CORPORATE TAX ASSOCIATION
of Australia Incorporated

26 May 2010

Department of the Senate
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SUBMISSION ON TAX LAWS AMENDMENT (RESEARCH AND DEVELOPMENT) BILL 2010

The Corporate Tax Association (CTA), which represents the taxation interests of about 120 of Australia's largest companies, welcomes this opportunity to offer comments on the Tax Laws Amendment (Research and Development) Bill 2010 (the Bill) as referred to the Senate Economics Legislation Committee on 13 May.

Although we can see that a number of the concerns we expressed in our earlier submissions have been addressed in the Bill, we remain concerned about what we see as the re-orientation of the incentive away from experimental development and more towards basic and applied research. We believe this is likely to have an adverse impact on a critical element of business R&D in this country. This impact needs to be considered in the context of R&D activities being increasingly mobile and the offer of worthwhile tax incentives for R&D in other countries.

From what members have said to us, many corporates expect to see their claims reduced significantly, mainly as a result of the proposed dominant purpose test for supporting R&D activities in a production environment. In some cases, corporates may form the view that the compliance costs involved in working up a claim are not warranted, and will not register projects they might have under the existing rules.

If the law is to be changed on the basis of the Bill as currently drafted, we strongly urge the government to monitor the level of claims – particularly for large business. In the event that the level of claims drops in a way that was not anticipated the government should move quickly to fine tune the eligibility rules so that an appropriate level of industry support is restored.

Objects Clause

During the course of the public consultation process last year the CTA and other external stakeholders urged the government not to include an objects clause that refers to R&D activities that would not otherwise occur and which are likely to involve spill-over benefits for the broader community. We are disappointed this remains a feature of

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the Bill because we consider there is a risk that, at the margin, a court or tribunal might be guided by such language in resolving disputed claims.

While those concepts may be well and good, they are impossible to prove and therefore should not be part of the statutory framework – even as part of an objects clause. Such language might well be appropriate for a second reading speech but, in our view, does not belong in the law itself. We would much prefer the objects clause to make reference to increasing the efficiency and international competitiveness of Australian business, which reflects what we regard as the proper rationale for the incentive.

Definition of Core R&D

The September 2009 Discussion Paper indicated the definition of core R&D was to be brought more in line with the Frascati definition. We consider that, broadly speaking, the existing sec 79B definition already reflected the Frascati definition whereas the proposed new definition does not. The proposed new definition covers basic research and applied research, but omits experimental development – yet this is where much of the R&D undertaken by business takes place.

We are also concerned that the language used in the definition of core R&D will lead the agencies to look for a high degree of formality in precisely defining the knowledge gap, and that it will create unrealistic expectations about the kind of scientific experiments that characterise pure or basic research, but not necessarily applied or developmental research.

Dominant Purpose Test – supporting R&D

There is, in our view, a very serious risk that much legitimate developmental research conducted by business and which contributes to making Australian business more efficient and competitive will be rendered ineligible by the introduction of a dominant purpose test for R&D – particularly when combined with a definition of core R&D that expresses a bias towards basic and applied research and looks for experiments using scientific methods.

We have previously argued that the government's revenue neutrality objective could be more easily and transparently achieved by applying a cap on the amount of eligible R&D expenditure. Such a cap would apply to consolidated groups on a per annum basis. It would be accepted by most large corporates as equitable and at the same time avoid the compliance costs and uncertainty that would accompany the proposed regime.

Increased compliance and uncertainty

The structure of the core and supporting R&D provisions will not only unduly limit corporate R&D claims but will also result in significantly higher compliance costs. The increased costs will be most obvious in the level of documentation required to support the principle of 'established science' (which in many cases will not be readily available)

and the increased burden arising from the need to distinguish between core and supporting activities as a result of the introduction of the dominant purpose test.

'New to the World' Test

On the question of new knowledge, a number of commentators have expressed concerns that the Bill imposes a "new to the world" test rather than a "new to the company" test, which was a feature of the existing regime. We are not sure whether raising the bar on newness in this way was, in fact, intended. If it was, we would strongly argue that a "new to the world" test would reflect a fundamental misunderstanding of how R&D works in a commercial environment.

Very few business R&D projects are aimed at making groundbreaking discoveries. Rather, they involve the more prosaic but nevertheless critical process of achieving step improvements in things as mundane as filling containers with food products while more efficiently minimising waste. Either way, the Bill needs to make it clear that seeking information or knowledge that is not reasonably available on commercial terms (excluding reverse engineering) is just as worthy a pursuit and should be supported by the incentive.

Revenue neutrality

In relation to the need for the changes to the incentive to be revenue neutral, we note that no modelling on the revenue impact of these changes has been released. To this end we remain of the view that the removal of the premium scheme (which we support) will in itself go a long way to recouping the cost of the various ways in which the incentive is to be improved.

Thank you again for this opportunity to offer comments on the Bill. Please feel free to contact me should you wish to discuss any aspects of this submission further.

Best regards,

(...)

Frank Drenth
Executive Director
Corporate Tax Association