

Ref: GN/KL/AS/cmb



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19 April 2010

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Pitcher Partners, including Johnston Rorke,
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Dear Sir/Ms

Tax Laws Amendment (Research and Development) Bill 2010 ("the ED")

For the purposes of this submission Pitcher Partners comprises 5 independent firms¹ operating in Adelaide, Brisbane, Melbourne, Perth and Sydney. Collectively we would be regarded as one of the largest accounting associations outside the Big Four. Our specialisation is servicing and advising smaller public companies, large family businesses, small to medium enterprises ("SMEs") and high wealth individuals - which we refer to as "the middle market" or "our target client base" in this submission. Thus our focus in reviewing the ED is on its implications for the middle market.

We are making this submission to highlight the concerns that we have regarding the ED - which proposes legislation to replace the research and development ("R&D") concessions in the Income Tax Assessment Act 1936 ("the 1936 Tax Act").

General comments on the R&D tax concessions and the ED

The current R&D tax concessions in the 1936 Tax Act have, in our experience, failed to encourage R&D to be conducted in the middle market. We were thus, initially pleased to note that the Government claims that the new R&D tax regime is designed to promote innovation in our target client base.

After reviewing the ED however, it is our view that unless fundamental changes are made to the proposed R&D tax regime in the ED it will probably also fail to encourage R&D to be conducted in the middle market.

¹ Including Johnston Rorke in Queensland.



The reason that we believe the new R&D tax regime outlined in the ED will probably fail to promote innovation in our target client base is the same reason that the current regime has failed - both the current and proposed R&D tax regimes exclude trusts.

That is, in the middle market trusts are a far more preferred business vehicle than companies - in fact, at best, companies are only on par with trusts as a business vehicle in this segment. (We also note that there are often commercial factors that make re-structuring from a trust to a corporate structure difficult - in fact, sometimes these commercial factors will even prevent such a re-structure).

To exclude trusts from being able to claim the benefit of the R&D tax concessions is to immediately disadvantage a large section of otherwise eligible claimants - if the Government is serious in its desire to encourage innovation in our target client base it will allow trusts (both fixed and non-fixed) to access the benefits of the R&D regime.²

Specific Comments on the ED

Whilst the Government has made some improvements to the proposed R&D tax incentive in the ED, these improvements are not enough to convince us that the new scheme will enhance business expenditure on R&D - in fact, we still fear that the proposed changes will actually undermine (rather than enhance) business expenditure on R&D.

We note that the new definition of R&D no longer uses terms such as "considerable novelty" and "high levels of technical risk" - effectively however, the underlying concepts which those terms represent are still contained within the revised definitions. Furthermore, we fear that this more restrictive definition of R&D will result in greater uncertainty as to what will be eligible R&D activities and therefore, will undermine the incentive nature of the concession.

The other area of uncertainty revolves around the scope of supporting R&D activities that are production activities or are directly related to production activities. The potentially wide breadth of such supporting R&D activities and the stricter dominant purpose test applied to these supporting activities serves as a disincentive to the conduct of R&D activities.

These stricter definitional requirements are further compounded by the multiple layers of testing and complexity introduced by the ED. In particular, taxpayers will need to determine whether they have any:

² If allowing non-fixed trusts to access the R&D tax regime is regarded as 'too risky' (so to speak) because it may allow amounts that have been sheltered by the R&D tax concession to be distributed to beneficiaries tax free, at the very least the Government should allow fixed interest trusts whose beneficiaries are subject to CGT event E4 to access the regime. This is because any distribution of a non-assessable amount that has been sheltered by the R&D tax concession in the case of a fixed interest trust will have tax consequences for its beneficiaries (i.e. it will either reduce the cost base of a beneficiary's interest in the trust, thus increasing any future capital gain, or directly result in an assessable capital gain for the beneficiary).



- core R&D activities;
- directly related supporting activities;
- supporting activities that are undertaken for the dominant purpose of assisting core R&D;
- excluded activities; and
- (finally) R&D activities that are potentially "production activities".

This level of complexity will serve as a disincentive to claimants in the middle market.

Further information

Please do not hesitate to contact either the writer (on 03 8610 5463), Kevin Lock (on 03 8610 5426) or Ali Suleyman (on 03 8610 5520) should you require any clarification of our comments.

Yours faithfully

PITCHER PARTNERS ADVISORS PROPRIETARY LIMITED

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