

Senate Select Committee on Financial Technology and Regulatory Technology
Department of the Senate
Parliament House, Canberra
By email: fintech.sen@aph.gov.au

11 August 2020

Dear Sir/Madam

Re: Request for additional information on R&D Tax Incentive arrangements

Thank you for the opportunity to contribute further to the ongoing inquiry on financial and regulatory technology.

With respect to the questions you asked, please find answers below:

- *Could you provide some examples of what type of software development StartupAus considers should be included in the R&DTI scheme?*

The current iteration of RDTI was introduced in 2010 with the intention of aligning software development with other forms of R&D. The Minister said in his second reading speech:

Recognising the pervasive nature of information technology in a modern economy, the new R&D Tax Incentive will ensure most software R&D is treated consistently with R&D occurring in other sectors.

Most software development should therefore qualify as eligible R&D, providing it meets legislative requirements. The bulk of software development is not currently eligible, however, as an increasingly narrow interpretation of the 'new knowledge' requirement has been applied.

Under s355-25(1)(b) of the Act, 'Core R&D Activities' are required to be conducted for the purpose of generating new knowledge. Importantly, s355-25(1)(b) identifies that 'new

knowledge' includes 'new knowledge in the form of new or improved materials, products, devices, processes or services'.

If this language in s355-25(b) is given full effect, software development which is done with the effect of producing 'new products', 'new devices', 'new processes', or 'new services' would be included as a Core R&D Activity, provided companies can meet the stringent legislative evidence and process requirements. This would include most software development, in line with the original intention of the scheme as outlined in the second reading speech.

Examples include:

- Experimental development of new software to meet an identified or hypothesised commercial market gap.
- Software development processes designed to iteratively add innovative features to an existing software product.
- Testing, improving, and refining software or software features identified above using innovative software development methods.

The current narrow focus of the interpretation of the 'new knowledge' component incorrectly limits the definition in favour of *research* and *invention* focused R&D, ignoring *development* and *innovation* focused activities (which are often more directly commercially applicable).

- ***What specific changes would need to be made to adequately address the treatment of software development under the RDTI?***

In the immediate term, there needs to be some reassurance given to vulnerable software companies. Firms with turnover of less than \$20m that have been claiming the incentive in good faith and on credible professional advice need to be confident that they are not going to be subject to audit processes unless their claims are manifestly unreasonable or have had sharp unfounded increases. **A moratorium on reviews and clawbacks** within these parameters should be introduced and remain in place until the introduction of a clear legislative fix to the way the R&D Tax Incentive operates or a new scheme that directly supports software development is implemented. This would help address uncertainty and reduce existential risk for good-faith claimants.

Reducing clawbacks helps reduce the immediate harm caused by software falling out of the RDTI, but it doesn't solve the larger problem: the outflow of support and capital from an area of activity vital for Australia's long term economic prosperity.

To address this, a clear path to supporting technology companies doing genuine software development work in Australia should be formulated. This goal can be achieved by adjusting the language of the legislation to meet the original intention that a broad array of software development activities qualify as Core R&D Activities.

StartupAUS proposed recommendations

1. That a moratorium be introduced on administrative reviews of good-faith R&D software claims filed by firms under \$20m in turnover until 1 July 2021.
2. That software development be explicitly identified as a Core R&D Activity in s355-25 with the addition of the following:
355-25
(1A) Software development activities will constitute Core R&D Activities where they satisfy 355-25(1) and generate new knowledge or improve on existing software products, devices, processes or services. This includes:
 - (a) development of new software to meet an identified or hypothesised commercial market gap;
 - (b) software development processes designed to iteratively add new features to an existing software product; and
 - (c) testing, improving, and refining software or software features.

Please contact me if you have any questions.

Yours faithfully,

Alex McCauley
CEO, StartupAUS