Senate Economics Reference Committee Inquiry

Tax Laws Amendment (Research and Development) Bill 2010 and

Income Tax Rates Amendment (Research and Development) Bill 2010

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1. Summary

Michael Johnson Associates (MJA) welcomes this opportunity to make this written submission to the Senate Economics Standing Committee (the Committee) regarding its Inquiry into the *Tax Laws Amendment (Research and Development) Bill* 2010 and *Income Tax Rates Amendment (Research and Development) Bill* 2010. This submission is made in support of our recent appearance before the Committee in Canberra on Thursday, 20 May 2010.

Having reviewed the current Bills and the accompanying Explanatory Memorandum (EM), particularly in light of the recent Senate hearings, MJA submits that the Bills should not be passed in their current form.

Our summary reasons are as follows:

- The R&D Tax Credit (the Credit) does not reflect the Government's announced policy that there would be a tightening of the eligibility criteria associated with the R&D Tax Concession (the Concession) to support genuine R&D.

  Rather, the Credit is a new program that introduces a number of new concepts and definitions in comparison to the Concession and their meaning is not universally agreed upon or understood by stakeholders.

- The Credit is not revenue neutral but appears to involve potentially large reductions in R&D support across all sectors of Australian industry. No modelling has been put forward by Treasury to support its contention that the proposed program is revenue neutral.

- The new definition of R&D is not better aligned with the Frascati Manual definition as had been previously contended by Treasury. In fact, the eligibility of the third limb of the Frascati definition – experimental development – is in real doubt.

- The splitting of R&D activities into categories of core and supporting, the restrictions around core activities in terms of "experimental activities" and "new knowledge" and the introduction of the dominant purpose test all add legislative uncertainty and administrative complexity to the R&D support framework. Treasury has failed to provide clear reasons for making the changes and, in doing so, jeopardises 25 years of institutional understanding around what is claimable R&D.

- The rewriting of the definition of R&D is a blunt instrument to deal with so-called "whole of mine" claims or alleged rorts. There are better mechanisms available to deal with these issues.

- The example projects in the EM have been reworked to the point where they fail to provide any useful guidance to taxpayers as to the meaning of the new definition of R&D. The examples are internally inconsistent, contradictory and bear little relationship to real-world commercial R&D activity.

- The new feedstock provisions are not a simple rewriting of the current provisions as has been contended by Treasury. They extend the concept of feedstock in terms of scope and expenditure categories in significant and uncertain ways whilst adding huge administrative complexity.

- The operation of the dominant purpose test and the new feedstock provisions combine to render most legitimate, production-based R&D ineligible thereby severely curtailing support across all industry sectors.

- The vastly increased administrative powers add significantly to the compliance burden of claimants and vest too much discretionary power in the hands of the assessment authorities in a program that is self-assessment based.

- The timeframe for converting the Second Exposure Draft into operative law has meant that the proposed changes have been prepared in haste with small windows of opportunity (if any) for real consultation.

This submission provides additional detail regarding the above reasons and builds upon our previously expressed views contained in various submissions.

Since the 2009 Federal Budget, MJA has been an active participant in the public consultation processes surrounding the Bills including the Treasury Consultation Paper and the two Exposure Drafts. In addition, we have been part of a small advisory group (comprising the Institute of Chartered Accountants, the Corporate Tax Association and the "Big 4" chartered accountancy firms) that has been invited to a series of meetings with the Government involving the Treasury, the Department of Innovation, Industry, Science and Research (IISR), AusIndustry and the Australian Taxation Office (ATO). As such, we feel that we are well positioned to provide this submission to the Committee and we stand fully behind all our previous written submissions to the Treasury regarding these matters. These submissions can be supplied to the Committee on request.

Finally, we have prepared and attached a more detailed analysis of the changes that we have identified when comparing the proposed Bills to the Second Exposure Draft (see Attachment A) and this work has added to our concerns.

2. Proposed Approach Going Forward

MJA believes that the eligibility rules associated with R&D activities and expenditure should not be changed on 1 July 2010. We believe that they should be reviewed in a process involving real consultation which includes development of guidelines with industry in a timely manner to allow a smooth transition to a start date of 1 July 2011. We believe that the focus of that review should be on the introduction of some expenditure controls on claims (eg. a cap on consolidated group claims) in the context of an unchanged definition of eligible R&D.

We believe that the main features of the Government's Credit, namely:

- higher base rates;
- introduction of foreign-owned intellectual property (IP);
- closure of the 175% Incremental Tax Concession; and
- revised approach to the eligibility of software

could be introduced on 1 July 2010 and a revenue neutral program outcome could be maintained.

3. MJA Supports the Government's Policy

Since the commencement of the National Innovation System (NIS) Review, MJA has strongly supported the main proposed changes to the R&D Tax Incentive. It is a matter of public record that we support the following aspects of the policy announced in the May 2009 Federal Budget:

- Conversion from a concession to a credit
- Introduction of increased base rates of support
- Extension of the refundable component of the Credit
- Introduction of eligibility associated with foreign-owned IP
- Closure of the 175% Incremental Premium
- Review of eligibility criteria to ensure that the program remains fiscally responsible

However, the announced tightening of eligibility criteria has been taken by Treasury as a justification for completely rewriting the basis of support for business R&D expenditure (BERD) thereby jettisoning 25 years of institutional understanding of a comparatively stable program in the process. The authority for this approach cannot be drawn from announced government policy.

It is has been apparent throughout the rewriting process that Treasury has been heavily influenced by the 2007 Productivity Commission (PC) Report, *Public Support for Science and Innovation*, 9 March 2007, which advocated a scrapping of the base Concession for all but the smallest companies and promoted a restricted incremental offering for the balance of taxpayers predicated on a narrower definition of R&D. However, the NIS Review's report, *Venturous Australia* (the Cutler Report), rejected the PC approach and recommended the polar opposite – an increase in the base Concession and a closure of the incremental provisions. And it was this approach that was adopted in the 2009 Federal Budget and subsequently echoed in the accompanying Innovation White Paper, *Powering Ideas: An Innovation Agenda for the 21st Century*.

MJA supports the approach suggested by the Cutler Report and taken up in the 2009 Federal Budget and White Paper. We submit that the wholesale changes proposed in the Treasury Consultation Paper of September 2009 and reflected in the two Exposure Drafts (of December 2009 and March 2010) and the Bills are not consistent with a "tightening of eligibility criteria" and result in a fundamentally new program providing a narrower basis of R&D support.

4. The Treasury's Rationale for the Change to the Definition has not been Established

In the recent Committee hearings, the main focus was on the impact of the proposed changes to the definition of R&D. The changes include a splitting of R&D activities into categories of core and supporting, a new definition of core R&D based on the concepts of experimental activities and new knowledge and a series of classifications for eligible supporting activities based on a hybrid of the notions of "directly related" and "dominant purpose".

Treasury has maintained that the changes to the definition of R&D contained in the Bills were needed for the following reasons:

- To support the 2009 Budget notion that support should only be provided to "genuine R&D"
- To maintain revenue neutrality
- To better align the definition with the internationally-accepted Frascati Manual definition

MJA submits that the Treasury has failed to establish the case for changing the definition on any of these grounds thereby raising serious questions as to whether the changes should be made. We are of the belief that the changes put the eligibility of a large amount of legitimate, production-based R&D into severe doubt whilst adding layers of complexity, uncertainty and associated compliance cost to the program.

We shall consider each of the Treasury arguments in turn.

Support Genuine R&D Only

In its September 2009 Consultation Paper, Treasury set out three example projects that it regarded as qualifying under the Concession that would be curtailed under a narrower definition of R&D. In our response at the time, we noted that the projects described were too generally described to definitively qualify them as eligible under the Concession. In fact, we noted our recent experience of decisions of the Tax Concession Committee (the TCC) of the Innovation Australia Board (the Board) that were denying eligibility (in our view, incorrectly) for far more specifically detailed projects in the described areas and, as such, the examples were hardly persuasive.

Since that time, Treasury has not been drawn on the rationale as to why production-based supporting R&D activities should be subject to a dominant purpose test other than the inference that the Credit should not support "business as usual" activities.

It has been our consistent submission that production-based R&D activities, however defined, are vital to the successful execution of corporate R&D projects and that their full eligibility should be recognised even where they occasionally amount to large claims for the operating cost of full-scale production processes.

Absent any real refutation of this notion from Treasury, stakeholders have had to discern another basis for the announced restrictions and the consensus that the actual concern of the Government is that large claims are seen as an excessive drain on revenue as was ventilated in the Cutler Report's "whole of mine" discussion.

If this is the real concern, we note that MJA, along with many other stakeholders, has indicated a willingness to investigate methods of limiting large claims including the introduction of a cap on group claims or a pre-approval process for R&D expenditures beyond a legislated limit.

The beauty of such approaches is that they introduce fiscal restraint without the legitimacy of the R&D being called into question. These suggestions have fallen on very deaf ears. This goes a long way to explaining why stakeholder submissions have been so disappointed with the Treasury approach as there seems a determination by the administration to change the definition so that much of vital production-based R&D is held to no longer be eligible R&D under the new regime in the face of years of acceptance and international best practice.

The resounding response from the Australian innovation community has been that changing the definition of R&D for all taxpayers is a very blunt instrument to limit the large claims of the very few.

Revenue Neutrality

Treasury acknowledged at the recent Committee hearings that the application of the rules contained in the Bills will reduce claims for currently eligible R&D expenditure in the region of 15-20%. However, Treasury contended that the shortfall would be made up by factors such as new program entrants so that the Credit would remain revenue neutral.

Many commentators have suggested that the cutbacks, particularly in the light of the freshly-announced feedstock provisions (discussed later in this submission), will be much more severe. For example, at the hearings, Caltex indicated that they believed that its eligible R&D tax claim would be reduced to 20% of its current level.

Typically, one would turn to the available modelling to test these divergent points of view. However, no such modelling has been made available by Treasury throughout the consultative process.

By way of contrast, MJA has supplied Treasury with modelling based on publically available figures that indicated that the increased rates of credit and the introduction of foreign-owned IP would be more than offset by the closure of the incremental provisions so that changes to the definition of R&D were not needed to keep the program at a revenue neutral position. This modelling can be seen in Attachment B to this submission. Attachment B is the MJA response to Treasury regarding the Second Exposure Draft and has been attached to this submission as it details many of MJA's concerns that pertain to components of the Bills that have not changed since the second draft.

Our above conclusion did not deter us from going on to suggest ways of limiting large claims in the spirit outlined in the Cutler Report.

At the hearings, Treasury would not be drawn on the sectoral impact of the changes saying they had only looked at the issues at a "macro" level. However, a consensus did emerge from the other stakeholders that appeared before the recent Committee hearings that there would definitely be "losers" under the changes – manufacturing; mining; infrastructure – without it being readily be apparent as to who would be the "winners". It was noted that the definitional changes apply equally to all SMEs and evidence was given at the hearings that the new complexities and compliance costs may actually cause many SMEs to exit the program despite the higher rate of assistance. In this context, it should be remembered that the effective halving of the available benefits under the Concession in the 1996 Budget saw program participation rates drop by some 30% in the next 3 years and led to a 5 year slide in reported BERD levels after more than 20 years of growth.

Treasury has not made out its case that the changes to the definition are needed to maintain revenue neutrality. This is exacerbated by the further reduction in R&D support identified with the new feedstock provisions discussed later in this submission.

Better Alignment with Frascati

The Treasury Consultation Paper put forward an argument that a narrower definition of R&D was needed to better align the Australian definition with the OECD Frascati Manual.

Whilst this justification has gradually disappeared from the two Exposure Drafts and the Bills, it is worth noting here that the proposed definition is clearly narrower than that described in Frascati.

This narrowing is attributable to the new Object provision and the new definition for core R&D activities being based on only the research components of the Frascati definition. This is despite the EM implying otherwise.

The OECD definition defines R&D as;

1. “creative work undertaken on a systematic basis in order to increase the stock of knowledge, including knowledge of man, culture and society, and

2. the use of this stock of knowledge to devise new applications.”

The first part is the research phase and is further broken down into:

a. **Basic research** is experimental or theoretical work undertaken primarily to acquire new knowledge of the underlying foundation of phenomena and observable facts, without any particular application or use in view.

b. **Applied research** is also original investigation undertaken in order to acquire new knowledge. It is, however, directed primarily towards a specific practical aim or objective.

The Object provision, s 355-5(2), states “this object is to be achieved by providing a tax incentive for industry to conduct, in a scientific way, experimental activities for the purpose of generating new knowledge or information in either a general or applied form”. The purpose of generating new knowledge is analogous with the Frascati definition of basic research whilst the references to general and applied forms line up with the two limbs of the Fracati definition detailed above.

The definition of core R&D activities in s 355-25(b) continues this ‘research only’ focus:

> “Core R&D activities are experimental activities that are conducted for the purpose of generating new knowledge (including knowledge about the creation of new or improved materials, products, devices, processes or services).”

The part in parentheses is limited to only the generation of new knowledge about the creation of new or improved materials, products, devices, processes or services. It replaces the Concession definition that includes the *actual* development of the creation of new or improved materials, products, devices, processes or services.

What is missing and causing consternation among those interested in seeing a workable and effective R&D incentive program is that this new definition of R&D ignores the development phase in part 2 of the Frascati definition.

The development phase is defined in the Frascati Manual as:

c. **Experimental development** is systematic work, drawing on existing knowledge gained from research and/or practical experience, which is directed to producing new materials, products or devices, to installing new processes, systems and services, or to improving substantially those already produced or installed. R&D covers both formal R&D in R&D units and informal or occasional R&D in other units.

All these aspects of R&D are excluded from the proposed R&D definition in the Credit but are certainly in the Concession. The Concession definition broadly encourages both research and development yet is only a subset of the total Frascati definition. It does not, for example, include R&D where the core activity is an excluded activity, is otherwise an ineligible expenditure or where the R&D is on business systems or an application of generally

understood practical experience. It is however much broader than basic or applied research into acquiring new knowledge which is the premise of the Credit definition.

The significant contraction of eligibility to exclude all systematic, investigative and experimental development work drawing on the knowledge acquired that is currently allowed under the Concession is a blow to the integrity of the system for two reasons;

1. The objective of the new program is to encourage more businesses to do more R&D. As “experimental development” makes up the majority of BERD , its exclusion removes far more from the program than the increases in the rate of support will add. It is worth noting in this context that several witnesses at the Committee hearings referred to the 2005 PC Report that suggests that 61% of Australian BERD comprises experimental development.

2. The economy benefits more from this third aspect of R&D than from the other two and it is this aspect that Australia struggles with. Australia has a world-class record of achievements in basic and applied research and a poor record of development and commercialisation. The Object clause seeks to encourage the types of R&D we already do well at the expense of the types of R&D that we are poor at when it is the type of R&D that we are poor at is the one that adds most value to the economy.

This new definition is counter to the Government’s stated objective in *Powering Ideas* and it excludes a proportion of business R&D. It is also counter-intuitive – supporting R&D has been found by all the studies cited by the PC and IISR as being a net positive for the economy and for Government revenues. Supporting only research is a net cost.

5. Changing The Definition of R&D to Deal with “Rorts” is a Mistake

The Committee hearings raised some examples of perceived “rorts” associated with the Concession.

It was very difficult to respond in detail regarding supposed R&D claims that were set out in the barest of detail. However, in Attachment A, we have undertaken an analysis to the best of our ability.

To the extent that the example projects are sustainable under the current legislation, we believe that the existing “directly related” definition in the Concession confines large operating cost claims to circumstances that only rarely occur. We have gone on to suggest mechanisms such as claim caps if the existing definition is seen as not being powerful enough in restricting production-based R&D expenditure.

To the extent that the projects are rorts in that they represent claims outside the detail and spirit of the legislation, changing the definition will not diminish the inclination of those who attempt to rort the system in the true sense of the word. Again, restricting the prevailing definition for all legitimate claimants does not seem to be the best way to curtail the mischievous activities of the few. Rather, effective administration accompanied by appropriate sanctions would be a much preferred option.

Further, the Committee did entertain some discussion that the current arrangements in some sense “crowded out” SMEs that otherwise might participate in the program. It is essential to note in this regard that the Concession is a self-assessment mechanism that has no upper limit on allowable claims. All eligible taxpayers may claim their full entitlement irrespective of

the level of claims of others. The support is not a fixed “pie” in the way that grants programs are limited.

No evidence has been led in recent years that the current base rate of support (7.5 cents) was preventing SMEs from claiming or that the rate was being kept at this level because of the claiming behaviour of others. It should be remembered that the base 125% deduction has now been in place for more than 14 years and, since 2001, the introduction of the R&D Tax Rebate opened up participation to a wide range of previously-disenfranchised claimants resulting in a large growth in participation rates that has now slowed over recent years.

6. The Legal Age and Stability of the Program is not a Case for Change

In addition to the emergence of the rorts argument at the Committee hearings, the Treasury responded to the raising of concerns about the loss of widely-held institutional understanding surrounding the Concession by saying that the Concession was old law, written in old language, and the lack of recent decisions legitimised the need for reform.

MJA does not oppose a rewrite of the program in modern legal language but we suggest that the aim should be to preserve the current program definitions and concepts except where there had been a clear policy directive to change them. The rewriting should be done cautiously and wholesale changes cannot be justified simply by the effluxion of time.

Similarly, we submit that the lack of recent case law bears witness to the stability of the program and indicates a general satisfaction amongst taxpayers with the existing arrangements. The very low number of claims disputed by the authorities has been recently highlighted by the Senate and independent reviews of the Concession have always pointed to its responsible use.

The above factors are important considerations and MJA is concerned by the attitude expressed by the administration at the Committee hearings. We do not agree that the age of the program and the lack of case law make out a case for dismissing the 25 years of institutional memory and understanding associated with the existing program.

7. The Proposed Definition of R&D Introduces a Range of Complexities and Uncertainties

MJA has made several submissions on the limitations of the new definitions of R&D that have been proposed by Treasury. These are summarised in our response to the Second Exposure Draft attached to this submission (see Attachment B). Attachment A also looks at some of the additional inconsistencies that have emerged in the EM particularly with respect to the example projects.

For the purposes of this overarching submission, MJA would like to look at one aspect of the discussions at the recent Committee hearings to underline the complexity and uncertainty of the issues in play.

A consistent theme amongst those who appeared was the belief that the narrower definition of core R&D and the introduction of the dominant purpose test for production-related R&D combined to eliminate claims for the majority of these activities.

By way of contrast, the administration assured the Committee that production-based R&D remained claimable though this was more likely to be the case because it qualified as core R&D as opposed to supporting. Treasury and AusIndustry pointed to the guidance in the EM that indicated that the eligibility was a matter of fact determined in the overall context and circumstances of the project.

Other stakeholders did not dispute that some work may qualify but were generally pessimistic as to the extent in comparison to the Concession and were not reassured by the expressed views of the authorities. It was pointed out that the EM was confused in its reasoning, the examples were hard to follow and that there was a lack of clear criteria as to how one would be able to identify core as opposed to supporting activities and dominant purpose as opposed to directly related supporting activities.

For example, in discussing supporting R&D activities, paragraph 2.26 in the EM states that "Being a purpose test, it is possible that activities that are similar in appearance might qualify as supporting activities in one context, but not in another" and that "...regard must be had to the overall circumstances within which the activity is conducted".

In this context, the evidence of the current Chair of the TCC of the Board, Mr Peter Thomas, was most illuminating. In advocating for the introduction of the dominant purpose test for the relevant classes of supporting activities, he went on to concede that its application was "all judgement in the end". This seems at direct odds with the views of the EM which see this as an issue of factual circumstance.

He went on to say that he did not know whether dominant purpose meant a greater than 50% purpose or the most heavily weighted purpose, though he felt it was the former.

Hence, in light of the Bill and the accompanying EM, the Chair of the administrative body that determines the eligibility of R&D activities under the current legislation was unable to provide the exact meaning of the test; a test he conceded was entirely judgement-based.

By way of contrast, the current "directly related" eligibility test for supporting activities has stood the test of time and has developed a widely-publicised, evidence-based approach to demonstrate compliance.

As such, the move to the dominant purpose test is a stunning example of how the proposed definition of R&D introduces a range of complexities and uncertainties for the taxpayer.

The fact that Mr Thomas also indicated that the question as to whether the new definition skewed support toward corporate research, away from corporate development, was something that "remains to be seen" only adds to the concerns we have raised in this submission.

8. The Feedstock Provisions are not a Rewrite of the Current Concession Provisions

The Treasury was adamant at the Committee hearings that the new feedstock provisions, made available for the first time with the introduction of the Bills and not made the subject of any public consultation, are a straightforward rewrite and consolidation of the existing feedstock provisions.

MJA agrees with the many stakeholders at the Committee hearings who directly disputed this contention. We submit that the proposed provisions are a major extension of the concept of feedstock offsets and, when combined with the changed definition of R&D, result in a drastic reduction in support for any operations-based R&D that generates a commercial value.

As such, the new provisions do not appear too dissimilar to the “augmented feedstock rule” that was supposedly abandoned after the First Exposure Draft.

The proposed provisions potentially exclude many more types of costs than the current provisions. They can exclude goods and materials that are not currently considered to be feedstock inputs. These include consumables, process chemicals, maintenance materials, fixtures and fittings and capital assets. This is caused by the failure of the wording of the proposed legislation or the EM to limit feedstock inputs to being the raw materials made into feedstock outputs in line with the EM to the *Taxation Laws Amendment Bill (No.1)* 1996.

The proposed provisions are ambiguous and unclear. “The expenditure” in s 355-465(1)(b)(i) can be interpreted as all the expenditure to obtain the R&D offset or just the expenditure on feedstock inputs. To be in line with the current legislation, “the expenditure” would have to be interpreted as only the expenditure on feedstock inputs. Paragraph 3.138 of the EM indicates that this is the intent but the Bills would be less ambiguous if s 355-465(1)(b)(i) said “for the expenditure on feedstock inputs”.

The biggest problems with the feedstock provisions in the Bills are as follows:

- the calculations required are so impractical that it will be impossible for a large proportion of businesses to apply these;

- those businesses that can apply the provisions will incur significantly higher compliance costs as product valuations and the tracking systems required are way in excess of normal tax and accounting requirements or reasonable integrity measures required for added benefits;

- it will fail to properly meet the intent as set out in Paragraph 3.142 of the EM “to ‘claw back’ the incentive component of the R&D tax offset that is enjoyed on the recouped feedstock expenditure” when and if company tax rates change;

- it will provide interest free loans to businesses potentially for years for products with long maturing times;

- it will have distortional and inequitable effects that will encourage R&D projects with high energy costs and high value raw materials over low energy and material projects; and

- it can create multiple deductions for the one economic cost that can only be clawed back once where there is a sequence of R&D activities to complete marketable product.

These problems are all caused by the following changes introduced in the Credit Bills:

- The Concession legislation uses a net calculation that excludes all feedstock inputs and only adds back any loss on sale. The Credit proposes to use a gross method that requires the feedstock inputs of each R&D activity to be included in the costing of that activity then a claw back adjustment is made to the revenue on the final sale or cost of these feedstock inputs. This change requires more work which will ultimately increase compliance costs to business. It can also add feedstock inputs costs many times but

only claws back feedstock outputs once, thus duplicating deductions and artificially inflating R&D expenditure.

- The Concession legislation calculates the feedstock adjustment of the R&D activity with a simple calculation requiring only one additional piece of information – the value of the feedstock output. The proposed Credit shifts this calculation to each and every sale of the final outputs from the R&D activity. These sales may be one or more years after the R&D activity.

- The shift in when the value of the feedstock output is calculated has the potential to replace one calculation per trial with an impossibly large number of calculations where the R&D activity:

    - results in multiple sales e.g. ten tonnes of trial material made that is ultimately sold in one kilogram lots,

    - is one of many processes to make the final marketable product that can each involve R&D activities requiring complex tracking of how much of the finished product is present in each sale, and/or

    - results in multiple products sold for a range of different process as a result of further processing after the R&D activity.

- The Concession legislation exactly adjusts the R&D claim to only include any loss created in the R&D process whilst the proposed Credit relies on the following inaccurate assumptions:

    - that the R&D tax credit is 1/3rd higher than the tax rate. This only works for the 40% credit and only whilst the tax rate is 30%, and

    - that every dollar spent to produce the marketable product creates exactly the same sale value so that this value can be apportioned over the different R&D activities and post-R&D activities.

Attachment A provides a more detailed analysis of the feedstock provisions.

As the above clearly demonstrates, Treasury's contentions regarding the new feedstock provisions are unsustainable.

9. The Proposed Administrative Arrangements Represent a Shift in Program Philosophy

The proposed changes to the administration of the Credit compared to the Concession include a significant increase in the powers for AusIndustry to review, reclassify and reject registrations. These include the technical possibility of rejection of R&D projects without AusIndustry having to meet with the taxpayer. This will result in more disputes that are not of the taxpayer's making. Feedback from the Government bodies on this issue is that they do not believe that AusIndustry would do this. This is an unsatisfactory response to unsatisfactory legislation, especially given the current performance of AusIndustry and the Board in administering the current Concession. There is growing evidence that the performance of AusIndustry in administering the current Concession needs to be questioned. Many reviews are believed to be taking an inordinate amount of time. Decisions by the Board are being made

contrary to advice from AusIndustry and by the Government-appointed independent experts which unequivocally support taxpayer claims. These concerns need to be responded to as we believe that current levels of confidence in the Concession compliance framework are at an all-time low amongst the business community.

Under these circumstances, the expansion of AusIndustry's powers, particularly with respect to registration, is counter-intuitive to the goal of providing more certainty to taxpayers. Further, the ability of AusIndustry to create potentially differing sectoral guidelines introduces the possibility of horizontal inequities. A taxpayer in one industry may be disadvantaged compared to a comparable taxpayer in a more favoured industry. A perception is rapidly emerging that the administration would like to control the level of benefits conferred in different sectors by use of the position statements which will move the program away from one of entitlement that can be planned for with confidence to one that reflects the views of administrators as to what is "genuine R&D" resulting in something akin to a merits-based grants program.

MJA submits that the administrative powers need to properly reflect the principles of self-assessment. If AusIndustry is able to create guidelines, then these must not create horizontal inequities and AusIndustry must be held to the Taxpayer's Charter. The right of a taxpayer to self-assess eligibility of R&D projects that will be reviewed equitably and consistently against published guidance that gives the same protection as a binding public ruling is critical. Where the guidance is merely the opinion of AusIndustry, it must be recognised as such with an appropriate independent dispute settling procedure that recognises the rights of the taxpayer.

10. The Timetable for the Introduction of the New Legislation is Not Sustainable

A consistent theme of the submissions to the Committee's hearings was that there has been inadequate time to digest the key documents associated with the introduction of the Bills.

The main causes of concerns are as follows:

- The Second Exposure Draft (which was materially different to the First Exposure Draft in many aspects) only allowed 11 days (across the Easter and school holiday periods) for stakeholders to prepare responses and it omitted key provisions such as those relating to feedstock.

- The feedstock provisions did not appear until the Bills were read in to Parliament. At the Committee hearings, Senator Back indicated that he was not aware that the provisions had been made available at all prior to the commencement of the Committee hearings.

- The Committee hearings began within a week of the Bills being read into Parliament meaning that written submissions actually follow rather than precede the hearings and that many stakeholders were unaware of the hearings taking place.

- The legislation will commence with no guidelines available to assist taxpayers and no transition process to allow taxpayers to make arrangements for the new legislative environment.

- AusIndustry has indicated that it will be rolling out its first wave of program material in July/August 2010 and that this will not be developed in consultation with industry.

At the Committee hearings, even the Chair of the TCC conceded that the above timetable represented a “fairly rushed process”.

One consequence of the rushed approach is that the EM contains a number of mistakes in terms of references to the Bills (see Attachment A).

Taken along with the wildly divergent views expressed at the Committee hearings, the timetable above has meant that the Bills and EM have been prepared in haste and are distinctly lacking in clarity and accuracy.

MJA submits that the package is in poor shape and should not proceed to law in its proposed form on 1 July 2010.

11.Conclusion

MJA supports the Government’s policy in introducing the Credit.

We have indicated an approach that would allow a number of the clear benefits to begin accruing by the introduction of modified Bills on 1 July 2010.

However, for the reasons describe above, we cannot support many of the reforms contained in the Bills and would ask that these features be made the subject of a measured consultation process with a view to the introduction of a final form of the Credit on 1 July 2011.