



TOYOTA MOTOR CORPORATION AUSTRALIA LIMITED

A.B.N. 64 009 686 097

9 February 2010

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

Dear Sir/Madam

**Toyota Motor Corporation Australia Limited (Toyota Australia)
Submission on Tax Laws Amendment (Research and Development) Bill
2010 Exposure Draft (R&D Bill)**

We thank you for the opportunity to comment on the R&D Bill. This submission should be read in conjunction with the Toyota Australia submission dated 27 October 2009 in connection with the Research & Development (R&D) Tax Incentive Consultation Paper (copy enclosed).

Toyota Australia is very concerned that the policy objectives of the R&D Tax Incentive will not be met by the R&D Bill as it stands. We are of the view that:

- The definition changes serve to produce what is arguably one of the most restrictive definitions of R&D found in any similar legislation in the world and, in doing so, likely excludes most of the typical forms of R&D undertaken in the manufacturing and associated operations of Toyota Australia.
- The definition changes increase rather than decrease complexity and associated administrative burden and cost. Given that the new R&D Bill contains a number of new concepts/terminology, companies will require specialist guidance in determining the application of the new provisions and this will undoubtedly lead to both additional compliance costs and uncertainty.
- The tightening of the definition of 'core R&D activities', together with the limitations on 'supporting R&D activities' and the further expansion of the

'exclusions list' mean that the support for R&D activities in the manufacturing industry will be substantially reduced. Such activities are fundamental to the successful execution of any programme of R&D.

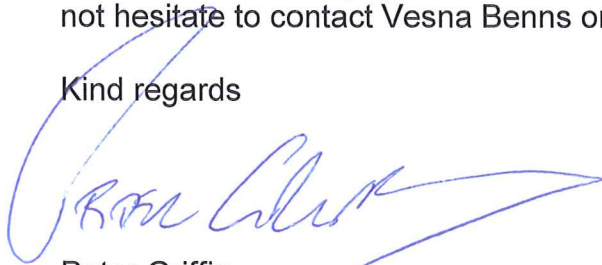
- The changes to the rules surrounding computer software fail to acknowledge the intrinsic role that computer software plays in a wide variety of business activities such as manufacturing.
- The amendment to the 'feedstock' rule raises uncertainty in terms of determining the market value of outputs produced by the R&D, particularly where the results of R&D are cutting edge. .
- The new R&D Bill introduces the requirement for companies to determine whether each separate R&D activity is a core or a supporting activity. Again such a measure adds both complexity and cost to the administration process.
- This review presents a missed opportunity to modify the R&D tax benefit regime to attract valuable and world leading R&D that may not meet the 'financial risk' criterion, but which has the potential to showcase and stimulate Australian talent and innovation.
- The promised 'revenue neutrality' is unlikely to be achieved as the proposed changes will significantly reduce the level of claimable activity.

Our concerns are set out in the attached submission. It is Toyota Australia's view that the R&D Bill will result in a significant overall reduction in R&D incentive as well as a distinct shift of any remaining incentive away from manufacturing enterprises such as Toyota Australia. That is to say, despite being a significant employer, exporter and generator of economic value, a significant proportion of the research and development activity undertaken by Toyota will not qualify for support under the R&D Bill; thereby impacting the attractiveness of Australia as a location for investment in manufacturing and associated R&D activities.

We urge Treasury to consider very carefully the impact of the proposed R&D Bill in light of the Federal Government's stated policy objectives relating to the encouragement of innovation in Australia.

Should you have any queries in connection with our submission, please do not hesitate to contact Vesna Benns on 03 9647 4597.

Kind regards



Peter Griffin
Divisional Manager
Corporate Affairs, Strategy & Environment

1. Definition Changes

The proposed definition changes include the requirement that core activities involve 'considerable novelty and high levels of technical risk'. This is substantially more restrictive than the move from "innovation or high levels of technical risk" to "innovation and high levels of technical risk" as highlighted in the consultation paper.

The questionable use of the word "considerable" raises a multitude of complex issues around the level of innovation or novelty that is required, which raises substantially increased business uncertainty with regards to the eligibility of activities.

Toyota Australia requests that the word "considerable" be removed as we consider that the objective of revenue neutrality would already be more than achieved via the use of "and" instead of "or" (which Toyota Australia does not support in any case).

Further uncertainty arises via the insertion of the word 'dominant' in connection with supporting activities, which are defined as those "undertaken for the *dominant* purpose of supporting core R&D activities". Unless an organisation exists for the sole purpose of undertaking R&D, then the 'dominant' purpose of any of its activities is likely to be commercial rather than R&D. This produces a new barrier to the eligibility of activities ordinarily claimed under the previous definition of R&D, and raises a new area of complexity and uncertainty around the identification of eligible activities. Although it is clear that the change is intended to significantly narrow the scope of R&D activities, it will now be necessary to demonstrate the dominant purpose at the time of undertaking the activities, adding a further level of uncertainty and increased administrative complexity.

We consider that the list of exclusions adequately excludes those activities that Treasury thinks should not attract R&D incentives, and hence the inclusion of the term "dominant" unnecessarily introduces new uncertainty and complexity, and should therefore be removed.

In summary the combined impact of the definition changes profoundly reduces the value of R&D Tax related benefits to Toyota Australia and increases the complexity and associated administrative burden/cost, thereby impacting the attractiveness of Australia as a location for investment in manufacturing and associated R&D activities.

2. Changes Relating to Software

The change to the eligibility of software R&D - to require a *commercial return* as well as a multiple sale to *non associates* requirement - is contrary to the direction of R&D, particularly within industries such as automotive (manufacturing and distribution), and forms an unnecessary restriction to what should be considered valuable R&D.

By way of example:

- Innovative software developed for use by dealers may be provided to them by an automotive manufacturer, free of charge. Although there is no 'direct'

**Toyota Motor Corporation Australia Limited (Toyota Australia)
Submission on Tax Laws Amendment (Research and Development) Bill
2010 Exposure Draft (R&D Bill)**

commercial return, a return would arguably be built in via increased customer satisfaction, improved sales etc; hence, a return could be argued to be inherent in the price of the car, yet such software R&D would not be eligible under the R&D Incentive.

- Development by Toyota Australia engineers of highly innovative software for in-house use, to assist in the development of innovative motor vehicle products, would be ineligible under the former or new R&D rules, despite such R&D highlighting Australian innovation and opening Australia to increased attention and investment.

Modern automotive manufacturing draws upon very advanced computer science and the impact of the change is to further restrict such fundamental R&D activity in the automotive manufacturing sector.

Toyota Australia considers that the requirement for a commercial return for software R&D should be removed; if not generally, then at least for industries such as manufacturing in which computer software is often intrinsically embedded in processes.

3. Feedstock Rule

The changes to the feedstock rule will result in a clawback of the R&D tax offset for the cost of the actual R&D activities, where the output of the R&D has a market value. This change raises considerable uncertainty in determining market value for a wide range of R&D results, which may include such things as 'one-off' prototypes, new or improved processes etc.

Toyota Australia recommends the R&D Bill or Explanatory Materials provide clarity and guidance in respect to the determination of 'market value'.

4. Other

The review of R&D tax incentives provides an opportunity to consider the types of R&D that may exist but do not currently attract incentives.

Toyotas Australian operations include the Toyota Technical Centre, which undertakes a significant amount of R&D that contributes to global designs of vehicles. The R&D undertaken by the Toyota technical Centre is cutting edge and world leading; but generally does not attract R&D tax benefits by virtue of the operation of the financial risk provisions (i.e. it is not funded by the Australian entity).

We understand that R&D tax incentives elsewhere in the world may take a less restrictive position on such "pure" R&D.

We request a consideration of a change to the 'financial risk' criterion where it can be shown that world leading advanced R&D is undertaken in Australia by Australians; whether or not undertaken with financial risk vesting in the Australian entity.