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# **Tax Laws Amendment (Research and Development) Bill 2010**

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Second Exposure Draft,  
31 March 2010

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AIIA Response,  
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## **EXECUTIVE SUMMARY**

AIIA welcomes this opportunity to provide comment on the Second Exposure Draft Tax Laws Amendment (Research and Development) Bill 2010, released on 31 March 2010. We note the changes in the second draft, which have to some extent incorporated industry concerns and corrected some of the inappropriate consequences of the first draft. In particular the abandonment of the multiple sales test is welcomed, as is the replacement of the former extensive software exclusions with a more limited in-house software exclusion. The generalised approach of not treating software R&D activity any differently from other R&D activity is welcomed.

While the overall sense of the latest changes are positive for the ICT sector, as a general principle AIIA notes that implementation of this new R&D regime will be the key determinant of its success or failure. Application and interpretation of guidelines of the scheme must remain flexible enough to ensure current (genuine) eligible activities are not excluded through inappropriate application of guidelines. AIIA has offered industry assistance to Department of Innovation, Industry, Science and Research and Treasury with the establishment of guidelines and/or training sessions for officials required to implement the new scheme.

Issues that remain of some ongoing concern to AIIA members are:

1. The administrative overheads imposed on applicants, especially SMEs, having to determine core as opposed to supporting activities
2. The interpretative difficulties of determining whether 'production' activities and excluded core activities are for the 'dominant' purpose of supporting core R&D
3. The continued extensive restrictions on commercially-focused R&D and the emphasis on scientific experiment as the basis of eligible R&D
4. Uncertainty about the application of apparent in-house software upgrades exclusions.

## **ABOUT AIIA**

The Australian Information Industry Association (AIIA) is Australia's peak technology industry body. Members involved in R&D activities under the current concession regime typically span large and small organisations and use web-based development tools and internet services to produce eligible R&D.

AIIA's role is to lead and represent the ICT industry in Australia to maximise the potential of the Australian economy and society. AIIA's membership encompasses all sectors of the ICT sector including hardware, software, services and telecommunications. It has almost 400 member companies, from individual consultants, small to medium enterprises to the world's leading multinational corporations.

AIIA member companies employ over 100,000 Australians, generate combined annual revenues of more than \$40 billion (approximately 5% of GDP) and export more than \$2 billion in goods and services each year.

## **Core and Supporting R&D activities**

The new and increased distinctions between core and supporting activities is necessary for tax integrity reasons and AIIA again welcomes efforts to reduce inappropriate claims on the tax credit regime and national revenue generally. However, the overheads required in interpreting which activities are core and which supporting (and the associated two tests of 'direct' or 'dominant') will require the provision to claimants of rigorous and sound guideline material and support.

The second draft is essentially a new and quite different R&D business support program from the one introduced in 1986. Changes to tax regimes of the magnitude proposed invariably have a greater impact on smaller organisations that cannot so readily absorb the costs of time devoted to administrative tasks such as interpretation of new legislation. This is especially the case when most of the institutional knowledge and experience of the current (1986) scheme is based on older concepts not readily transferred to the new credit scheme. New 'core' concepts, which now require claimants to assess whether they are seeking new information to solve a problem and whether they need to do an 'experiment' to uncover that knowledge, will require substantial and clear guidance to ensure legitimate activities are not excluded through lack of interpretative assistance.

## **Production Activities and the dominant purpose test**

It is unclear to AIIA why "the risk of the new R&D tax incentive inappropriately supporting 'business as usual activities' is greatest when production is involved." This seems to be a new concept and approach (FAQ document, page 3). Given that 'production' is defined as activities that 'produce goods or services', the application of a dominant purpose test to such activities risks the exclusion of otherwise eligible R&D that may be the outcome of 'production activities' in the software development (services) environment. AIIA suggests a clear example of the production of services and how the dominant purpose test might apply thereto is warranted.

## **Definitions**

The new definition of core activities is an improvement over the first draft. Removal of ambiguous concepts is welcomed. The emphasis on scientific method, hypotheses and experimental approaches appears to pre-suppose a 'laboratory' environment that may act as a disincentive to smaller organisations and less experienced claimants who undertake otherwise eligible software R&D in less structured ways. In today's Web and Cloud based environments software development takes place rapidly, real-time and in a distributed fashion. This of itself will not necessarily exclude software R&D but the initial perception of claimants may be that their activities do not comply because they do not seem to be 'scientific' or 'experimental'. This may dissuade such potential claimants from adopting the new tax credit regime.

## **In-house systems upgrades**

The policy intent as explained to AIIA in consultations is to specifically exclude public funding support for in-house changes or upgrades to existing software applications where the features and/or functionality remain largely unchanged from the user's perspective, i.e. the result is essentially business-as-usual. The reason for this is that even if some productivity gains may result, such gains mainly benefit the organisation undertaking the improvements; there is no spill-over to the wider economy. AIIA understands this policy intent, however notes that, since productivity is a major contributor to global competitiveness which in turn drives national wealth, providing incentives classified as other than R&D to encourage the adoption (including extension) of technology by both large and small organisations to increase productivity is an imperative.

The exclusion in the second draft (355-30 (o)), is, according to the Explanatory Material, aimed at 'certain in-house software', but not that which is "of an applied nature" (page 19) or which may qualify as supporting R&D. It remains unclear to AIIA whether this exclusion is intended to encompass upgrades, because the meaning of 'internal administration of business functions' is not a concept that has been defined in the draft or sufficiently clarified in the Explanatory Material. AIIA suggests that a simple textual addition that includes 'upgrades' as an example of internal administration would assist claimants. It would also help to meet the government's objective of not supporting activities which do not produce additional public benefit.