CPA Australia Ltd
ABN 64 008 392 452
Level 20, 28 Freshwater Place
Southbank VIC 3006
Australia
GPO Box 2820
Melbourne VIC 3001
Australia
Phone 1300 737 373
Outside Aust +613 9606 9677
Website cpaaustralia.com.au

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Dr Kathleen Dermody
Committee Secretary
Senate Economics Legislation Committee, SG.64
PO Box 6100
Parliament House
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Dr Dermody,

SUBJECT: SUBMISSION ON TAX LAWS AMENDMENT (RESEARCH AND DEVELOPMENT) BILL 2013

CPA Australia represents the diverse interests of more than 150,000 finance, accounting and business professionals in 121 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders.

Against this background we provide this submission concerning the proposed amendments to the research and development (R&D) tax incentive in Tax Laws Amendment (Research and Development) Bill 2013 (the R&D Bill) and the accompanying Explanatory Memorandum (EM) which are the subject of a current inquiry by the Senate Economics Legislation Committee.

General comments

CPA Australia has long stated that Australian businesses of all sizes need to be encouraged to continually innovate in order to ensure that they are internationally competitive and to realise the opportunities presented by the Asian Century.

We have therefore supported initiatives, such as the R&D tax incentive, as part of a broad holistic policy framework to help foster and embed an innovative culture within Australian businesses and to ensure that Australia is not in an uncompetitive position in attracting and retaining the intellectual capital required to develop technology and realise the spill-over benefits it provides to the broader economy.

However, given the tight fiscal environment we note the Government's intention to limit access to the R&D tax incentives for Australia's largest companies. If the Bill is to proceed, we recommend that a post implementation review of the economic and competitiveness impacts of the change be undertaken three years after the proposed commencement date of the amending legislation. This will enable the Government to gauge whether this cut in R&D support has significantly reduced the R&D spend of Australian affected corporate groups or encouraged them to relocate their R&D programs offshore to more tax competitive jurisdictions.

It would also be prudent as part of this review to determine whether the proposed criterion of a $20 billion assessable income cap will create asymmetrical outcomes where an ineligible Australian headquartered corporate group with $20 billion group turnover does not carry out local R&D activities but a foreign owned competitor with worldwide turnover well in excess of $20 billion conducts local R&D even though their domestic assessable income is below this $20 billion limit. Such an outcome appears counterintuitive to one of the underlying purposes of the incentive.

The above factors should also be considered in the proposed Taxation White Paper and any future review of the incentive by the Productivity Commission.

Specific comments

We also make the following specific comments in respect of the proposed $20 billion aggregated assessable income test:

- For the purposes of calculating the $20 billion aggregated assessable income cap under proposed section 355-103(2) of the Income Tax Assessment Act (1997) (the ITAA (1997)), assessable income will not only include the R&D entity's assessable income but also the assessable income of any entity that it is connected with it, entities it is affiliated with and entities which are affiliated with it.

  As illustrated in Example 1of the EM, the inclusion of the assessable income of an entity which is affiliated with the R&D entity refers to the assessable income of a foreign owned parent company where the Australian entity is expected to act in accordance with the wishes of that foreign parent.

  In contrast an entity which is an affiliate of the R&D entity will include a local company which is not wholly owned but which is expected to act in accordance with the wishes of the R&D entity.

  We recognise that the inclusion of the assessable income of such affiliates may prevent certain avoidance opportunities.

  Firstly, by ensuring that a foreign parent does not directly derive Australian assessable income that would otherwise have been derived by the local R&D entity and cause it to breach its $20 million cap, and secondly by having a partly owned local company carry out R&D activities on its behalf in lieu of a wholly owned subsidiary where the company acts in accordance with the wishes and directions of the R&D entity.

  Accordingly, we recognise that any 'grouped' assessable income under the proposed $20 billion cap should include the assessable income of both the foreign parent and any non wholly owned company which is effectively controlled by the R&D entity.

  However, we are concerned that this grouping mechanism is being achieved through the use of the 'affiliate' concept defined under section 328-130 of the ITAA (1997).

  To recap, section 328-130 of the ITAA (1997) provides that an individual or a company is an affiliate of a taxpayer if the individual or company acts, or could reasonably be expected to act, in accordance with the taxpayer's directions or wishes, or in concert with the taxpayer, in relation to the affairs of the business of the individual or company.

  From a practical perspective it should be noted that the above concept of affiliate was designed to determine the potential eligibility of small business entities which met the $2 million aggregated turnover test to access certain tax concessions particularly the small business capital gains tax concessions.

  Accordingly, the provision was designed to ensure that the turnover of an individual or company could be included in the calculation of the $2 million aggregated turnover test of a small to medium sized enterprise (SME) where an individual or company was informally controlled by another entity who could either direct their actions or who could act in concert with them.

  However, this test is inherently subjective and its application is dependent on the particular facts in issue. Accordingly, many tax practitioners and their clients have found the 'affiliate' concept extremely difficult to apply in practice even in the SME market.

  This difficulty has been compounded by the lack of any current binding public taxation rulings from the Australian Taxation Office (ATO) to clarify when an individual or company will be acting in accordance with another entity's directions or acting in concert with such an entity for section 328-130 purposes.

  Given the Federal Government's commitment to reducing complexity and regulation we therefore believe that a more appropriate grouping test would be a modified form of continuity of ownership test under section 165-12 of the ITAA (1997).

  Under such a test the aggregated assessable income of the R&D entity would include the assessable income of any foreign parent company which owns shares carrying more than 50 per cent of the capital, dividend and voting rights of the R&D company, and the assessable income of any company in respect of which the R&D entity owns shares carrying more than 50 per cent of the capital, dividend and voting rights in that subsidiary company.

Such an approach would ensure that the grouping mechanism was objectively determined thereby providing more certainty for larger corporate groups and their tax advisers who are highly familiar with the application of the continuity of ownership test.

It would also have the added benefit of ensuring that there would be no need to include the assessable income of a connected entity as defined under section 38-125 of the ITAA (1997). This is another concept under the small business entity provisions which is proposed to be applied to large corporate groups as related parent or non-wholly subsidiary entities of an R&D entity in large corporate groups with a turnover of $20 billion will overwhelmingly be companies.

Thus, by extrapolating the 'more than 50 per cent test' in the above way significant simplicity could be obtained as it would no longer be necessary to include the assessable income of any affiliate or connected entity under the $20 billion or more aggregate assessable income cap; and

- The commentary and examples in the EM concerning the application of the proposed $20 billion aggregated assessable income test do not currently recognise that the companies seeking to satisfy this test will invariably be the head company of a consolidated group or multiple entry consolidated group which will automatically include the assessable income of wholly owned companies, trusts and partnerships within that group.

  We believe that the efficacy of the EM would be further improved if the commentary and examples were amended to illustrate the interaction of the proposed $20 billion aggregated assessable income test and the tax consolidation provisions.

If you have any questions regarding the above, please contact Mark Morris, Senior Tax Counsel

Yours faithfully

Paul Drum FCPA
Head of Policy