cost of the risk involved. Companies receiving tax incentives are better able to manage the inherent risk associated with R&D. The Government should not underestimate the positive environment that is created when support is provided in a broad-based way to all companies willing to assume the risk of R&D.

Spillover benefits are clearly good for the economy. However, business (and R&D) is conducted in a fiercely competitive environment where canny players protect from any form of spillover. The desire to encourage the sort of R&D that provides spillover might be a little misplaced as the resultant spill will not be limited to Australia but will run to overseas competitors also.

#### Principle 6

*Eligible R&D activity will be defined as systematic, investigative and experimental activity that:*

- (a) involves both innovation and high levels of technical risk; and*
- (b) is for the purpose of producing new knowledge or improvements.*

R&D activities of the highest calibre often involves both innovation and high levels of technical risk, but seldom do they appear in the same “**R&D activity**”. (note: the current definition talks about “**R&D activities**”).

The proposal begs the question: is there an R&D activity that can be *systematic, investigative and experimental that involves both innovation and high levels of technical risk*?

If the word **and** must be used (and it looks like it must), perhaps it could be used by requiring each R&D project to include:

- (a) systematic, investigative and experimental activities that involve innovation; **and***
- (b) systematic, investigative and experimental activities that involve high levels of technical risk...*

In other words, using old tax concession parlance: so long as there is either “core activities” involving innovation and high levels of technical risk, or several “core activities” where at least one involves innovation and another involves high levels of technical risk, the new requirements are satisfied.

*Question 6: How should the new R&D tax incentive treat software R&D?*

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Answer 6: Software is 4-lane highway running through the middle of the world economy. Australia has some of the smartest propeller heads on the planet. Making them jump through more hoops simply because they produce software for in-house use runs contrary to the Government's desire to support R&D that is most likely to produce net-benefits for the Australian economy.

Paul McMullan

Director