



Government of **Western Australia**
Department of **Commerce**

Science, Innovation And Business

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Enquiries: Michael Dickson

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

SUBMISSION ON THE NEW R&D TAX INCENTIVE

The Western Australian Department of Commerce has responsibility for assisting the development of a range of industries in this State. Encouraging innovation, including research and development, is a central component of industry development strategies.

This Department understands that innovation, research and science will solve issues affecting society, the community and the economy. As an industry development agency, the Department's prime focus is on activity that has an economic impact. As such the Department of Commerce's innovation focus is on *'Improvements in technology, products, services or business operations that lead to a distinct competitive advantage or productivity gain.'*

The proposed R & D tax incentive changes are therefore of great interest to the Department. The general direction of changes, especially in respect to smaller companies, is welcome.

One possible benefit that may flow from the changes could be an increase in the number of university or research institution "spin-off" companies established in Australia. The funding of research through the proposed R & D tax incentives may also lead to greater university equity participation in start-up companies. Further, there may be increased local industry take up of government funded university and research institution based innovation.

Increased capture of IP flowing from universities and research institutions will be a positive contribution to the Australian economy, helping to maintain a diverse economy with new companies emerging based on

internationally competitive technologies. It will also increase the return on investment flowing from government funding.

Impacts

Change rarely occurs without impact. In the case of the planned tax incentive changes, the Western Australian resource sector may be impacted. The resource sector is the single largest source of R&D in the State. Business expenditure on R&D related to the resource sector was \$1,592 million in 2007/8, up from \$1,279 million in 2006/7 and \$742 million in 2005/6.

The resource sector will likely be impacted by the narrower definitions that are applied to companies with turnovers above \$20 million. The increased complexity of determining core and supporting infrastructure will impact on projects. The new “innovative and high technical risk” rule that will apply to judging eligible R & D may also exclude a range of projects based on subjective assessment.

Issues

Australia has a complex tax system that some may say acts as a constraint on business activity. In general when changes are made to the tax system the Department of Commerce would like to see:

- Simplification of tax rules and associated compliance cost reductions;
- Greater clarity and certainty of eligibility;
- Reduced risk of future tax rule re-interpretations impacting historic tax liabilities where companies have acted legally, openly and in good faith; and
- Fairness and equality.

Given the above principles, specific areas of concern include:

- The basic qualification rule for consideration of what activity constitutes R & D has been changed to require both innovation and high technical risk. This could have a major impact on qualifying activities. Innovative businesses may be concerned over future re-assessment of eligibility and potential negative impacts. Pre-agreement that a project is R&D, so long as the project proceeds to a logical end, will remain important.
- Further, early research and development is about the total risk profile for a project. A product could be truly innovative and may only have moderate technical risk, however at an early stage of development there may be a high commercial risk in that the market may not accept the new product. It is the total risk profile,

both technical and commercial that business will consider in deciding to undertake research. If the “and” rule is to be implemented then it would be preferable to consider a wider definition of risk.

- Subjectivity of definitions such as high technical risk, research and innovation create uncertainty. Companies may be concerned that during audits a subjective review of previously approved activity may be seen in a different light and have its tax incentive status changed. Pre-evaluation and approval on a project basis will remain important.
- The new definition of core and supporting research with potentially different treatment for each category creates complexity and confusion. Research and development should be treated as a project – even if the definition is narrow.
- Clarity regarding an agreed point in a project when the research is deemed to have been completed. This will be important in adding clarity for companies.
- Clarity about the level of proof required to say an activity is research.

The Department would prefer to see research defined in terms of Research Projects, possibly with an agreement as to when a project qualification for tax incentives expires.

Certainty of what qualifies for R & D taxation incentives and for what period may be more important than under the previous scheme.

Conclusion

In summary, the general direction of changes is positive. Research and development, including innovation, are critical to the long term competitiveness, productivity and diversity of the economy. Increased innovation, especially if retained in Australia through incentives such as R & D tax incentives, will increase individual wealth, government revenues, reduce current account deficits and help reduce the impacts of unemployment. As such, while the changes should be close to revenue neutral, simplicity and certainty should be equally important goals, even if there is a slight initial cost.

Yours sincerely

Brian Bradley
Director General