

## **R&D Tax incentive changes – submission to exposure draft legislation**

Dingo Australia (Dingo Mini Diggers Pty Ltd) is a highly innovative privately owned Australian manufacturer that created the Mini-Digger/Loader market in the early nineties where no market previously existed. (see [www.dingo.com.au](http://www.dingo.com.au))

It thus creates not only jobs in the manufacturing and sales area but in the offshoot companies and small businesses that buy Dingo machines and attachments to contract with, hire out or increase productivity within their business. There are over 7500 dingo machines that have been produced and sold to Australia or exported world wide.

I came to Dingo in May 2005 from 30 years in Accounting Public Practice and was not surprised to learn that they had never made a tax claim for the R&D expenditure that was most definitely incurred every year. The reason I was not surprised is that very few smaller companies have the resources or skills to record, calculate and apply for (and continue to do these things) in relation to the existing R&D tax incentive system.

Dingo has consistently spent about 2.5% of its turnover on R&D activities and I have been able to convince the senior management team that with the R&D tax incentives in place it pays to keep the process of constant innovation happening.

It would be very easy to stop doing R&D in these times. Our company has suffered two years of successive losses due to the economic meltdown. This has followed many years of profits > \$4M. The company was forced to restructure and downsize but we certainly kept R&D alive.

What will the legislation changes mean to our company?

Basically it makes it much harder to prove a claim. I don't have an issue with tightening up the system to protect revenue but these changes affect SME's more than anybody.

- We regard ourselves as an SME with a turnover of \$28M. The \$20M limit on SME's is a joke and should be increased to at least \$40M. We are a small private company with 90 employees. The distinction should be between listed public companies and privately owned companies (with a turnover of less than \$40M)
- Proving "considerable novelty" as against "innovation" is going to be very hard – see examples below.
- Supporting activities – it is very hard for our small business to dedicate activities specifically to R&D. To remain viable we must make full use of all resources and therefore they are spread between R&D and normal production – there is no predominant purpose test that could be adequately satisfied.
- Exemptions – software unless it is developed and sold by our company. We don't develop software, we buy software and maybe adapt it for use by our R&D team. This cost is now excluded.
- Pre production activities including demonstrations and trial runs. How are we to gauge the commercial effectiveness of an R&D project if we don't do this? Excluding this activity is like making something for the market place without any idea if it is going to be commercially viable – see example below.
- Feedstock principle – we have always recovered costs by selling trial products or reabsorbing material – you now want us to value this at the end of a project! Some (most) projects go on over a period encompassing two financial periods at least. How do we value this at the end of a financial period? More red tape and cost!

Those are just some issues that arise with the new legislation.

I wish to point out three examples of activities that would have passed the old test.

### **Example 1 – Tracks on our Dingo Machine.**

The Dingo machine is traditionally a 4 wheel skid steer machine. Some overseas competitors make dedicated track machines (as opposed to putting tracks over the wheels). To put this onto a Dingo requires considerable innovation and testing to come up with a better ride, no loss of power in turning, addressing safety issues and of course actual performance in different conditions. Is it innovative – yes. Does it involve high levels of technical risk – yes. Could it be called as having considerable novelty – No – because tracked machines have been around for 100 years.

### **Example 2 – A Dripper hose layer**

This project was brought about by a recognition of water restrictions and involved making an attachment for a Dingo that inserted dripper hose under existing turf quickly and cost effectively without ripping the whole lot up. This probably would pass the considerable novelty test but the actual production of this unit was only a very small part of the total cost. Most of the cost was incurred in testing and trail runs – the cost for both of which is now an excluded cost. In the end the attachment was made but commercially it was a failure – nobody wanted it even though the concept and green credentials were very obvious. Under the new rules we would be very unlikely to do such a risky project.

### **Example 3 – A brand new Dingo model**

To keep pace with competition we need to introduce a newer and better Dingo model. This generates turnover as our customers opt to upgrade and it also keeps us at the forefront of technology. This dingo model incorporates new concepts such as a triple pump hydraulic system, improved hydraulic performance, more safety features however is 90% the old machine. Separating the bits that may have considerable novelty would be hard if not impossible.

Dingo is a small Australian manufacturing company (a dying breed) that gets virtually no government support for anything.

- Will this legislation stop us doing R&D? – No, we will always do R&D.
- Will not having R&D tax incentives change our activities – Yes we will spend less on R&D and we will not record this R&D separately – no statistics for your ABS
- Will it send us to the wall – a lot of other things will send us to the wall first but in February 2009 we were within 2 weeks of closing down. Had we not benefited from R&D tax concessions in prior years this may have been the difference between continuing or going to the wall.
- Will we put in a R&D claim – Not likely – like many other small business's we don't have the in-house resources to navigate this complex legislation and set up recording systems therefore we rely on the larger account firms to help (the smaller accounting firms don't have the resources also) – this involves a large cost outlay before we even start and therefore the end result has to be positive. The uncertainty regarding the benefit will deter us from starting the process.

The government with this legislation is only attracting those small businesses with the whacko type concepts that have very little chance of commercial success or the very large ones who can afford to put dedicated teams in place to claim the incentive. Companies like ours are largely ignored even though we have proven commercial success using innovative ideas over the years.

**Martin Browne FCPA GAICD - Accountant/Administration & Finance**