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1 November 2018

Dear Sir/Madam

**Inquiry into the provisions of the Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 - R&D Tax Incentive**

Thank you for the opportunity to provide information in relation to your inquiry into the provisions of the *Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018* ("the Bill") relating to the R&D Tax Incentive (RDTI), the relevant items being Schedules 1, 2 and 3.

The Bill's proposed changes to the RDTI follow several years of review, including most recently, Treasury's consultation on an exposure draft titled *Treasury Laws Amendment (Research and Development Incentive) Bill 2018* ("the ED") and its accompanying consultation paper.

The RDTI provisions in the Bill have much in common with the ED. We have attached our submission to the Treasury consultation on the ED.

In the Bill, the government has taken welcome action in relation to a number of matters covered by recommendations in our submission. The matters raised in our submission which have not been addressed in the Bill and would in particular merit further consideration by the Committee are the following:

- The implementation of the intensity provisions should be reconsidered or deferred until 1 July 2019. Deferral will allow taxpayers time to adjust their R&D investment plans in response to the proposed law changes which were announced in May 2018.
- Consideration should be given to excluding certain expenditure from the "expenditure" denominator in the R&D intensity calculation. In particular we are concerned about financing costs (otherwise entities would have a different intensity based on whether they can self-fund R&D or need to borrow) and those costs which are specifically ineligible as notional deductions under the RDTI.

- The definition of "clinical trials" should be modified to specifically include certain R&D activities which must occur in order for in-human trials to be possible, such as toxicology analysis and the short-run manufacturing of the drug or device that is to be trialled.
- The legislation should make clear that additional assessable income arising from a feedstock or clawback adjustments is not "ordinary income" and will therefore not be included in the calculation of the annual turnover of the entity.

In terms of the overall RDTI policy direction, our fear is that the proposed intensity measure may accelerate the current negative trajectory in business expenditure on R&D, and that the 4% rate would not be sufficient to represent a genuine incentive to undertake additional R&D.

International experience, and indeed Australia's prior experience, indicates that a base rate of at least 7.5% needs to be in place in order for business to regard it as a genuine incentive.

We support the need to have a well-balanced and fiscally viable RDTI and we were pleased to see the Bill address the following issues raised in our submission to the ED:

- Clarification on the definition of total expenses to be either those worked out in accordance with Australian accounting standards or (where those do not apply), commercially accepted principles relating to accounting (see KPMG recommendations two and five);
- Exclusion of certain expenditure from the denominator, such as where it would result in double counting (see KPMG comment three);
- Clarification that clinical trials include the in-human trialling of medical devices (see KPMG comment eight);
- Deferral of publication of RDTI entity details until 24 months after the end of the entity's financial year (see KPMG comment 12).

Our other comments remain relevant and we hope the attached submission is of value to the Inquiry.

Yours sincerely

[redacted]

David H Gelb
Partner

Yours sincerely

[redacted]

Grant Wardell-Johnson
Partner