

5 February 2010

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

Business
Council of
Australia



Dear Sir/Madam

**SUBMISSION ON NEW RESEARCH AND DEVELOPMENT TAX CREDIT
EXPOSURE DRAFT LEGISLATION**

The Business Council of Australia (BCA) welcomes the opportunity to make a submission to government on the Exposure Draft of the Tax Laws Amendment (Research & Development) Bill 2010.

In considering the Exposure Draft, the BCA notes that the legislation is being developed against the backdrop of heightened – and growing – awareness of the importance of productivity to Australia's future prosperity. It is also being developed in the context of a difficult fiscal environment.

Innovation is an important determinant of productivity in the economy. Technological advance manifested in new and better products and better production techniques is the key to enhancing multifactor productivity. Reflecting this, the BCA welcomes the high priority the government has placed on improving innovation as a key plank of the microeconomic reform agenda, and we endorsed the objectives of the 2009 policy statement *Powering Ideas*.

The proposed changes to incentives around research and development contain a number of improvements on the previous arrangements. This includes the proposed shift from a tax concession mechanism to a tax credit system (which will be of particular benefit to small and medium size enterprises) and the change in focus from the location of intellectual property ownership to that of location of the R&D activity.

The BCA is concerned however that the Exposure Draft contains provisions which involve a tightening of definitions that will have a practical effect of lowering the extent of research and development activity in Australia. Moreover, the government's intention for a simpler and more predictable system will not be met under the arrangements proposed in the exposure draft. The proposed arrangements will likely have the effect of significantly increasing the compliance burden around the program.

The BCA's concerns with the proposed arrangements centre around four areas.

- We consider that the proposed change in definition of core R&D activities – from requiring innovation *or* high levels of technical risk to requiring *both* considerable novelty *and* high levels of technical risk – will not make the system more predictable. The interpretation of 'degree of novelty' is likely to be an area of contention going forward, especially where there are, as is common practice, incremental improvements over time. Indeed there is a risk that the proposed changes will introduce a more academic approach to R&D – in so far as the purpose of activities needed to qualify will be to acquire new knowledge or information, rather than the application of that knowledge.
 - In the past, BCA member companies have been concerned that the R&D policy framework was too restrictive to science-based innovation and provided insufficient support for encouraging greater R&D activities, including the commercialisation of new technologies.
- The introduction of a dominant purpose test for supporting activities likewise represents a significant tightening of the existing test and has the potential to introduce considerable uncertainty over the eligibility of claimed activities. This includes important activities such as clinical trials and other product development trials. In addition many supporting activities have both a commercial purpose and well as an R&D purpose and providing evidence that one purpose is clearly dominant over the other will be difficult in many cases. This uncertainty is acknowledged in the Explanatory Memorandum.
- The anti-commercialisation provisions seek to deny the credit for successful R&D but will continue to reward failed R&D. Companies will generally undertake R&D activities for the purpose of ultimately obtaining a profit from that R&D. The augmented feedstock rule could be construed as simply rewarding failed R&D activities and penalise companies for success. While this provision will have an effect on all industries, it will have a particular impact on sectors such as manufacturing, mining and engineering.
- A further concern with the proposed changes to the R&D regime relate to the treatment of software development, which will preclude R&D associated with the integration of commercial or open source software or the provision of computer software services irrespective of whether such integration involves considerable novelty and high levels of technical risk. The various proposed exclusions are likely to discriminate against genuine information technology related R&D activities in Australia.
 - At a time when we are striving to boost Australia's international competitiveness, a comparison of the proposed R&D arrangements with the current Singapore R&D tax concession, suggests that there are many examples of projects in the telecommunications industry that are likely to qualify in Singapore yet may fail to receive support under the proposed arrangements here.

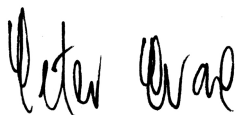
The BCA accepts that the changes to the R&D incentive arrangements should be revenue neutral. The abolition of the 175% premium concession will contribute toward this objective. However the extent of the uncertainty that is likely to result from the proposed definitional and eligibility changes and the new feedstock provisions will invariably reduce business expenditure on research and development in Australia.

We suggest that further work is required to explore alternative options to those proposed in the Exposure Draft. It will be important to find an approach that is consistent with the objective of encouraging innovation.

The research and development tax credit should be designed in a way that signals the importance of research and development to our industries and to enhancing productivity across the wider economy.

The BCA would welcome the opportunity to discuss and provide feedback on alternative options.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Peter Crone', written in a cursive style.

Peter Crone
Director Policy