AUSTRALIA'S INNOVATION SYSTEM

CPA Australia's submission to the Senate Economics References Committee

July 2014

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CPA AUSTRALIA

About CPA Australia

CPA Australia is one of the world's largest accounting bodies with a membership of more than 150,000 finance, accounting and business professionals working in over 121 countries across the globe.

We have a history that stretches back to 1886, and have been actively involved in Asia since the early 1950's. We currently have nine offices in Asia and more than 35,000 members working in the region.

CPA Australia is committed to a creative engagement with governments and their agencies on behalf of members and in the broader public interest to encourage the adoption of economic and social policies that foster improvements in Australia's productivity and global competitiveness.

Innovation in Australia

By our nature, Australians are an innovative people.

As a nation we have created innovations which have transformed the lives, and businesses, of people around the world. From cochlear implants to spray on skin, building techniques including the Favco tower crane, the black box flight recorder in aircraft safety and world leading technological advances including Wi-Fi and the first quantum bit, the list ought to be a source of national pride.

However while our inventors and innovators have always had to compete with the best and brightest elsewhere, globalisation has transformed the way we do business. With advances in technology over the past few decades we have seen the advent of global supply chains, expanded global distribution networks, and more importantly for Australia, the need to compete on a global basis not just for ideas, but to keep them onshore.

Just as this major transformation has occurred in the way goods and services are produced, the same can be said about how, and more importantly for Australia, where global businesses innovate.

With our changed global world it is appropriate that Australia take a step back and look at what we want to achieve, and what it is going to take to underpin our international competitiveness. The answer for most developed economies invariably comes to a few key issues - productivity, competitiveness and innovation.

This is the same conversation that is happening around the world and the answer is complex.

In part it relates to the ability of business and governments to have the right mindset to look forward and to realise that we are no longer merely competing for research and development grants, but rather what we offer, or don't offer, as a country to support innovation. The answer to this question for many firms today is having a very real impact on the decisions of global and Australian firms to establish, expand and even to leave Australia. Innovation policy may not be about getting in front, at this critical stage it may just be about not getting left behind.

It is in this context that we see this review and its vital importance for Australia's future.

Establishing a 'culture of innovation' in Australia?

An important starting point is how broadly we define innovation.

To some it will mean new ideas, new methods of doing an existing task or the commercialisation of new ideas. To others it will mean a completely new product, a new market or a new technology which has the potential to change peoples' daily lives.

We believe it should encompass all of this, and more.

In recent conversations CPA Australia has had with industry about innovation in Australia, a reoccurring theme is the need to develop and nurture an 'innovative culture' in Australia. The central theme remained the same – Australia needs the right incentives and support from government, business and other key stakeholders if we are to change our mindset when it comes to innovation. We need to make innovation a part of the systemic thinking of both Australian business and government. Innovation needs to become a part of how we do business every day, not something special or unique.

This idea is not new. In a Harvard Business Review case study on design thinking and innovation the authors posed a simple question: Imagine that Apple takes over your company. What would it change? One good question can allow you to look from the outside in. By asking the right questions, you can get amazing solutions.

It is this simple but important lesson that could change the way that Australia and Australian businesses look to the future.

What this case study illustrated was that the innovators of MP3 players failed to take the idea to its natural conclusion. Rather, they stopped short of asking the next round of innovation questions, and therefore failed to see the transformative effect that this technology could have on the global music industry. Apple saw this opportunity and developed the industry changing technology behind iTunes – and the rest is history.

It is this innovative way of thinking which needs to become a part of our culture if we are to create, and compete, in the new and globalised world.

This brief example also illustrates that innovation, in the most part, is driven by commercial imperatives and led by business. Rather than create, it is government's role to support innovation and ensure that the policy settings are such that innovation is allowed to thrive, rather than be stifled by misaligned and competing policies and objectives.

So what action can be taken now to support Australia's innovative future?

CPA Australia believes the fundamental tenets of a robust and enduring national innovation policy is the implementation and maintenance of an internationally competitive income tax regime, with specific policy settings designed to attract and retain both the human and financial capital necessary to increase national productivity and our international competitiveness on a sustained basis.

Tax policy should not only be directed at nurturing initial research and development (R&D) activities but should also be extended to provide a range of specific new incentives to encourage third parties to invest in appropriate innovative projects and to reward entrepreneurs. This can be done in a number of ways, such as the current R&D incentive, but also by concessionally taxing any royalty income or capital gains arising from the licence or sale of related patented intellectual property.

The development of such a 'whole of business life' set of complementary tax policies will assist in the development, commercialisation and successful exploitation of new products, processes and services that will help transform Australia into a more knowledge based and innovative economy.

CPA Australia calls on this review to inform and guide the upcoming tax white paper to ensure that innovation in Australia is supported, rather than hindered, by our tax system. Australia's tax system should be our competitive advantage which encourages and attracts investment and innovation in Australia.

Specific tax measures

CPA Australia recommends the following specific tax initiatives which should be embedded as part of our ongoing national innovation agenda:

1. Retain the existing R&D tax incentive for all Australian companies, including for large companies with turnover greater than $20 billion. CPA Australia also supports lifting the threshold for SME's who are eligible for the refundable 45 per cent tax offset from the current $20 million turnover limit to a $50 million turnover limit. This change will increase the vital cash flow that is so important to innovative start-ups and those at an early stage in their development;

2. We need to improve the access to funding and the attractiveness of investing in innovations in Australia. CPA Australia suggests that revision of the rules associated with venture capital limited partnerships would go some way to addressing this major barrier to innovation, and

3. The creation of a tax incentive based on the UK patent box regime, or similar, so that the income stream and capital gain arising from the licensing or sale of successfully patented R&D is taxed at a low, and attractive, rate. Importantly this rate would need to be set at a level that matches, and ideally betters, that offered by the UK other countries. Only through this change will Australia be seen as an attractive place to invest in innovation. Associated to this is the need to improve the simplicity and ease of obtaining and enforcing Australian and global patents for Australian firms. Such policies would lift Australia's global competitiveness and investment attractiveness of Australia to multinational companies.

Each of these specific recommendations is discussed further below:

1. Retention of R&D tax incentive

CPA Australia has long advocated that an internationally competitive R&D tax incentive be maintained. This was extensively discussed in our submission to Treasury, dated 26 October 2009, on the design features of the current R&D tax incentive (attached).

In our view it is paramount that the R&D tax incentive be fundamentally retained in its existing form so that companies of all sizes, including those with turnovers above $20 billion, and across different industries, have certainty regarding potential R&D tax credits when making medium and long term investment decisions.

It is better that we incentivise large multi-national entities to conduct their job-creating research and development work in Australia, rather than encourage them to shift those activities to other, more tax attractive jurisdictions in our region.

The value of R&D tax credits has been supported by a number of academic studies including by Nick Bloom, Rachel Griffith and John Van Reenen in their article entitled 'Do R&D tax credits work? Evidence from a panel of countries 1979-1997' which concluded that '…The econometric analysis suggests that tax changes significantly effect the level of R&D even after controlling for demand, country-specific fixed effects and world macro-economic shocks. The impact elasticity is not large (just over 20.1), but over the long-run may be more substantial….'[1]

Despite this study being undertaken some time ago, it highlights the correlation between an effective R&D tax policy which encourages innovation and actual business investment in research and development. This is further supported by real work experience where international investments in R&D have increased in line with the increase in R&D tax incentives being offered by governments around the world.

From the Australian perspective, the R&D tax incentive under Division 355 of the Income Tax Assessment Act 1997 (ITAA 1997) has had the advantage of being broadly based, reasonably stable and typically well understood by the tax profession and the business community.

As such it has been regarded as far more reliable to business than the making of industry specific grants, which have lacked the transparency, reliability and clarity as the R&D tax incentive.

Given the various changes to the R&D regime from the year ended 30 June 2012, we believe that it is now imperative to minimise any material changes to the R&D tax incentive going forward so that investors and other stakeholders can have some degree of certainty in making future investment decisions.

As a result we do not support the current proposal to exclude companies with aggregated assessable income of $20 billion or more from the concessional 40 per cent non-refundable tax offset. If progressed, this proposal may have a significant negative impact R&D investment and innovation decisions by large multinational entities in Australia and will significantly decrease Australia's attractiveness as a destination to undertake R&D.

In our view the only significant change required to the R&D incentive is to increase access to the 45 per cent refundable R&D tax offset to help fund the R&D activities of a broader range of SME companies.

As such we support extending the scheme to companies whose aggregated turnover is $50 million or less, rather than the $20 million limit that currently applies. This would send a clear signal that Australia supports business led innovation and R&D in the SME sector.

[1] Journal of Public Economics 85 (2002) at page 21

This position accords with Recommendation 8.3 of the Cutler review into the National Innovation System from 2008.[2]

2. Recalibrated venture capital limited partnerships

In our experience the most vexing issue associated with most R&D activities is often the inability of a company to move from the start-up phase to the commercialisation of the new or improved product, process or service. In many cases the main problem is the access to appropriate funding, such as venture capital.

To remedy this limitation we believe that there is some benefit in revising the current tax rules associated with venture capital limited partnerships to allow for a full CGT exemption to apply to the disposal of an investment held in such a partnership, subject to appropriate eligibility criteria.

For example, to provide some rigour around this type of regime, any entity may be required to meet specific governance standards that would be set by Innovation Australia, have a minimum funding of, say, $200 million to provide for a diversified investment portfolio and a possible further requirement that over 70 per cent of the funds raised would need to be spent on eligible R&D activities that are undertaken within Australia.

Unlike the existing early stage venture capital limited partnerships the fund's operation would not be limited to early stage development and commercialisation but would relate to any part of the life cycle of the innovation – from development to commercialisation. Furthermore, any entity (including a complying superannuation fund) would have the option of acquiring up to 50 per cent of the investment in any such limited partnership.

Other alternate means of providing financial assistance to enable start up R&D companies to expand could include:

- Introducing a competitive innovation grants program broadly along the lines suggested under Recommendation 9.1 of the 'ventorousaustralia' report.[3] The aim here would be to provide selected capital strapped companies with sufficient funds to finance the expansion of their operations. Eligibility for this funding could be based on the merits of both the intellectual property developed and its capacity for broader commercial exploitation. This could be capped to provide assistance to, say, the top 400 innovative companies requiring financial assistance. However, rather than require repayment of any grant funding, Innovation Australia could be issued a nominal or minority equity interest in the company so that part of any future royalty income stream is retained by the Government in return for their early funding support; and

- Reinstate R&D concessional loans with appropriate interest holidays so that a certain portion of the principal can be invested in the commercialisation of R&D under an investment

[2] Venturous Australia Report, Cutler & Company Pty Ltd, 2008 at page 22
[3] Venturous Australia Report, Cutler & Company Pty Ltd, 2008 at page 23

strategy agreed by Innovation Australia. Care would need to be taken in designing such a regime to minimise the risk of default of principal loan repayments.

One of the issues that has arisen in Australia over recent years and is a part of many innovation and infrastructure debates is the desire, or potential, for government to 'tap' into the significant funds currently held within the Australian superannuation industry.

First and foremost, the responsibility of superannuation fund trustees is to act in the best interest of fund members. Their primary objective is long term retirement savings, that is, growing and maximising their members' retirement savings. As such, funds may be encouraged to adopt particular investment principles, or to make particular investments, such as in infrastructure or venture capital, but only if there is an economic benefit to members and it is in members' best interests.

However, fund investments, should not be mandated in any way. For funds to invest in particular 'causes' or in a particular way, the investments must be compatible with the retirement savings goals of fund members and be economically attractive in their own right or through appropriate incentives. Restricting investments may result in a distortion of markets and may not provide the optimal outcome for fund members. Mandating a particular investment may place unsustainable demand on a particular asset class, attract investments away from well performing asset classes or lock investors into falling markets.

3. Enact patent box regime for patented intellectual property

CPA Australia believes that there is considerable merit in creating a tax regime based on the 'patent box' tax incentive recently introduced in the United Kingdom.

This would be especially important to the 'top 100' corporate groups as this would increase the attractiveness of undertaking risky R&D in Australia. It would also increase Australia's attractiveness to those businesses that rely on R&D developments such as the pharmaceutical industry, who would be rewarded for undertaking these activities in Australia, by having any income streams and capital gains arising from the licencing or sale of any resulting patented intellectual property taxed at a significantly reduced tax rate.

Such an initiative would help Australia retain and attract internationally mobile capital to especially in key industry sectors such as pharmaceuticals and the digital technology.

Given the global nature of investments in innovation, the failure of Australia to introduce a patent box type scheme will result in Australia becoming increasingly uncompetitive as other countries are likely to introduce these types of schemes over coming years to compete with the UK model.

Complementary Tax Measures

Apart from the specific initiatives already discussed, we believe that the capacity of companies to undertake R&D in Australia will be significantly improved if they are complemented by a broader range of more generic tax reforms. These include:

1. Cut in corporate tax rate

CPA Australia believes that the capacity of business to invest in R&D will be enhanced by a reduction in Australia's corporate tax rate.

Despite the proposed 1.5 per cent Paid Parental Levy on Australian businesses earning taxable income of more than $5 million, we have welcomed the current Government's commitment to reducing the company tax rate by 1.5 per cent to 28.5 per cent from 1 July 2015. This policy is in accordance with our long held view that the company tax rate should be reduced to a more internationally competitive rate.

Such an initiative will more generally improve the international competiveness of the business tax system, facilitate further capital inflows into Australia and enhance national productivity.

As a corollary the benefits of the refundable and non-refundable R&D tax offset should also proportionally decrease as the rate of company tax is reduced so that the cuts in both the level of support and the tax burden are properly aligned.

Taking this approach we also contend that the proposed cut in the refundable and non-refundable tax offsets by 1.5 per cent from 1 July 2014 as announced in the 2014-15 Federal Budget should be deferred by 12 months to 1 July 2015 to align this change with the proposed reduction in the corporate tax rate on that date.

2. Establishing an internationally competitive employee share tax regime

Many start-up R&D companies are seriously constrained by a lack of funds and therefore may not be in a position to attract and retain highly valued staff through cash salaries alone.

If Australia is to become an innovative country and compete globally, Australian companies must be able to attract and retain the best global talent. To do this they must also be in a position to be able to offer world leading benefits, which for technology companies in particular, includes an employee share scheme.

However, the current provisions concerning employee share and option schemes under Division 83A of the ITAA 1997 are an impediment to employees acquiring an equity interest in their employers as they have become overly complex and convoluted.

In practice, employees have a taxing point under Division 83A for employee share schemes that generally occurs prior to sale of the shares or options. This trigger point occurs on either the issue of the equity or at a later point in time such as when certain key performance indicators are met (and forfeiture conditions are lifted). Neither of these triggers points coincides with the actual sale of these shares.

By deferring the taxing point until a later point in time (i.e. when the shares are sold), employees would then have the cash to fund the payment of any income tax liability.

As a further incentive, it is CPA Australia's view that any gain which is made as part of an employee share scheme should also be treated as a capital gain rather than as ordinary or statutory income.

By way of example, an employee could be issued with shares to a value of $10,000 which have a value of $50,000 when certain restrictions are lifted, and an even higher value of $100,000 at the time of sale.

Division 83A would currently operate to tax (as income) the value of either $10,000 at the date of issue or $50,000 when the restrictions are lifted, depending on how the relevant share plan is designed. Either of these creates a potentially significant cash flow issue for the employee to fund this tax liability and a major disincentive for these schemes in Australia. This would compare to taxing a $100,000 capital gain when the shares are sold, and when the employee has the cash on hand to pay the tax liability.

Moreover, under our proposed model, the amount of any capital gain could be potentially reduced by utilising capital losses and/or the 50 per cent CGT discount assuming all the requirements of Division 115 of the ITAA 1997 have been met.

Our proposed initiative would dovetail well with the suite of tax policies designed to encourage entrepreneurial innovative behaviour although we recommend that care be taken to ensure that such share or option plans complement rather than replace salaried remuneration for key staff.

By changing these rules Australian firms could then offer similar types of employee benefits that are currently used to lure our best and brightest to the US and the UK.

Conclusion

This review needs to be seen as the start of an ongoing conversation about innovation in Australia. Innovation should be at the forefront of government policy and needs to be seen as a driver of change in Australia across all industries, not just manufacturing, and as a key determinant of Australia's future economic growth and our ability to attract global capital, skilled workers and investment.

For further information, or to discuss this submission in greater detail, please contact Bryce Prosser, Chief Economist on (03) 9606 9959 or Mark Morris, Senior Tax Counsel on (03) 9606 9680.

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Dear Sir or Madam

Submission on the New Research and Development (R&D) tax incentive

We welcome the opportunity to lodge a submission in response to the consultation paper issued by Treasury in respect of the new R&D tax incentive.

CPA Australia represents the diverse interests of more than 122,000 members in finance, accounting and business in over 100 countries throughout the world. Our mission is to make CPA Australia the global professional designation for strategic business leaders.

In our view the development of a streamlined, efficient and equitable R&D tax credit regime is essential if Australia is to ensure that it has a robust, productive and internationally competitive economy for the next generation.

The availability of such an incentive is necessary if the private sector is to successfully deal with a raft of unprecedented challenges including, amongst others, reducing carbon emissions, constructing a national broadband network, competing for international investment in R&D, and coping with the increasing cross border exchange of intellectual property via the internet.

Accordingly, we strongly endorse the Federal Government's decision to provide a refundable 45 per cent R&D tax credit for companies carrying out R&D whose grouped turnover is less than $20 million, as we have long advocated the need to provide tax incentives to encourage small to medium sized companies to innovate. We similarly support the introduction of the non-refundable 40 per cent R&D tax credit for companies whose grouped turnover exceeds A$20 million as it significantly increases the level of tax incentives potentially available for companies carrying out eligible R&D activities.

We further believe that the take-up of the concession will also potentially increase if Australian companies are no longer required to effectively own the intellectual property arising from R&D undertaken locally.

However, we do have significant concerns that the current design features of the proposed regime as set out in the consultation paper will have a profound adverse impact on all companies seeking to claim R&D tax credits under the new regime.

In particular, CPA Australia does not support the proposed changes to the definition of eligible R&D activities as set out in design principles 6 and 7 of the consultation paper. These

proposals will respectively require companies to establish that their core R&D activities involve both innovation and high levels of technical risk, and to apply differential rules for core and supporting R&D activities. It is envisaged these changes will create considerable uncertainty and significantly increase compliance and administration costs.

Accordingly, we recommend that the existing definition of core R&D activities be retained to ensure that claimants can rely on either innovation or high levels of technical risk in making R&D tax credit claims. Moreover, we believe that eligible core and directly supporting R&D activities should receive the same level of support under the new R&D tax incentive as such activities are interdependent and both are commercially required for the successful completion of a R&D project. In our view the retention of these well understood and commonly applied concepts will enable companies to more effectively transition from the current R&D tax deduction concession to the new R&D tax credit regime.

We understand that the changes canvassed in design principles 6 and 7 appear to have been inserted to reduce the potential cost of the new R&D tax incentive.

However, we believe that the bulk of the cost of financing the revised R&D tax credit regime can be funded from the proposed abolition of the 175 per cent incremental R&D deduction. To the extent there is a funding shortfall it would be preferable for such a deficit to be funded by other means which may involve treating certain R&D supporting activities as being non-creditable after appropriate consultation has taken place with all stakeholders including CPA Australia. In our view this option should only be considered as a last resort strategy.

Further details of our eighteen specific recommendations are set out in the attached submission.

If you have any questions regarding the above, please contact Mr. Mark Morris on (03) 9606 9860 or via email at mark.morris@cpaaustralia.com.au.

Yours faithfully

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Enc

Submission on the new research and development (R&D) tax incentive

CPA Australia strongly believes that the development of a streamlined, efficient and equitable new R&D tax incentive is essential if Australia is to ensure that it has a robust, productive and internationally competitive economy for the next generation.

The availability of such an incentive is necessary if the private sector is to successfully deal with a raft of unprecedented challenges including, amongst others, reducing carbon emissions, constructing a national broadband network, competing for international investment in R&D, and coping with the increasing cross border exchange of intellectual property via the internet.

Given its significance to the nation, CPA Australia previously lodged a detailed submission on the 'Review of the National Innovation System' on 30 April 2008 which listed, amongst other things, various recommendations concerning any recalibration of the existing R&D tax concession.

We therefore welcome the opportunity to provide this submission in respect of the 'Consultation Paper – The new research and development tax concession' which was issued by Treasury on 18 September 2009.

In preparing this submission CPA Australia has consulted with a broad array of our membership including R&D specialists in 'Big 4' accounting firms, mid market consulting firms, boutique management consultancies, niche R&D advisers and academics to ensure that we provide a balanced and thorough view of how the proposed tax incentive will impact all sectors of the economy.

CPA Australia members and staff also attended public meetings on the consultation paper which were recently conducted by representatives of Treasury and the Department of Innovation, Industry, Science and Research in most capital cities which were most helpful in clarifying various issues canvassed in the consultation paper.

Our submission has been structured to address each of the design features and questions as they sequentially appear in the consultation paper given the close correlation between the principles listed and the questions raised.

In addition, we have appended a list of ancillary recommendations which Treasury may wish to consider in developing any exposure draft legislation on the proposed R&D tax incentive which is included as Attachment A of this submission.

Our recommendations are as follows:

1. The new R&D incentive should allow companies resident in Australia to potentially claim R&D tax credits regardless of where the resulting intellectual property is legally owned which should enable multinational companies to appropriately access the R&D incentive whilst simultaneously enabling the IPC to be abolished.

2. All entities should be potentially eligible to access the new refundable R&D tax credit to ensure that this measure is appropriately accessed by small and medium sized businesses which often use non-corporate entities for succession planning purposes and commercial flexibility.

3. Eligible companies should be able to self assess whether they can claim up to 10 per cent of the total cost of an R&D project on eligible overseas R&D expenditure applying the criteria set out in the Innovation Australia (Overseas Research and Development Activities) Guidelines (2004).

4. The efficacy of the standard R&D tax credit will only be realised if the existing definition of eligible R&D activities is maintained. In our view any incremental costs in funding the increased rate of tax credit can be funded through the proposed abolition of the 175 per cent incremental R&D concessional deduction, and the exclusion of certain directly related supporting activities (if required).

5. Further clarity should be provided in the exposure draft legislation concerning the ability of companies to carry forward surplus standard R&D tax credits including confirmation that such companies will be required to satisfy the COT or SBT in carrying forward such amounts. Once these rules are determined it will be necessary to clarify how such credits will be characterised for tax effect accounting purposes.

6. We commend the proposal to introduce a 45 per cent refundable R&D tax credit but its utility will be significantly restricted if the proposed limitations on the definition of eligible R&D activities are introduced. Accordingly, we recommend that the increased cost of funding the refundable tax credit be sourced from savings arising from the proposed abolition of the 175 per cent incremental R&D concessional deduction, and the exclusion of certain directly related supporting activities (if required).

7. All non-enhanced deductions should be claimed as deductible under the general deductibility rules in section 8-1 of the ITAA (1997). However, Sub Division 40-B of the ITAA (1997) should be amended to expressly treat allowable core technology expenditure as being a depreciating asset which is amortised over a period of time akin to the write off period currently available for such costs under section 73B(12A) of the ITAA (1936).

8. Payments made to associates should be allowable when incurred, as deferring the recognition of such amounts until they are paid under a cash basis would add unnecessary complexity to the proposed regime.

9. Any legislation and accompanying administrative framework developed in relation to the proposed R&D tax credit regime must be efficient, transparent and equitable. Care should be taken in amending the incentive as on-going amendments have eroded the understanding of the current regime by claimants leading to reduced take-up and increased compliance costs. The ability to achieve a new simplified legislative regime will be significantly compromised if the proposed changes to the definition of 'eligible R&D activities' is applied.

10. The reference to 'additionality' and 'spillover' in design feature principle 5 should be included in the objects clause of the exposure draft legislation on the new R&D tax credit as they represent two of the crucial outcomes of conducing eligible R&D activities in Australia for the broader community. However, these by products of conducting R&D locally should be excluded from any prescriptive R&D eligibility criteria as that would only create uncertainty amongst claimants.

11. Design Feature 6 should not be implemented in designing the new R&D tax credit regime, and the existing definition of core R&D activities should be retained to ensure that claimants can rely on either innovation or high levels of technical risk in making R&D tax credit claims.

12. Design Feature 7 should not be implemented as both eligible core and directly supporting R&D activities should both be eligible for the standard and refundable R&D tax credits as such activities are interdependent and both required for the successful completion of an R&D project.

13. None of the five methods canvassed to limit the costs of directly supporting R&D deductions should be adopted as they will all lead to increased complexity, significant compliance costs and potentially deter companies from utilising the proposed R&D tax incentive.

14. The current list of activities excluded from the definition of core R&D activities should be retained under the new R&D tax credit regime. In addition, directly supporting activities should not be excluded unless there is a revenue shortfall under the new regime which is not funded from savings realised from the abolition of the 175 per cent R&D incremental deduction.

15. Software development should be eligible to qualify as a core R&D activity even where the work was not undertaken for a purpose of commercial use by multiple non-associates.

16. A 60 per cent R&D tax credit should be introduced to encourage the development of new or improved low-emissions technology to reflect the higher commercial risks associated with the development of such technology. Such credits would be claimed as part of an eligible

company's refundable or standard tax credits depending on the company's annual grouped turnover.

17. Remove the Commissioner's unlimited power to issue amended assessments in respect of companies claiming the concession so that both taxpayers and the Commissioner will be subject to a common 4 year amendment period.

18. Establish a national institute for innovation and creativity to ensure that appropriate consultative processes are adopted before changes to the new R&D tax credit regime are implemented.

Commentary on each recommendation is provided below.

Design Feature - Principle 1

The new R&D tax incentive will be available to companies incorporated in Australia for R&D conducted in Australia. Location of ownership of the resulting IP will not be relevant.

CPA Australia recognises that the international exchange of intellectual property has become much more fluid since the inception of the current R&D tax concession in 1985.

Given the advent of the internet, an increasingly mobile international workforce and mounting international competition for R&D funding, we recognise that it may be preferable to design a tax concession based on the local 'spill over' benefits of R&D being conducted in Australia rather than requiring that any resulting intellectual property be owned by Australian residents.

We also believe that the proposed policy of allowing all Australian resident companies to claim the concession for R&D conducted in Australia is superior to the current alternate mechanism whereby multinational companies have been able to access the 175 per cent International Premium Concession (IPC) as part of the broader R&D tax concession. Whilst the introduction of the IPC was a meritorious initiative we are concerned that its application is poorly understood by multinational companies who we believe would better comprehend the proposed simplified eligibility criteria that R&D credits will be available in Australia if it is claimed by an Australian resident company regardless of where the intellectual property resides.

Recommendation 1

The new R&D incentive should allow companies resident in Australia to potentially claim R&D tax credits regardless of where the resulting intellectual property is legally owned which should enable multinational companies to appropriately access the R&D incentive whilst simultaneously enabling the IPC to be abolished.

Paragraph 19 of the consultation paper expressly states that '...only companies will be eligible for the new R&D tax incentive'. Moreover, it expressly provides that there would be significant integrity and administrative issues in extending eligibility to other entities especially trusts.

We note that no commentary or analysis is provided to support this assertion. Moreover, we are concerned that the exclusion of structures such as trusts from being eligible claimants will defeat one of the principal purposes of the reconfigured R&D incentive which is to intentionally redistribute support for 'small and medium sized businesses' as set out in paragraph 10 of the consultation paper.

In practice many small and medium sized businesses often employ other entities such as trusts in carrying on their business for succession planning purposes and for commercial flexibility.

In our view the take-up rate of the proposed refundable tax credit by small and medium sized businesses will be hampered by this limitation as many entities will prefer to retain their existing business structure for commercial and family purposes rather than incorporate a company so it can access the new R&D incentive.

Recommendation 2

All entities should be potentially eligible to access the new refundable R&D tax credit to ensure that this measure is appropriately accessed by small and medium sized businesses which often use non-corporate entities for succession planning purposes and commercial flexibility.

Question 1

Should there be any exceptions to the general rule that eligible R&D activity must be conducted in Australia?

In practice, we note that it is often commercially necessary for Australian resident companies to conduct some element of an 'eligible R&D project' offshore as the requisite facilities or expertise is not available in Australia. This contingency is recognised under the current R&D tax concession which allows eligible companies who obtain 'provisional certificates' to claim concessional deductions for overseas R&D expenditure where such eligible costs do not exceed 10 percent of the total cost of the R&D project. This is especially relevant for Australian claimants who are members of multinational groups who use testing facilities of related overseas parties.

We understand that companies have found it difficult to comply with the provisional certificate process and have been deterred from claiming such costs due to the administrative delays and costs in having such certificates issue.

Accordingly, we believe that all eligible companies should be able to self assess whether they can claim up to 10 per cent of the total cost of an R&D project on eligible overseas R&D costs applying the criteria set out in the Innovation Australia (Overseas Research and Development Activities) Guidelines (2004). Such an approach is congruent with the increased focus on self assessment under the new regime.

Recommendation 3

Eligible companies should be able to self assess whether they can claim up to 10 per cent of the total cost of an R&D project on eligible overseas R&D expenditure applying the criteria set out in the Innovation Australia (Overseas Research and Development Activities) Guidelines (2004).

Design Feature - Principle 2

The Standard R&D Tax Credit will be available at a rate of 40 per cent for eligible R&D expenditure and can be carried forward where a company's income tax liability is zero.

We commend the proposal to introduce a standard R&D tax credit at a rate of 40 per cent for eligible R&D activities for companies which have an annual 'group turnover' in excess of A$20 million. Such a tax credit is prima facie equivalent to a concessional R&D tax deduction of 133 per cent applying the current corporate tax rate which is prima facie a significant improvement on the current 125 per cent 'base' concessional rate of deduction.

However, we note that potential claimants of the standard R&D credit believe that the net benefit obtained from such a credit will be less in aggregate than that currently claimed under the existing R&D tax concession due to the narrowing of the definition of 'eligible R&D activities' as discussed in the commentary below concerning design principles 6 and 7.

In our view the policy driver of obtaining increased local R&D through the availability of the R&D tax credits will only be realised if the existing definition of eligible R&D activities is maintained for the reasons discussed below.

We believe that such an outcome can be achieved as the increased costs to fund the standard R&D credit can be substantially financed by the savings realised from the proposed abolition of the 'incremental 175 per cent concessional R&D deduction'.

In particular, our members have advised that most of the growth in claims made under the concession in recent years have been due to increased claims for the 175 per cent incremental deduction which we contend has been of dubious benefit from a public policy perspective as it has often been an unexpected windfall gain for claimants rather than a measure directly affecting their commercial behaviour.

To the extent there is a shortfall in eligible expenditure such amounts could be potentially funded through the exclusion of certain directly supporting activities following consultation with claimants and the broader tax profession. Whilst this latter step is undesirable, it is preferable to excessively restricting the scope of eligible R&D activities should Treasury identify any revenue shortfall after realising the savings from the abolition of the incremental R&D deduction.

CPA Australia representatives would be pleased to participate in such discussions if required to work with Treasury staff and other stakeholders to determine how any revenue shortfall can be appropriately funded.

Recommendation 4

The efficacy of the standard R&D tax credit will only be realised if the existing definition of eligible R&D activities is maintained. In our view any incremental costs in funding the increased rate of tax credit can be funded through the proposed abolition of the 175 per cent incremental R&D concessional deduction, and the exclusion of certain directly related supporting activities (if required).

Paragraph 35 of the consultation paper also notes that unutilised standard tax credits can be carried forward which will result in a similar outcome to the existing regime where deductions claimed under the R&D tax concession has created carried forward tax losses.

Further clarity of this principle is required as the ability of a company to carry forward tax losses is typically onerous given the complex rules associated with the application of the continuity of ownership test (COT) and the same business test (SBT) under Division 165 of the Income Tax Assessment Act (1997) ('the ITAA (1997)').

This is particularly important for companies which may be in a tax loss position for a prolonged period of time which may be reasonably widespread given the current economic downturn.

In addition, further consultation is required in determining the characterisation of such tax credits for the purpose of recognising a deferred tax asset for tax effect accounting purposes. CPA Australia representatives would be pleased to consult with other stakeholders on the financial reporting implications of the measure once the rules associated with carrying forward surplus standard R&D tax credits are determined.

Recommendation 5

Further clarity should be provided in the exposure draft legislation concerning the ability of companies to carry forward surplus standard R&D tax credits including confirmation that such companies will be required to satisfy the COT or SBT in carrying forward such amounts. Once these rules are determined it will be necessary to clarify how such credits will be characterised for tax effect accounting purposes.

Design Feature - Principle 3

The Refundable R&D Tax Credit will be available to companies with a turnover of less than $20 million at a rate of 45 per cent for eligible R&D expenditure.

We also strongly support the proposal to introduce a refundable R&D tax credit at a rate of 45 per cent for eligible companies which have a group turnover of less than A$20 million.

The capacity to cash out any unutilised credits is to be commended as it will help to ensure start up companies engaging in innovative activities remain commercially viable during the early development stage. We also note that the A$20 million threshold is considerably more appropriate than the existing $5 million turnover threshold under the existing R&D tax offset. Moreover, the ability to cash out surplus credits avoids the above uncertainty concerning the carried forward status of unused credits and how they should be recognised for financial reporting purposes.

However, we stress that the narrowing of the definition of eligible R&D activities will also impact eligible claimants of the refundable 45 per cent R&D tax credit in that their restricted ability to qualify

for the credit under the proposed changes may outweigh any net benefit obtained. This is discussed further below.

It should also be noted that the restrictions outlined in design principles 6 and 7 will significantly increase compliance costs and create uncertainty especially if the proposal to apply differential rules to core and supporting R&D activities is applied. Smaller companies will typically have less resources to effectively fund such costs and manage risk than larger corporate claimants.

Accordingly, we believe that any increased costs arising from the introduction of the 45 per cent refundable R&D tax credit be financed through the abolition of the incremental 175% R&D deduction and the exclusion of currently eligible directly supporting R&D activities (if required). In that sense the incremental funding of both the standard and refundable tax credits must be from the same pool of savings.

Recommendation 6

We commend the proposal to introduce a 45 per cent refundable R&D tax credit but its utility will be significantly restricted if the proposed limitations on the definition of eligible R&D activities are introduced. Accordingly, we recommend that the increased cost of funding the refundable tax credit be sourced from savings arising from the proposed abolition of the 175 per cent incremental R&D concessional deduction, and the exclusion of certain directly related supporting activities (if required).

Question 2

How should the new R&D tax incentive treat R&D expenditure that is currently deductible at 100 per cent?

Paragraph 39 of the consultation paper canvasses the issue of how 'non-enhanced' research and development expenditure should be treated upon the commencement of the proposed R&D tax credit regime. Such expenditure is not currently eligible for the concessional rates of deduction at either the 125 per cent or the 175 per cent rates.

Instead such amounts are treated as being either deductible outright at a rate of 100 per cent (e.g. interest and residual feedstock costs) or amortised over a period of time (which cannot be less than three years) in respect of allowable core technology expenditure under section 73B of the Income Tax Assessment Act (1936) ('the ITAA (1936)') which sets out the rules for the current R&D tax concession.

We do not believe that such amounts should be treated as creditable as they are not currently subject to any concessional treatment under the existing R&D deduction rules, and complexity may be created by only allowing such amounts to be creditable by claimants of the 45 per cent refundable tax credit.

As the provisions of section 73B of the ITAA(1936) will be repealed on the enactment of new provisions dealing with the R&D tax credit in the ITAA(1997) it is instead recommended that the deductibility of these 'non- enhanced' costs be dealt with under the 'normal tax rules'.

Accordingly, where revenue costs such as interest and residual feedstock expenditure have been incurred such costs should be allowable under the general deductibility provisions of section 8-1 of the ITAA (1997). However, we anticipate that amendments will be required to section 40-30 of the ITAA(1997) to make it clear that core technology is a depreciating asset for Sub-division 40-B purposes and that specific rules be inserted so that the write off period of such an asset is equivalent to the existing write off period specified under section 73B(12A) of the ITAA(1936).

Recommendation 7

All non-enhanced deductions should be claimed as deductible under the general deductibility rules in section 8-1 of the ITAA (1997). However, Sub Division 40-B of the ITAA (1997) should be amended to expressly treat allowable core technology expenditure as being a depreciating asset which is amortised over a period of time akin to the write off period currently available for such costs under section 73B(12A) of the ITAA (1936).

Question 3

Should expenditure incurred to associate entities only be eligible for the new R&D tax incentive where paid in cash?

Paragraph 42 of the consultation paper canvasses the option that expenditure incurred to associates will only be claimed when they are paid in cash. We understand that this suggestion was canvassed as Treasury are concerned that amounts accruing to associates when a cash refund is received in respect of the allowable amounts which may lead to certain timing differences.

CPA Australia does not support restricting creditable amounts to those paid in cash as it would detract from the commonly understood rules relating to 'incurred' expenditure. In our view deferring a credit for payments until they are creditable will add a layer of unnecessary complexity as all taxpayers accessing this regime will be applying an accruals basis in determining incurred costs. This is directly contrary to the stated objective introducing a simplified incentive as set out under paragraph 9 of the consultation paper.

Furthermore, in our view no compelling argument has been advanced as to why these transactions between associates should be treated any differently to any other related party transactions between Australian resident business taxpayers.

Recommendation 8

Payments made to associates should be allowable when incurred, as deferring the recognition of such amounts until they are paid under a cash basis would add unnecessary complexity to the proposed regime.

Design Feature - Principle 4

Legislation for the new R&D tax incentive will provide support for the scheme's efficient and effective administration.

We believe a key deliverable arising from the reconfigured R&D tax incentive is the enactment of legislation and an accompanying administrative framework which will result in an efficient, transparent and equitable regime.

This need is paramount as the provisions dealing with the existing R&D tax concession in sections 73B to 73Z of the ITAA (1936) have become inordinately complicated. In our view this complexity has been largely engendered by numerous policy shifts which have been reflected in the concession's provisions since its commencement in 1985.

For example, one of the by-products arising from the abolition of the 175 per cent incremental deduction is that there will be no need to include equivalent provisions to sections 73P to 73Z in the new regime. We believe that has this measure not only failed to achieve its intended purpose but that it added complexity which may have led to some speculative gains, created dysfunctional investment patterns and increased compliance costs of affected claimants.

Thus, we would strongly recommend that any legislation developed not only be simple and efficient but that Treasury recognise that successive amendments to the incentive will create uncertainty and confusion amongst claimants and advisers. This is especially crucial for larger corporate taxpayers who will claim the standard R&D tax credit as they will embed systems throughout their organisations to track claims and supporting data and thus require some consistency of approach in the short to medium term to comply with and appropriately utilise the new regime.

Despite these comments we have concerns that the above efficient regime will not be realised due to proposed changes to the definition of 'eligible R&D activities' canvassed in design principles 6 and 7.

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In particular, the proposal that differential rules (including potential levels of credit relief) will apply to 'core' and 'directly supporting' R&D activities involves a totally unnecessary level of complexity which will again lead to uncertainty or a reduced take-up of the incentive. In practice, claimants will make claims in respect of R&D projects which may contain a variety of core and supporting activities over

the useful life of the project. As the categorisation of such activities into either core or supporting activities is often highly subjective some claimants may be deterred from accessing the concession or may simply try to characterise the bulk of their claims as being 'core' activities in order to obtain access to the R&D tax credit.

We believe such distinctions add little value as core and supporting activities are invariably intrinsically linked under a single 'R&D project' which is also how such activities will be viewed from a business perspective.

We stress that the introduction of differential rules for such activities will inevitably add complexity to the regime, and that if this suggestion is being canvassed as a revenue saving measure that alternate cost savings strategies be developed by Treasury in consultation with key stakeholders.

Recommendation 9

Any legislation and accompanying administrative framework developed in relation to the proposed R&D tax credit regime must be efficient, transparent and equitable. Care should be taken in amending the incentive as on-going amendments have eroded the understanding of the current regime by claimants leading to reduced take-up and increased compliance costs. The ability to achieve a new simplified legislative regime will be significantly compromised if the proposed changes to the definition of 'eligible R&D activities' is applied.

Design Feature - Principle 5

The new R&D tax incentive should target R&D that:

a) is in addition to what otherwise would have occurred; and

b) provides spillovers — benefits that are shared by other firms and the community — that are large relative to the associated subsidy.

CPA Australia was very concerned that the above design feature may have been incorporated as part of the prescriptive criteria for conducting R&D in Australia on the issue of the consultation paper as it would only create further uncertainty in the market especially given other proposed changes to the definition of 'eligible R&D activities'.

However, following public consultation on the proposed R&D tax credit it is our understanding that the above comments in respect of 'additionality' and 'spillover' will merely be included in the objects clause of the proposed exposure draft legislation.

CPA Australia believes that this is appropriate as eligible R&D under the existing R&D tax concession would invariably result in additional knowledge and expertise being gained which ultimately manifests itself into significant spillover benefits for the community given our increasingly mobile work force and dynamic commercial environment.

Recommendation 10

The reference to 'additionality' and 'spillover' in design feature principle 5 should be included in the objects clause of the exposure draft legislation on the new R&D tax credit as they represent two of the crucial outcomes of conducing eligible R&D activities in Australia for the broader community. However, these by products of conducting R&D locally should be excluded from any prescriptive R&D eligibility criteria as that would only create uncertainty amongst claimants.

Design Feature - Principle 6

Eligible R&D activity will be defined as systematic, investigative and experimental activity that:

(a) involves both innovation and high levels of technical risk; and

(b) is for the purpose of producing new knowledge or improvements.

CPA Australia strongly opposes any change to the definition of eligible core R&D activities requiring such activities to involve both innovation and high levels of technical risk in order to be eligible for the new R&D tax incentive.

We believe that such a change will have a profound adverse impact on claims by both small to medium sized companies as well as larger corporate groups.

Our concern is predicated on the commonly held view amongst our members that the 'high level of technical risk' requirement imposes a lesser standard than that of 'innovation' given how those terms are extensively defined under section 73B(2B) of the current R&D tax concession in the ITAA (1936).

In our experience this is also a commonly held view by AusIndustry personnel as well as the bulk of R&D specialist consultants concerning the practical application of the existing definition of eligible R&D activities.

Accordingly, claimants have often relied on the 'high level of technical risk' limb in seeking eligibility for R&D activities as the work undertaken constituted incremental R&D rather than cutting edge research which was novel, unique or potentially patentable. Nonetheless the impact of such incremental R&D has cumulatively added considerable value over time in the creation of improved materials, products, devices, processes or services. In our view such claims would be far less viable if the proposed dual requirement of 'innovation' and 'high levels of technical risk' was introduced unless it is accompanied by a significant change in interpretation of those terms.

Indeed, we are concerned that the proposed R&D incentive will be skewed towards pure and basic research which prima facie appears strategic but which ignores the commercial reality that companies undertake 'commercial R&D' to gradually improve their products and processes in response to changing market conditions.

This is a pity as all stakeholders for a quarter of a century have sought to alert all segments of the private sector that the existing concession was not intended to be limited to 'white lab coat' research but that it has a much broader focus in assisting Australian companies develop products and processes in order for claimants to be more internationally competitive.

It is for the above reasons that CPA Australia supports the retention of the well established and commonly understood definition of core R&D activities being systematic, investigative and experimental activities that involve innovation or high levels of technical risk.

As discussed, we believe any revenue savings required to fund the new R&D tax credit regime can be funded through the abolition of the 175 per cent incremental R&D deduction and further exclusions of directly supporting activities if this is required. In our view it would be highly detrimental if revenue savings were financed by the above change to the definition of eligible R&D activities.

Recommendation 11

Design Feature 6 should not be implemented in designing the new R&D tax credit regime, and the existing definition of core R&D activities should be retained to ensure that claimants can rely on either innovation or high levels of technical risk in making R&D tax credit claims.

Design Feature - Principle 7

Supporting R&D will continue to be recognised under the new R&D tax incentive but claims will be subject to new limitations.

CPA Australia is extremely concerned with any proposal to provide differential support for core and directly supporting R&D activities.

The implementation of such a proposal would create considerable uncertainty amongst claimants resulting in reduced claims whilst inevitably increasing compliance and administrative costs of those companies which continue to utilise the R&D tax regime.

In practice, the current regime recognises that a project will typically involve some core R&D activities which are innovative and highly risky which will be mandatorily supported by some other directly supporting activities which must be carried out to ensure that the overall 'R&D project' is completed. That is, core and directly supporting R&D activities are invariably interdependent in that both must take place in order for an R&D project to be finalised. Given this interdependence the current R&D concession correctly does not attempt to reduce the level of support on the basis of whether activities are core or supporting as all such activities should be incentivised equally.

We are of the strong view that a similar approach should be applied in respect of eligible core and directly supporting activities under the proposed new R&D incentive.

Recommendation 12

Design Feature 7 should not be implemented as both eligible core and directly supporting R&D activities should both be eligible for the standard and refundable R&D tax credits as such activities are interdependent and both required for the successful completion of an R&D project.

Question 4

Should supporting activities:

(a) **be capped as a proportion of expenditure on core R&D?**

  (i) **If so, what would be the appropriate proportion (for example, 1:1)?**

(b) **only be eligible where they are for the sole purpose of supporting core R&D activity?**

(c) **exclude production activities or dual role activities?**

(d) **only be eligible on a net expenditure basis?**

(e) **attract a lower rate of assistance than core R&D?**

  (i) **If so, what would be the appropriate rate be?**

Given our comments in respect of Design Principle 7, CPA Australia does not support any of the five listed alternatives in restricting the costs of eligible directly supporting activities.

As discussed, we believe that the bulk of the cost of funding the revised R&D tax credit regime can be funded from the abolition of the 175 per cent incremental deduction. To the extent there is a funding shortfall it would be preferable for such a deficit to be funded by other means which may involve excluding certain supporting activities after appropriate consultation has taken place. In our view this option should only be considered as a last resort strategy.

For sake of completeness we note that all five of the options canvassed have serious conceptual limitations which reduce their potential efficacy.

The first option of capping allowable supporting R&D costs so that they are a proportion of core R&D activities in option (a) fails to recognise that a project spread over multiple years may have the core R&D allowable in a particular year whereas the required supporting R&D activities take place in the following year. In these circumstances no tax credit would be potential available for supporting R&D activities in the subsequent year as it takes place in a year when no core R&D activities take place. As discussed, it is inappropriate to treat core and supporting R&D activities as being separate activities as they are inherently integrated over the life of an R&D project.

Both options (b) and (c) are misconceived as most supporting activities may not be carried out for the sole purpose of supporting a core R&D activity as usually such activities will be undertaken for dual purposes of supporting the core R&D activities and obtaining a commercial result. This is certainly the

case with trial runs of new products where the work is undertaken to develop new products which are often commercially saleable. If this criteria is adopted it would effectively wipe out claims for a significant amount of supporting activities which would inhibit the take-up of the new R&D tax credit for the reasons detailed above.

The complexities of complying with option (d) are so considerable that it is not a credible alternative as companies in practice are not going to typically claim the concession if they need to determine the net expenditure of claims. It is also utterly contrary to the object of creating a simple R&D tax credit regime as set out under paragraph 9 of the consultation paper.

The option of having a lower rate of assistance for supporting R&D activities vis a vis core R&D activities in option (e) would potentially be the preferred option should one of these five alternatives be required to be adopted provided it is set at an appropriate rate which encourages claimants to participate in the concession. However, this option would undoubtedly create complexity and as a corollary deter companies from participating in the concession as well as lead to significantly increased compliance and administration costs.

Recommendation 13

None of the five methods canvassed to limit the costs of directly supporting R&D deductions should be adopted as they will all lead to increased complexity, significant compliance costs and potentially deter companies from utilising the proposed R&D tax incentive.

Question 5

Should the current list of activities excluded from being considered core R&D be:

(a) amended in any way?

(b) extended to exclude certain activities from being considered supporting activities?

We believe that the current list of activities which are excluded from the definition of 'core' R&D activities under section 73B(2C) of the ITAA (1936) should be retained under the new R&D tax credit regime.

Moreover, we do not believe that any directly supporting activities should be treated as an excluded activity unless such an amendment is required to help fund any revenue shortfall in financing the new R&D tax credit regime which cannot be financed from savings arising from the abolition of the 175 per cent incremental R&D deduction. Should such savings be necessary it is strongly recommended that all stakeholders are involved in such a process so that appropriate measures can be taken without undercutting the viability of the scheme.

Recommendation 14

The current list of activities excluded from the definition of core R&D activities should be retained under the new R&D tax credit regime. In addition, directly supporting activities should not be excluded unless there is a revenue shortfall under the new regime which is not funded from savings realised from the abolition of the 175 per cent R&D incremental deduction.

Question 6

How should the new R&D tax incentive treat software R&D?

We recommend that all software development be eligible to qualify as a core R&D activity even where the work was not undertaken for a purpose of commercial use by multiple non-associates.

In our view the repeal of the multiple sale test may give added impetus for increased investment in information technology by the finance and communication sectors who have traditionally invested heavily in in-house software development to improve their own efficiency and productivity.

We also believe that the extension of the concession to such in house software development will ultimately manifest itself in significant 'spillover' benefits for other service sectors.

In our view such a change is necessary as the House of Representatives Standing Committee on Economics, Finance and Public Administration confirmed in May 2007 that the services sector now accounts for about three-quarters of Australia's GDP and an even larger share of total employment as around 85% of employed Australians work in that sector[1].

Recommendation 15

Software development should be eligible to qualify as a core R&D activity even where the work was not undertaken for a purpose of commercial use by multiple non-associates.

[1] p.7, House of Representatives Standing Committee on Economics, Finance and Public Administration, *Servicing our future; Inquiry into the current and future directions of Australia's services export sector*, May 2007

ATTACHMENT A

Climate Change

As set out in our pre budget submissions for the 2008-09 and 2009-19 years we have long contended that the carbon pollution reduction scheme is only one part of a comprehensive suite of policies required to reduce emissions.

In particular, we believe that appropriate incentives must be introduced to encourage SMEs to invest in new technology to reduce emissions. In our view the development and deployment of a wide range of low-carbon technologies by the private sector is essential in improving energy efficiency and achieving the deep cuts in emissions that are required.

Given the commercial risks in developing low carbon technologies we believe that such incentives should also carry a premium rate given the urgency for business to subsequently develop and commercially market such technologies.

Accordingly, we recommend that a 60 per cent R&D tax credit be provided to all companies engaged in conducting R&D to develop low-emissions technology. Such credits will only be refundable to the extent that an eligible company's annual turnover does not exceed A$20 million so that any equivalent credits derived by a company whose turnover is in excess of this amount will be eligible for the standard R&D tax credit.

Recommendation 16

A 60 per cent R&D tax credit should be introduced to encourage the development of new or improved low-emissions technology to reflect the higher commercial risks associated with the development of such technology. Such credits would be claimed as part of an eligible company's refundable or standard tax credits depending on the company's annual grouped turnover.

Remove the Commissioner's unlimited capacity to amend

We strongly support any proposal which will ensure that the Commissioner's capacity to issue amended assessments in respect of disallowed R&D claims should be capped to 4 years from the date of issue of an assessment (in the absence of fraud or evasion).

In our view the Commissioner's current unlimited capacity to amend assessments for disallowed R&D tax concession claims under section 170(10A) of the ITAA (1936) is a legacy of the concession as originally introduced when it was only intended to be a temporary measure.

We believe that it is anomalous to maintain this treatment as it is inequitable as a taxpayer's right to request amended assessments is capped to 4 years and leads to asymmetrical outcomes.

It also places unnecessary administrative burdens on companies and detracts from the certainty the regime should offer eligible claimants.

Recommendation 17

Remove the Commissioner's unlimited power to issue amended assessments in respect of companies claiming the concession so that both taxpayers and the Commissioner will be subject to a common 4 year amendment period.

Improved consultative processes

We note that one of the findings of the productivity working group at the 2020 summit was the establishment of a national institute for innovation and creativity[2].

We suggest that one of the functions of the above body may be to monitor the appropriateness, effectiveness and efficiency of the proposed R&D tax credit being a crucial part of Australia's national innovation strategy.

Such a process would be advantageous if the Institute comprised a broad cross section of stakeholders from both the public and private sector which would ensure that appropriate consultative processes take place before any changes to the R&D tax credit regime are implemented.

Recommendation 18

Establish a national institute for innovation and creativity to ensure that appropriate consultative processes are adopted before changes to the new R&D tax credit regime are implemented.

[2] p.7, Federal Government, *Australia 2020 Summit – Initial Summit Report*