

19 April 2010

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

RE: NSW Business Chamber's R&D Tax Incentive Submission

The NSW Business Chamber welcomes this opportunity to comment on the second exposure draft of the *Tax Laws Amendment (Research and Development) Bill 2010*, released by the Government on 31 March 2010. The NSW Business Chamber represents the interests of over 30,000 companies across NSW and the ACT, ranging from owner-operators to corporations, and from manufacturers to service providers.

The NSW Business Chamber made a submission regarding the first exposure draft on 5 February 2010. Our submission raised concerns about the following proposed changes:

- Changing the definition of core activities, to require both novelty and high levels of technical risk;
- Restricting eligibility of supporting R&D activities through introduction of the dominant purpose test; and
- Dramatically limiting support for successful R&D through the augmented feedstock rule.

We note that the issues raised in our submission were very similar to those raised by other organisations, and were broadly reflective of the concerns generally held by most stakeholders.

In response to the feedback received, redrafting was undertaken by the Government to "ensure that the legislation is clearer and to remove unintended consequences."¹ Treasury's response to stakeholders set out the following key revisions to the legislation:

- The inclusion of a new definition for core R&D;
- Less restrictive treatment of supporting R&D activities;
- "Forgoing" the augmented feedstock rule; and
- A less restrictive approach to software exclusions.

The NSW Business Chamber supports many of the changes proposed in the letter. In particular, the removal of the augmented feedstock rule is strongly supported and entirely consistent with both our submission and the submissions of many other organisations.

¹ Treasury's letter of 31 March regarding the second exposure draft legislation for the new R&D Tax Incentive.

However, we do continue to hold some concerns about the legislation as currently drafted and the degree to which it gives effect to both the Government's policy intention and the statements set out in Treasury's letter of 31 March.

The object clause. The new object clause (s355-5), when taken in conjunction with the new definition for core R&D (discussed below), appears to reflect an intention to limit support to research and exclude development. This is despite the fact that development represents the largest and most important aspect of business expenditure on research and development. Removing support for development would shift commercialisation activity overseas and undermine the capacity of the scheme to secure the benefits of R&D for the Australian economy.

Such an outcome would appear to be completely at odds with the current understanding of the policy objective. A rewording of these sections is essential to explicitly make clear that the R&D tax incentive is aimed at supporting both research *and* development.

The new definition for core R&D. Treasury's consultation guide² states at paragraph 10 that the revised definition "uses clear language instead of ambiguous concepts." However, we would note that the introduction of a new test with new wordings and interpretations has the potential to create uncertainty. Similar concerns were raised by a number of parties in relation to the proposed inclusion of the term "considerable novelty" in the first exposure draft.

Augmented feedstock rule. We strongly support the decision in the consultation guide at paragraph 25 to remove the augmented feedstock rule. However, it appears that the proposed legislation regarding feedstock has not yet been drafted, and the exposure draft simply states that "a feedstock adjustment rule is under consideration." We are disappointed that stakeholders have not been provided with the opportunity to review and comment on this aspect of the legislation. We recommend that this section of the legislation be released for comment once it has been drafted, to confirm that the rule is implemented in a manner consistent with the policy intent set out in the consultation guide.

The dominant purpose test. We previously raised concerns about the dominant purpose test, noting that the requirement for businesses to differentiate between core and supporting R&D, and then identify the dominant purpose of supporting R&D, would increase both complexity and uncertainty. While the proposed changes in the second exposure draft would reduce the range of circumstances in which the dominant purpose test would be applied, the potential problems associated with the application of this rule remain.

In looking at the overall suite of proposed policy changes, we acknowledge the Government's publicly stated policy intent that the aggregate impact of the legislation be Budget neutral. However, much of the commentary in submissions to date has suggested that the proposed changes would actually result in a significant reduction in aggregate Government support for R&D.

² Treasury, *The new research and development tax incentive, consultation guide – 2nd exposure draft*, March 2010.

The Government could provide greater assurance and transparency to the community by publicly releasing its costings, outlining the expected savings which would flow from each of the proposed tightenings in eligibility criteria, and demonstrating that, in aggregate, the legislative amendments were Budget neutral. Such an approach is recommended.

In summary, while we are supportive of many aspects of the proposed legislative changes, there are still areas where we believe the legislation could be improved to better meet the Government's publicly stated policy intent without undermining a desire for the changes to be revenue neutral. Procedurally, providing stakeholders with the opportunity to comment on the redrafted feedstock provisions, and publicly releasing the anticipated budgetary impacts of the legislative changes could be expected to lead to more well considered policy outcomes.

Should you require further information or clarification regarding our position, then please do not hesitate to contact Mr Micah Green, Policy Adviser Tax & Competitiveness on 02 9458 7259 or via e-mail at micah.green@nswbc.com.au.

Yours sincerely,



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